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Informality in the Arab Region: Another Facet of Inequality

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“Societies across the world are facing many complex and interwoven challenges—poverty, inequality, environmental degradation, demographic change, discrimination and violence—that threaten our efforts to enable people everywhere to live a peaceful, decent and dignified life on a healthy planet”.

Ban Ki Moon, former Secretary-General, United Nations
Policy Innovations Transformative Change
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1. Introduction

Inequality has evolved to become one of the main social, economic and political challenges of our times. The rich have become richer and the poor have remained embroiled in a struggle to make significant gains in income. The persistence of inequality is cause for the adoption of sound and coherent policies backed by political will to empower the lowest income earners in a just, equitable and inclusive manner that respects their human rights. However, focusing only on income inequalities is but a piecemeal approach that limits the analysis to a quantitative angle and ignores such social dimensions as education, access

to resources and decent jobs, opportunities, well-being, health, life expectancy, welfare, assets and social mobility, among others.

Inequality has had detrimental socio-economic impact, most notably in the informal sector. The interplay between informality and inequality has generated considerable debate in the past decades, as many studies have shown that high inequality, precisely income inequality, aggravates informality. Informal employees earn significantly less than those in the formal sector. The growth of the informal sector

renders the relationship between inequality and informality mutually reinforcing. Nevertheless, this relationship is dynamic and varies across regions, countries and economic arrangements. Many Arab economies suffer from a large informal sector that varies in size and composition of informality, which has contributed to shaping the patterns and dimensions of inequalities in a variant but mutually reinforcing manner.

Goal 8 of the 2030 Agenda for Sustainable Development calls for promoting sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all. Within this framework, the economic growth and social protection nexus has recently gained importance in the Arab region, particularly since the notable gains realized by the Arab region in the past two decades in economic growth and GDP were not commensurate with reducing unemployment and were not effectively translated into the creation of decent jobs. Even though the Arab region had managed to create some jobs, participation in the labour force stagnates in comparison to many other regions, primarily owing to the relatively low participation of women and youth in the labour force.

The Arab Watch on Economic and Social Rights (2016) claims that informal employment is a major

“We cannot advance the development agenda without addressing the challenges of inequality within and between countries – the widening gap between skilled and unskilled workers, the chasm between the formal and informal economies, the growing disparities in health, education and opportunities for social and political participation.”

Kofi Annan, former Secretary-General, United Nations
July 2005

<https://search.archives.un.org/uploads/r/united-nations-archives/1/1/1/11455abc335b7d08e44fbc68c708f3a2bfb33e7a9f11a09ed5ae285439aadb4/S-1092-0028-01-00015.pdf>

determinant of instability at the global and regional levels whereby it represents between half and three quarters of the non-agricultural workforce in developing countries. The report adds that “Perhaps the widening share of informal labour in Arab countries in non-agricultural sectors is mainly the result of policies of ‘Openness’, neo-liberal globalization, youth boom, rural migration in great numbers as a result of neglecting rural areas in general and the agriculture sector in particular, in addition to large waves of incoming migration.”¹

2. Informal Economy and Inequality

In 1989, De Soto (1989) advanced a straight forward and simple definition of informality as the collection of firms, workers, and activities that operate outside the legal and regulatory frameworks thereby avoiding taxation and regulation without benefiting from state protection and services. He pointed out that informality can be caused by agents “exiting” the formal sector due to cost-benefit factors; or by the exclusion of agents from the formal sector which becomes restrained.²

There is an overall conception that the term “informal economy” is quite diverse in its definition as it encompasses substantial variations in terms of workers, enterprises and entrepreneurs all of whom face distinctive challenges that vary in intensity across

national, rural, and urban contexts. The term “**informal economy**” is preferable to “informal sector” because the workers and enterprises are not limited to one sector of economic activity, but intersect in many sectors. According to the ILO, the term “informal economy” refers 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; or the law discourages compliance because it is inappropriate, burdensome, or imposes excessive costs*”.³



Together wage workers and own-account workers constitute workers in the informal economy, with the latter suffering from regular shifts, insecurity and vulnerability as much as the former. Unfortunately, workers in the informal economy often remain trapped in poverty as they are denied protection, rights and representation.⁴

While the informal sector refers to informal enterprises, informal employment refers to informal jobs. Employment in the informal economy can be defined as the sum of employment in the informal sector and informal employment found outside the informal sector. Employment in the informal sector and informal employment refer to different aspects of informality, the former referring to employment in a non-agricultural informal sector and the latter denoting the number of persons whose main (or only) job was informal.

