



LUDWIG
INSTITUTE
FOR SHARED
ECONOMIC
PROSPERITY

THE HIDDEN WORKFORCE:

THE IMPACT OF THE INFORMAL
ECONOMY ON FUNCTIONAL
EMPLOYMENT





MISCONCEPTIONS ABOUT INFORMAL WORKERS

There is a widespread misconception that the informal economy is booming and informal workers are thriving financially, benefiting from lucrative side gigs, tax loopholes for unreported income, or the ability to monetize their hobbies and free time in the booming digital economy.

But this perception is far from the truth. The truth is the informal economy primarily serves as an outlet for the struggling working and middle classes who are unable to secure well-paying jobs in the formal job market.

Official employment statistics fail to accurately capture the informal economy and shed light on how informal workers are truly faring. The question remains: just how pervasive is the informal economy, and how are informal workers doing?

To answer these questions, the Ludwig Institute for Shared Economic Prosperity (LISEP) measured informal work through the lens of the True Rate of Unemployment (TRU) — a measure of the “functionally unemployed” — to determine the extent to which lower-income individuals rely on unreported income, like gig work or one-off jobs, to bridge the gap to functional employment.

Using data from the Current Population Survey (CPS) and the American Time Use Survey, LISEP tracks the number of people working informally on an average week and the extent to which the informal economy compensates for bad jobs.

While anyone working “under the table” counts as informally employed, they remain functionally unemployed if they cannot earn a living wage and full-time status when considering both their formal and informal labor combined.

Key Takeaways:

- The informal economy does not make up for the large percentage of functional unemployment reported by the TRU in the formal market. It has minimal impact: only 3.3% of the population worked informally between 2003 and 2022.
- Workers seeking but unable to find formal employment and those in the worst-paying formal occupations are much more likely to work informally. They turn to the informal economy out of necessity because the formal labor market offers no viable alternative.
- The informal economy was more prevalent during the Great Recession. Informal work can soften the blow of layoffs and reduced hours for workers, but it is not a viable solution in the long run.

What is informal work?

The Ludwig Institute for Shared Economic Prosperity defines informal work as income-generating activities conducted outside traditional employment and wage-tracking systems. Most informal workers work under the table for legal enterprises hoping to save on labor costs, earn cash through individual gigs, or have small businesses that don't report their income. Generally, informal work supplements earnings from formal jobs to help households make ends meet. As a result, informal employment most often resembles precarious employment: low-paying, sporadic, and unable to support an individual, let alone a family.

Why use the True Rate of Unemployment to measure the informal labor market?

LISEP's True Rate of Unemployment (TRU) measures the percentage of the U.S. labor force that is functionally unemployed — the jobless, plus those seeking but unable to secure full-time unemployment paying above the poverty line. Unlike the headline unemployment statistics, the TRU considers job quality when measuring functional employment. Informal workers can reach functional-employment status if informality allows them to earn above poverty wages and work full-time hours. Likewise, a self-employed worker becomes functionally employed if unreported income allows them to earn more than \$20,000 a year.

Not all informal workers participate in the labor force. To accurately measure the extent to which the informal economy compensates for bad jobs, LISEP uses the TRU Out of the Population (TRU OOP) — the percentage of the whole U.S. population that is functionally unemployed.

YES

What is informal work?

NO

BABYSITTING

INFORMAL RENTAL INCOME

DAY LABOR
Construction, agriculture, etc.

SELLING USED GOODS

GARDENING

DRIVING ON A RIDESHARE APP
and other tracked digital gigs

STREET VENDOR
Food, arts and crafts, etc.

