

“Imagine getting your phone repaired. One option is an official Apple-certified repair shop with invoices, taxes, and warranties. The other is a guy fixing phones from his backpack at a street corner — cheaper, faster, no receipt. Same service, same customer need — two different economies.”

 **This is exactly what the text means by the formal and informal economy!**

The (In-)formal Economy

Alejandro Tomé
Alexia Posoiu
Benjamin Kangas
Julian Heubach



Comparison Of Both Economies



“Formal Repair Shop”

Legal Structure

- Officially registered, issues invoices and warranties, can be held legally accountable

Cost Structure

- Pays taxes, rent, insurance, and employee wages, and compliance with safety and quality standards (-> **higher prices**)

Access to Resources

- Access to bank loans and insurance and authorized supplier contracts

“Informal Repair Service”

Legal Structure

- Unregistered, no formal contracts, no warranty or legal obligation

Cost Structure

- No taxes or regulatory costs, often operates from home or street, minimal overhead (-> **lower prices**)

Access to Resources

- Relies on personal savings and cash flow, with limited access to formal supplier networks

Why The Informal Economy Exists And Why It Matters



Economic Necessity

If Population growth exceeds Job Creation, people cannot wait; they still need income

Economic Shocks

Informal Economy acts as an economic shock absorber during crises

Institutional Failure

When regulatory costs exceed perceived benefits, rational actors avoid formality

Global Scale

Accounts for most of the employment in developing countries, and a significant share of GDP in developed countries

Creates Inefficiencies and Resilience

Economy becomes less structured and tax-funded, yet stronger in short-term survival

Why it exists

Why it matters

Unfair cost competition

- Informal firms do not pay taxes, social security contributions or comply with full regulation
- Allows lower operating costs and puts pressure on the margins of formal companies
- Creates a structural cost asymmetry that formal companies cannot match without breaking regulations

Market distortion and reputation effects

- Quality and safety inconsistencies may damage industry reputation
- Loss of trust in the markets can leave long lasting consequences on company level
- In some cases, informal markets can serve as an entry point for entrepreneurship, with some companies later formalizing

Regulatory and administrative burden

- Formal companies must comply with labor, environmental and consumer protection laws
- Leads to limited flexibility in hiring, pricing and reconstructing compared to informal companies
- Greater transparency limits the strategic discretion of formal companies and bureaucracy induced by regulations slows decision making

Strategic implications

- Formal companies need to respond to the distorted competition
- Differentiation through quality, branding and reliability
- Leveraging scale advantages and engaging in institutional strategies like lobbying can give an advantage to formal companies and polish industry reputation

Negatives

- Loss of tax revenues leads to weaker public services
- Reduced social protection for social workers decreases national well-being
- Inaccurate economic statistics can lead to misjudged policy decisions

Positive/Adaptive

- Provides employment where formal jobs are unavailable
- Generates income for low-income populations
- Acts as a buffer during economic crises

Institutional factors

- Nations with large informal economies have common factors
- Low trust in the government is often linked with large informal economy
- Weak institutions are more prevalent in countries where the informal economy is large

1

Real Market Competition

Customers choose between formal and informal sellers ignoring rivalry between them substitutes that affect price, demand, and market share.

2

Pricing Pressure

Lower costs allow informal firms to charge less, forcing formal firms to adapt pricing, differentiation, or value propositions.

3

Market Reality Check

They reflect actual market conditions and demand levels.

4

Strategic Planning Accuracy

Including them as competitor leads to more realistic strategies and forecasts.





How do Informal Sellers affect Gucci?

- | | |
|-----------------------------|---------------------------------|
| ○ Revenue loss | ○ Erosion of Customer Loyalty |
| ○ Brand image & exclusivity | ○ Difficulty in Market Analysis |
| ○ Customer confusion | ○ Price undermining |



The duality of informal economy

- the relationship between the two economies -

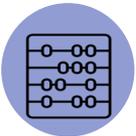


Game time !!



Dysfunctional

0



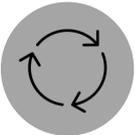
Systemic

1



Distortion of markets

0



Product of them

1



Undermine

0



Sustain

1

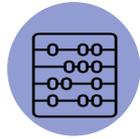
Game time !! - Answers

1 - Systemic



Dysfunctional

0



Systemic

1

0.5 - Both



Undermine

0



Sustain

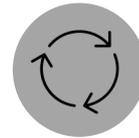
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1 - Product of them



Distortion of
markets

0



Product of them

1

Game time !! - Explanations

- **Dysfunctional or Systemic**

The informal economy is systemic. It is not simply a breakdown of the system, but a recurring and embedded feature of modern capitalism.

- **Undermine or sustain formal firms?**

It both sustains and undermines them — increasing flexibility and lowering costs, while also creating competitive pressure and institutional strain.

- **Distortion or product of markets?**

It is better understood as a product of market dynamics, emerging from competition, regulation gaps, and labor market pressures rather than standing outside them.

Comparative Framework

The advantages and constraints of informality are often two sides of the same structural mechanism.

Reinforcing effects	Constraining effects
<ul style="list-style-type: none">• Cost flexibility• Risk distribution• Market adaptability	<ul style="list-style-type: none">• Regulatory asymmetry• Institutional erosion• Competitive pressure



The Core Tension

The informal economy embodies a **structural tension**. It *increases efficiency and adaptability* but often *reduces social protection and regulatory coherence*. It simultaneously *supports and challenges the formal sector*.

Flexibility	vs	Stability
Efficiency	vs	Protection
Adaptability	vs	Institutional strength

Final Question

How should we best understand the relationship between the **formal** and **informal economies**?

- a) The informal economy is a temporary dysfunction that disappears with stronger regulation.
- b) The informal economy operates independently from the formal economy.
- c) The informal economy undermines the formal economy and should be eliminated.
- d) The informal and formal economies are structurally interconnected, simultaneously reinforcing and constraining one another.

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Thank you!

Any Questions?