

## Social Policy Gaps and the Welfare Burden of Informal Sector Workers in Nigeria

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### Abstract

The informal economy has consistently contributed to social and economic development through income and job creation, thereby enhancing people's well-being. This paper examines the implications of existing policy gaps in Nigeria's informal sector and how these gaps contribute to the welfare burden on informal-sector workers. The study provides a description of the informal economic sector and offers a general overview based on relevant literature. Data from the Nigerian Bureau of Statistics (NBS), the International Labor Organization (ILO), and the International Monetary Fund (IMF) were used to assess the size and components of Nigeria's informal economy, as well as its role in the country's economic growth and the welfare of its people. The study finds that informal sector significantly supports welfare through job creation and functions as an economic shock absorber. The study concludes that the government should recognize and prioritize the informal economy in its development policies and implement a more inclusive and equitable social protection framework to lessen the welfare burden on informal-sector workers.

**Keywords:** Informal economy, informal sector workers, welfare burden, social protection, Nigeria

### Introduction

The informal economy accounts for over half of global employment and provides about 90% of livelihoods in developing countries (Bank of Industry [BOI], 2022). According to the International Labor Organization ([ILO], 2018), over 2 billion people are part of the informal employment sector. This implies that approximately 60% of the global workforce is employed in the informal economy. Also, the new employment trend mainly includes part-time jobs, flexible or inflexible employment contracts, temporary agency work, employment through contract firms, casual employment, contract labor, and outsourcing services to people with non-fixed schedules, all of which benefit from the growth of informality within the informal economy (ILO, 2012). In Africa, particularly in sub-Saharan Africa, the informal economy plays a vital role in the economy and significantly contributes to the welfare of the people (Etim & Daramola, 2020). In Nigeria, a substantial

percentage of the country's active labor force works in the informal economy sector (Osiki, 2020).

The flexible nature of the informal economy has continued to provide a measure of support for those who cannot fit into the formal sector. Generally, the informal economy (including unpaid workers in households and family enterprises, casual wage employees, paid house help, street vendors, artisans, and market women) has continued to be the means of survival for the less privileged people in poor rural settings in developing countries (Mahadea & Zogli, 2018). The informal economy is more active in terms of welfare and economic survival during periods of slow growth and economic decline resulting in a drop in the country's GDP. As a result, an increasing output gap leads to uneven income distribution among people (Pettinger, 2017). Thus, the government's inability to protect the people and the formal employment sector's inability to cater to the employment needs of the

people indicate that they become economically active in the flexible informal economy because they see it as an available alternative and often as the only survival option. In other words, the informal economy becomes a viable option because of disguised employment, joblessness, lack of funds, absence of social protection, and lack of social benefits (Etim & Daramola, 2020).

Regardless of the contributions of the informal economy, workers engaged in this sector hardly have access to decent work (Osiki, 2020), as they are hardly protected by any existing legal framework and have no basic work rights. Generally, wages in the non-formal sector are below average and often just enough for survival. In addition, informal workers often operate at a survivalist level, believing that their situation is temporary and that they will eventually be absorbed into the formal sector. However, this idea is no longer valid for most people in the informal economy of developing countries due to economic circumstances. Consequently, they tend to stay in the informal sector for most of their productive lives (Etim & Daramola, 2020). This study highlights the significance of the informal sector, its associated challenges, and examines how social policy gaps exacerbate their welfare burden. Thereafter, it offers suggestions to improve this sector.

### **Methodology**

This desktop research involves a review and analysis of secondary sources. This study is based on analyzing scholarly literature, policy documents, institutional reports, and public datasets. Secondary data were also obtained from published works of government agencies and non-governmental organizations (NGOs), as well as international agencies, including reports from the International Labour Organization (ILO), the United Nations Organization (UNO), and the World Bank, as well as reliable internet materials.

Secondary data constitutes a large volume of data that has been collected and compiled and is now easily accessible for research endeavors.

