



# Why do consumers purchase goods and services in the informal economy? <sup>☆</sup>



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## ARTICLE INFO

### Article history:

Received 1 April 2013

Received in revised form 1 August 2013

Accepted 1 November 2013

Available online 12 December 2013

### Keywords:

Consumer behavior  
Informal sector  
Underground economy  
Shadow economy  
European Union

## ABSTRACT

To evaluate critically the dominant discourse that consumers acquiring goods and services in the informal economy are rational economic actors seeking a lower price, the results of a 2007 Eurobarometer survey involving 26,659 face-to-face interviews in 27 European Union member states form the basis for analysis. The finding is that achieving a lower price is the sole motive for just 44% of informal economy purchases, one of several rationales in 28% of transactions, and not a rationale in 28% of acquisitions. Consumers also use the informal economy to circumvent the shortcomings of the formal economy in terms of the availability, speed, and quality of goods and services provision, as well as for social and redistributive reasons, with multilevel mixed-effects logit regression analysis revealing how the prevalence of these rationales significantly varies across populations. The paper concludes by discussing the theoretical and policy implications of the findings.

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## 1. Introduction

When consumers ask, “How much for cash,” they are knowingly initiating the purchase of a good or service in the informal economy. Similarly, when suppliers offer a lower price without a receipt or for cash, most consumers know that they are engaging in an off-the-book transaction. The aim of this paper is to advance understanding of consumers' motives for making these purchases in the informal economy. Until now, despite transactions in the informal economy equating to 31.2% of global GDP (Buehn & Schneider, 2012), with the notable exception of a study in Slovenia (Culiberg & Bajde, 2013), the reasons for consumers purchasing goods and services in the informal economy has yet to receive attention from scholars. Instead, the widespread assumption, grounded in a rational economic actor model of consumption and the consumer, is that consumers acquire goods and services in the informal economy simply to save money (Allingham & Sandmo, 1972; Richardson & Sawyer, 2001). The following question remains, however. Is paying a lower price always the motive or do additional drivers pull and push consumers into making informal sector purchases?

To answer this question, Section 2 reviews both the dominant rational economic actor explanation for consumers purchasing goods and services

in the informal economy, along with two alternative explanations that these transactions result from either social and redistributive rationales, or the failures of formal businesses in terms of the availability, speed and quality of their goods and service provision. To evaluate these possible explanations, Section 3 briefly presents a 27-nation European survey involving 26,659 face-to-face interviews and Section 4 reports the results. Revealing that consumers are not always simply rational economic actors seeking a lower price, Section 5 then discusses the theoretical and policy implications.

Before commencing, however, a definition of the informal economy is necessary. The informal economy here refers to remunerated exchanges, unregistered by or hidden from the state, for tax, social security, and/or labor law purposes, but that are legal in all other respects (European Commission, 2007a; Williams, 2004). Hence, if the good and/or service is illegal, or no money changes hands, such transactions fall outside the informal economy and are instead part of the criminal or unpaid economy respectively. Nevertheless, blurry edges remain such as when the consumer gives gifts or in-kind labor in lieu of monetary payment (White & Williams, 2010). The current definition deems only exchanges involving money as part of the informal economy.

## 2. Explaining consumer participation in the informal economy

Today, the view of the informal economy as a residue from a past mode of production that is fast disappearing is invalid (Geertz, 1963; Lewis, 1959). The recognition is that the informal economy is a persistent, extensive, and growing feature of the global economy, employing some 60% of the global workforce (Jütting & Laiglesia, 2009). This is problematic because formal businesses witness unfair competition, informal workers

<sup>☆</sup> The authors thank the European Commission for funding the survey design and providing access to the resultant database of Eurobarometer wave 67.3. Comments by Jan Windebank, University of Sheffield, and John Round, Moscow Higher School of Economics on an earlier draft were helpful in revising the paper. As always, however, the normal disclaimers apply.

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lack the same legal protections as formal workers, and informal sector purchasers lack insurance cover, legal recourse if they receive a poor job, guarantees in relation to the work that they pay for, and certainty that the service or product conforms to health and safety regulations (Gallin, 2001; Williams, 2004). Understanding the reasons for participation in order to prevent this illicit activity is therefore important.

When examining what drives people to participate in the informal economy, understanding suppliers' motives and developing policy measures to tackle the supply-side are the usual focus (Chen, 2012; Dekker, Oranje, Renooy, Rosing, & Williams, 2010; European Commission, 2007a; OECD, 2012; Williams & Renooy, 2013). Understanding consumers' motives and preventing such illicit consumer behavior receives little attention. This study, in consequence, presents a review of different possible explanations for consumers participating in the informal economy, each suggesting very different drivers and policy approaches.