**TEMP WORK THROUGH
STAFFING AGENCIES**

PERFORMING
Bands, dancing, etc

**FREELANCERS REPORTING
ALL INCOME**

UNDER-THE-TABLE TAXI SERVICES

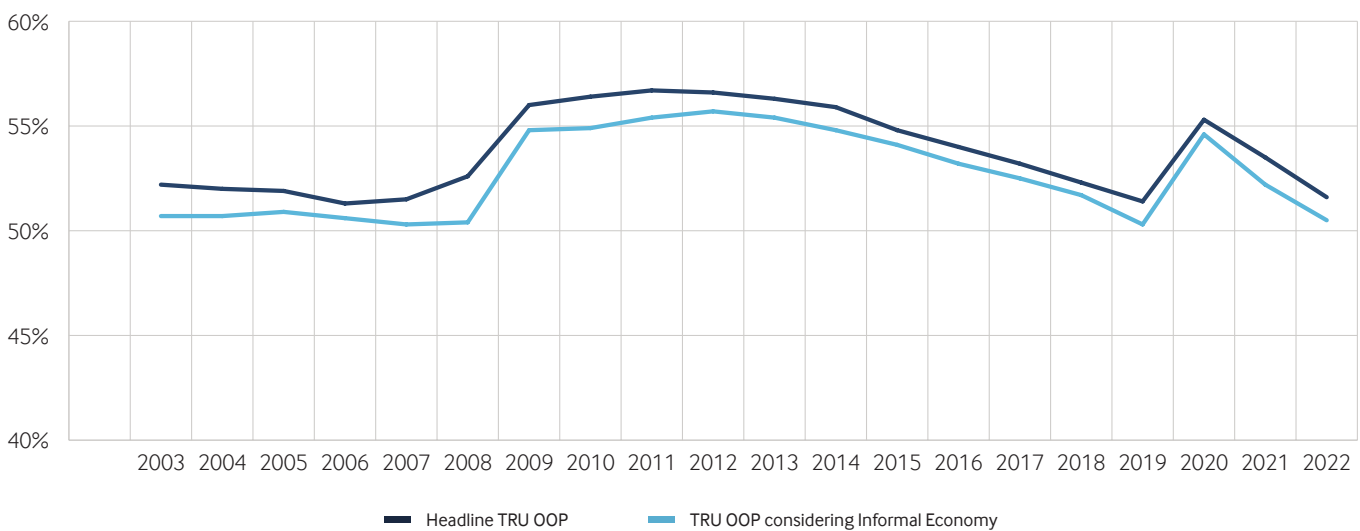
**WORKING IN EXCHANGE
FOR LODGING**

TRU OUT OF THE POPULATION VS UNEMPLOYMENT OUT OF THE POPULATION

The informal economy has minimal impact on employment since only a small fraction of the labor force works under the table. It affects functional employment even less — most informal jobs are sporadic and low-paying and rarely make up for poverty jobs. Between 2003 and 2022 on average, the informal economy only

decreased the TRU OOP by 1.1 percentage points (pp.) compared to by 1.8 pp for U3 unemployment out of the population (U3 OOP). In 2022, the informal economy decreased the TRU OOP by 1.1 pp., from 51.6% to 50.5%. U3 OOP fell by 1.2 pp., from 40.1% to 38.9%.

The Informal Economy only reduces functional unemployment by 1.10 percentage points on average, compared to 1.80 pp. for unemployment



