

Is Informal Normal?

Informal employment in times of Shifting Wealth

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- 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

Is Informal Normal?

1 Overview

2 Structural change and informality

3 Informality and middle income segments

4 A Policy Framework

Definition

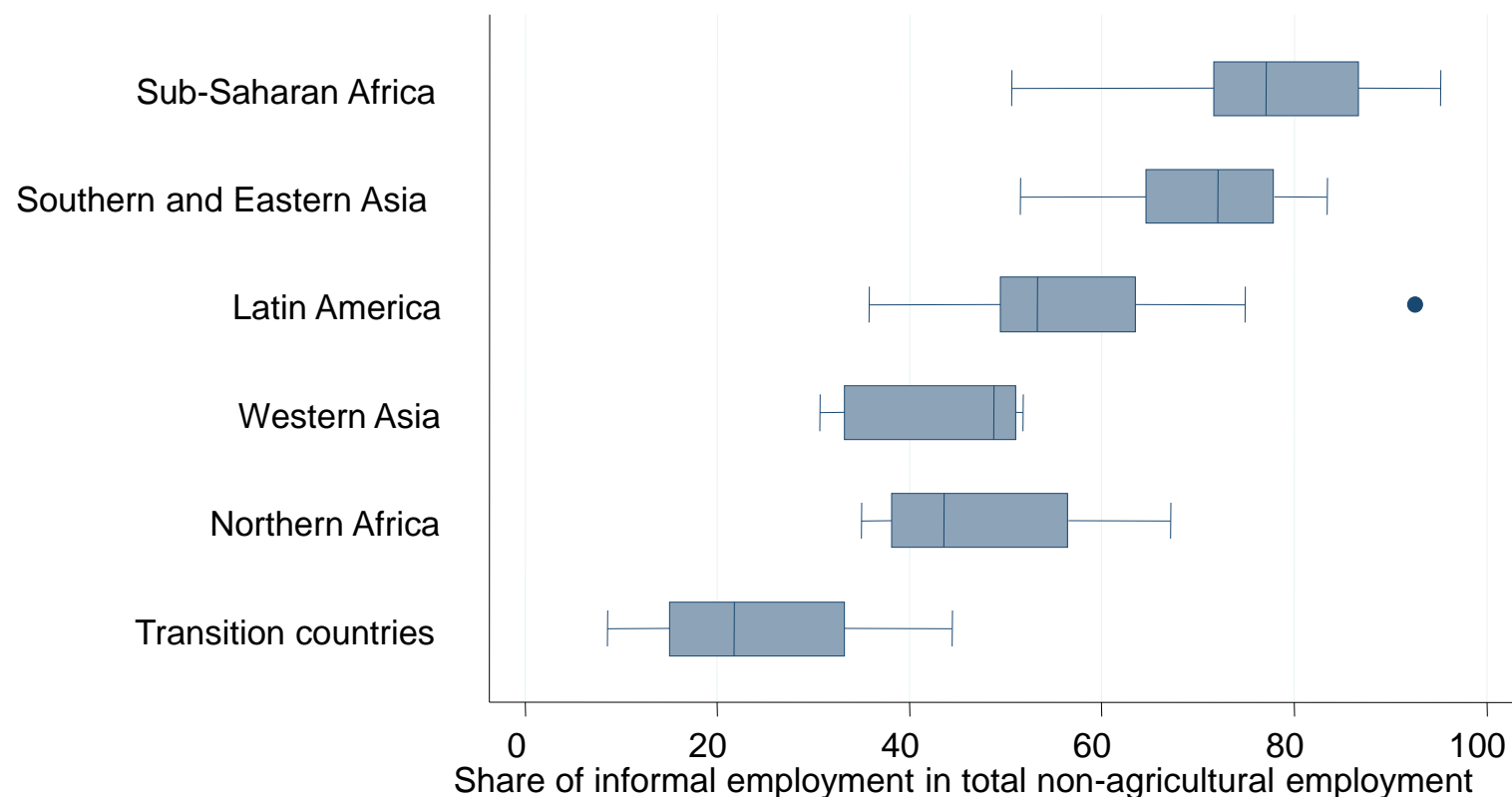
Informal employment refers to jobs or activities in the production and sales of legal goods and services which are not regulated or protected by the state

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

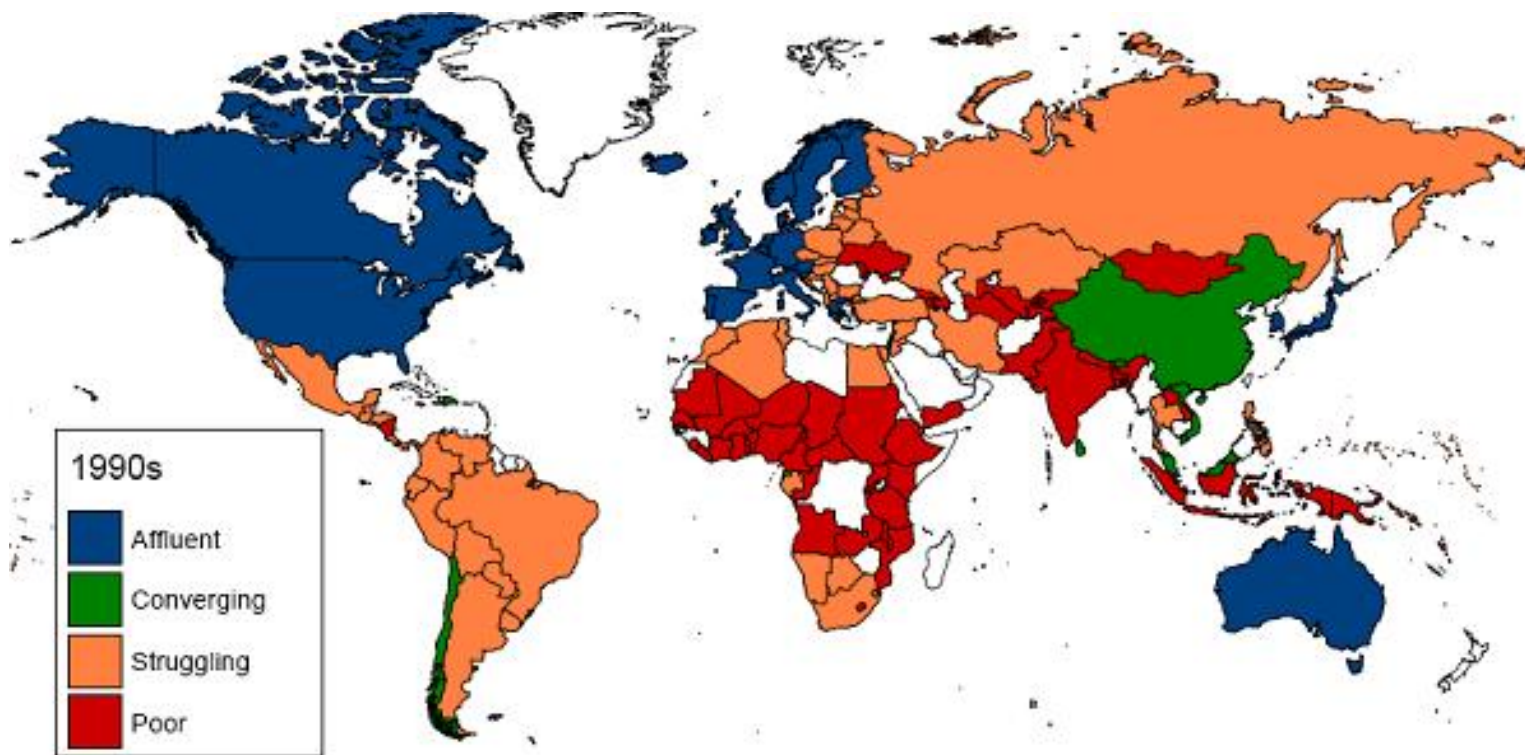
Informal employment is pervasive in the developing world

