

Formal Legal Remedies for Contractual Non-Compliance by Informal Sector Enterprises in Nigeria

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Abstract

This study examined the formal legal remedies for contractual non-compliance by informal sector enterprises in Nigeria. The study emphasized the key features of informal sector enterprises in Nigeria, especially the illegal nature of some of the enterprises. The concepts of illegal contract and void contract were extensively discussed as they relate to the enforceability of contracts and legal remedies available for contractual non-compliance in the informal sector. The study identified the remedies available for non-compliance with contractual terms to include damages, specific performance, rescission and restitution, declaration and injunction. However, the study noted that some of these remedies may not be readily available for informal sector operators because the law may refuse to give full effect to a contract on the ground of illegality or because it is in some other way contrary to public policy, which appears to be the lot of many informal sector enterprises in Nigeria.

Key words: Legal Remedies; Contracts; Contractual Compliance; Informal Sector; Illegality; Nigeria

1. Introduction

The informal sector can be defined as market-based production of goods and services, whether legal or illegal, that escape detection in the official estimates of gross domestic product (GDP). The activities in this sector cover almost every field of economic activity, ranging from petty trading and personal services to informal construction, manufacturing and

repairs (Smith 1994; Ajakaiye and Akerele 1996; CBN/FOS/NISER 2001; Oduh et al. 2008). In Nigeria, the activities in this sector include several small and unregistered sole proprietor businesses, and in some instances, joint-partnership businesses which can be found both in rural and urban settlements across the country. However, the nature of the economic activities engaged in varies considerably from one locality to another. For example, in the rural areas, farming activities and allied occupations such as hunting, fishing, weaving, blacksmithing, basket and pot making as well as leather works are more prevalent. However, in urban centres like Lagos, Enugu, Abuja, Port Harcourt, and Kano, informal economic activities include trading, small scale manufacturing and repairing industries, such as carpentry, upholstery, furniture making, woodworks, metalworks, bakery, goldsmithing, tailoring, bricklaying, and printing. Those in the repairing occupations include, among others, the automobile mechanics, electricians, clock and watch repairers, and cobblers (Olowu and Okotoni 1996).

Apart from the economic activities enumerated above, numerous informal sector activities in contemporary Nigeria are illicit, especially those conducted on the external scene. These activities include drug peddling/trafficking, currency trafficking, money laundering, smuggling, advance fee fraud (generally known as '419'), over invoicing / under invoicing, 'crude oil bunkering' or theft, kidnapping for ransom, illegal arms trade, human trafficking, among others. Ezeobi (2012) estimated that Nigeria lost about \$7 billion to crude oil theft in 2011. Obviously, the main features of the enterprises in this sector are the illegal nature of some of the enterprises and the fact that the enterprises in this sector typically operate outside the regulatory capture (that is, not registered with the Corporate Affairs Commission and so do not subscribe to both corporate income tax and Pay-As-You-Earn tax) (Fleming, Roman, and Farrell 2000; Gbanador 2007).

Till date, existing studies on the Nigerian informal sector have concentrated on estimating the size of this sector as percentage of the official GDP as well as the causes and consequences of this sector. Examples of existing empirical studies that examined the structure, composition, size, causes and consequences of the informal sector in Nigeria are Salisu (2001), CBN/FOS/NISER (2001), Schneider (2007), Oduh et al. (2008), Ariyo and Bekoe (2012), and Ogbuabor and Malaolu (2013). Clearly, a large scope still needs to be covered towards a more comprehensive understanding of the informal sector in Nigeria. The sole

objective of this study is to examine the formal legal remedies for contractual non-compliance by informal sector enterprises in Nigeria. This is the first research work in Nigeria to examine the legal dimension of informality.

The significance of this study can be emphasized in terms of its benefits to prospective foreign and domestic investors, the government and the general public. To the investors, this study will provide them with up to date information on the formal legal remedies available to them in the event of a contractual breach by informal sector enterprises in Nigeria since ignorance of the law cannot be accepted by the Nigerian courts as an excuse. To the government, this study will enable it to appreciate the existing laws relating to informality in Nigeria so that amendments can be made where necessary in order to encourage and strengthen investments and other commercial enterprises in Nigeria. This study will deepen the existing literature on informality in Nigeria and also serve as a guide for future researchers within and outside Nigeria. This study is therefore a major step towards promoting a well functioning national economy in Nigeria.