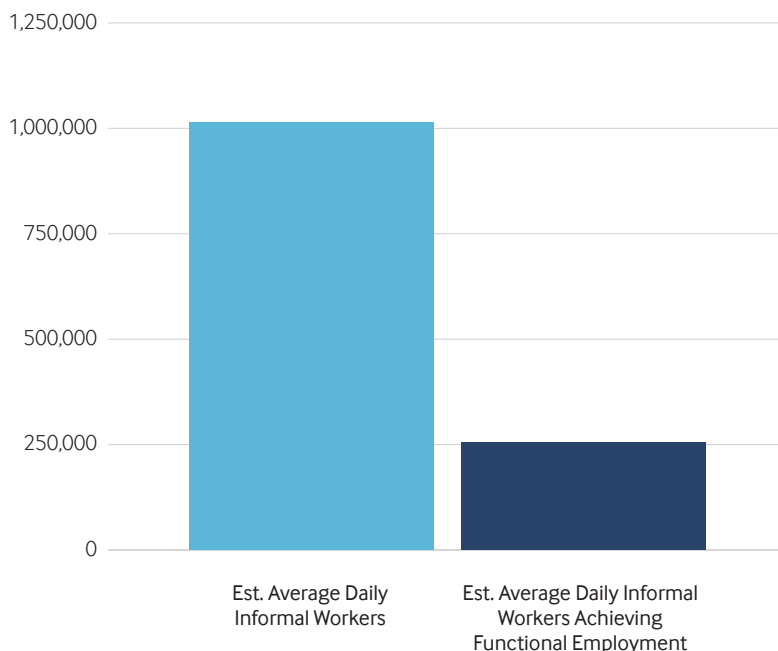


INFORMAL INCOME DOES NOT MAKE UP FOR BAD JOBS

Most people who work informally or underreport their income lack decent opportunities in the labor market. They are more likely to be unemployed but seeking work or have a low-paying job and rely on informal channels for additional income to get by. On average between 2003 and 2022, 3.3% of the working-age population worked informally — about 1.14 million (M) daily and

7.99M weekly workers. When considering the informal market in addition to the formal market, functional employment only improves by 1.70M in a given week, or a mere 1.5%. When considering unreported earnings from self-employed workers, an additional 0.95M (5.7% of the self-employed) can earn above poverty wages.

Informal Employment Pushed over 250K Workers into Functional Employment on an Average Day between 2020 and 2022



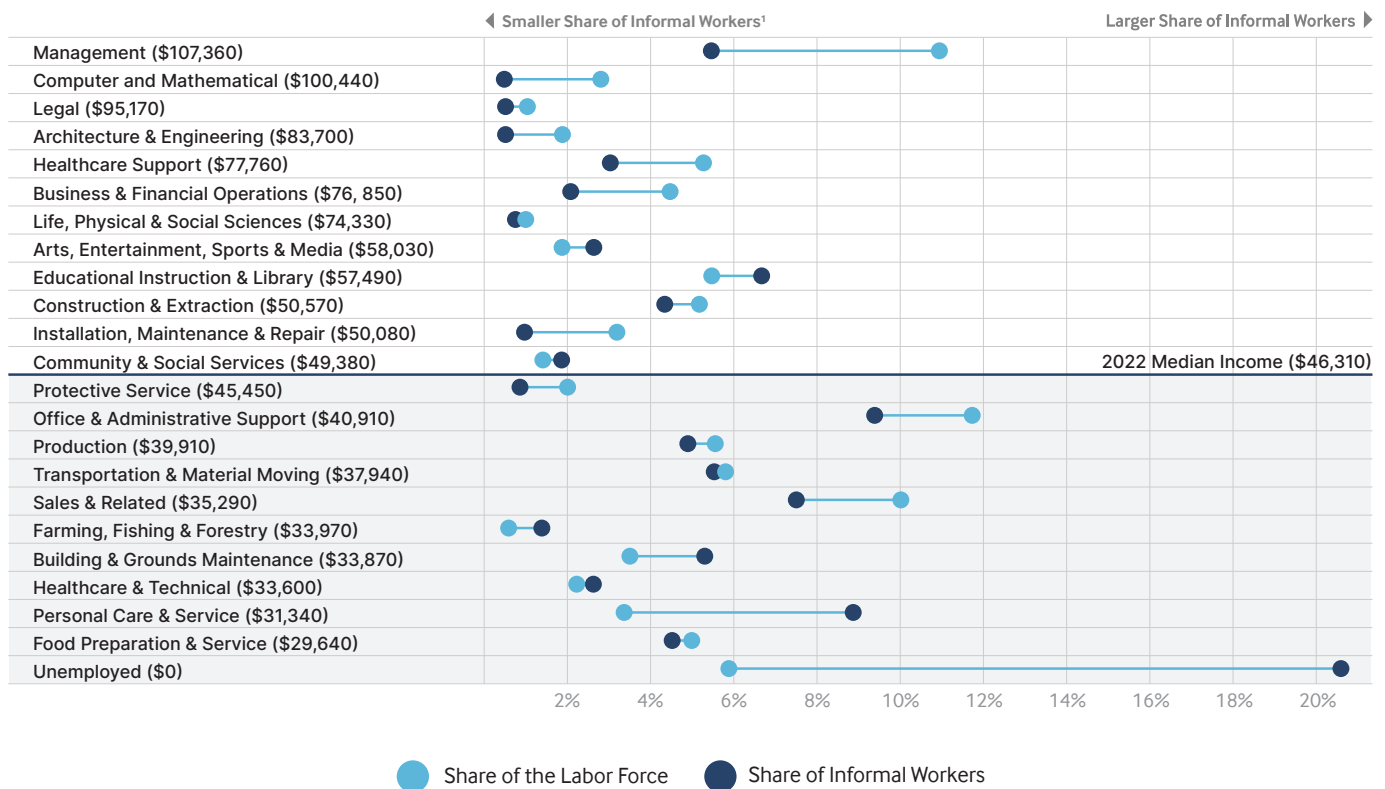
***MOST PEOPLE WHO
WORK INFORMALLY OR
UNDERREPORT THEIR
INCOME LACK DECENT
OPPORTUNITIES IN THE
LABOR MARKET.***

