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## Informal Economies

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## Informal Economies

### Abstract

The informal economy comprises the parts of the economy that are not regulated. These parts include illicit activity like the sale of drugs, architects doing work under the table, hairdressers who operate in cash and don't report their income, businesses employing illegal workers, and businesses operating without government required licenses. Informal economic actors are often self-employed, or are employed elsewhere and operating an informal business on the side as a means for supplemental income. Often, informal economic actors are undocumented immigrants who risk being discovered if documentation is heavy. Acting informally allows income to be generated without documentation.

### Keywords

Buffalo, Poverty/Low Wage Work/Income Inequality, Exploitative Businesses, Fact Sheet, PPG, PDF

## **Informal Economies**

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### **1. What is an informal economy?**

- The informal economy comprises the parts of the economy that are not regulated. These parts include illicit activity like the sale of drugs, architects doing work under the table, hairdressers who operate in cash and don't report their income, businesses employing illegal workers, and businesses operating without government required licenses.<sup>i</sup>
- Informal economic actors are often self-employed, or are employed elsewhere and operating an informal business on the side as a means for supplemental income.<sup>ii</sup>
- Often, informal economic actors are undocumented immigrants who risk being discovered if documentation is heavy. Acting informally allows income to be generated without documentation.

### **2. What is good about informal economies?**

- Informal economies provide income to many who do not qualify, can't attain, or do not have time for regular jobs. Examples of this would be the single mother who works full-time formally and sews clothing on the side for additional income.
- Informal economies are primarily cash economies. As such, and given the legally dubious nature of how the cash was acquired, much of that money is not saved in banks but spent. This increases the speed at which money moves throughout the economy.<sup>iii</sup>
- Because they are outside of governmental regulation, in theory informal economies cost the government nothing by way of subsidies.



### 3. What is bad about informal economies?

- Informal economies are generally exploitative. By not paying taxes, informal economic actors are availing themselves to government benefits like infrastructure or public services without paying for them. The burden for providing for the services and infrastructure that society enjoys shifts to those who are formalized.
- The government cannot regulate how informal businesses treat their employees. Consider a small informal business that operates selling bootleg CDs on the street. The person running this business can treat and pay his employees less optimally than would be required legally.
- Informal economies, especially in urban areas, are representative of the cyclical nature of racial and social discrimination in both criminal and civil systems. Inequality and segregation, in conjunction with the criminal justice system, make it difficult, if not impossible, to ever formalize one's economic activity. This one-way street leads to less, if any, economic development.

### 4. What causes informal economies to occur?

The causes of informal economies are manifold and sometimes quite difficult to ascertain. However, below are examples of things that cause the never-ending cycle of informal economic actors:

- The lack of legitimate banking services/financing in urban areas and the rise in less formal check-cashing services and rent-to-own stores.
- The War on Drugs causes a disproportionate amount of young males 18-30 to end up in prison, causing a host of problems that lead to the furtherance of informal economies.
- The cost and difficulty of obtaining licenses to operate businesses legitimately can act as a barrier to formalization.



**5. What is the current banking and financing situation in and around the inner city where informal economies are strongest?**

- The Buffalo News suggests that very few of the city's banks are located in poorer areas. "Today, there are only 18 bank branches left on the East Side -- a quarter of the 72 in the city -- and most of those 18 are on the outskirts of the inner city, near the Broadway Market, Kaisertown or the University at Buffalo's South Campus."<sup>iv</sup>
- Nicholas Gentile, who manages two of the bank branches mentioned by the News, says that the banking industry is well aware of the current situation, "The inner city is a difficult place to do business for traditional banks," he says, "Our fee schedule is geared for protecting those who have more money. At individual branches, we would like more leeway in providing services for lower-income customers with modified fee schedules, but as of right now individual managers are unable to change fee schemes."<sup>v</sup>
- "Crime cannot be ignored either," he says, "It's hard to even employ tellers at some branches because of fears of robbery. The worse an area is crime-wise, the more expensive our insurance is and it becomes less likely that branches can operate."<sup>vi</sup>
- When asked what residents in these areas do for banking services, Mr. Gentile said, "We get a lot of people in here who complain about fees at alternative check-cashing locations, but who want the check to clear right away because they need the money." Banks, following UCC regulations, often take too long to provide the money for some of these residents. Often, people turn to neighborhood check-cashing services to provide the quick cash they need from checks.<sup>vii</sup>



**6. How does the lack of formal banking services in poorer areas cause informal economies to exist, and how does this hurt residents in affected areas?**

- The dearth of legitimate banking services throughout much of the poorer areas of Buffalo and the barriers confronting those who do try to use traditional banks (like past financial problems, lack of proper registration information, or inaccessibility due to location)<sup>viii</sup>, leads many to rely on check-cashing outlets in corner stores.
- Check cashing outlets are a perfect example of a thriving informal economy that can negatively affect economic development for its customers. It is illegal under state law for non-licensed businesses to charge more than 99 cents for cashing a check (businesses licensed under the state Banking Dept. can charge up to 1.64% of the check's value).<sup>ix</sup>
- The Buffalo News found that only one area check cashing service in the area is properly licensed, placing the rest of them squarely within the informal economy. Instead of following state regulation in the amounts these businesses charge per check, they are essentially charging whatever they can get away with. Often, the amount is subject to haggling or negotiation. Government checks (which many residents are cashing regularly) tend to be marked up even more<sup>x</sup>
- Residents in low-income areas suffer because the myriad reasons that keep them out of traditional banks drive them to check-cashing services that cost them much more in the long run—and the profits made by check-cashing services are mostly informal, meaning that money is not pumped back into the system.



