

## ***Revealed Informal Activity***

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### **Abstract**

A major open question in the informal sector literature is the definition of what it means to be in the informal sector. Many characterizations have been used in the literature, for example, firms that are unregistered or employ a small workforce or firms/economic enterprises that do not have access to formal capital markets. Also many people may participate in both formal and informal activities. We need to be able to classify households (or individuals) into the informal sector.

We infer informal sector activity using income and expenditure surveys, defining total income as the sum of labor income, transfers, and the change in asset position. If after accounting for all of these sources of income there is still a large difference in announced income and announced expenditure then we argue that the household is participating in the informal sector.

We apply this method to the case of Bulgaria using LSMS income and expenditure surveys before and after a significant economic reform. We show how our assignment rule behaves under a number of variations, and compare the assignment to assignments made using other indicators of informal sector activity. We also look at sample statistics for variables of interest show how these vary across assignment rules. We examine movements into and out of informality under the different assignment rules.

Our initial work on Bulgaria shows the informal sector acting as a buffer for households during periods of crisis when formal sector employment opportunities are limited. In this sense the presence of an informal sector provides a “safety net” and is welfare improving. This result is not robust to the assignment rule, with some very standard assignments showing a very different role for the informal sector.

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