It is also a credible source of information when systematic procedures are followed and evaluative steps are adhered to in its utilization in research (Johnston, 2014). Key concepts were extracted, compared, and interpreted in relation to the broader socioeconomic context in Nigeria. The data enabled the authors to appraise the extent to which the informal economy generally contributes to the welfare of citizens and reduces unemployment and associated social problems that could erupt in society. One of the key objectives of this study was to analyze the social policy gaps and the welfare burden of informal sector workers and suggest meaningful ways to strengthen the informal sector in Nigeria and enhance its capacities for the realization of a better and inclusive society.

### **Theoretical Framework**

This paper is anchored on the social welfare capacity theory. Social welfare theory analyzes and formulates propositions on social welfare in different economic situations (Chipman & Moore, 1978). It focuses on the analysis of social welfare, which is defined as the happiness of individuals in society. Specifically, this paper adopts the lens of analysis of the Indian Economist and 1998 Nobel Prize Winner, Amartya Sen, which involves two normative assumptions (Sen, 1999). The first assumption is that people have the freedom to achieve their well-being. This is of primary importance and a precondition for other pursuits and achievements. The desire for individual well-being in a situation of limited opportunities for gainful employment in the formal sector propels Nigerians to seek opportunities in the informal sector as a means of achieving welfare, which the theory refers to as the primary motivation for engagement in the informal sector.

The second assumption is that the freedom to achieve well-being must be understood in terms of people's capabilities in relation to the social situation and structure in which they find themselves. While some people do not have adequate qualifications for the few available jobs in the formal sector, others have adequate

formal training but cannot secure employment in the formal sector. To ensure welfare, they seek opportunities in the informal sector. Some individuals have an entrepreneurial orientation but lack access to capital. Others seek to acquire entrepreneurial skills to become self-sufficient, driven by their desire to work independently. The informal economic system accommodates all these categories of individuals with diverse orientations, absorbing them so that they can chart their own course. This theory captures the orientation of different categories of people in the informal sector.

### **Informal Economic Sector**

One of the issues associated with policies related to the informal economy is the problem of deriving a suitable definition. As stated by Cole and Feyissa (1991), there are certain key points used while defining the informal economy, including size, non-restricted entry, legal status, and private ownership and management. According to Aryeetey (2021), the informal economic sector refers to unregulated small-scale economic activities that are often family-owned and not registered under the country's legislation.

According to the International Labour Organization (ILO, 2003), the informal economy is defined by employment categories. Informal employment can be referred to as self-employment and wages that are neither recognized, regulated, nor protected by any available legal or regulatory framework. These employment categories therefore include self-employed people, people who head their family businesses, unpaid family workers, workers who earn wages, including informal workers, casual workers who have no specific permanent employer, domestic workers in the homes, paid domestic workers, workers who work temporarily, those whose work is on a part-time basis, workers who are not registered, and unregistered employers, including people who own informal enterprises. In other words, informal employment is characterized by employment in non-government organizations that are mostly unregistered and do not

provide protection for their workers in terms of social security and legal protection.

Frosch and Walsh (2025) emphasized the complexity and heterogeneous nature of the informal economy. They opined that the diverse nature of actors and activities in the sector leads to difficulty in collecting data. The informal economy comprises a diverse range of individuals and businesses that engage in various economic activities often overlooked and disregarded in standard statistical economic analysis (Dell'Anno & Adu, 2020). Economic activities in these criteria include activities in manufacturing, construction, and masonry, as well as other informal services such as repairing all types of vehicles, radio and television sets, cooling, hair making, and carpentry work.

Furthermore, the ILO (2023) acknowledges that the informal economy comprises economic activities that do not fall under the official economy and are thus referred to as an informal economy. This is further characterized by the general income sector of the market, in which various types of revenue and means of production are not subject to government regulation and are carried out in an environment where similar activities are regulated. According to Women in Informal Employment Globalizing and Organizing (WIEGO), approximately 2 billion people worldwide are in informal employment, representing around 60% of workers (WIEGO, 2023).