LOW-INCOME GROUPS ARE MORE LIKELY TO WORK UNDER THE TABLE

Informal workers participating in the formal labor market lack decent job opportunities. Of those participating in the labor force, 20.5% of informal workers are unemployed — four times more than the unemployment rate for non-informal workers. Even when they have formal jobs, informal workers disproportionately find themselves in low-paying occupations. For example, 10.9% of informal workers

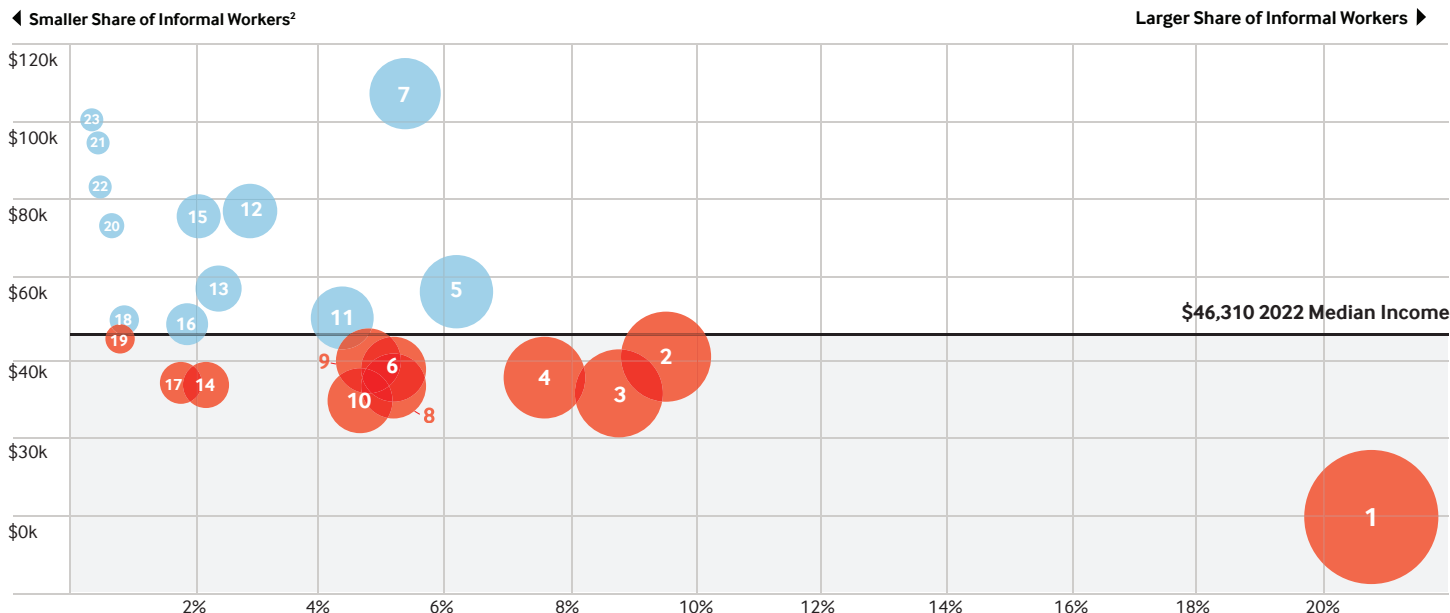
with formal jobs are personal care and service workers, such as childcare workers and hairdressers, even though these jobs only make up 3.5% of occupations. Indeed, personal care and service was the second worst-paid occupation in 2022, at just \$15.07 per hour at the median — meaning at least half earned less than \$31.3k annually.

