

# Contribution of Informal Sector to Welfare and Employment

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## ARTICLE INFO

### Article history:

Received 9 December 2020

Revised 21 May 2021

Accepted 19 June 2021

### Key words:

Informal sector,  
Employment,  
Welfare,  
Community economy,  
Formal system,  
Public policy,  
Inclusive development.

## ABSTRACT

*The informal sector plays a vital role in providing employment and improving people's welfare, especially in countries where the economic system has not been able to accommodate the entire workforce formally. This research aims to critically examine the contribution of the informal sector to job creation and community welfare through a qualitative literature review approach. By analyzing various academic literature and official reports, it is found that the informal sector serves as a socio-economic buffer in the face of structural pressures and economic crises. The sector has yet to receive adequate legitimacy and institutional support, which has resulted in its vulnerability to exploitation and income instability. The analysis also shows that the informal sector has the potential for economic transformation if supported by adaptive and contextualized policies. This research emphasizes the importance of repositioning the informal sector within a more inclusive and equitable economic development framework. The results of this research are expected to enrich public policy discourse and encourage policy formulation that is more participatory and responsive to the dynamics of the community economy.*

## INTRODUCTION

In the structure of the Indonesian economy, there is one layer that is growing dynamically but is often positioned outside the mainstream of policy, namely the informal sector. In the midst of global economic fluctuations, this sector has shown remarkable resilience in sustaining the lives of people, especially low-income groups. In many cities and rural areas, this sector is present in the form of street vendors, home-based workers, day laborers, and non-formal transportation services. Their activities not only support household consumption, but also absorb a large amount of labor, which is often not covered by the formal sector (Neilson & Arifin, 2013).

The role of this sector is becoming increasingly vital as the formal sector has limited capacity to provide sufficient employment. When the formal business world faces pressure, it is the informal sector that is able to absorb excess labor, while maintaining socioeconomic stability. In big cities, millions of people rely on non-formal economic activities that are flexible and easily accessible without the need for large capital or higher education. Their existence is an integral part of a more inclusive economic system (Cazes & Verick, 2013).

The contribution of the informal sector is often overlooked in the formulation of national economic policy. The sector's flexibility allows it to provide alternative employment amid economic fluctuations. In fact, its role is not only limited to job creation, but also indirectly improves community welfare through local economic turnover. Many of these actors are self-employed, but they still play an important role in sustaining the local economy and indirectly creating jobs. This sector is a buffer for the household economy, providing space for people to survive and even thrive, amidst the limitations of the social security system and the high cost of living in urban areas (Rani, 2019).

It is time for a scientific and systematic review of the real contribution of the informal sector in the economy, especially in relation to improving community welfare and job creation. Many policies are designed with a primary focus on the formal sector, such as large industries and medium-large enterprises, without considering the complexities and needs of the informal sector. A thorough understanding will provide a basis for formulating policies that are more equitable and accommodating, so that the huge potential that has been hidden can be maximized in a sustainable and strategic manner (Setyanti, 2020).

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While the informal sector contributes greatly to job creation, its legal status, which is not fully recognized, is a fundamental problem. Its vague legal status means that activities in this sector are considered illegal or semi-legal, preventing businesses from enjoying the basic rights of formal workers. Many actors in this sector work without adequate legal protection, are not covered by the social insurance system, and are vulnerable to repressive actions by law enforcement officials. Such actions not only harm informal businesses economically, but also reinforce their marginalized position in the social structure. These practices not only create economic losses, but also deepen the social stigma against informal businesses, which are often seen as disruptive or unproductive. This creates ongoing uncertainty and vulnerability, especially in the midst of unstable economic dynamics (Hart, 1973).

The informal sector is often faced with limited access to productive resources, such as capital, training and market information. Limited business capital is one of the most obvious constraints, as most informal business owners do not have the asset collateral or credit history needed to access financing from formal financial institutions. Information on consumer trends, government regulations, and market opportunities is also difficult for informal businesses to access in the absence of adequate communication networks or institutional support. This causes their productivity to remain low and not develop optimally. Based on Todaro's (1981) research, it is stated that one of the main characteristics of the informal sector is the use of simple technology and low capital, which ultimately limits the capacity to grow and innovate. Such low innovation capacity due to lack of resources, training and information has contributed to productivity stagnation in the sector. As a result, despite the large number of workers absorbed, the informal sector's contribution to national economic growth remains limited.

The incompatibility between the informal sector and the formal economic system creates an unhealthy structural dualism. When economic regulations are only designed for the formal sector, informal businesses struggle to adjust, widening social and economic disparities. As a result, informal sector actors have no room to grow within the existing regulatory framework. Lewis (1954) asserts that this inequality will continue if there is no structural intervention to bridge the two sectors. Without a change in approach, the informal sector will continue to be a space for subsistence work rather than a place for true economic empowerment. The right approach can strengthen national economic resilience with policies that expand the productive base of the informal sector.