### 2.1. Financial gain explanation

A longstanding and dominant view in the literature on the informal economy is that participants in informal transactions are rational economic actors pursuing financial gain (Bajada, 2002; Davis, 2006; Fortin, Garneau, Lacroix, Lemieux, & Montmarquette, 1996; Gallin, 2001; Sassen, 1997). This derives from the seminal work of Allingham and Sandmo (1972) who represent informal workers and consumers as rational actors weighing up the rewards and risks of their actions and disobeying the law when the expected penalty and probability of detection are smaller than the profits. The resulting focus is on developing public policy measures to alter the cost/benefit ratio confronting suppliers and consumers either by raising the actual and perceived likelihood of detection and sanctions for those caught or by providing incentives to source goods and services formally (Richardson & Sawyer, 2001; Williams & Renooy, 2013).

Here, for the first time in the literature, this dominant explanation for consumer participation in the informal economy undergoes testing by evaluating the following hypothesis.

**H1.** The motive of financial gain drives consumers to purchase goods and services in the informal economy.

### 2.2. Social/redistributive rationale explanation

An alternative explanation takes inspiration from a body of critical, post-structuralist, post-development, post-capitalist thought that transcends the conventional thin portrayal of economic endeavor as always purely market-like and profit-motivated. This alternative explanation instead adopts thicker portrayals of monetary exchange, which recognizes the complex mix of logics, including social logics, often at work (Gibson-Graham, 2006; Leyshon, Lee, & Williams, 2003; Zelizer, 2005). The result is a representation of participants in informal markets as social actors rather than rational economic actors (Nelson & Smith, 1999; Round & Williams, 2008; Williams, 2004). This view recognizes that informal work often takes place in a familiar context (for and by kin, neighbors, friends, and acquaintances), or for social or redistributive rationales such as to give an unemployed person money in a manner that avoids any connotation of charity, which might prevent the recipient from accepting the money (Kempson, 1996).

These exchanges are thus more like paid favors than profit-motivated market-like transactions (Williams, 2004). Testing of the following hypothesis evaluates this explanation.

**H2.** Social and/or redistributive motives drive consumers to purchase goods and services in the informal economy.

### 2.3. Formal economy failure explanation

A third possible explanation is that consumers purchase in the informal economy due to the failures of the formal economy (De Soto, 1989,

2001; Maloney, 2004; Small Business Council, 2004). These failings translate as the lack of availability and reliability of formal businesses, the speed of their goods and services provision, and the quality of the goods and services that they provide. From this perspective, "the real problem is not so much informality as formality," (De Soto, 1989, p. 255) and unless formal business resolves these failings, consumers will continue to purchase in the informal economy. Testing the following two hypotheses evaluate the market failure explanation.

**H3a.** The lack of availability of goods and services on the formal market drives consumers to purchase goods and services in the informal economy.

**H3b.** The informal economy's faster or better quality service drives consumers to purchase goods and services in the informal economy.

## 3. Method

To evaluate what drives consumers to purchase goods and services in the informal economy, the results of Special Eurobarometer No. 284 ("Undeclared work in the European Union"), involving 26,659 face-to-face interviews in all 27 European Union member states (European Commission, 2007b) form the basis for analysis. This survey employs the same multi-stage random (probability) sampling methodology as other Eurobarometer surveys, with the weighting process ensuring that on the issues of gender, age, region and locality size, the sample is proportionate to the universe in each country.

The interview schedule adopts a gradual approach toward sensitive questions, commencing with attitudinal questions, then questions on the purchase of goods and services in the informal economy, and, finally, questions regarding the supply of informal work. Here, the participants' responses as consumers are the focus for analysis. The first question is: Have you in the last 12 months acquired (1) any goods [and (2) any services] of which you have good reason to assume that they embodied undeclared work (i.e., that the income was not completely reported to tax or social security institutions)? The second question is: From the following, what made you buy it undeclared instead of buying it on the regular market? (lower price; faster service; better quality; good or service is not available on the regular market; in order to help someone who is in need of money; as a favor among friends/relative/colleagues).

## 4. Results: consumers' motives for informal sector purchases in the EU-27

The finding is that 9% of the survey participants across the EU-27 purchased one or more services in the informal economy during the last 12 months and 6% one or more goods. Since some acquire both goods and services informally, the result is that 11% of participants acquired a good and/or service in the informal economy over the last year.

Analyzing consumers' motives, Table 1 reveals that a lower price is the sole motive for just 44% of consumers' informal purchases, one of several rationales in 28% of cases, and not a rationale in the remaining 28% of cases. Rationales other than financial gain, therefore, prevail in 56% of purchases in the informal economy.

Social and/or redistributive rationales are the sole driver of 10% of all informal purchases and combine with other reasons in a further 15% of cases. Formal sector failures are the sole reason for 15% of informal purchases and combine with other motives in another 23% of cases.

For the purposes of analyzing how consumers' motives vary across the EU-27, member states form four geographical regions: Western Europe (Belgium, Germany, France, Ireland, Luxembourg, The Netherlands, Austria, and the UK); Eastern and Central Europe (Bulgaria, Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovenia, and Slovakia); Southern Europe (Cyprus, Greece, Spain, Italy, Malta, and Portugal); and the Nordic countries (Denmark, Finland, and Sweden). Table 1 reveals the variations in consumer motives across EU regions.

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