Formal vs. Informal Labor Force Participation by Sector 2003-2022



¹ Refers to the share of an occupation among informal workers who are in the formal labor force, meaning those with formal jobs and the unemployed jobseekers.

Top Sectors for Informal Work



- 1. Unemployed**
Share of Informal Workers: 20%
Annualized Median Income³: \$0
- 2. Office and Administrative Support**
Share of Informal Workers: 9.5%
Annualized Median Income: \$40,910
- 3. Personal Care and Service**
Share of Informal Workers: 8.7%
Annualized Median Income: \$31,340
- 4. Sales and Related**
Share of Informal Workers: 7.5%
Annualized Median Income: \$35,290
- 5. Educational Instruction and Library**
Share of Informal Workers: 6.6%
Annualized Median Income: \$57,490
- 6. Transportation and Material Moving**
Share of Informal Workers: 5.6%
Annualized Median Income: \$37,940
- 7. Management**
Share of Informal Workers: 5.4%
Annualized Median Income: \$107,360
- 8. Building and Grounds Cleaning and Maintenance**
Share of Informal Workers: 5.3%
Annualized Median Income: \$33,870
- 9. Production**
Share of Informal Workers: 4.7%
Annualized Median Income: \$39,910
- 10. Food Preparation and Service**
Share of Informal Workers: 4.6%
Annualized Median Income: \$29,640
- 11. Construction and Extraction**
Share of Informal Workers: 4.3%
Annualized Median Income: \$50,570
- 12. Healthcare Practitioners and Technical**
Share of Informal Workers: 3.0%
Annualized Median Income: \$77,760
- 13. Arts, Design, Entertainment, Sports, and Media**
Share of Informal Workers: 2.6%
Annualized Median Income: \$58,030
- 14. Healthcare Support**
Share of Informal Workers: 2.5%
Annualized Median Income: \$33,600
- 15. Business and Financial Operations**
Share of Informal Workers: 2.1%
Annualized Median Income: \$76,850
- 16. Community and Social Service**
Share of Informal Workers: 1.9%
Annualized Median Income: \$49,380
- 17. Farming, Fishing, and Forestry**
Share of Informal Workers: 1.7%
Annualized Median Income: \$33,970
- 18. Installation, Maintenance, and Repair**
Share of Informal Workers: 0.9%
Annualized Median Income: \$50,080
- 19. Protective Service Occupations**
Share of Informal Workers: 0.8%
Annualized Median Income: \$45,450
- 20. Life, Physical, and Social Science**
Share of Informal Workers: 0.7%
Annualized Median Income: \$74,330
- 21. Legal**
Share of Informal Workers: 0.5%
Annualized Median Income: \$95,170
- 22. Architecture and Engineering**
Share of Informal Workers: 0.5%
Annualized Median Income: \$83,700
- 23. Computer and Mathematical**
Share of Informal Workers: 0.4%
Annualized Median Income: \$100,440

2 Refers to the share of an occupation among informal workers who are in the formal labor force, meaning those with formal jobs and the unemployed jobseekers.

3 Annualized median income is derived from the occupation's median hourly wage rate and assumes the median earner in that occupations works 40 hours a week for all 52 weeks of the year.

