Is Informal Normal?

Informal employment in times of Shifting Wealth

Juan R. de Laiglesia
OECD Development Centre

Latin American and Caribbean Labour Markets and the Global Economy
Santiago de Chile, 14-15 June 2011
Overview

• Informal employment is:
  – pervasive,
  – persistent even in countries with adequate growth, and
  – hardly a hidden phenomenon.

• Global economy: two salient features for informality
  – Increased growth with structural change: role for trade in affecting informality?
  – Emerging middle class.

• Informal employment pervasive but heterogeneous
  → differentiated approaches
<table>
<thead>
<tr>
<th></th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Overview</td>
</tr>
<tr>
<td>2</td>
<td>Structural change and informality</td>
</tr>
<tr>
<td>3</td>
<td>Informality and middle income segments</td>
</tr>
<tr>
<td>4</td>
<td>A Policy Framework</td>
</tr>
</tbody>
</table>
**Definition**

*Informal employment refers to jobs or activities in the production and sales of legal goods and services which are not regulated or protected by the state*

Statistical implementation (ILO), based on *employment relationship* (employer protection):

- Informal employment = employment in the informal sector + informal employment in the formal sector
  - Informal sector: self-employed (employers, own account workers, family helpers) + wage employees + employers in micro-enterprises (less than five workers)
  - Formal sector: Wage employees and paid domestic workers without social protection
Informal employment is pervasive in the developing world.

Share of informal employment in total non-agricultural employment (%)

- Sub-Saharan Africa
- Southern and Eastern Asia
- Latin America
- Western Asia
- Northern Africa
- Transition countries

Source: OECD, 2009
Shifting Wealth: The four-speed world in the 1990s

Source: OECD Development Centre, Perspectives on Global Development 2010 Shifting Wealth
Shifting Wealth: The four-speed world in the 2000s

Source: OECD Development Centre, Perspectives on Global Development 2010 Shifting Wealth
Cross-country patterns suggest that the share of informal employment should decline with economic growth....

[Graph showing relationship between share of informal employment and PWT: Real GDP per capita (Constant Prices: Chain series, 2000)]
yet despite growth, informal employment persists in many countries
Growth patterns accompanied by structural change

**Agriculture**

- Changes in share of VA, agriculture % vs. Annualized GDP per capita 1990-2009
- Converging, struggling, poor categories indicated

**Services**

- Changes in share of VA, services % vs. Annualized GDP per capita 1990-2009
- Converging, struggling, poor categories indicated

**Industry**

- Changes in share of VA, industry % vs. Annualized GDP per capita 1990-2009
- Converging, struggling, poor categories indicated
Structural change has a composition effect but it can be small.

Informality in Mexico, by agricultural/non-agricultural sector

- Formal workers (except agricultural)
- Informal workers (except agricultural)
- Self-employed (except agricultural)
- Agricultural workers (subordinated and self-employed)

Source: de Laiglesia et al (2009)
Trade and informality

Theoretical mechanisms:

- Competition $\rightarrow$ cost saving in the form of informally produced inputs or labour: increase in informality (e.g. Goldberg and Pavcnik, 2003)
- Heterogenous firms $\rightarrow$ more productive firms formalise, less productive firms exit: fall in informality (Aleman-Castilla, 2006)
- Tradable vs non-tradable $\rightarrow$ change in relative profitability/price leading to fall in informality

Empirical evidence

- Country-specific effect of liberalisation: negative (Mexico, Aleman-Castilla, 2006), zero (Brazil, Pavnik and Goldberg, 2003), positive (Colombia pre-labour reform, Pavnik and Goldberg, 2003).
- Macro evidence suggests that informal employment falls with trade but informal output share increases (Fugazza and Fiess, 2010)
Manufacturing trade liberalisation and informality

Tariff reduction in Brazil (1991-2001)
Between and within dimensions

\[
\Delta_{c+\tau} \frac{I_{\text{informal}}}{I_{\text{total}}} = \Delta_{c+\tau} \Delta_{c} \sum_{i} a_{i} + \sum_{i} i_{a} \Delta_{c} \sum_{a_{i}} + \varepsilon
\]
Sector composition of informality (Brazil)

- Highly concentrated: 2/3 of informal workers in agriculture (30%), trade and repair activities, domestic service and construction.