2. Theoretical Literature (Theories of Informality)

There are four main theories of informality in the literature. These include: modernization, dependency, structuralism and neo-liberalism theories (Yusuff 2011).

2.1. Modernization Theory:

The main proponent of the modernization theory is Rostow (1960). He characterized informality in the less developed countries largely as a “social problem” internal to and caused by the backward socio-economic systems of individual countries. According to him, the policy prescription was for these countries to acquire “modern” values, “modern” legal institutions and political systems, and “modern” capitalist economies. In most cases, the “modern” was understood as being synonymous with western values, institutions, and market economies. In essence, the issue of informality is not rooted in capitalist exploitation and extraction (as argued successively by neo-Marxist and dependency theorists), rather these countries had not yet been sufficiently incorporated into the modern world or the international economy. Thus, it is only a matter of time and these countries would “take-off” and “catch-up” with the developed countries. Proponents of modernization theory saw the informal sector as a remnant of traditional, pre-capitalist modes of production and subsistence strategies common to isolated rural

communities such that informal sector economic units were trapped outside the modern economy because they lacked proper education, skills, and value orientations. The main weakness of the modernization theory is that the informal sector is neither seen as an important component of the overall economy that can engender economic growth, nor as a reservoir of entrepreneurial training and talent. It is seen as a problem to be solved and not a development strategy to be harnessed and promoted.

2.2. Dependency Theory:

It was the pioneering works of ILO (1972) and Hart (1973) that crystallized the phenomenon of unregulated economic activity into the term “informal sector”. The contribution of Hart (1973) had such a broad and original impact because it focused on the complex, organized, and dynamic income generating activities of informal enterprises. In effect, Hart (1973) found that informal activities were not a mere extension of traditional subsistence strategies and that participants in these unregulated activities were not universally condemned to poverty and marginality. However, other scholars working within the dependency tradition had characterized informal workers as universally poor and emphasized the sector’s supposed marginal position vis-à-vis the modern capitalist sector (Portes and Schauffler 1992). Furthermore, in terms of developing a systematic definition of what constituted the informal sector, proponents of the dependency theory (such as Tokman 1978 and PREALC 1978), often described the many common characteristics of enterprises in the sector. These characteristics include: little capital, low technology and production, little profits, utilization of unpaid family labour, easy entry and exit, low efficiency and competition. Furthermore, the dependency approach saw the goal of informal activities as mere survival, not profit maximization. Informal firms were often characterized as taking advantage of their ability to avoid taxes and regulations and exploiting niche areas overlooked by larger and less flexible firms. The weakness of the dependency theory is that it sees the informal labour arrangement as taking place largely outside the exploitative formal relations of production. As such, the informal sector was viewed largely with suspicion as a mere transposition of the rural subsistence sector into the urban environment.

2.3. Structuralism:

Structuralists insist that informality is not simply the result of excess labour supply or over-regulation. Instead, the central element of the

structuralists' theory is the insistence that informality is in essence an alternate form of labour utilization (and often exploitation) by capital. Put differently, Maloney (2004) stated that informal sector workers are not just there by some accident or flaw in capitalist development. Instead, these workers are actively "informalized" by capital under the logic of peripheral capitalist accumulation. A critical shortcoming of this theory is that while industrial subcontracting is a central feature of informal activities in Latin American cities, it is a comparatively insignificant feature of informal sector activities in developing countries like Nigeria. The common feature in African informal sector is the 'subsistence' informal economy in which economic actors are fully occupied in informal means of income generation (Capecchi 1989; Ishola 2008).