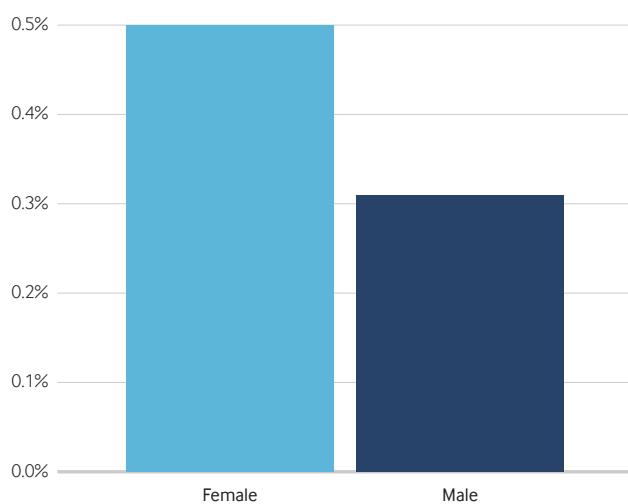


WOMEN, BLACK AND HISPANIC POPULATIONS PARTICIPATE MORE IN THE INFORMAL ECONOMY

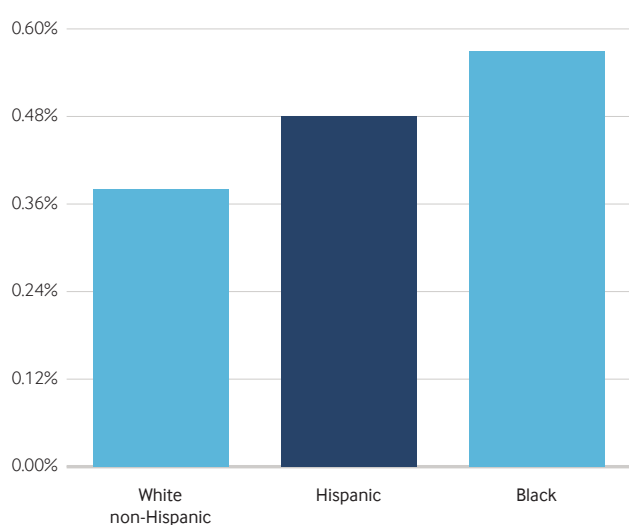
Disadvantaged groups who are more likely to earn poverty wages or settle for part-time work also tend to work informally at a higher rate. Women represented 6 of every 10 informal workers throughout the whole period. Between 2020 and 2022, 0.50% of women reported working informally compared to just 0.31% of men, and they also had a functional unemployment rate almost 10 percentage points higher and earned 22% lower wages than men at the median. Similarly, Hispanics earned

28% less than non-Hispanic white people and 0.48% of them reported working informally in the same period compared to 0.38% of non-Hispanic white workers. Similarly, 0.57% of Black workers, earning 27% less at the median than non-Hispanic whites in the formal market, reported being informally employed. Groups who struggle to find adequate jobs in the formal labor market turn more often to the informal economy out of necessity.