Decomposition of changes over time

<table>
<thead>
<tr>
<th></th>
<th>Between</th>
<th>Within</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-2001</td>
<td>-2.3%</td>
<td>1.4%</td>
<td>-0.9%</td>
</tr>
<tr>
<td>2002-2006</td>
<td>-0.7%</td>
<td>-2.0%</td>
<td>-2.7%</td>
</tr>
</tbody>
</table>

- In 1991/2001 increases in informality in manufacturing (food processing, metal goods manufacturing and textiles)

Dominant effects:

- Fall in agricultural employment dominates (-5.6% in 91/01)
- Changes in composition and informality in services
Informal in what sector? Differences in outcomes

Wage distribution by formal/informal status (Mexico, 2007)
The changing face of the global middle class

Share of global middle class consumption

But middle segments are largely informal

Brazil

Bolivia

Chile

Mexico

<table>
<thead>
<tr>
<th></th>
<th>Poor</th>
<th>Middle Class</th>
<th>Better off</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bolivia</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chile</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **Formal employees**
- **Non Agricultural Self-employed**
- **Agricultural Self-employed**
- **Self Employed (with tertiary education completed)**
- **Non Agricultural Informal Employees**
- **Agricultural informal employees**
Informality matters for coverage (example: pensions)

Formal workers

Informal workers


Social Protection and Informality in LAC

• Informality is also an issue for the middle class:
  – Many middle class workers in LAC countries are informal
  – Heterogeneity matters for coverage outcomes

• Challenge of increasing coverage in social protection
  • pensions, health, unemployment insurance
  • Dual systems can leave a “missing middle” in coverage

• Not necessarily the source of duality, but should avoid reinforcing duality:
  – Universal entitlements, means tests vs job or occupation links,
  – Incentives: Compulsory or opt out affiliation (self-employed), portability
From monolithic informal employment…
...to two (or multi)-tiered informal employment
Key issues on multi-tiered informal employment

• Mobility:
  – High levels of mobility in both directions suggest not only queuing for jobs
  – But benefits from mobility and barriers even between types of informal jobs depend on factors that make better jobs accessible (education, gender)
    • Barriers to physical mobility (portability, entitlement, migration, e.g. Hukou)
    • Access to capital, education, assets (Barret and Carter, 2007; Klasen and Woolard, 2005)
    • Cost of search (Rama, 2003; Bernabè and Stampini, 2008)
    • Social institutions and discrimination (gender, race, age)

• Gender
  – Women not necessarily more likely to be informal
    (in LAC, difference in shares explained largely by domestic workers)
  – But often in worse jobs, with lower incomes
  – Much more likely to move out of the labour force
What can we do about it? A policy framework

• Beyond “business as usual” (growth concerns and poverty alleviation)

• Improving the quality also of informal jobs

• Addressing heterogeneity across and within countries (two-tiered informal employment)

• Three common ingredients:
  – More and better jobs
  – Incentives for choosing formality
  – Protecting and promoting informal workers

• Role of trade:
  – Limited role for trade to affect informality directly
  – New opportunities but also increased volatility, need to account in policy mix.
More and better jobs

• Macro-economic policies:
  – Crucial importance for employment outcomes
  – Objective setting: Employment creation versus inflation targeting; is there a trade-off and what to do about it?

• Structural and sector policy
  – Employment elasticity of growth and driving sectors
  – Recognise gender differences across and within sectors
  – More policy coherence: social protection and business promotion agenda

• Labour market reform: better regulation and inclusive institutions
  – Engaging informal workers and their representation
Providing incentives for the upper-tier

• Business climate reforms to lower the cost of formality
  – Reduce regulatory compliance costs, tax administration reform, public goods

  *plus*

• Enforcement of labour, tax and social security regulations, including strengthening labour inspections

• Improving the benefits of formality
  – Better governance, public service, linking contributions and benefits
Promoting and protecting informal workers

• Inclusive education and training
  – adapted to informal workers, including women, and recognising experience in informal work

