LUDWIG INSTITUTE FOR SHARED ECONOMIC PROSPERITY

THE HIDDEN WORKFORCE:

THE IMPACT OF THE INFORMAL ECONOMY ON FUNCTIONAL EMPLOYMENT

EXECUTIVE SUMMARY

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There is a widespread misconception the informal economy — income-generating activities conducted outside traditional employment and wage-tracking systems — 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.

Through its Informal Economy study, LISEP provides evidence it is low-income workers who turn to the informal market out of necessity. Although informal work provides necessary financial support, it remains precarious and does not compensate for a lack of decent opportunities in the formal market. The study estimates between 1.14 million (M) and 7.99M people worked informally on an average week from 2003 to 2022 — 3.3% of the U.S. working-age population. Between 0.24M and 1.70M people become functionally employed because of informal employment, and accounting for unreported income indicates 0.95M more self-employed people earn above poverty wages each year.

Key findings:[1]

- **Informal work has a limited impact on functional unemployment** in the labor force and out of the population. On average, the TRU is only 0.08 percentage points (pp.) and the TRU Out of the Population (TRU OOP) 1.10 pp. lower when considering unreported labor and earnings throughout the period. Overall, this translates to 2.6M more workers being functionally employed, 4.4M people finding jobs and 3.5M joining the labor force on an average year.
- **Low-income individuals are considerably more likely to work informally.**
    - » Workers in **low-paying occupations** such as personal care and service workers and **unemployed jobseekers** are **considerably more likely to work informally.**
    - » **Women, Black and Hispanic populations** who are more likely to involuntarily work part-time and earn a poverty wage **make up a disproportionately large share of informal workers.**
- **Informal employment does not offset bad job quality in the formal market.** The share of the workforce with functional unemployment can increase when many informal workers join the labor force without full-time and living-wage jobs. For example, from 2014 to 2018, the TRU rose on average by 0.7 pp. after considering unreported labor and earnings since only 13% of the 4.2M informal workers who joined the labor force were functionally employed.
- **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 turning to the informal economy. Many of them relied on informal jobs to maintain a full-time and living-wage status after layoffs and reduced hours.

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. 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.

INFORMAL WORKERS OFTEN EARN LOW WAGES, HAVE NO BENEFITS, AND ARE NOT PROTECTED BY LABOR LAWS.

1 All the provided statistics in the key findings refer to the upper-bound estimate of informal workers. The upper-bound estimate (Scenario B) holds that 8.0M people work informally on an average week between 2003 and 2022. The range of estimates provided on page 1 refers to both the lower-bound and upper-bound estimates. See the Research Paper for more details.

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