2.4. Neo-liberalism Theory:

Neo-liberalism is an ideology based on economic liberalism. The ideology favours economic policies that minimize the role of the state and maximize the private business sector. Neo-liberalism seeks to transfer control of the economy from public to the private sector under the belief that it will produce a more efficient government and improve the economic health of the nation. According to De Soto (1989), a key proponent of this ideology, the informal sector is a response to excessive state regulations and other unfavourable macroeconomic conditions. This theory subscribes to the notion that the informal sector comprises entrepreneurs who choose to operate informally in order to avoid the costs of formal registration and other unfavourable conditions in the business environment. Proponents of neo-liberalism believe that entrepreneurs would continue to produce informally so long as government procedures are cumbersome and costly, property rights remain deficient and accessibility to productive resources like finance and technology remain elusive. Under this ideology, those entrepreneurs who generate income for themselves and their families in the informal sector are regarded as the 'real revolutionaries', who heroically stand up to the tyranny of excessive state regulations; those informal workers are the real seeds of the free market (deregulatory) doctrine.

3. Empirical Literature on the Nigerian Informal Sector

Ogbuabor and Malaolu (2013) examined the size, development, and causes of the informal sector of the Nigerian economy. They found that

unemployment, tax burden, government regulation, and inflation are the most important drivers of informality in Nigeria.

Ogbuabor, Malaolu, and Mba (2013a) examined the impact of informality on domestic savings in Nigeria for the period 1970 to 2011 using ordinary least squares (OLS) estimation methodology. The estimation results of the long run model indicate that informality hinders the growth of domestic savings, while the degree of financial depth impacts significantly and positively on domestic savings in Nigeria.

Ogbuabor, Malaolu, and Mba (2013b) examined the impact of informality on the liquidity of the banking system in Nigeria. The results indicate that informality impacts negatively on the liquidity of deposit money banks in Nigeria. Specifically, the results showed that a unit increase in the size of the informal sector results in 7.44% deterioration in the liquidity of deposit money banks in Nigeria.

Ariyo and Bekoe (2012) estimated the informal sector in Nigeria over the period 1975 – 2010 using the currency demand approach. They found that tax rate, inflation, interest rate, high income inequalities, low productivity of the Nigerian tax system due principally to deficiencies in tax administration and collection systems, and complex legislation are the main drivers of informality in Nigeria.

Oduh et al (2008) used the general MIMIC methodology to estimate the determinants of the informality in Nigeria over the period 1970 to 2005. The study found that declining income, high tax burden, high black market premiums, and government control of the economy are some of the most important drivers of informality in Nigeria.

Schneider (2007) used the DYMIMIC and Currency Demand Methods to estimate the informal economies of 145 developing, transition, and highly developed OECD economies over the period 1999 to 2005. The study found that an increased burden of taxation and social security contributions, combined with labour market regulations are the main causes of informality in those economies. Furthermore, the results show that the informal economy reduces corruption in high income countries, but increases corruption in low income countries.

Salisu (2001) utilised the MIMIC approach in the study of the hidden economy in Nigeria. The study found that tax rate, inflation and declining per capita income are the major determinants of informality in Nigeria.

3.1. Research Gap / Contribution to Knowledge

In spite of the numerous empirical studies on the informal sector in Nigeria including the ones reviewed above, no empirical study known to the authors of this paper has examined the legal dimensions of informality in Nigeria. This study is therefore a pioneer attempt aimed at filling this gap in the literature by examining the formal legal remedies for contractual breaches by informal sector operators in Nigeria.

4. Enforceability of Contracts in the Informal Sector in Nigeria

To start with, a contract is an agreement which is enforceable at law. In other words, a contract is an agreement which the courts of law will enforce. The agreement is the result of exchange of mutual undertakings between two or more parties. The parties mutually agree to confer certain benefits on each other which on the other hand attract certain burdens on each of the parties. This is the whole essence of a contract.

In Nigerian law of contract, for a contract to be enforceable, the contract must meet certain minimum requirements. These requirements are (i) agreement which comprises offer and acceptance, (ii) consideration, (iii) intention to create legal relations, (iv) the parties must have contractual capacity, and (v) the contract must not be illegal nor be against public policy. Some authors distinguish between elements of a valid contract and vitiating elements and treat the last two criteria as merely vitiating elements. However, for purposes of enforcement, the distinction does not appear to have any practical significance since the absence of contractual capacity or the presence of illegality will result in unenforceability. If a contract is unenforceable, it loses value no matter how valid it is in terms of the presence of agreement, consideration and intention to create legal relations.