Percent working informally on an average day between 2020-2022



Percent working informally on an average day between 2020-2022

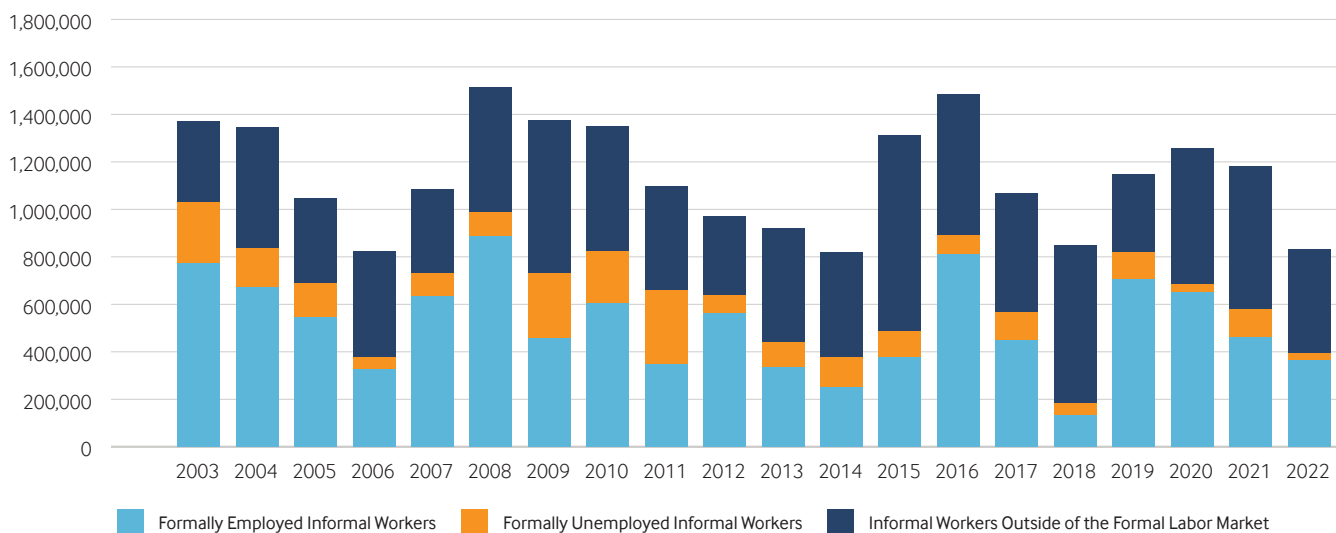


INFORMAL EMPLOYMENT CAN SOFTEN THE BLOW OF ECONOMIC DOWNTURNS, BUT IT'S NOT A VIABLE LONG-TERM SOLUTION

The informal economy was more incidental during the Great Recession. In 2008, the TRU decreased the most from 28.3% to 26.8%, as 5.0M workers became functionally employed after leaning more on informal work. Many of them relied on informal jobs to maintain a full-time and living-wage status after layoffs and reduced hours. Between 2008 and 2010, the TRU OOP fell by 1.6 pp. yearly on average after accounting for informality, compared to 1.0 pp. during the rest of the period

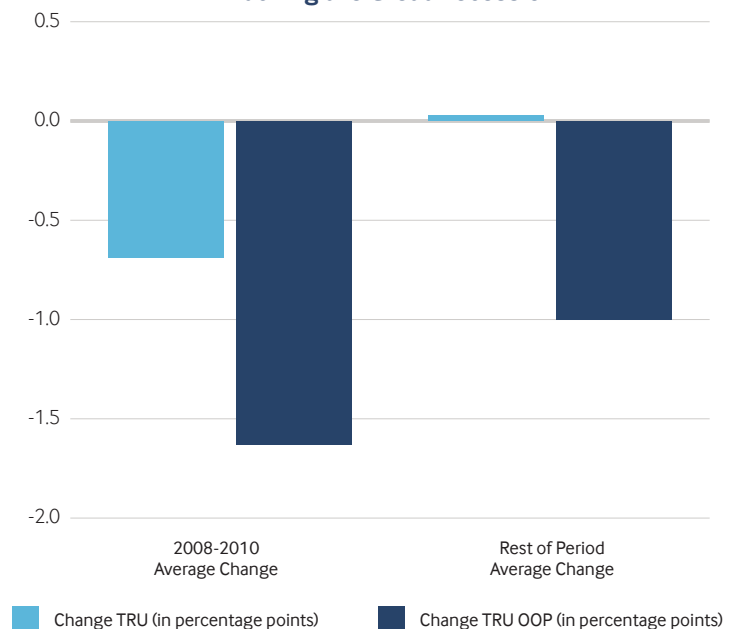
considered. More people worked under the table, as well: informal employment was 29% higher during the Great Recession than during other years while the labor force increased by 2.6 pp. annually, compared to 2.2 pp. in the remainder of the period. Conversely, this also means headline metrics ignoring the informal economy are further from the mark during crises. Unsurprisingly, more people depended on informal income to stay afloat in a struggling labor market.

29% more people worked informally in a day during the Great Recession than during other years on average



INFORMAL EMPLOYMENT SOFTENS THE BLOWS OF REDUCED WAGES AND HOURS, BUT IT DOES NOT REPLACE FULL-TIME JOBS OR LIVING WAGES.