Employment in the informal sector is an enterprise-based concept and covers persons working in units that have “informal” characteristics in relation to, for example, the legal status, registration, size, the registration of the employees, their bookkeeping practices, etc. Informal employment is a job-based concept and encompasses those persons whose main jobs lack basic social or legal protections or employment benefits and may be found in the formal sector, informal sector or households. Almost all persons employed in the informal sector are in informal employment. However, not all those in informal employment belong to the informal sector: there may be persons working outside of the informal sector (i.e., either in the formal sector or in households producing for own final use) that have informal employment.⁵

Though the informal economy is wide ranging and heterogeneous, it can be classified into several categories comprising informal employment inside the informal sector which includes employers, employees, own-account workers, contributing family workers, and members of cooperatives. It also comprises informal employment outside the informal sector such as employees in formal enterprises (including public enterprises, the public sector, private firms, and non-profit institutions) or in households (e.g. domestic workers) without social protection, contributing family workers in formal enterprises, the self-employed and the wage employed, home-based workers, street vendors and waste pickers.⁶

In some Arab countries with sizable and growing labour forces, and where unemployment, underemployment and poverty are prevalent, workers are absorbed by the informal economy not by choice but out of a need to survive. The alternative would be to remain without a job, incapable of generating income and hence becoming vulnerable, which eventually will exacerbate socio-economic inequalities. Although informal jobs are easier to enter and have less demanding pre-requisites for education,



Table 1: Share of employment in the informal economy in total non-agricultural employment since 2005 in selected Arab countries.

Country	2000-04	2005-09	2010-14	2011	2012	2013	2014	2015
Algeria	41.3	45.6	37.3	40.7	37.7	37.3		
Egypt	45.9	51.2	49.6		49.6			
Lebanon	51.8							
Morocco	67.1	78.5	69.2	70.9	71.5	69.2		
Palestine	43.4	57.2	52.2					
Sudan			31.9					
Syria	30.7	31.4						
Tunisia	35	36.8	38.8		33.9	37.8	38.8	40.8
Yemen	51.1		75.1					

Source: Charmes. J. The informal economy: Definitions, Size, Contribution, Characteristics and Trends.

skills, technology and capital, they often fail to meet the criteria of decent work. However, by availing goods and services at low prices, ironically, the informal economy contributes to meeting the needs of the poor.⁷

According to the ILO, as most workers in the informal economy and their families do not benefit from social protection, they are particularly vulnerable to various inequality-associated risks and contingencies, including health, safety at work, loss of earnings. The prevalence of informal employment in many parts of the world, which has worsened because of the global crisis, coupled with a pervasive trend

towards higher levels of precarious employment characterized by low job security and no pension benefits, not only affects the current living standards of the population, but is also a severe constraint that prevents households and economic units trapped in informal jobs from increasing productivity and finding a route out of poverty. While the ILO asserts that it is necessary to facilitate transitions from the informal economy to the formal economy,⁸ others have argued that formalizing the informal economy is not necessarily the solution, and it remains difficult to ascertain whether this option is the most suitable for countries which are characterized by a large informal economy.

3. The Growth of Informality in the Arab Region

Difficulties in measurement are often encountered as the share of the informal sector and its characteristics are associated with numerous variables. This is predominantly the case of the Arab region whereby the paucity of up-to-date and comprehensive data for the entire Arab region constitutes an obstacle to painting a realistic picture of the complexity of informality and the different dynamics that shape it. More importantly, the relationship between informality and inequality has not been systematically and fully examined in the Arab region, even though some studies have addressed

these phenomena in select Arab countries.

There has been an ongoing debate about the causes and perpetuation of informality. To explain the underlying factors that have led to the growth of the informal economy, Mishra and Ray (2011)⁹ provide empirical evidence that supports the existence of a complimentary relationship between the informal economy and corruption and high-income inequalities. They argue that in societies where inequalities are highly manifested, individuals and firms face



difficulties in accessing formal credit and modern technology which in turn forces them to resort to informal employment. In general, the growth of informality also implies unjust competition between informal and formal workers who must deal with tax payments and regulation, and a loss of government revenues. This is relevant to Arab countries with prominent socioeconomic inequalities.