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



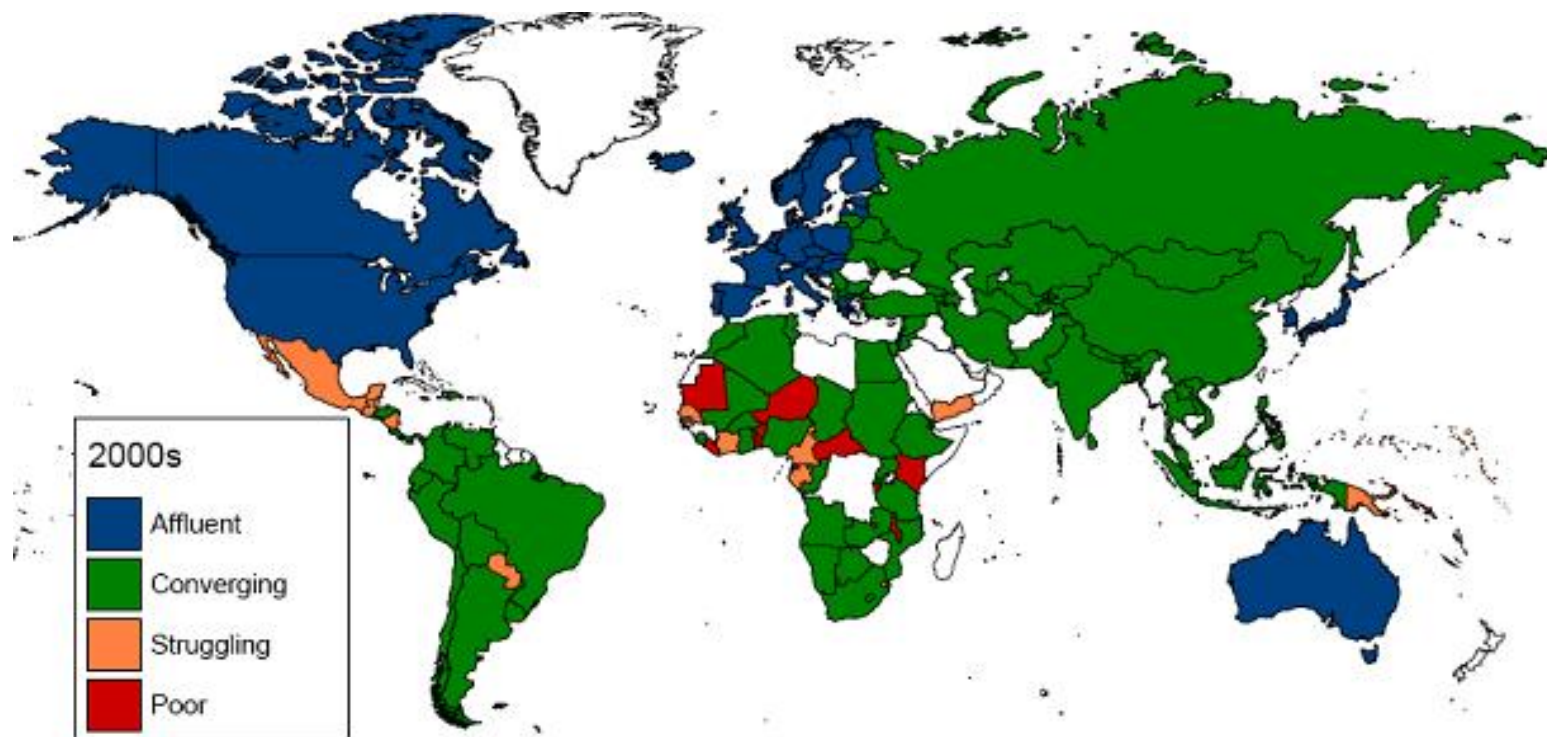
Source: OECD, 2009

Shifting Wealth: The four-speed world in the 1990s



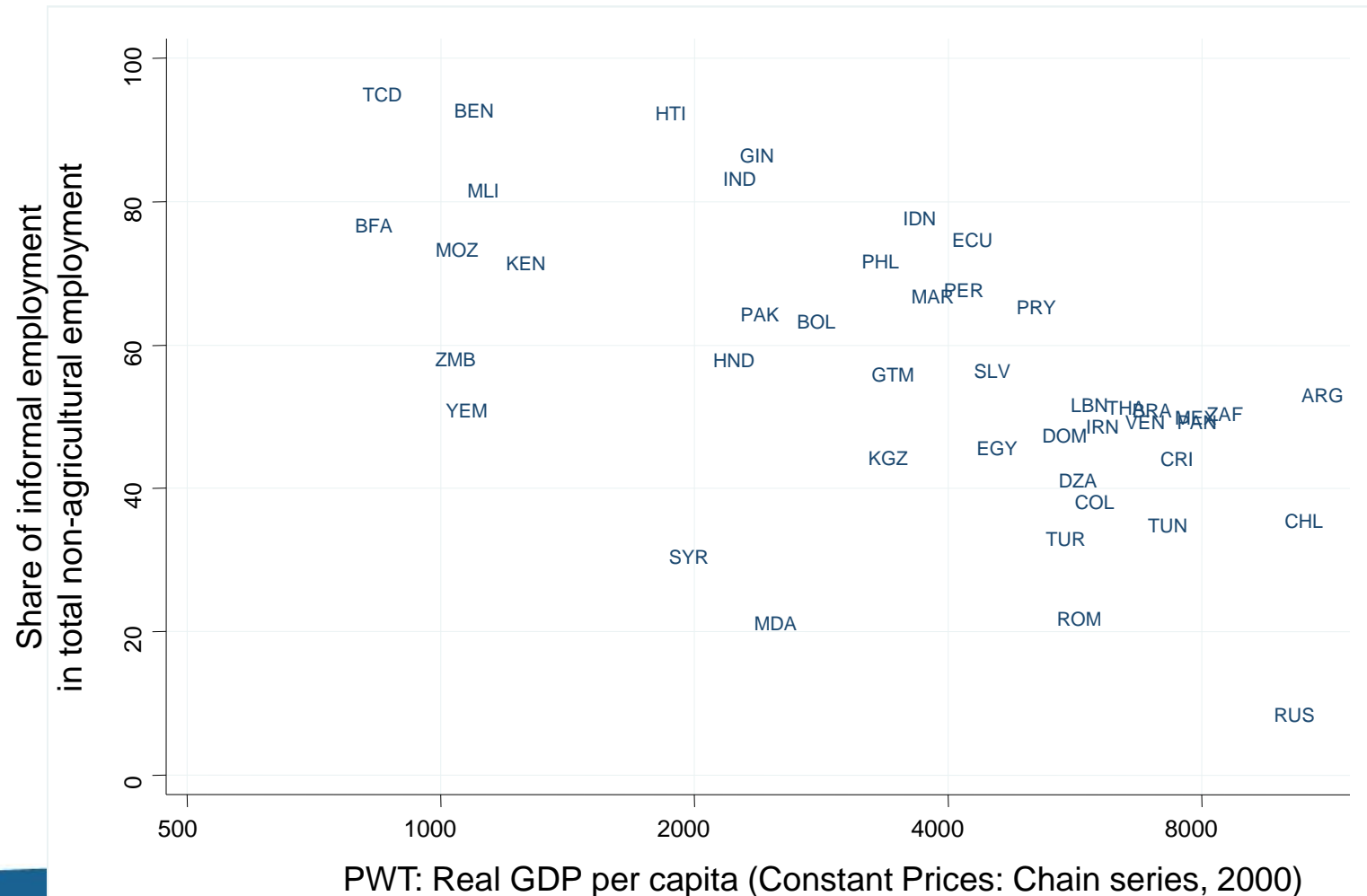
Source: OECD Development Centre, *Perspectives on Global Development 2010 Shifting Wealth*