The informal economy which is also described as the shadow economy or grey economy depicts economic activities carried out by individuals, economic units or organizations in law or practice, which have no formal contractual arrangements binding the people involved. However, the informal economy does not include illegal business activities (Etim & Daramola, 2020). The informal economic activities within this context include those non-regulated economic activities that do not operate within the accepted norms of society in that they are not regulated or registered with the government and do not fall under the tax categories. The organization for economic co-op-

eration and development (OECD) postulates that employees engaged in the informal economy operate at the lowest level of the organization and on a relatively small scale (OECD, 2019). Hence, in situations where labor relations exist, they are often based on personal and social relationships rather than contractual arrangements that provide legal protection for workers.

The classification of informal employment as stipulated by the International Conference of Labor Statistics includes the informal economy and all informal employees working for various unregistered and undocumented economic outfits

(ILO, 2003). For developing economies, such as the Nigerian economy, informal employment is characterized by several factors, including lower educational levels and limited skills, compared to those in the formal sector (Etim & Daramola, 2020). Workers in the informal economy often lack vocational training or skill development, resulting in longer working hours. Table 1 highlights the differences between informal and formal economic sectors.

Table 1: *Differences between the informal and formal economic sector*

Characteristics	Informal economy	Formal economy
Entry	Unrestricted Entry	Restricted entry
Funding	Local resources	Dependence on foreign funding
Ownership	Ownership by family	Ownership is Corporate
Scale of Operation	Small-scale operation	Large scale activities
Organization	Unorganized	Organized
Job security	Job not secured	There is Job security
Operation	Labor intensive	Capital intensive
Market competition	Competitive market	Protected market
Taxation	Tax is highly unregulated	Easily Taxable
Market regulation	Unregulated markets	Regulated

*Source: Extracts from reviewed literature*

### Informal Economy Employment Categories

Informal employment is characterized by self-employment and wage employment, which are often not recognized or regulated by the government or any other legal or regulatory framework United Nations Conference on Trade and Development (UNCTAD). The informal economy can be identified and characterized based on the following employment categories (UNCTAD, 2021):

1. *Self-employment category*: This category encompasses own-account workers, family business owners, unpaid family workers, traders who buy and sell goods, and in the service sector who are self-

employed.

2. *Wage workers category*: These categories of informal workers include employees of informal enterprises, casual workers without a fixed or permanent employer, home workers, paid domestic workers, temporary and part-time workers, bricklayers (Masons), carpenter apprentices, mechanics apprentices, and unregistered workers (including garment workers), street vendors, and street waste pickers.
3. *Employer category*: This category includes owners and individuals who run informal businesses, such as small-scale



manufacturers, transportation workers (including motorcyclists, commonly known as okada riders, tricycle drivers, also referred to as keke drivers in Nigeria), farmers, and small business owners.

In an informal economy, work conditions and earnings differ among different categories of employees. In addition, a vast majority of workers lack legal recognition, and their jobs are insecure. Informal workers can be found everywhere, on the streets, in their places of business, in their casual jobs, and in private homes (Adewale & Akinola, 2020; Ogunniyi & Olagunju, 2024). In other words, the Nigerian informal economy, like other informal economies in sub-Saharan Africa, is plagued by numerous problems and challenges, despite its significant contribution to the country's economic development. Some of these issues challenge the informal economy, including institution-based inadequacies, lack of legal recognition and protection, dangerous work and employment conditions, poor administration and enforcement of existing laws, and exclusion of informal entrepreneurs in the decision-making process at the national and policy-making level, especially when the informal economy contributes more than half of the country's employment opportunities.

### **Size and Structure of the Nigerian Informal Economy**

The global economic crisis of recent decades has led to an increase in the size of the informal economy in almost all developing economies worldwide, including Nigeria. The size of the informal economy has been estimated in various ways across countries, using different parameters. However, these estimates are vague and ambiguous across countries (Dell'Anno & Adu, 2020). However, key contributors in the informal sector stated that approximately half of urban workers in developing countries are employed informally (Chen, 2012), while the Bank of Industry (BOI, 2022) estimated the informal economy in Nigeria to be as large as 90%. Hence, the informal economy is not only relevant, but also large. The relevance and

outstanding nature of the informal economy are derived from the employment opportunities it provides for the most vulnerable groups such as the poor, women, and youth (Uko et al., 2020).