The ILO points out that informality is principally a governance issue and that its growth can often be attributed to:

1. inappropriate, ineffective, misguided or badly implemented macroeconomic and social policies, frequently developed without tripartite consultation;
2. the lack of appropriate legal and institutional frameworks;
3. the lack of good governance for the proper and effective implementation of policies and laws; and
4. lack of trust in the institutions and administrative procedures. Some macroeconomic policies, including structural adjustment, economic restructuring and privatization policies are not targeting employment, cut-down jobs or fail to create sufficient new jobs in the formal economy.

The Arab Watch on Economic and Social Rights (2016) indicates that “since the eruption of the “Arab Spring”, Arab countries have been facing major challenges that can almost be described as “existential challenges”. Arab countries were unable to deliver basic social needs, eliminate inequalities and ensure justice, and uphold the rights of their citizens because of the absence of accountable, impartial and equitable governance structures and lack of respect for political diversity. The absence of basic economic and social rights, like the “right to work, social protection, fair taxation, distribution policies, and many other rights, is considered one of the main factors affecting stability”.

Box. 1. Informal Sector in Morocco: Urbanization, corruption and taxes

In Morocco, a study by Bourhaba and Hamimida has found that in 2015, the informal economy contributed around 43% of GDP. According to this study, among the main contributors to the rapid growth of the informal economy in Morocco are urbanization, corruption and the burden of taxes. Pursuant to industrialization and the improvement in services which result in economic development, cities begin to attract rural inhabitants. However, the inability of the formal sector to take in the excessive labour force resulting from the advent of urbanization pushed a portion of the labour force into the informal sector. In addition, the study also claims that the increase in the informal sector in Morocco could be a consequence of corruption which drives people to opt for the informal sector not only to avert the high cost of regulatory frameworks but to avoid being trapped by the dark economy. The heavy burden inflicted by high taxation is also a detrimental factor behind the proliferation of the informal economy as citizens attempt to conceal their real incomes to evade government taxes. This pushes them into favoring the informal economy which in turn negatively impacts on government revenues. The study pointed that a tax increase of 1% leads to an increase in the informal economy size by 0.11%.

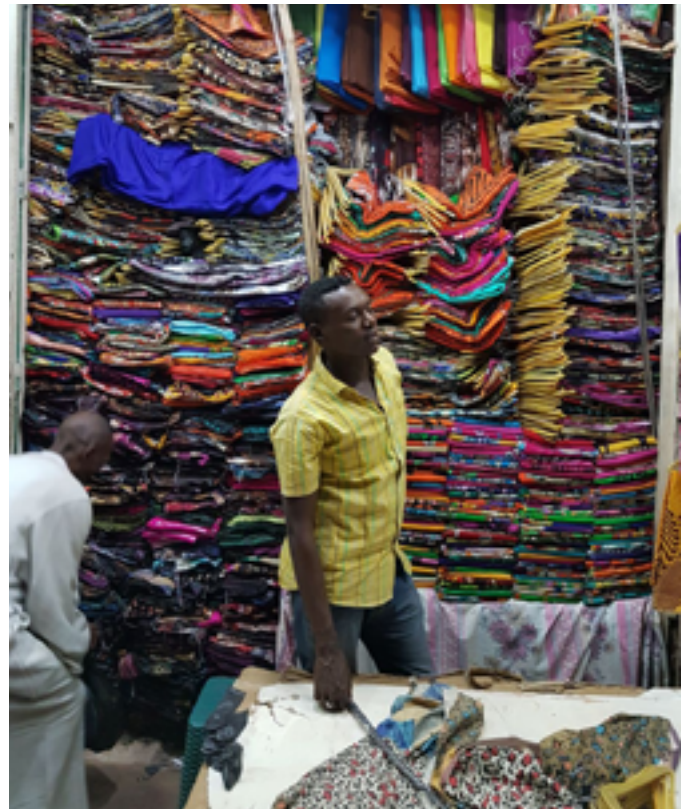
Source: Bourhaba O. & Hamimida M. (2016). An estimation of the informal economy in Morocco. International journal of economics and finance; Vol. 8, No. 9; 2016 ISSN 1916-971X E-ISSN 1916-9728 published by the Canadian Center of Science and Education.