Shifting Wealth: The four-speed world in the 2000s

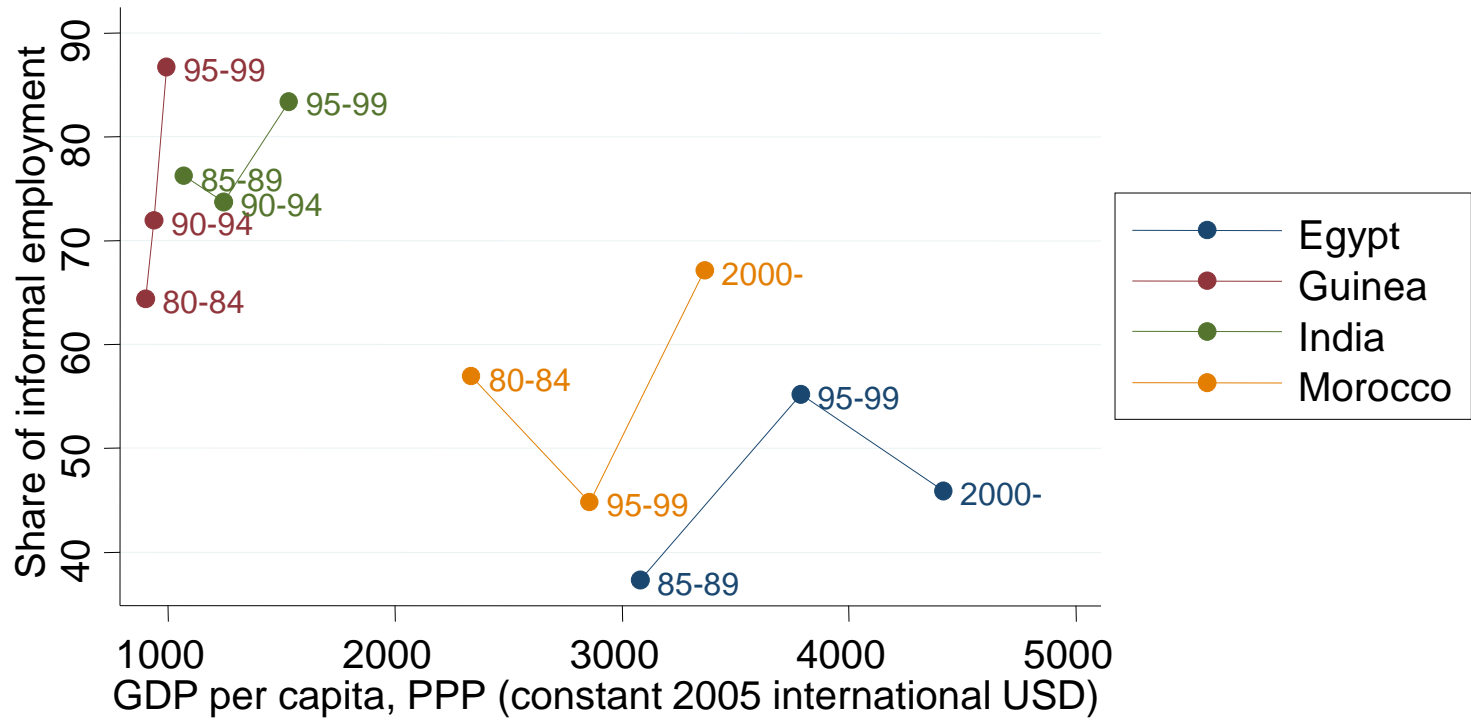


Source: OECD Development Centre, *Perspectives on Global Development 2010 Shifting Wealth*

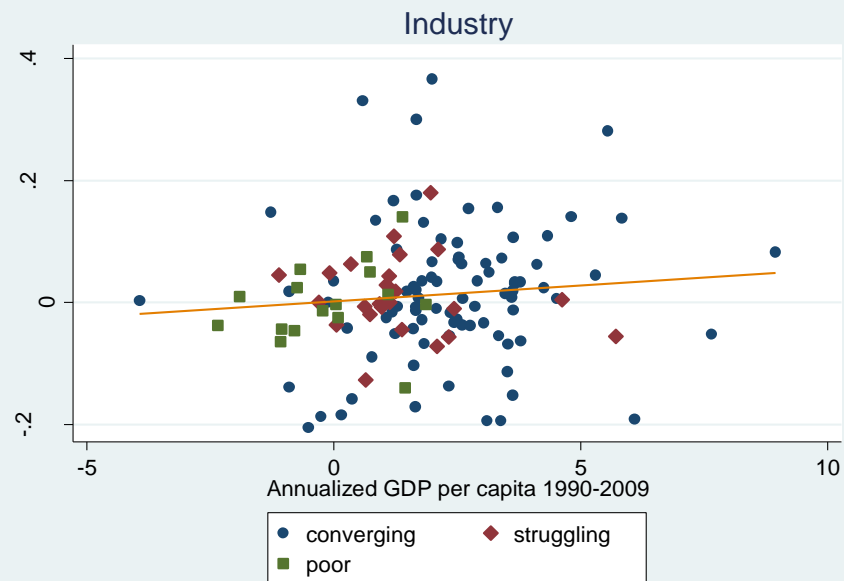
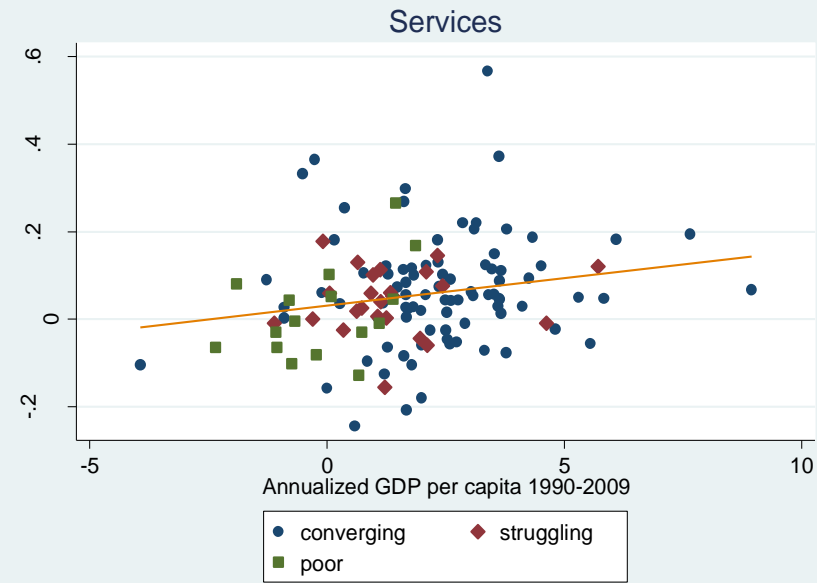
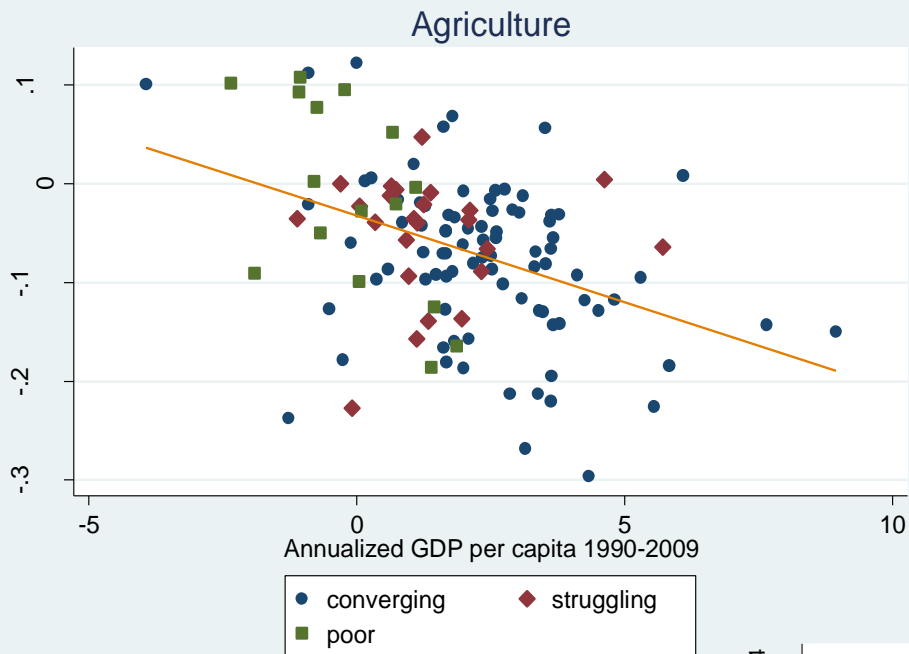
Cross-country patterns suggest that the share of informal employment should decline with economic growth....