Nigeria's informal economy can be categorized into informal manufacturing and non-manufacturing activities. According to Uko et al. (2020), the prevalent manufacturing activities in Nigeria are food, beverages, tobacco production, textiles, and clothing apparel. This accounts for approximately 69 percent of all informal manufacturing activities. The National Salaries, Incomes, and Wages Commission (NSIWC) survey report on the informal sector of the Nigerian economy classified economic activities into seven (7) categories namely: agricultural, manufacturing, gas and water supply, building and construction, wholesale, retail trade and restaurant, transport, storage and communication, and community, social, and personal services (NSIWC, 2024).

The informal economy unarguably plays a prominent role in poverty alleviation in developing economies by creating job opportunities and stimulating the formal sector. Subsequently, the informal economy acts as a cushion during economic recession and financial crises, especially in resource-dependent countries such as Nigeria and most countries in sub-Saharan Africa. However, it eventually poses several economic risks and difficulties. Economic policies are rendered ineffective because they reduce the reliability and credibility of the size of the formal economy (based on which all economies are evaluated), leading to a loss of tax revenue and enlarging the labor force unproductively, ultimately reducing the nation's international competitiveness with other nations of the world.

As a result, many countries have focused their attention not only on size but also on the performance of their informal economy (Uko et al., 2020). However, due to the lack of accurate official statistics on the size of Nigeria's informal economy, research efforts have been limited to the country's formal sector. Hence, it has been

difficult to obtain accurate statistics on how monetary and fiscal policies are transmitted to the informal economy and the implications for the overall health of the country's economy (Uko et al., 2020). It is very difficult for an economy to record long-term growth if the majority of its economic activities are performed outside the scope and limits of monetary and capital policies and taxation regimes. Often, issues such as low productivity in the informal economy, women's dominance, and government policies are associated with a high informal economy in developing countries. Therefore, efforts aimed at improving labor and organizational productivity are often ineffective. (Garzarelli & Limam, 2019).

### **Social Policy Gaps and the realities of the Informal sector's welfare burden**

In economics, welfare is generally understood as the conditions that enable a good life and the fulfillment of human preferences (Cooper et al., 2023). Welfare can be measured from the perspectives of income and expenditure. However, it is generally recommended that when assessing welfare in less developed countries, it is better to base it on expenditure rather than income (Atkin, et al., 2024; Kassahun, et al., 2020) because measuring household income is challenging in these countries due to much of it coming from the informal economy, especially from self-employment. In addition, income is not stable over the course of one's lifetime, whereas consumption is relatively more stable, making it easier to evaluate (Haughton & Khandker, 2009). In addition, data on expenses have additional information because consumption decisions are related to other household expenses, such as nutrition and health (Meyer & Sullivan, 2003). Moreover, there is a high chance that household income is underreported compared to consumption expenditure.

The Nigerian informal economy is not only a tailpiece in the country's economic narrative and representation, but also an essential part of its economic narrative that shapes the fate and well-being of millions of Nigerians who make

their living in the informal sector (Chen, 2012; NBS, 2023). This sector of the economy has continued to be an escape route for millions of Nigerian workers, who cannot be absorbed in the regulated formal economic sector (IMF, 2022). Thus, the informal economy is a major contributing factor to Nigerians' welfare and well-being. The capacity of the informal economy to generate employment is important and cannot be overlooked, especially with regard to its enormous contribution to the economy. The informal economy is even more relevant now because the employment capacity of the Nigerian formal sector is drastically reduced. The implication of the formal sector's inability to absorb more workers while it is pushed to the informal economy is that the informal economy is undoubtedly a valid and indisputable driver and instrument of employment generation in Nigeria. The activities of the informal economy in Nigeria and West Africa were concisely outlined, encompassing small business owners, farmers, manufacturers, domestic workers, tailors, domestic helpers, transporters, and small service business owners. These listed business engagements cover the essentials of the informal economy and thus give room for the informal economy to take in many people who cannot be accommodated or absorbed into the formal sector of the economy, either because they have little or no education or as a result of their living environment (Uko et al., 2020).