• Social protection
  – Cash transfers are useful poverty alleviation tools
  – Social protection/assistance for workers (universal coverage programmes), including childcare provision mechanisms
  – Public works, work guarantee programmes, unemployment insurance

• Seeing the shades of grey:
  – Lack of portability of benefits harms the most vulnerable
Thank you
Annex
Share of Self-Employment in Total Non-Agricultural Employment
The challenge of coverage: Pensions

Source: OECD Latin American Economic Outlook 2011, forthcoming

Note: Share of affiliates (Bolivia and Mexico) or contributors (Brazil and Chile), over working age population. Authors calculations based on national household surveys.
Policy recommendations

- **Coverage**: Protect through minimum pensions (protect)

- **Affiliation**: Compulsory or *opt-out* for self-employed workers (enforce)
  - Better mobility
  - Funding of solidarity pillars

- **Incentives for contribution** through public cofinance (Matching defined contributions).
Heterogeneity in coverage among informal workers

- Self Employed (with tertiary education completed)
- Non Agricultural Informal Employees
- Non Agricultural Self-employed
- Agricultural Self-employed
- Agricultural informal employees

Why is persistent informality worrying?

Informal work is very diverse but, on average:

• The share of informal workers is strongly correlated with poverty rates (700 million informal poor workers)

• Substantially lower earnings for informal employees:
  – 1.1 of minimum wage in Morocco, India.
  – Less than half of average wage in Mexico, Brazil.

• Multiple social costs of informality:
  – Shortfall in pension, health and labour safety coverage, fiscal receipts
  – High vulnerability to idiosyncratic and aggregate shocks... the crisis!
Informal employment is strongly correlated with poverty.

Earnings in informal work: low and heterogeneous

Income and wages in small informal enterprises
Multiples of minimum wage

Source: Is Informal Normal?, OECD Development Centre 2009
Notes: *Relative to average wages; definitions and years vary, see table 2.5 for details
The gender dimension of informal employment

• Economic research and policy focused on Labour Force Participation (LFP)
• Neglect of quality of jobs
• Working women are not systematically more likely to be informal…
  …but they are overrepresented in worse forms of informal employment and earn substantially less
• The causes largely overlap with causes of low LFP:
  – social institutions, limited entitlement to resources and assets, limited freedom to move.
Women in informal employment

Share of informal employment in total non-agricultural employment (in %)

- India: Men 82.9%, Women 85.7%
- Indonesia: Men 78%, Women 77.2%
- Philippines: Men 70.8%, Women 73.4%
- Kenya: Men 59.1%, Women 83.1%
- South Africa: Men 51%, Women 64.9%
- Thailand: Men 49.1%, Women 54.3%
- Brazil: Men 50.2%, Women 52.3%
- Mexico: Men 47.8%, Women 53.5%

Source: OECD Development Centre, 2009
Gender (earnings) gaps in informal employment

(2) Data for Ethiopia, Brazil, Colombia, Mexico and Turkey are for urban areas only.
Source: Various sources, see OECD Development Centre (2009), Chapter 2 for details.
Job mobility and informality

• High mobility (at least in middle income countries) including between formal and informal in both directions

• Somewhat surprising labour dynamics: moves from formal to informal
  → not only queuing for the formal jobs.

• But: mobility depends on the same factors that make better jobs accessible (e.g. educational level and gender)
Transitions in and out of informal work (Mexico)

<table>
<thead>
<tr>
<th>Year</th>
<th>Formal</th>
<th>Informal</th>
<th>Without job</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>Formal</td>
<td>65.5</td>
<td>Informal</td>
<td>18.2</td>
</tr>
<tr>
<td></td>
<td>Informal</td>
<td>19.7</td>
<td></td>
<td>42.1</td>
</tr>
<tr>
<td></td>
<td>Without job</td>
<td>7.1</td>
<td></td>
<td>7.1</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>23.9</td>
<td></td>
<td>18.8</td>
</tr>
</tbody>
</table>

Transitions in Mexico (by gender)