yet despite growth, informal employment persists in many countries



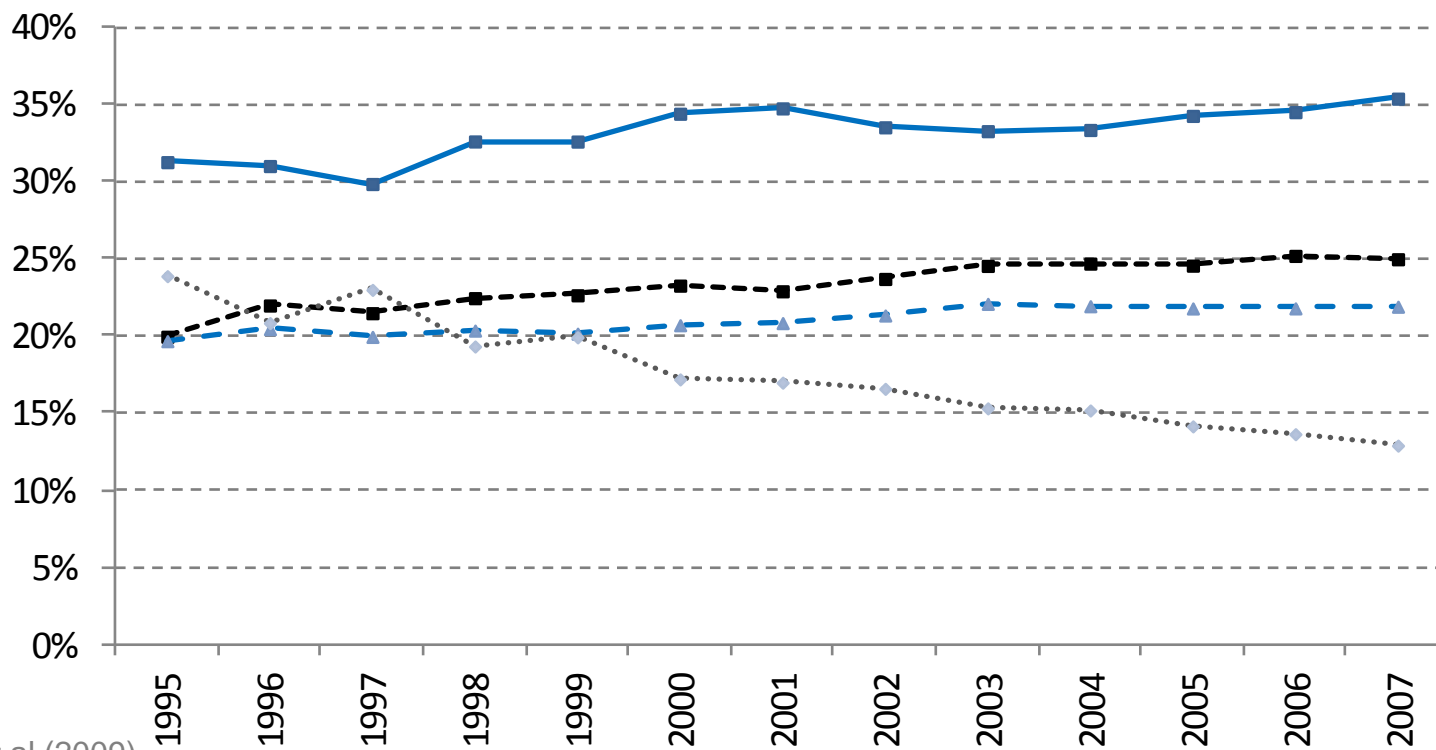
Growth patterns accompanied by structural change



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)

Theoretical mechanisms:

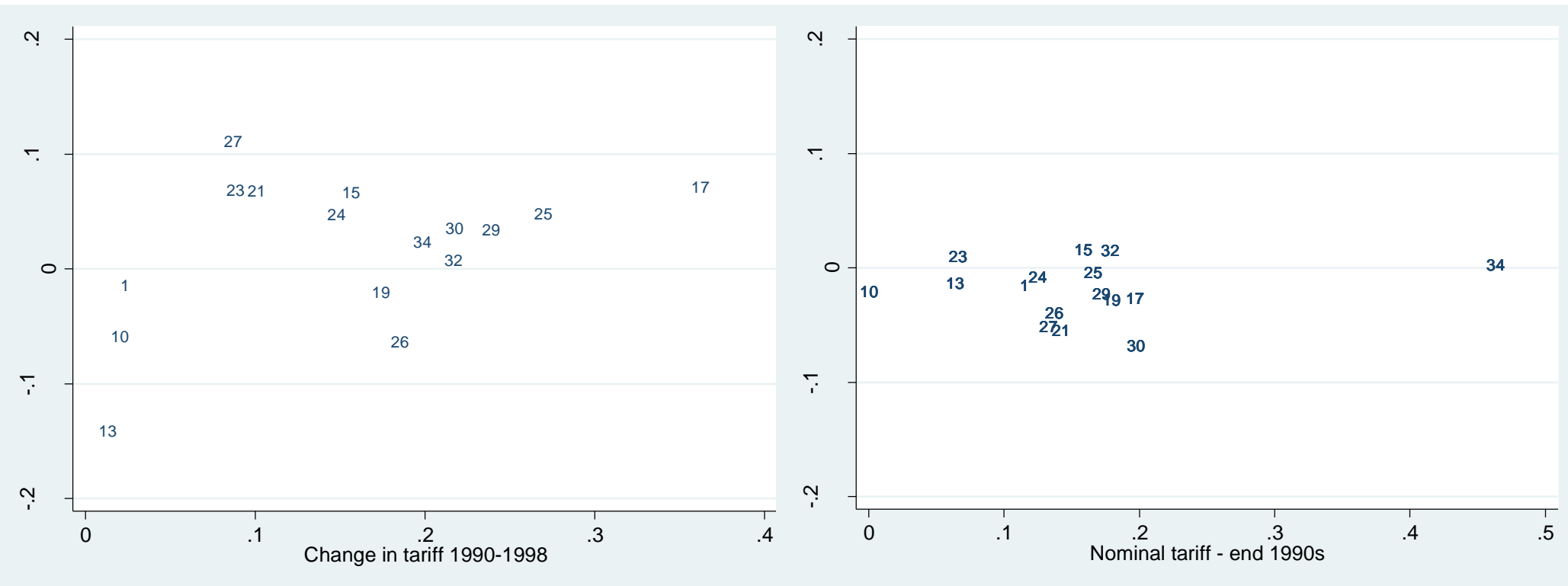
- Competition → cost saving in the form of informally produced inputs or labour: increase in informality (e.g. Goldberg and Pavcnik, 2003)
- Heterogenous firms → more productive firms formalise, less productive firms exit: fall in informality (Aleman-Castilla, 2006)
- Tradable vs non-tradable → change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