The inequality and limitations faced by informal sector actors have major implications for the socio-economic balance in the community. When millions of people depend on unprotected and unstable jobs, economic uncertainty becomes commonplace. This not only affects individual or household income, but also impacts purchasing power, consumption, and the ability to access basic services such as education and healthcare. When access to decent and sustainable employment is limited, social inequality will continue to expand, creating more complex social pressures in the future. Since the informal sector is the mainstay of millions of people's survival, understanding its place and mechanism in the economic structure is urgent. It is not enough to see it as a transitional sector towards the formal economy, but it must be understood as an integral part of the national economic system.

There is a considerable gap in the literature that comprehensively discusses the role of the informal sector from a welfare and labor perspective. Existing research is generally fragmentary and has not touched on strategic aspects that can strengthen the sector's position as an important element of national economic empowerment. Without holistic mapping, the sector's role in supporting economic and social stability is often underestimated. Academic efforts are urgently needed to explain the contribution of the informal sector and map its potential synergies with employment and welfare policies.

This research aims to analyze the contribution of the informal sector in creating jobs and improving community welfare. This research will highlight how the informal sector operates within the uncertainty of the economic system, as well as the extent to which its role can be strengthened as a strategic component of national economic development. The results of this research are expected to provide theoretical and practical contributions to the formulation of policies that are more inclusive and based on socio-economic realities.

## RESEARCH METHOD

This research uses a qualitative approach with a library research method that aims to collect, examine, and analyze various relevant literature sources related to the role of the informal sector in improving community welfare and job creation. The research was conducted by reviewing theories, previous research results, and scientific documents that are directly related to the topic under study. This approach allows researchers to construct conceptual and empirical understanding from various perspectives, so as to obtain a deep and comprehensive synthesis of the issues discussed (Neuman, 2006).

The data collection process in this research focused on credible written sources such as academic journal articles, scientific books, research reports from national and international institutions, and relevant official statistical data. Subsequently, the data were analyzed using content analysis techniques, by identifying themes, patterns, and relationships between concepts related to the contribution of the informal sector to welfare and employment. This method is considered suitable for examining complex socio-economic issues through understanding existing scientific narratives (Bowen, 2009).

## **RESULT AND DISCUSSION**

Amidst the dynamics of globalization and rapid population growth, not all communities have equal opportunities to access the formal economy. Many individuals face limitations in education, skills and structural barriers that prevent them from entering the formal job market. In this reality, alternative economic spaces emerge that do not rely entirely on state regulation but remain vibrant and productive. Local initiatives born from the needs and creativity of the community become the main drivers of economic activities that take place outside formal supervision, but have a great impact in sustaining daily life (Gibbs et al., 2014).

Urban centers and developing regions are witnessing various forms of non-formal businesses that are growing fast and dynamic. From street vendors, informal services, to small-scale home-based businesses, all these activities go hand in hand with the pulse of the local economy. They not only fulfill the economic needs of households, but also become an important part of the distribution of goods and services that reach consumers directly. In many cases, informal economic actors have shown resilience in adapting to market pressures and changing policies, demonstrating that they are not just fillers of the system void, but real actors in the national economic landscape (Lema, 2018).

The sustainability of this sector is not only determined by economic pressure, but also by social and cultural values within the community. Many non-formal economic activities are born out of community solidarity, trust between individuals, and informal problem-solving mechanisms. In other words, this sector is deeply rooted in social relations that enable individuals to survive in uncertain economic conditions. The role of the non-formal sector in development cannot be separated from the social sphere in which it grows, and policy approaches to it cannot be based solely on legalistic frameworks or statistical figures (La Porta et al., 2008).

Given the wide spectrum of contributions, it is inadequate to view the sector as a product of the formal system's irregularities. In fact, in many ways, the informal sector offers flexibility, efficiency and responsiveness that are often not found in the formal economic structure. It is present as a counterweight as well as a support for the labor system that is not yet inclusive. When the formal sector faced a crisis, it was the informal sector that became the social safety net for millions of workers who lost their jobs or could not access the formal labor market. This sector is growing because it is able to answer needs that have not been touched by formal mechanisms in a fast and relevant manner. Through an unbiased understanding and approach to these people's economic activities, we can open up new opportunities in integrating the informal sector into a more equitable and participatory national development framework (Fayomi et al., 2017).

The informal sector has become one of the main backbones in the dynamics of employment in developing countries, including Indonesia. When the formal economic system has not been able to create sufficient employment opportunities, the informal sector emerges as an alternative space that absorbs millions of workers from various educational backgrounds and skills. The existence of this sector is particularly pronounced in urban and semi-urban areas, where economic activities take place quickly and are not entirely structured within a legal-formal framework. The informal sector not only acts as a socio-economic safety net, but also as a production space that is adaptive to change. While it is often viewed as a marginalized sector, it contributes significantly to creating employment opportunities, especially for vulnerable groups such as women, youth and rural migrants (Chen, 2001).