With this basic premise, it becomes clear that there is a link between enforceability of contracts and the legal remedies available to the injured party. If the contract is not enforceable in the first instance, no legal remedy can proceed from the courts. If however, the contract is enforceable, then, the question of which remedies can apply to assuage or pacify the injured party arises. Bearing in mind that some of the chief characteristics associated with the informal sector in Nigeria are existence outside the government or corporate business sector, existence of unregulated and competitive markets, and illegal nature of some of its enterprises, it is apposite to consider in some detail the issue of illegality as it affects the enforceability of the contracts and legal remedies available for contractual non-compliance in the informal sector.

An illegal contract is one which is invalidated either by express statutory enactment or by rules of common law (Anson 1999; Sagay 1999). Sometimes, a distinction is made between an illegal contract and a void contract. Thus, where the law refuses to assist in any way a person who founds his cause of action upon such an agreement or where the law states that such an agreement is not to have legal effect, the agreement is said to be void (Anson 1999; Sagay 1999). Some authors think that the distinction appears to be one without a difference and both practically mean the same thing. However, experience has shown that the distinction may be important in terms of the consequences to be attached to the classification. Once a contract is illegal, it is void. Furmston (1981) stated that a contract that is expressly prohibited is illegal. For Sagay (1999) and Williston (1990), illegal contracts are those prohibited by statute or at common law, the making of which will in most cases be visited by some form of sanction other than mere voidness. Void contracts on the other hand are those which have not been expressly prohibited and which attract no sanctions or penalties but which do not give rise to any rights whatsoever (Sagay 1999). For instance, section 3 of the Hire-Purchase Act declares void any provision in the hire-purchase agreement by which an owner of goods let on hire-purchase or a person acting on his behalf is authorized to enter upon the premises for the purpose of taking possession of the goods or is relieved from liability for any such entry.

A contract may also be void at common law. Where a contract is void at common law, it is so because the courts have declared it to be so over a long period of time. Such types of contract are now almost fixed. These are contracts which violate no basic feelings of morality but run counter to certain social and economic attitudes. According to Sagay (1999), one clear distinction between an illegal contract and a void contract in the Nigerian scheme is that in the former, the contract is expressly prohibited and its formation is followed by a sanction, whereas in the latter, the contract is not expressly prohibited and its formation is never followed by a sanction. It merely creates no rights in the parties (Sagay 1999). The distinction is founded on the understanding that certain agreements are so obviously inimical to the interest of the community that they offend almost any concept of public policy while some other agreements (that is, void agreements) violate no basic feelings of morality, but run counter to social or economic expediency (Furmston 1981).

According to the learned Furmston (1981), common sense suggests that the consequences at law of entering into one of these so-called illegal contracts should vary in severity according to the degree of impropriety that the conducts of the parties disclose. It is obvious that an agreement to commit a crime cannot be put on the same footing as an undertaking by a servant that he will not later enter the employment of a rival trader. The former is so transparently reprehensible judged by any standard of morals that it must be dismissed as illegal, with the result that both parties must be excluded from access to the courts and denied all remedies; but the latter should certainly not attract the full rigour of the maxim *ex turpi causa non oritur actio*, with its implication that it can originate no rights or liabilities whatsoever. The parties have done nothing disgraceful, they have not conspired against the proprieties and although they cannot be allowed to enforce such part of the contract as is tainted, it would be unjustifiable to regard them as outcasts of the law unable to enforce even the innocent part of their bargain.

The result is that where the degree of culpability is high, the contract would normally be illegal, but where it is low, the contract would merely be void. In the former, the principle of *ex turpi causa non oritur actio* (an action does not arise from a base cause) will apply in its full rigour. In the latter case, the principle does not apply in its full rigour. In this case, the doctrine of severance can apply to sever the illegal part from the innocent part.