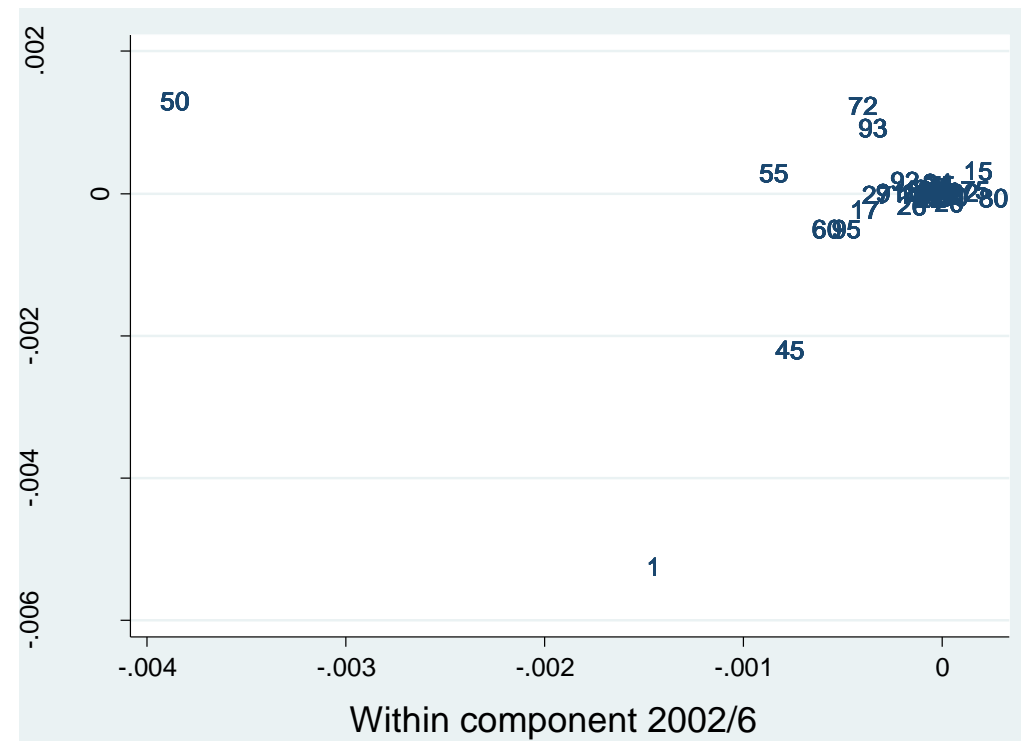
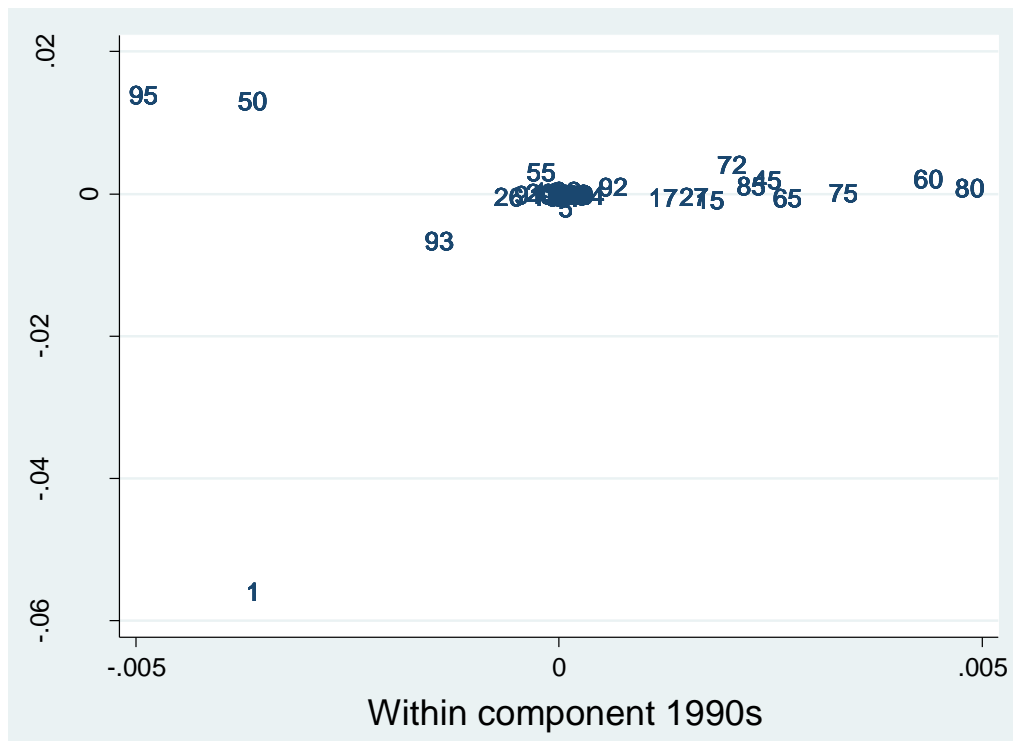
Manufacturing trade liberalisation and informality

Tariff reduction in Brazil (1991-2001)



Between and within dimensions

$$\Delta_{t \rightarrow \tau} \frac{L^{informal}}{L^{total}} = \Delta_{t \rightarrow \tau} i_t = \sum a_{jt} \Delta_{t \rightarrow \tau} i_{j,t} + \sum i_{j,t} \Delta_{t \rightarrow \tau} a_{j,t} + \varepsilon$$



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

	Between	Within	Total
1992-2001	-2.3%	1.4%	-0.9%
2002-2006	-0.7%	-2.0%	-2.7%

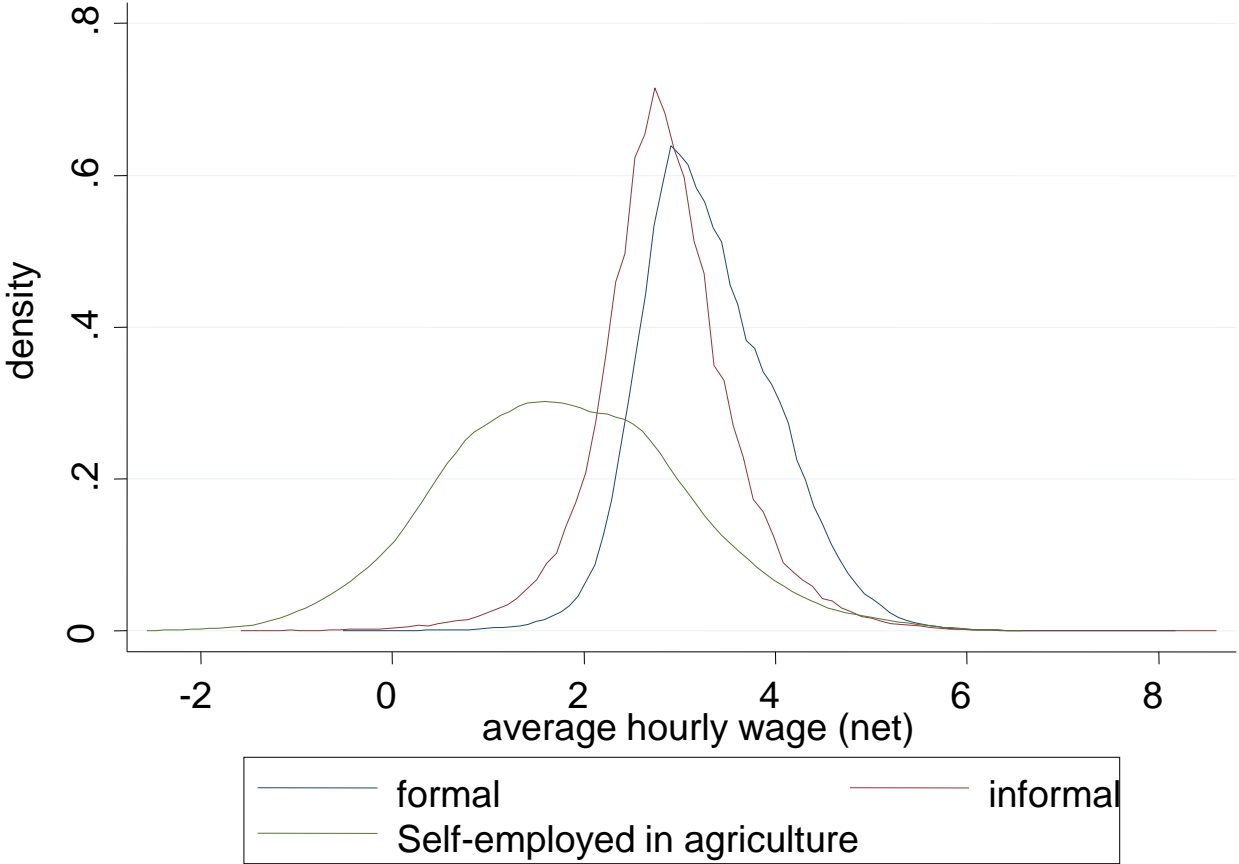
- In 1991/2001 increases in informality in manufacturing (food processing, metal goods manufacturing and textiles)