This in turn resulted in increasing poverty, spreading unemployment and marginalization which were in fact considered by many as the catalysts that precipitated the protests in the Arab region.¹⁰

To show the significance of the informal sector as one of the main root causes that sparked the protests and movements in Tunisia, we should look at Tarek el-Tayeb Mohamed Bouazizi, a 27 year-old informal worker in a marginalized area in Tunisia who did not gain anything from the consequences of economic growth and development nor was his human dignity and economic and social rights ensured, nor did he benefit from public services or the protection of the law.¹¹ However, the law was definitely not on his side when his only means of subsistence and source of survival for his family was seized. He was oppressed and disregarded and considered inconsequential. He ended up self-immolating.

Others have argued that informality is caused by excessive regulation by the state, which creates incentives for economic activity to take place outside the purview of regulations. However, Kanbur argues, “even if the presence of regulation could explain the *level* of informality, for it to explain *increases* in informality the regulatory burden would have had to have increased. But, in fact, it is well appreciated that in the last two decades of liberalization, the regulatory burden has, if anything, decreased. The regulation-based explanation of increasing informality is thus weak at best.” In fact, Kanbur also adds that deregulation explains increasing informality of particular kinds: notably, de-formalization of once-formal jobs and industrial outwork. Deregulation of labour markets has created an environment in which formal firms, seeking to reduce labour costs, are increasingly hiring some workers as core standard workers and others as peripheral workers under informal arrangements.¹²

The second main causal explanation presented by Kanbur for increasing informality centers on fundamental trends in technology and trade, which, he argues, have reduced the employment intensity of growth in the formal sector. This phenomenon of “jobless growth”, which has been for decades a specific phenomenon to the Arab region, implies that the formal economy is incapable of catering to the employment needs of a growing labour force. According to Kanbur, the technology-trade explanation



seems to be a more plausible explanation for trends in informality. If we accept this explanation, he notes, “*we are also forced to accept that informality is here to stay*” since “*the forces shaping technology and trade are unlikely to reverse in the next two decades*”. He claims that instead of receding as a result of development, the very nature of current development means that informality will increase.¹³ Along the same lines, the OECD¹⁴ also confirmed that informal is indeed normal. But how can the Arab region deal with this assertion amidst its sociopolitical dilemmas, its diverse economic configurations and the enduring conflict and dissension among Arab political entities?

According to Aita (2016), in order to deal with the challenges associated with the expansion of the informal sector in the Arab region, and amidst the growing political turmoil and complexities and the accompanying socio-economic uncertainties, it becomes necessary to come up with a new “employment-decentralization-regional and urban planning” nexus that delineates a framework for research, analyses and policy development that will ultimately link informality, urban growth and the improvement of infrastructure in Arab countries suffering from a dominant informal economy.¹⁵

Similarly, Saif¹⁶ (2013) argues that there is a need for new approaches to tackle the burdens and challenges of the informal sector in the Arab region particularly when it is undergoing economic transformation and when there is undisputed evidence by research groups and the ILO that the informal sector is expanding. Nevertheless, two factors make it very difficult to establish a clear-cut depiction of the informal sector in the Arab region. These are difficulties in measuring the informal sector and the multitude of variations across Arab countries in the size of the informal sector which indicate that the causes of its spread also vary from one country to another. However, one common feature present in several Arab countries is the absence of incentives to participate in the formal sector, especially when the services provided by the government are marginal when compared to the financial liabilities and taxes they impose.

Moreover, the informal sector in many Arab countries continues to draw young entrants to the labour force at a time when governments have failed to create job opportunities and enhance the labour conditions and provide incentives that diminish the growth of the informal economy. The result is having considerable numbers of vulnerable citizens, albeit employed, but who are outside the regulated formal economy and who do not enjoy their rights of receiving fair and just protection and social security under labour laws.

However, Saif¹⁷ believes that, in the Arab region, the solution does not necessarily lie in formalizing the informal sector. Governments are thus required to devise new approaches that foster long term solutions and take serious steps towards adopting mechanisms focused on enhancing the skills of informal sector workers and improving their performance, improving their working conditions and increasing their wages, giving them positive incentives in the form of access to funding and resources needed to join the formal sector, and changing the legal frameworks within which they operate.

Accordingly, in a volatile and diversified region such as the Arab region, the multitude of dynamics and considerations that shape the structure of the labour force and the compelling manifestations of the prevalence of the informal economy call for acute measures at the policy and practical levels to cope with a lingering problem that is seemingly here to stay.¹⁸

Assaad (2014) argues that in the Arab region, the incidence of public employment is high for the educated middle class, citizens of oil-rich monarchies, and members of key sects, tribes or ethnic groups. Employment in the formal private sector is minimal, thus leading to a growth in informality especially where the public-sector workforce diminished due to fiscal realities.¹⁹

Box 2. Tunisia Informal Workers: Are they better off?