It is important to note that the flexible nature of the informal sector makes it responsive to macroeconomic pressures. When there is an economic recession or slowdown, the informal sector tends to expand in reaction to shrinking opportunities in the formal sector. This happens because the informal sector does not require strict regulations, large capital, or a complicated recruitment system. Economic actors can enter and exit the sector easily, making it a means of survival in an uncertain economic situation. Within this framework, the role of the informal sector becomes very significant in maintaining social and economic stability at the grassroots level. It is important for the government and stakeholders to design policies that recognize and support the strategic role of the informal sector.

The contribution of the informal sector to improving community welfare cannot be ignored either. While activities in this sector are often subsistence in nature and do not generate high incomes, the informal sector provides economic opportunities for those excluded from the formal labor market. Activities such as trading in traditional markets, being a motorcycle taxi driver, and small household-based businesses provide regular income that can support the basic needs of the family. The informal sector has the advantage of flexibility in terms of working time and location, which is very suitable for the needs of low-income people. While productivity levels and wages in the informal sector tend to be low, its existence provides relatively stable economic certainty under structural uncertainty (Fields, 2004). It is important for the government to not only see the sector as a regulatory issue, but also as a partner in welfare development. Through friendlier policy approaches, such as providing access to microcredit, skills training, and minimal social protection, the informal sector can be more effective in improving people's welfare in a sustainable manner.

These contributions take place in an economic system that does not fully accommodate the existence of the informal sector in a fair and inclusive manner. Many informal sector actors work without legal protection, without access to social security, and without involvement in economic policy formulation. These conditions make the informal sector vulnerable to exploitation, criminalization, and policy discrimination, especially in terms of controlling public space and access to production resources. Policy structures that are still dominantly based on the formal sector often ignore the needs and realities of the informal sector, which is the foundation of the people's economy (Hart, 1973).

Data limitations and lack of serious attention from policy makers mean that the informal sector does not have a strong bargaining position in public policy formulation. Ignorance of the realities on the ground leads to ineffective, or even counterproductive, policies for the development of the sector. In fact, this sector is very diverse and complex, encompassing various forms of economic activities that operate within a spectrum of different legalities. The lack of valid data makes it difficult for the government to design targeted interventions, while informal sector actors themselves are often poorly organized, making it difficult to form a strong collectivity. The openness of the economic system to the dynamics of the informal sector remains a major challenge (Portes & Sassen-Koob, 1987). Without efforts to strategically bridge the formal and informal worlds, the social and economic gap will continue to widen.

The relationship between the informal sector and social inequality is also noteworthy. As the informal sector is largely comprised of low-income, unstable and under-protected jobs, high dependency on the sector tends to reproduce structural poverty. Unequal access to education, health services, and decent housing are part of the long-term consequences of dependence on the informal sector. Individuals who rely on informal sector earnings are often unable to access quality education for their children or adequate health services. This not only prolongs poverty, but also closes off opportunities for upward social mobility. The existence of the informal sector does help to reduce short-term social turmoil, but in the long-term it can be an obstacle to socioeconomic mobility (De Soto, 1989). It is important for policymakers to not only see the informal sector as an emergency solution to unemployment, but also as a strategic arena that needs to be empowered and integrated to systemically reduce social inequality.

There is also evidence that the informal sector can develop into a more productive economic unit if given the right support. Some micro and small enterprises from the informal sector were able to transform towards legality and market expansion after gaining access to entrepreneurship training, technical assistance, and small business loans. This combination of policy support and ongoing coaching helps informal businesses upgrade and make greater economic contributions locally and nationally. This shows that the informal sector is not always synonymous with stagnation and poverty, but has great potential for growth if the support structure is taken seriously (Mead & Liedholm, 1998). The informal sector should be viewed not merely as a labor issue but as a potential driver of inclusive economic development. This approach not only increases productivity, but also reduces social inequality and strengthens the national economic structure from the grassroots level.

It is important to understand that the existence of the informal sector is not simply a result of the failure of the formal sector to absorb labor, but is an inherent part of a dualistic economic structure. The informal sector emerged because of the real needs of the community to create an economic space that is flexible and adaptive to social and economic realities that are not ideal. The informal sector is not only a complement to the formal sector, but also reflects a form of people's economic creativity in responding to the limitations of the system. When this sector is given a fairer place in economic policy, its innovative potential can be further developed to promote inclusive economic growth. In other words, structural recognition of the existence of the informal sector as a partner in economic development is needed (Tokman, 2007).