Dominant effects:

- Fall in agricultural employment dominates (-5.6% in 91/01)
- Changes in composition and informality in services

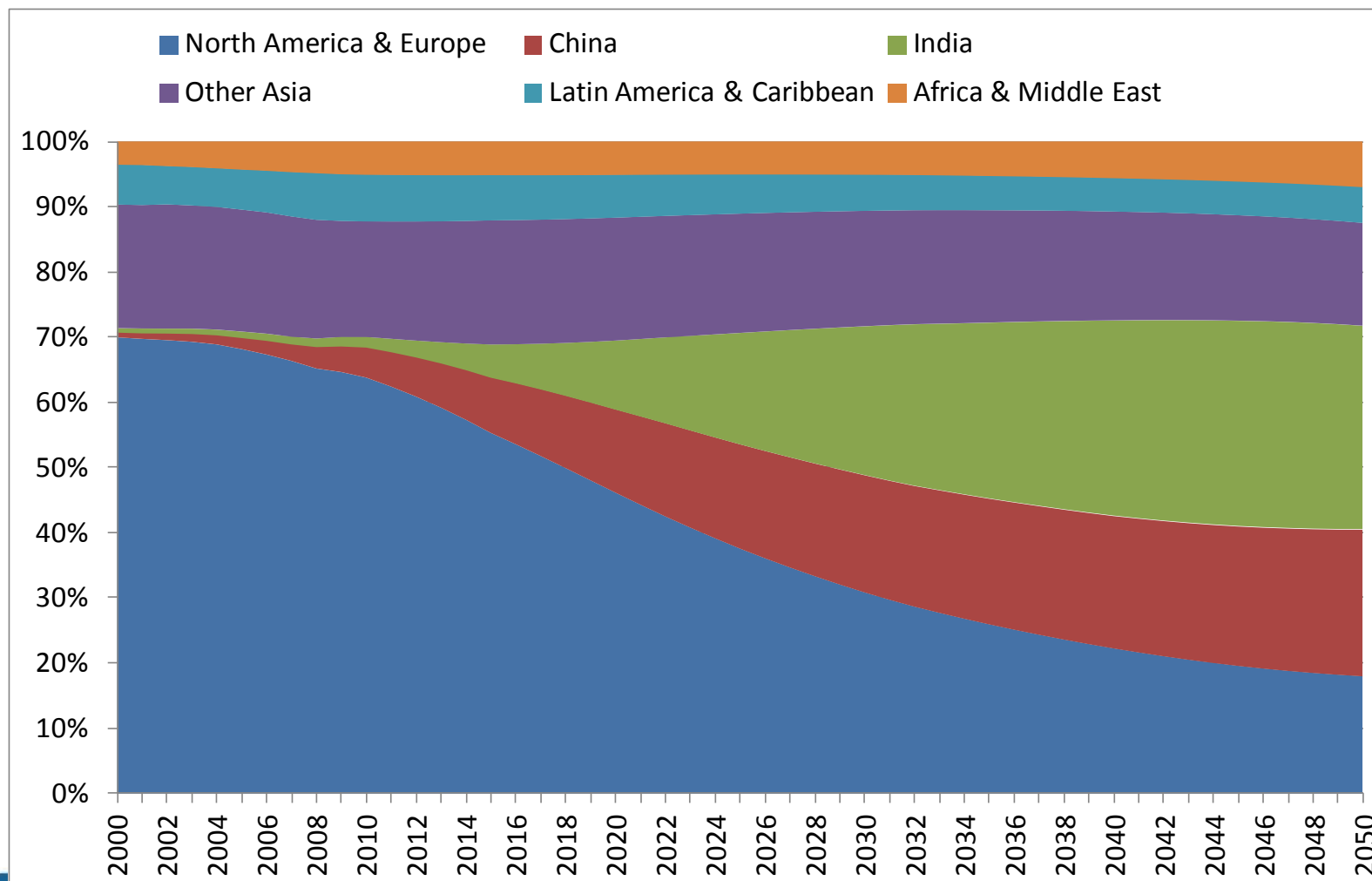
Informal in what sector? Differences in outcomes

Wage distribution by formal/informal status (Mexico, 2007)

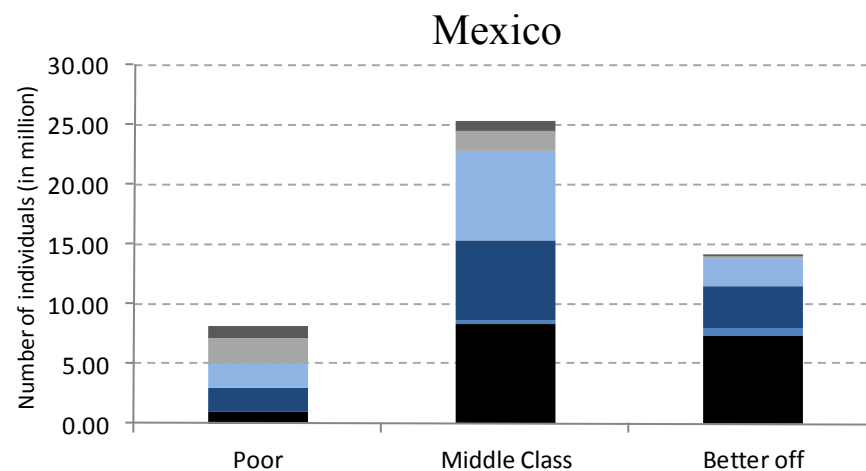
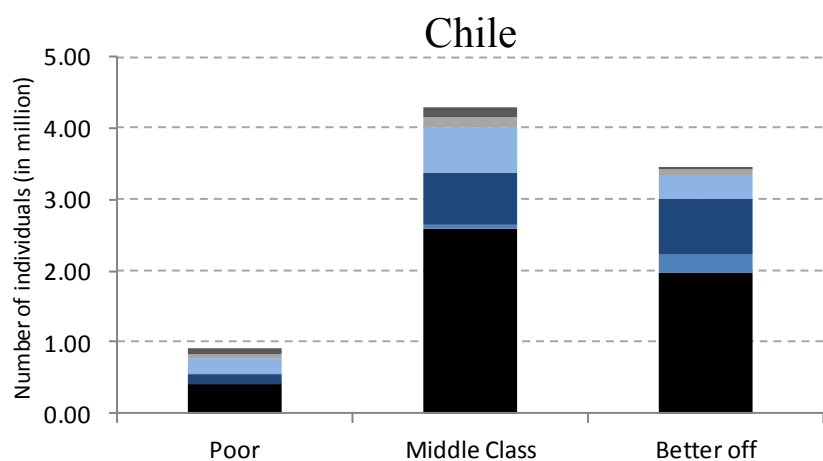
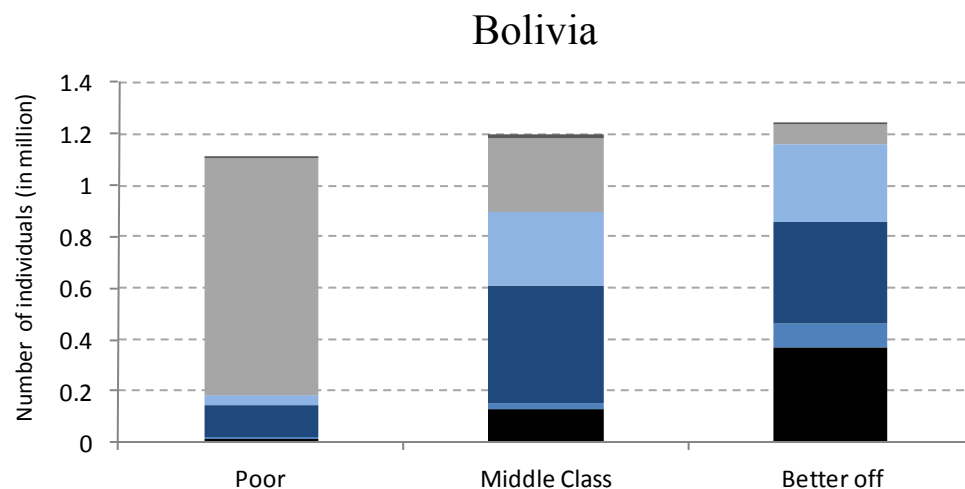
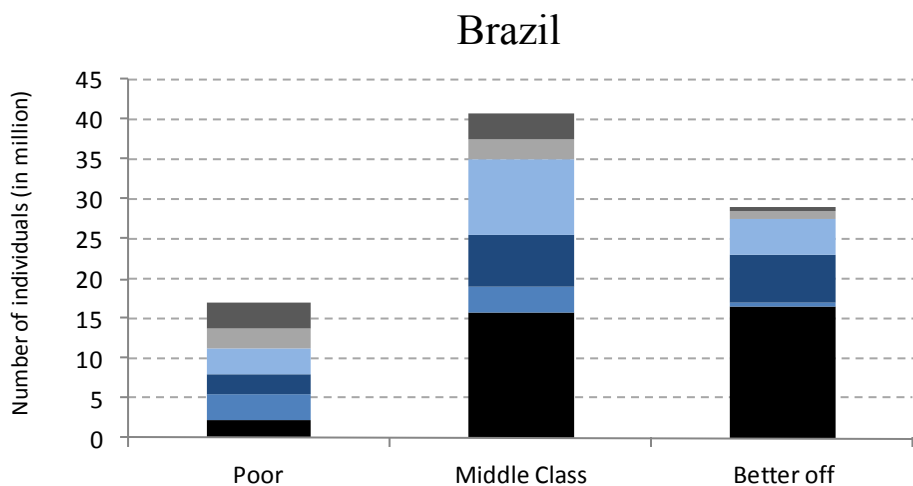