Examples of contracts that are illegal by statutes include:

- i. Contracts expressly prohibited by statute. For instance, in *Sodipo v Lemminkainen*, the Exchange Control Act 1962 banned the sale or purchase or loan of foreign currency or gold otherwise than through an authorized dealer or authorization by the Minister. The plaintiffs brought a claim against the defendant for the repayment of loans in foreign currency totaling \$1, 169, 817. 41 (one million, one hundred and sixty nine thousand, eight hundred and seventeen united states dollars, forty one cents) and £17, 000 (seventeen thousand british pounds). There was no indication that the Minister had authorized these payments in foreign currency, nor were they carried out through an authorized dealer. Although the issue of illegality was not in their pleadings, the trial court of its own motion raised it and asked the parties to address it on the point. The High Court ruled that the Act did not apply to the plaintiffs, a Finnish company but on appeal, the Supreme Court held that the transaction was illegal and unenforceable in any court because it was a

breach of the Act. According to the Supreme Court, it is settled law that “a contract that is expressly or implicitly prohibited by statute is illegal. Where the contract made by the parties is expressly forbidden by statute, its illegality is undoubted” (Nigerian Weekly Law Report 1986).

ii. The regulation of a particular trade or profession or dealing in a particular commodity or resource. This would be the case of for instance dealing in crude oil.

iii. Protection of a class of the public, or the promotion of an object of public policy. Very prominent in this category is illiterates’ protection under the Illiterates’ Protection Act and Money Lenders Act. Under the Illiterates Protection Act for instance, a person who writes or prepares a document for an illiterate person must read it over and explain the contents to the illiterate person before the latter signs or makes his mark. The writer of the document must also write his name and address on the document. Section 4 of the Act provides a fine of 50 pounds or six months imprisonment for failure to comply with the above provisions.

Similarly, under the Money Lenders Act, a money-lender must fulfill among others, the following conditions before he can recover: there must be a memorandum in writing signed by the parties before the money is lent, indicating the date on which the loan was made; the amount of the principal; and the rate of interest per centum per annum payable in respect of the loan. The money-lender must issue a receipt for every payment made to him, and so on. Failure to comply is an offence for which the lender is liable to 20 naira fine in the first instance and 10 naira for each day the offence continues. The courts have applied these provisions very strictly.

iv. Revenue raising statutes. Where the object of a statute is merely to raise revenue for the State, for example, payment for licence or stamping, it appears that contracts in breach of such provisions are not usually illegal merely because of absence of such license or stamping. This is also the case of non-registration of business premises. The non-registration does not render illegal sales conducted by the owner. Many tax legislations would also come within this category.

Contracts that are illegal at common law include: a contract to commit a crime, a tort or a fraud; contracts prejudicial to the status of marriage; contracts prejudicial to public safety; contracts prejudicial to the administration of justice; contracts that tend to promote corruption in public life; and contract to defraud revenue.

Contracts that are void at common law are contracts to oust the jurisdiction of the courts; contracts that are sexually immoral; and contracts in restraint of trade.

5. Consequences of Illegal Contracts in Nigeria

The question that arises is what are the consequences of these illegal and void contracts? The question is germane because it leads naturally to the crux of the discussion, which is legal remedies available for contractual non-compliance.

The consequences would depend on whether the contract is *ex facie* illegal or not. The distinction is important because a contract may not be illegal though performed illegally as distinct from where the contract is completely illegal in the sense that there can be no legal way of performing a prohibited activity. Where the contract is *ex facie* illegal, that is illegal as formed and therefore completely prohibited, either by statute or common law, neither party can derive any right or interest from it. Here, innocence is irrelevant. In such a case, once a court becomes aware of the illegality, it is the duty of the court to stop the case and dismiss the claim for being void and unenforceable. The rule is (subject to a few exceptions) *in pari delicto*, that is, both parties are equally guilty. The result is that no party can bring an action to make any claim whatsoever under the contract. If any party has performed his own side of the bargain, or transferred money or rendered service, the courts will refuse to compel the other party either to perform or return any money received by him. The principle is *in pari delicto portio est condition possidetis*, that is where both parties are equally guilty, the condition of the party in possession of either money or other property is the better one. *Everet v Williams* is regarded as *locus classicus* where an armed robber sued a fellow armed robber for refusing to produce the numerous bounties realized from their robberies. The court declared the writ to be scandalous and impertinent. The plaintiff's solicitor was attached for contempt and fined 50 pounds while both plaintiff and defendant were subsequently executed (Megarry 1955).