Informal work impacted the TRU more during the Great Recession

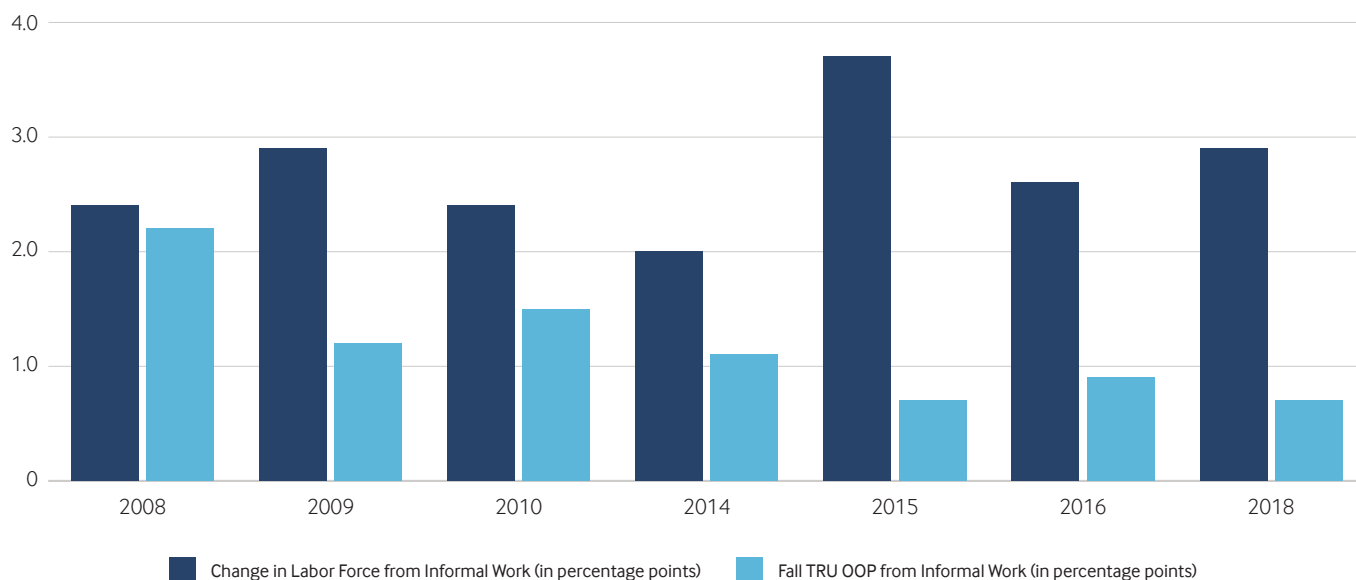


THE INFORMAL LABOR MARKET RARELY PROVIDES FUNCTIONAL EMPLOYMENT

In other periods with strong informal employment such as 2015 and 2016, unreported work did not boost functional employment as much as it improved employment. Informal employment softens the blows of reduced wages and hours, but it does not replace

full-time jobs or living wages. So, informal work can help a laid-off worker weather the storm of temporary unemployment, but it cannot provide bare-minimum living wages in the long run.

During the Great Recession, the informal sector had a stronger impact decreasing functional unemployment than in other years with high informal employment



CONCLUSION

While the informal economy is a cushion for economically-distressed workers, it does not make up for lamentable opportunities in the formal labor market. Informal workers often earn low wages, have no benefits, and are not protected by labor laws. They are also more likely to be exploited by their employers. The informal economy can be a lifeline for people who are struggling to make ends meet, but it is not a solution to the problem of low-quality jobs. It's crucial to recognize

that women and Hispanic and Black individuals, more often trapped in bad jobs, constitute a disproportionately large segment of the informal economy. By deliberately ignoring job quality, the Bureau of Labor Statistics' headline unemployment measure presents policymakers with a misleading picture of a healthy labor market. Instead of recognizing the importance of employment standards, the Bureau of Labor Statistics disregards a key factor in the economic well-being of American workers.





**LUDWIG
INSTITUTE**
FOR SHARED
ECONOMIC
PROSPERITY