The changing face of the global middle class

Share of global middle class consumption



But middle segments are largely informal

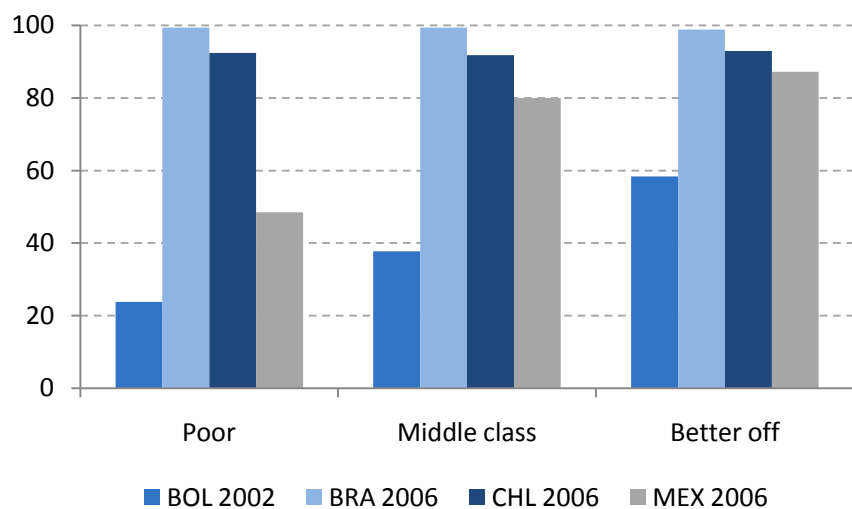


- Formal employees
- Non Agricultural Self-employed
- Agricultural Self-employed

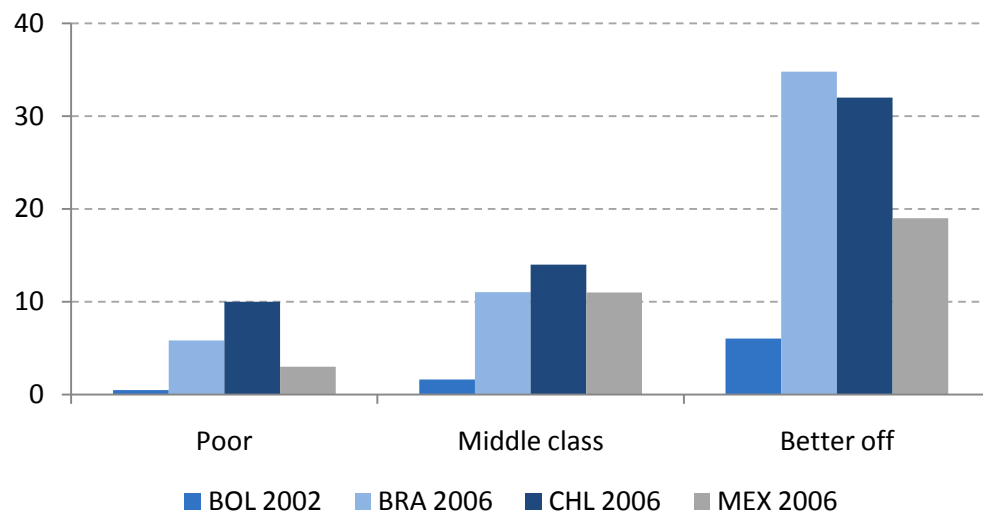
- Self Employed (with tertiary education completed)
- Non Agricultural Informal Employees
- Agricultural informal employees

Informality matters for coverage (example: pensions)