The informal economy thus serves as a sort of defense, shock absorber, and buffer against unemployment in the country. It enables a significant portion of the population to earn a living and enhance their welfare (Onwo & Ohazulike, 2021). This has made it possible for many people to have job opportunities rather than stay openly unemployed. In addition, the informal economy has been a key factor in providing a safety net during times of economic crisis. For instance, the informal economy helped to improve the welfare of people during the COVID-19 pandemic as many Nigerians, especially women in low-income areas, turned

to the informal economy to earn money for their household.

In the face of economic uncertainty, the informal economy continues to act as a buffer against shocks by demonstrating outstanding resistance and adaptability. This adaptability was particularly at play during times of economic uncertainty, such as the 2008 global economic meltdown, which saw many countries' economies taking a nose dive. While large corporations struggled to adjust to the new economic reality, informal businesses quickly rose to the challenges of changing economic circumstances (Premium Times Nigeria, 2023). Thus, the informal economy's flexibility and adaptability are valuable positive features, especially in times of crisis, such as economic recession and the COVID-19 pandemic, as they paved the way for business continuity, particularly remotely, despite lockdowns.

According to the National Bureau of Statistics (NBS) labor force report for the second quarter of 2023, most people in the workforce (88.0%) were self-employed in the second quarter of 2023, while 8% of those within the working-age range were engaged in subsistence agriculture (NBS, 2023). Overall, informal economy employment was 92.7% in the second quarter, while the employment-to-population ratio was 77.1%. This implies that the sector has created a higher employment-to-population ratio than the formal sector in the country. Hence, the informal economy is an antidote to unemployment. The informal economy has become an integral part of the economy because it has continued to expand. However, it is not only important because it has continued to expand; it is also significant because this expansion has led to new manifestations that are now recognized as ways to promote growth and reduce poverty in the country (Aguilar & Guerrero, 2020).

Furthermore, unrestricted entry into the informal economy has enabled many people to participate in this sector as they desire. While the formal sector requires some checks and balances, the informal economy is easy

to join and leave. Thus, becoming a trader can be decided overnight. With the required capital (where necessary), business activities can commence without special registration or strict entry regulations. In turn, this gives the individual the opportunity to provide for their household. Not only does this help, but family finances also enable the person to undertake this venture. According to the NBS (2023) data on the Nigerian labor force, women are more vulnerable and more likely to join the informal market. Hence, finding a source of income in an informal economy leads to well-being. While the effects of informal income on individual and household welfare are not easy to measure as a result of factors bothering on sector irregularity and lack of registration and government minimal intervention, its impact on the people is multi-faceted, particularly when considering the input of women in the informal economy in developing countries, especially in Nigeria, where women entrepreneurs abound.

According to Muhammad et al. (2021), a study on Pakistani women found that they contribute to the economy through informal entrepreneurship, including farming and the buying and selling of commodities. Hence, the status of women improves through informal entrepreneurship. This improvement in their status subsequently leads to enhanced status and the family's overall well-being. Women's involvement in entrepreneurial activities is an age-old system that helps transform readily available resources into goods and services. In this process, employment opportunities are created for women and their dependent relatives (Burton et al., 2019). Not only does the informal economy generate employment opportunities for these vulnerable groups, but it also often yields other benefits that can lead to wealth creation, ultimately fostering social empowerment (Kungwansupaphan & Leihaothabam, 2016). Informal entrepreneurship, a part of the informal economic sector, is therefore a form of informal employment where the women involved not only carry out these business activities but also encourage other women around them who can

see the opportunities and tap into it. Thus, the informal economy improves the welfare of women through entrepreneurship, and women's empowerment helps reduce gender inequality, marginalization of women, and the relegation of women's work (Bastian et al., 2019). In other words, the more financially independent women become, the higher their level of well-being (Muhammad et al., 2021).

Notwithstanding their level of income, studies have shown that when women generate income, their income leads to an increase in the family's economic and societal well-being. In other words, women in the informal economy not only contribute to their family's well-being but also spill into society as a result of the multiplier effect derived thereof. Furthermore, economic activities in an informal economy increase the self-esteem and well-being of those involved. It helps in managing work–family relations; it also allows for flexible working hours, unlike in the formal economic sector, where the job is often tied to specific working hours and working patterns. Hence, the welfare of children from such families is improved due to the flexibility of working hours, while other family members are also prone to improved welfare and overall wellbeing.