The paucity of data and knowledge about the characteristics of the informal sector in Tunisia, and the extensive proliferation of the informal economy in terms of scope and size, compelled the Tunisian General Labour Union (Union Générale Tunisienne du Travail, UGTT) to carry out a field study on 1,128 informal workers to examine the implications on the economy, notably following the 2011 revolution.

The results indicated that the disparities between the income generated by the formal and informal sectors demonstrate a wide increase in the contribution of the informal economy to the GDP from 30% in 2010 to 38% in 2013. The outcome of this survey also revealed that within the same sector, a civil servant earns half the annual income of an informal worker who typically earns around 18,725 Tunisian Dinars, which somehow challenges the conventional assumption that workers in the formal sector usually earn more than workers in the informal sector. Moreover, the study also revealed a close correlation between the informal sector and the illicit trade and smuggling activities especially in commodities such as tobacco and fuel which are pronounced in certain border regions. Contrary to what one would imagine, despite the precariousness of their work and their awareness of the dangers and threats they are exposed to due to the absence of civil rights, social protection and health security, informal workers, especially self-employed workers, have indicated that they are “satisfied” with the income they generate through trafficking certain products via smuggling corridors and are therefore reluctant to go into the formal sector.

Source: Trabelssi K. (2013). Current state of the informal economy in Tunisia as seen by its stakeholders: Facts and alternatives. Tunisian General Labour Union.

Hanieh (2016) points out that inequalities that have plagued the Arab region for the past two decades are largely manifested by vast and enduring disparities in the ownership and control of economic wealth, access to resources and markets, and the exercise of political power. Inequalities exist within and

between Arab states and are visible in numerous social indicators such as gender, national origin, age and citizenship status. These disparities are clearly demonstrated in labour market distributions²⁰, and have tremendously shaped the growth of the informal employment.

5. What Can Be Done? Some Policy Options for the Arab Region

There is no one-size-fits-all solution to the problem of informality. Some believe that it is about expanding the capacity and outreach of institutions primarily designed to address the situation of wage employment in the formal sector. Others consider formality in terms of registration and sanctions for non-compliance with the law, which in turn is regarded by some as counter-productive, since it does not consider the many avenues towards formalization, the limited choices facing most informal economy actors or the range of incentives which can encourage a genuine movement out of informality. While others believe that reform should go much further, by rethinking or reinventing policy frameworks, instruments and the culture of outreach to suit the specific conditions of the informal economy.

The limits of a single comprehensive approach suggest that a very diverse and rich range of multidimensional approaches that can be combined into integrated policy frameworks and adapted to each specific country context are more feasible.

According to Chen and Harvey, such policies should therefore target the following objectives:²¹

- “promoting formal employment through pro-employment macroeconomic and sectoral policies focusing especially on the development of sustainable micro, small and medium enterprises (MSMEs);
- reducing informal employment by lowering the cost of transitions to formality through the creation of an enabling policy and regulatory environment that reduces barriers to formalization, while protecting workers’ rights and increasing the benefits of being formal by promoting a greater awareness of the advantages and protection that come with formalization (business development services for MSMEs, access to the market, productive resources, credit programmes, and training and promotional programmes to upgrade informal economy units); and
- increasing decent work in the informal economy by developing a national social protection floor for all, implementing a minimum wage and

Box 3. Government initiatives to support the transition to the formal economy in Egypt

The Egyptian Prime Minister recently stated that the size of Egypt’s informal economy has reached 1.6 trillion LE. Along the same lines, the Minister of Planning and Administrative Development declared in one of her statements that the integration of informal sector, which contributes about 40% of GDP, into the formal economy is impeded by diverse obstacles including complicated procedures for business establishment and operations, exclusion from the market, as well as inability to seek funding. To this end, and in order to encourage the informal sector to join the formal economy and in an effort to ensure that all individuals or entities can find adequate and regulated financial solutions at suitable prices, the Central Bank of Egypt (CBE) launched an initiative that fosters “financial inclusion” and provides bank financing for micro, small and medium enterprises.

Source: Egypt Today. Egypt’s informal economy reaches LE 1.6 trillion: PM. September 16 2017, accessed on 2 December at <https://www.egypttoday.com/Article/3/23120/Egypt%E2%80%99s-informal-economy-reaches-LE-1-6-trillion-PM>.



health and safety incentives, organizing workers from the informal economy and encouraging informal enterprises to join together in production conglomerates or cooperatives, and supporting the development of social economy enterprises and organizations.”