**7. Does America’s War on Drugs lead to fewer informal economic activities?**

- In theory, America’s War on Drugs is supposed to reduce drug-related crime, which would thereby reduce the existence of that particular informal economy and its offshoots. However, drug laws and the ways that the law is enforced in heavily affected areas lead to a vicious cycle that can trap actors within the informal economic system, not allowing them to ever operate formally.

**8. What is the societal impact of War on Drugs, and how does it create a never-ending cycle?**

- Many drug laws enacted within the last 40 years, starting with the Rockefeller laws, introduced mandatory minimum sentencing for various drug offenses. While these minimums were reduced during the Pataki Administration, the mandatory minimums are still significant, and tend to punish offenders for seemingly long periods of time. This, in conjunction with what many feel is a “broken window policing” enforcement strategy in highly affected areas leads to a disproportionate number of younger males being sent to prison (especially African-American males 18-30).<sup>xi</sup>
- Aside from the societal ramifications that result from a large percentage of the population being out of the workforce and community for large portions of their lives, there are other civil penalties and social consequences for those who have been convicted of crimes.
- There has been a vast proliferation of new civil penalties for convicted criminals that act as barriers for them to contribute formally to the economy. These penalties, which nominally exist to protect law-abiding citizens and to prevent recidivism, have made it difficult or impossible for ex-cons to obtain public or private housing, receive federal financial aid, or sometimes even obtain a driver’s license. Some experts believe that

this makes it even harder for the urban poor (especially minority males) to rejoin their families or communities in an honest or productive fashion. Instead, these individuals are often forced back into acting within the informal economies (like illicit drugs) that got them into trouble in the first place.<sup>xii xiii</sup>

- The political power is also taken largely out of these areas, as for redistricting purposes, prisoners are counted as residents of the county in which their prison is located. This makes it more difficult for highly-affected areas to break the cycle of operating in informal economies even harder. Residents most strongly affected also have the least say about the civil and criminal penalties that can cause operations of informal economies to be the norm.<sup>xiv</sup>



## 9. Can WNY's informal economies help economic development in the region?

- On small, individual levels, there can be economic development caused by informal economic activity. Examples would include informal businesses that become successful enough to legitimize and start officially putting money back into the economy or the informal business that doesn't formalize, but makes enough money or employs enough workers to provide legitimate economic boosters to the community (like jobs or increased consumer spending).
- On a wider, more macro level, WNY's informal economies are mainly mired in a cyclical quagmire that causes many informal actors to operate with little to moderate financial success and little or no opportunity for personal or economic advancement. The fact that many opportunities for informal operation are illegal decreases their economic value to the community and increases the chances that operators will end up in jail.



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- <sup>i</sup> <http://www.fieldus.org/Projects/InformalEconomy.html>
- <sup>ii</sup> [http://www.fieldus.org/publications/IE\\_Rural.pdf](http://www.fieldus.org/publications/IE_Rural.pdf)
- <sup>iii</sup> [http://www.1001how2.com/politics/The-Blessings-of-the-Black-Economy\\_32914/](http://www.1001how2.com/politics/The-Blessings-of-the-Black-Economy_32914/)
- <sup>iv</sup> <http://www.buffalonews.com/281/story/352218.html>
- <sup>v</sup> Interview with Nicholas Gentile, Branch Manager for M&T, 11-10-08.
- <sup>vi</sup> Interview with Nicholas Gentile, Branch Manager for M&T, 11-10-08.
- <sup>vii</sup> Interview with Nicholas Gentile, Branch Manager for M&T, 11-10-08.
- <sup>viii</sup> <http://www.buffalonews.com/281/story/352218.html>
- <sup>ix</sup> <http://www.buffalonews.com/281/story/352211.html>
- <sup>x</sup> <http://www.buffalonews.com/281/story/352211.html>
- <sup>xi</sup> Interview with Professor Terri Miller, 11-9-08.
- <sup>xii</sup> Interview with Professor Terri Miller, 11-9-08.
- <sup>xiii</sup> Civil Penalties, Social Consequences, eds. Christopher Mele, Theresa Miller, 2005, p. 3, p. 33.
- <sup>xiv</sup> <http://prisonersofthecensus.org/>