As in Indonesia, the existence of the informal sector is deeply intertwined with socio-cultural dynamics. Many economic activities are not formally recorded, but are deeply rooted in the social practices of the community. Family businesses, collective labor, and networks of trust characterize the informal sector, which is often lacking in the more structured formal sector. This phenomenon shows that the success of informal enterprises is not only determined by economic factors, but also by the socio-cultural context in which they grow. These characteristics make the informal sector a living economic space that is integrated with the social life of the community, not just an escape from the formal sector. The approach to the informal sector cannot only be based on the logic of administrative legality, but also needs to consider the social and cultural sphere in which this sector grows (White & Lind, 2003). This approach enables the formulation of policies that are more relevant, participatory, and sensitive to the real conditions of informal business actors.

The informal sector also has a high resilience capacity in the face of global economic change. During the 1998 monetary crisis, this sector became the main pillar of household economic sustainability in Indonesia. Many workers who were laid off from the formal sector then turned to the informal sector and managed to build micro-enterprises that have survived to this day. Without complicated administrative procedures and large capital requirements, the informal sector is able to adjust quickly to national economic emergencies. This proves that the informal sector does not only serve as a temporary buffer, but can also become a new economic motor if given proper incentives and recognition (Fayomi et al., 2017). With an inclusive and evidence-based policy approach, the informal sector is not only able to survive the crisis, but also become a catalyst for more equitable and resilient economic growth in the future.

It is important not to oversimplify the role of the informal sector as a permanent solution to unemployment and poverty. Over-reliance on this sector without structural improvements can create productivity stagnation and exacerbate social vulnerability (Ruzek, 2014). Workers in the informal sector do not have legal certainty, access to skills training, or opportunities for upward economic mobility. This disorganization, if left unchecked, will create an unequal economic structure that is difficult to develop. The informal sector should therefore be seen as a starting point for integration into a more formal economic system, rather than an end in itself. This process requires transformative policies that bridge the gap between the two sectors (Fields, 2004).

From a public policy perspective, strengthening the capacity of the informal sector requires adaptive and contextualized interventions. Training programs, legal protection, and access to finance should be designed based on the real needs of sector actors, not just based on formal economic standards that are often inappropriate. Collaboration between government, academia, and civil society organizations is important to build a shared understanding of the strategic value of the informal sector in inclusive and equitable economic development (Chen, 2001). With structured and data-driven cooperation, the informal sector can be seen not only as an emergency solution to unemployment, but also as a strategic asset in creating economic justice and long-term social welfare.

Overall, the contribution of the informal sector to job creation and improving people's welfare is crucial but has not been optimally managed within the framework of a predominantly formalistic economic system. In many developing countries, including Indonesia, this sector is the mainstay of millions of people working in micro-enterprises, street trading, or domestic work. For this reason, a multi-dimensional approach is needed that not only sees the informal sector as a problem, but also as an opportunity for socio-economic transformation. If this sector is given a proper place in the policy and development system, then its potential can be enhanced to become a productive force that promotes equity and sustainable economic growth. Building synergies between the informal and formal sectors is urgent as a strategy to realize economic growth that is sustainable, fair, and in favor of all levels of society.

## CONCLUSION

The informal sector has a great capacity to create jobs and support community welfare, especially in an economic system that has not fully accommodated its existence. This sector developed as a response to the limitations of the formal system, which is unable to absorb the entire workforce, while also reflecting the resilience of the people's economy in the face of structural uncertainty. While it is often seen as a marginal economic activity, the informal sector actually plays a key role in socio-economic stabilization. Its contribution takes place within a policy framework that does not provide adequate legal protection, access to financing, or structural recognition. This situation places the informal sector in a paradoxical position-quantitatively strong but institutionally weak-that hinders the potential for broader socio-economic transformation. This hampers the informal sector's great potential to become an agent of broader socio-economic change.

The limited structural accommodation of the informal sector in the formal economic system has long-term implications for the quality of welfare and labor productivity. Most informal sector actors work in conditions without social security, minimum wage, or proper labor protection. High dependence on this sector without adequate policy intervention can strengthen social inequality and hamper economic mobility, especially among vulnerable groups. It is not enough to understand the informal sector as a social safety net, but rather as an integral part of the national production system that needs to be responded to with a transformative policy framework. Appropriate policy interventions can bridge the disconnect between microeconomic potential and macro institutions, which have been operating in isolation.

It takes seriousness from policy makers to build an adaptive approach that is rooted in the real needs of informal sector actors. Steps that can be taken include developing inclusive policies based on valid data, strengthening the capacity of actors through entrepreneurship education and access to microfinance, and drafting regulations that accommodate the diversity of non-formal economic activities without limiting the flexibility that is the strength of this sector. Cooperation between the government, academics, and civil community organizations needs to be improved to produce interventions that are not only administrative, but also contextual and participatory in supporting the transformation of the informal sector towards strengthening the community economy.

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