The 2015 International Labour Conference culminated in the adoption of recommendation 204: *Transition from the Informal to the Formal Economy*. It recognizes that the prevalence the informal economy in all its dimensions is a main impediment to the realization of the rights of workers; acknowledges that informality has numerous causes, including governance and structural issues, and that the adoption of adequate public policies in a context of social dialogue can accelerate the process of transition to the formal economy. It also acknowledges that informal workers, do not prefer to, but, end up in the informal sector owing to the dearth of opportunities in the formal economy and the absence of decent jobs and inadequate social protection.²²

Recommendation 204 brings forth some key provisions which member countries should take into consideration when designing coherent and integrated strategies to facilitate the transition to the formal economy. The recommendation further requests governments to assess and diagnose the factors, characteristics, causes and circumstances of informality in their national contexts in order to establish the appropriate legislative and regulatory frameworks and formulate the adequate sustainable and inclusive strategies, policies and measures that will contribute to the transition to the formal economy. As such, recommendation 204 ultimately advocates the establishment of an integrated national policy framework that expedites the transition to the formal economy and should be incorporated into national development strategies or plans as well as in poverty reduction strategies and budgets.²³

Arab governments should thus consider regulating their labour markets in a manner that ensures transparency, promotes horizontal and vertical mobility among the workforce, stimulates productivity and delivers an adequate level of income and social protection. The salient economic structure of the Arab region consisting of high dependency on natural resources, low levels of industrialization and a sizeable informal economy, combined with a rigid segmentation of the labour market, comprises eminent challenges to policymakers.²⁴

In sum, what needs to be developed for the Arab region is a policy framework that recognizes the importance of the informal economy, regulating it when necessary, but mostly seeking to increase its productivity and improve the working conditions of those who work in it so as to facilitate transitions

“Countries need to adopt a balanced approach in the design of policies to grow to formal sector. This means focusing on ways to increase the productivity of the informal sector, while working to support the expansion of formal businesses.”

IMF blog
8 August 2017

available at https://blogs.imf.org/2017/08/08/chart-of-the-week-the-potential-for-growth-and-africas-informal-economy/?utm_medium=email&utm_source=govdelivery



to formality. The goal is to make informal activities part of a growing formal economy, offering decent jobs, productivity gains and economic growth. The challenge for Arab policy-makers is to find the right balance of incentives for formality and of disincentives for remaining informal. Country experience shows that approaches anchored in social dialogue, based on capacity building and opening up access to a full range of resources, as well as tailoring taxation, financing and social security systems to the specific challenges faced by informal economy actors, can make formalization a much more attractive option and have a more sustained impact.

In the informal economy, working and living conditions are often intertwined. Improving working conditions therefore means improving the physical and psychosocial conditions and income security of workers, and the interface between their work and their personal, family and community lives. Issues such as wage regulation, working time, maternity

protection and the work–family balance have traditionally been perceived as largely inapplicable in the informal economy. A priority area of action is therefore to demonstrate that this is not the case and what can be done. Chen and Harvey point that governments have a primary role to play in facilitating transitions to formality. Political will and commitment, and the structures and mechanisms for proper governance, are essential. They argue that governments have a lead responsibility to provide an enabling environment for sustainable formal enterprises and to extend the coverage of social security, particularly to groups in the informal economy who are currently excluded.²⁵

It is necessary for countries of the Arab region to undertake multi-dimensional assessments of the determinants and characteristics of informality and





its interlinkages with inequality, poverty, governance structure and political dynamics within each country, with a view towards formulating a comprehensive and integrated framework that is based on the ILO's recommendation 204 and shaped by the distinctive national specificities and complexities. In other words, each country needs to find its own formula for regulating the informal sector and devising the requisite mechanisms and monetary and financial initiatives that are in line with its national constituencies and that ultimately lead to reducing

the injustices of the informal sector and promoting inclusive and just development. Changes of this kind are contingent upon tremendous determination whether at the macro, institutional or sectoral levels. In doing so, however, it is imperative to adopt an approach that fosters dialogue among all stakeholders and close partnership with other non-governmental concerned groups (civil society, NGOs, CBOs, etc.) in a participatory and inclusive manner that ensures that the voices of citizens are taken into consideration throughout the process.

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