However, the informal sector workers in Nigeria bear a heavy welfare burden as a result of policy gaps. For instance, there is inadequate coverage of social protection schemes, as existing policies rarely cover informal sector workers. According to Holmes et al. (2020), informal sector workers are often excluded from social policy schemes like the National Social Investment Program (NSIP) and the National Health Insurance Scheme (NHIA) due to a lack of awareness, inadequate documentation, and the bureaucratic process involved in registration. Hence, workers in the informal sector are pushed into high out-of-pocket expenses for healthcare, housing, education, and retirement. Furthermore, fragmented policy structures and weak institutional frameworks contribute to the exclusion of informal sector workers, increasing their vulnerability. Additionally, a lack of awareness and a

communication gap between policymakers and informal sector workers also contribute to their exclusion from policy engagement. Hence, not only are informal sector workers mostly excluded from social policy schemes (Akanbi, 2016; Holmes et al., 2012), but the absence of inclusive policy frameworks also leaves them unprotected (ILO, 2018).

Despite the significant contribution of the informal economy to the economies of sub-Saharan African countries, there is a persistent failure to fully utilize the enormous capacity of the informal economy for economic growth. This is because of the lack of practical goal-oriented policies that can enhance the economic activities of the informal economy and bring them under the scope of formal government regulations. Hence, it is necessary to bring large and well-established informal organizations under the formal, regulated network of the formal sector to make them enjoy single taxation instead of the unregulated, often crude methods of taxation at the local government, state, and federal levels. It is also pertinent to encourage smaller informal micro-enterprises to maintain strict record-keeping and legal coverage. Sakanko & Ewugi (2017) argued that while the informal economy is a source of income for a large number of people in Nigeria, it is difficult to establish its exact contribution to the country's economic growth and development due to a lack of proper accountability (Augustine et al., 2020; Dell'Anno & Adu, 2020). Therefore, although the informal economy is often positively associated with economic growth, development, and welfare over the long term, it must be demonstrated as statistically more significant.

### **Conclusion and Recommendations**

This paper highlighted the essential role of the informal economy in the development of the Nigerian economy, particularly emphasizing the contribution of the informal economy to the welfare of the people. This is important in terms of policy formation and implementation, as there is a need to recognize the importance of the informal economic sector towards the welfare of



Nigerians and the country's economy. This study relied largely on secondary sources, which may not fully capture the complex and diverse experiences of informal workers across the country's geopolitical zones. Despite these limitations, efforts have been made to ensure the validity of the research using credible sources.

While we can recognize and acknowledge the role of the informal economy regarding output and employment potentials for the teeming population of developing nations and, more importantly, Nigeria, there is a need to recognize and acknowledge the difficulties in keeping records of the size of the informal economy in terms of composition and activities. It is evident that Nigeria needs to consider the importance of highlighting the informal economy in its development policy options as a means to further strengthen both the informal economy and the country's overall economy. The government must, in fact, take a keen interest in the activities of the informal market in terms of regulations. Not only in terms of tax revenue for the government but also as a form of capacity building for the informal economy. Hence, policy interventions should come in dual dimensions: first, to increase revenue for government in terms of tax through a more formal regulation of informal economic activities, and second, to regulate the sector and improve facilities so that the people actively working in the informal economy sector will also have a sense of belonging through government facilities, such as soft loans and decent business environments.

Finally, the government should create more jobs to reduce congestion in the informal market sector, considering the vast and diverse activities of the informal sector in Nigeria and its significant contributions to employment generation, entrepreneurship, training, and skills development. In addition, while not overlooking the huge amount of money involved in the sector, it becomes imperative for the government to explore the gradual incorporation of the system into the formal economy as a way of reaping revenue from the sector. This will involve implementing regulatory frameworks and not leaving

the sector entirely in the hands of individuals, as is currently the case.

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