If however, the plaintiff can show that he is not *in pari delicto*, as for example, that he was induced by fraud, duress or undue pressure to enter into the contract, he will be allowed to recover any property transferred under the contract (*Atkinson v Derby* [1862] 7 H & N 934). If the plaintiff is also induced by fraudulent misrepresentation, he will be allowed to recover (*Hughes v Liverpool Victoria Legal Friendly Society* [1916] 2 KB 482). Where there is a fiduciary relationship between the

parties, and the plaintiff is the beneficiary, that is, the party reposing trust and confidence in the defendant, he will be allowed to recover property transferred under an illegal contract between them (Sagay 1999). Where the purpose of the statute or public policy is to protect the plaintiff from the defendant, for example, illiterates' protection, the plaintiff will be allowed to recover any property transferred under the transaction covered by the law violated. Similarly, where the claim can be based on a ground entirely independent of the illegal contract, the claimant may recover money or property transferred under an illegal contract.

In the case of contracts void at common law, the consequences would depend on whether the contract as a whole is void or whether a part of it is void. Where the whole of the contract is void, the contract as a whole cannot be enforced. However, where a contract contains partly valid terms and partly void terms, the doctrine of severance can be applied to enforce the valid terms. On the whole, it is important to note that unlike illegal contracts, in void contracts, money paid or property transferred by one party to the other side is recoverable.

6. Legal Remedies for Breach of Contractual Terms by Informal Sector Operators in Nigeria

Generally, remedies available for non-compliance with contractual terms or breach of contract include damages, specific performance, rescission and restitution, declaration and injunction. These remedies are generally available for breach of contract irrespective of whether the breach occurs in the formal sector or informal sector or whether the party involved is a corporate or unincorporated entity or an individual. Some of these remedies can be asked for jointly or in the alternative. While some are common law remedies such as damages, others are equitable remedies such as injunctions and specific performance. However, it is obvious that some of these remedies may not be readily available for informal sector operators depending on the circumstances of the case. Where for instance the parties are in *pari delicto*, and the transaction is tainted with illegality, no court of law will come to the assistance of the parties and the party who has lost money or property must be left to go home and brood over his loss.

However, where the transaction is merely void and not illegal, or, the parties are not in *pari delicto*, the innocent party can recover by way of rescission and restitution as far as possible.

It is relatively clear that once the contract is void or tainted with illegality, the court cannot make an order of specific performance. The

reason is not far-fetched. It is because as an equitable remedy, the courts will not allow itself or the law to be used as an engine or vehicle of fraud or illegality.

In respect of injunctions, injunction as an equitable remedy applies in a wide variety of cases and may be helpful in cases where specific performance will be inapplicable. This is because injunctions could be prohibitory as well as mandatory. Where it is prohibitory, it acts to restrain a party from further going on with a particular transaction. Where it is mandatory, it acts to order a party to do some positive act in order to undo a negative act already done by the party. An order of injunction could be very useful where the parties are not in *pari delicto*.

Declaration serves to authoritatively declare or pronounce on the rights and liabilities of the parties without enjoining anybody to do or refrain from doing anything. Naked declaration of rights is seen as a weak form of remedy. Therefore, declarations are usually joined with an order of injunction and can actually be a veritable instrument when co-joined with injunction.

In the final analysis, it is important to recognise that the law may refuse to give full effect to a contract on the ground of illegality because the contract involves the commission of a legal wrong or is in some other way contrary to public policy (Treitel 2003). This appears to be the lot of many informal sector enterprises, especially those involved in the external sector.

7. Conclusion

The main objective of this study is to examine the formal legal remedies for contractual non-compliance by informal sector enterprises in Nigeria. The features of the informal sector enterprises in Nigeria were discussed. The theories of informality and the recent empirical studies on the Nigerian informal sector were also presented. The concepts of illegal contract and void contract were extensively discussed with detailed examples especially as they relate to the enforceability of contracts and legal remedies available for contractual non-compliance in the informal sector. The study identified the remedies available for non-compliance with contractual terms or breach of contract to include damages, specific performance, rescission and restitution, declaration and injunction. However, some of these remedies may not be readily available for informal sector operators depending on the circumstances of the case.

This is because the law may refuse to give full effect to a contract on the ground of illegality or because it is in some other way contrary to public policy and this appears to be the case of many informal sector enterprises in Nigeria.

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