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Informal salaried</td>
<td>Formal salaried</td>
</tr>
<tr>
<td>Informal salaried</td>
<td>46.7</td>
<td>22.3</td>
</tr>
<tr>
<td>Formal salaried</td>
<td>18.9</td>
<td>61.8</td>
</tr>
<tr>
<td>Self-employed</td>
<td>18.6</td>
<td>9.7</td>
</tr>
<tr>
<td>Not working</td>
<td>15.1</td>
<td>23.6</td>
</tr>
<tr>
<td>Total</td>
<td>25.5</td>
<td>34.1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Informal salaried</td>
<td>Formal salaried</td>
</tr>
<tr>
<td>Informal salaried</td>
<td>36.3</td>
<td>14.3</td>
</tr>
<tr>
<td>Formal salaried</td>
<td>14.3</td>
<td>55.3</td>
</tr>
<tr>
<td>Self-employed</td>
<td>10.6</td>
<td>2.3</td>
</tr>
<tr>
<td>Not working</td>
<td>5.6</td>
<td>4.5</td>
</tr>
<tr>
<td>Total</td>
<td>10.2</td>
<td>11.6</td>
</tr>
</tbody>
</table>

## Transitions in Mexico (by education)

<table>
<thead>
<tr>
<th></th>
<th>More than 6 years of education</th>
<th>Less than 6 years of education</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2002</td>
<td>2005</td>
</tr>
<tr>
<td>Informal salaried</td>
<td>41.1</td>
<td>43.8</td>
</tr>
<tr>
<td>Formal salaried</td>
<td>23.4</td>
<td>14.0</td>
</tr>
<tr>
<td>Self-employed</td>
<td>14.9</td>
<td>26.0</td>
</tr>
<tr>
<td>Not working</td>
<td>20.7</td>
<td>8.7</td>
</tr>
<tr>
<td>Informal salaried</td>
<td>43.8</td>
<td>14.0</td>
</tr>
<tr>
<td>Formal salaried</td>
<td>14.0</td>
<td>45.7</td>
</tr>
<tr>
<td>Self-employed</td>
<td>15.6</td>
<td>8.7</td>
</tr>
<tr>
<td>Not working</td>
<td>26.6</td>
<td>19.7</td>
</tr>
<tr>
<td>Total</td>
<td>16.0</td>
<td>17.1</td>
</tr>
<tr>
<td></td>
<td>30.1</td>
<td>7.2</td>
</tr>
<tr>
<td></td>
<td>16.5</td>
<td>17.1</td>
</tr>
<tr>
<td></td>
<td>37.4</td>
<td>61.0</td>
</tr>
</tbody>
</table>

Mobility and welfare

• Multi-tiered informal employment as a useful framework: Relative size?

• Barriers to mobility:
  – Barriers to physical mobility (portability, entitlement, migration, e.g. Hukou)
  – Access to capital, education, assets (Barret and Carter, 2007; Klasen and Woolard, 2005)
  – Cost of search (Rama, 2003; Bernabè and Stampini, 2008)
  – Social institutions and discrimination (gender, race, age)

• Also barriers to better informal jobs
## Determinants of contributing to the pension system

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>I</td>
<td>IV</td>
</tr>
<tr>
<td>Income (log)</td>
<td>[0.23***]</td>
<td>[0.14***]</td>
</tr>
<tr>
<td>Income * formal</td>
<td>[-0.15***]</td>
<td></td>
</tr>
<tr>
<td>Income * independent</td>
<td>[0.19***]</td>
<td></td>
</tr>
<tr>
<td>Income * independent (HE)</td>
<td>[0.07***]</td>
<td></td>
</tr>
<tr>
<td>Income * informal salaried</td>
<td>[0.12***]</td>
<td></td>
</tr>
<tr>
<td>Independents</td>
<td>[-0.88***]</td>
<td>[-0.99***]</td>
</tr>
<tr>
<td>Independents (HE)</td>
<td>[-0.64***]</td>
<td>[-0.69***]</td>
</tr>
<tr>
<td>Informal workers</td>
<td>[-0.88***]</td>
<td>[-0.99***]</td>
</tr>
<tr>
<td>Controls for</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Educational attainment</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Sector</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Household composition</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Pseudo R²</td>
<td>0.12</td>
<td>0.69</td>
</tr>
<tr>
<td>N</td>
<td>163660</td>
<td>163652</td>
</tr>
</tbody>
</table>