Formal workers



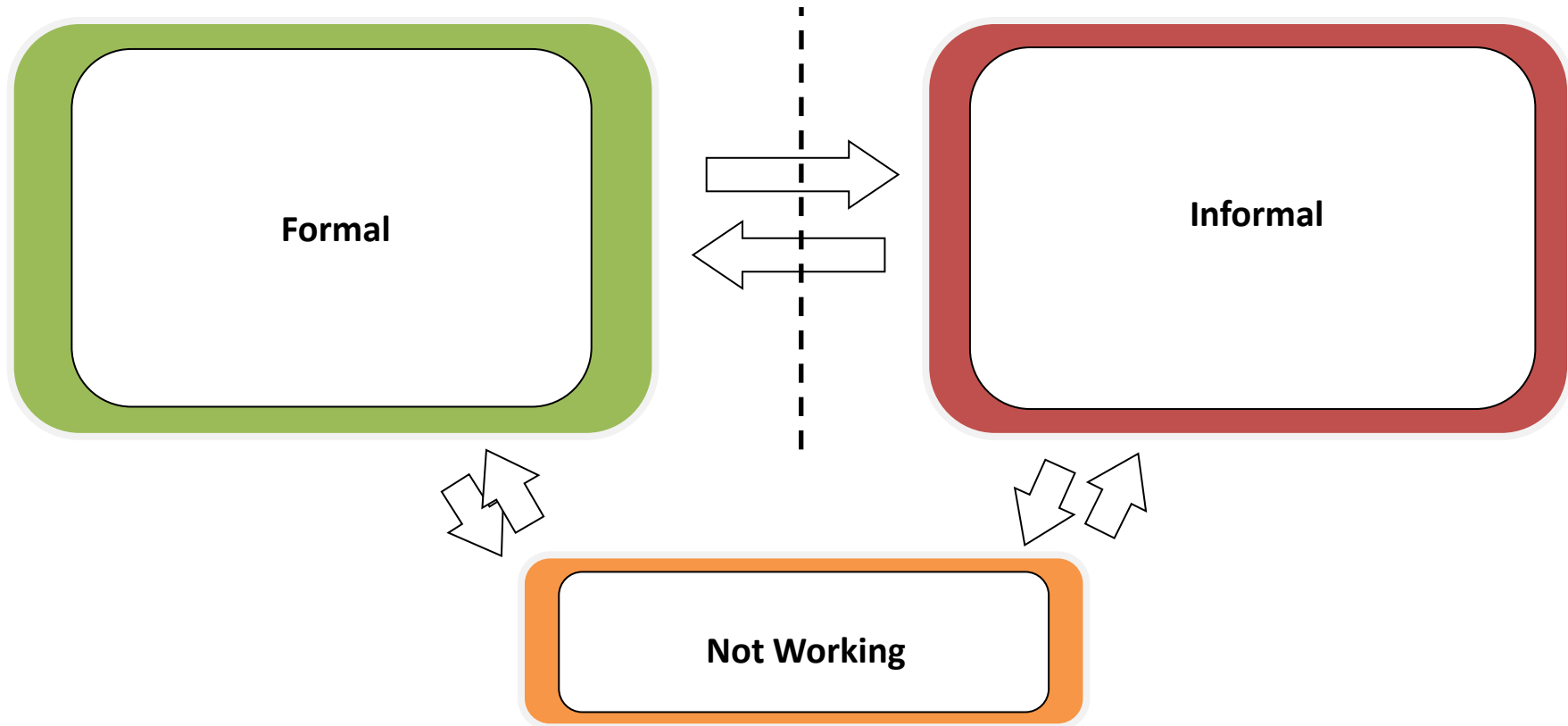
Informal workers



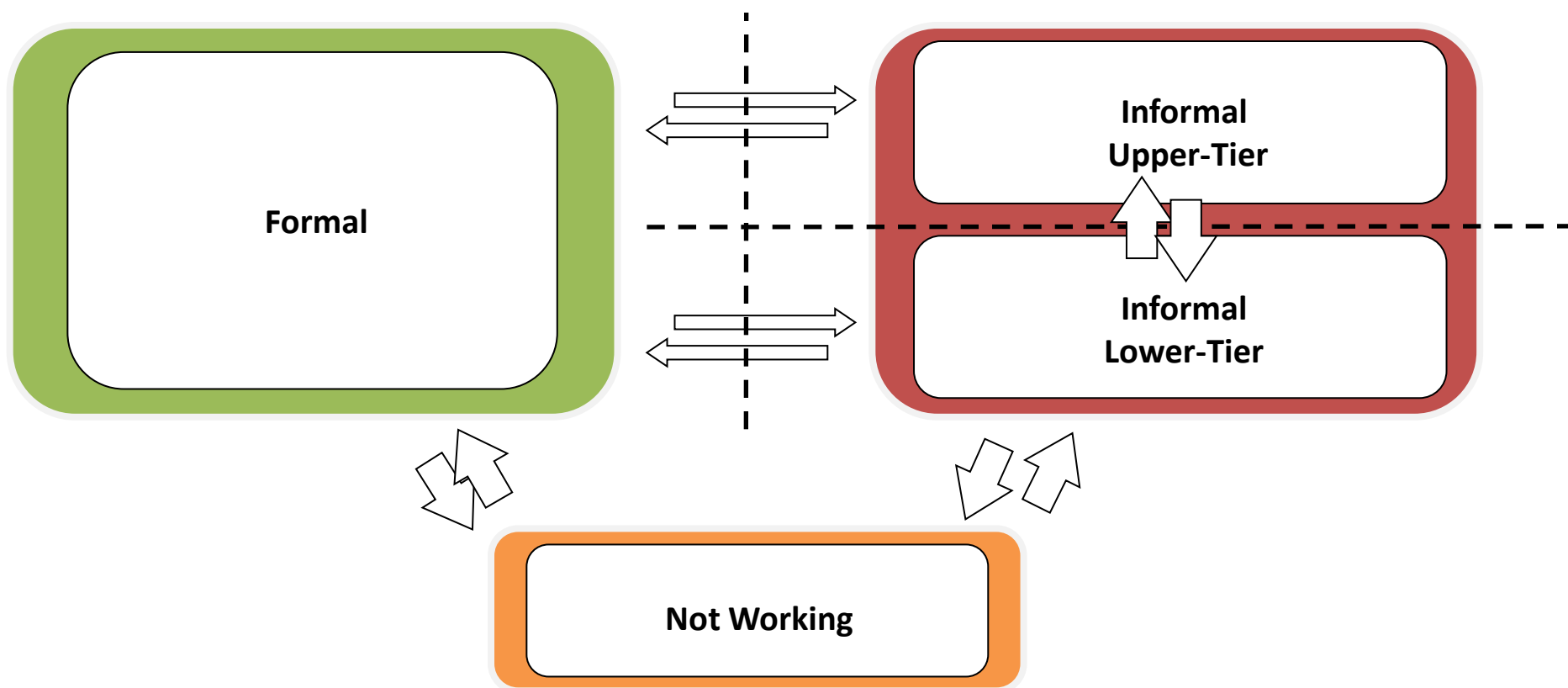
Social Protection and Informality in LAC

- 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

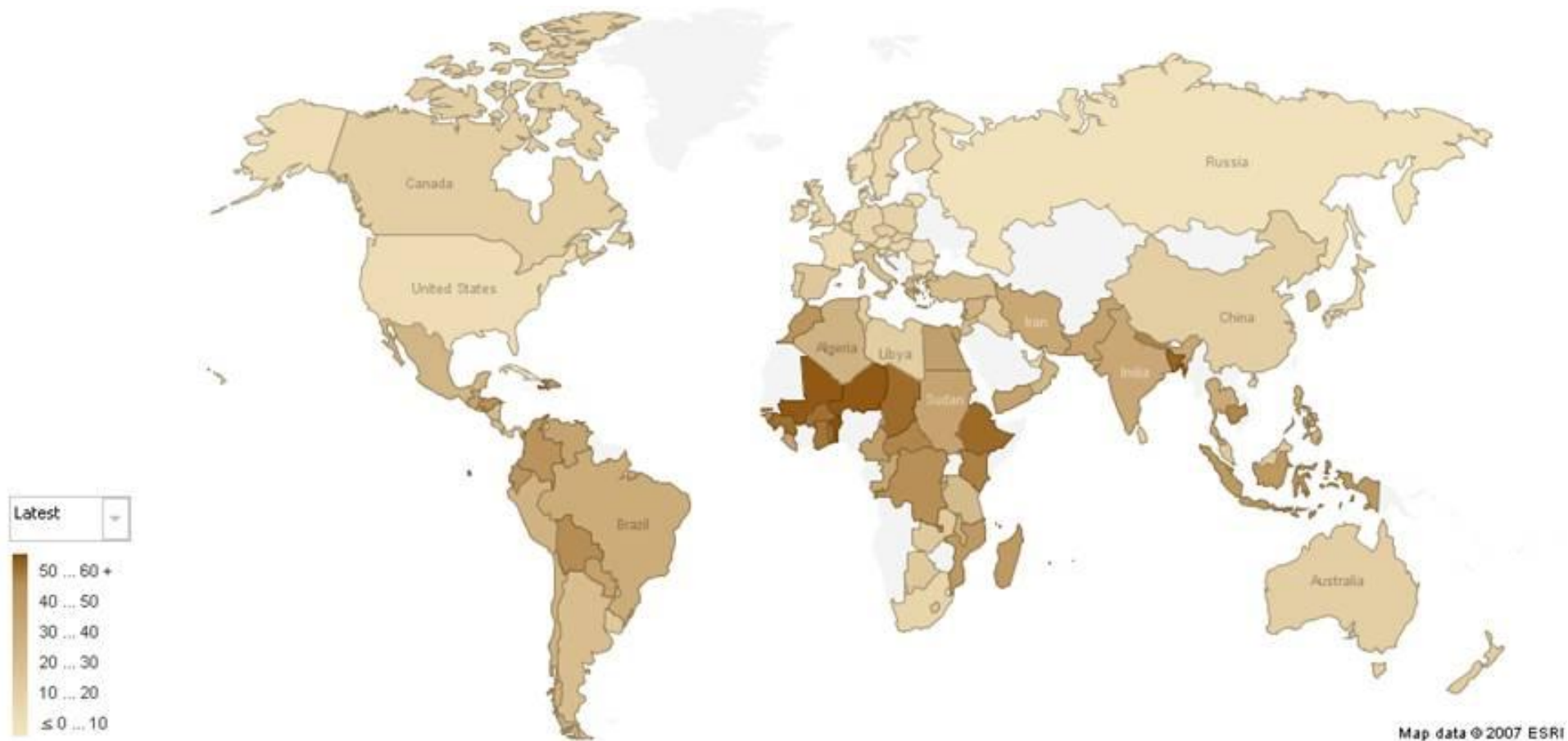
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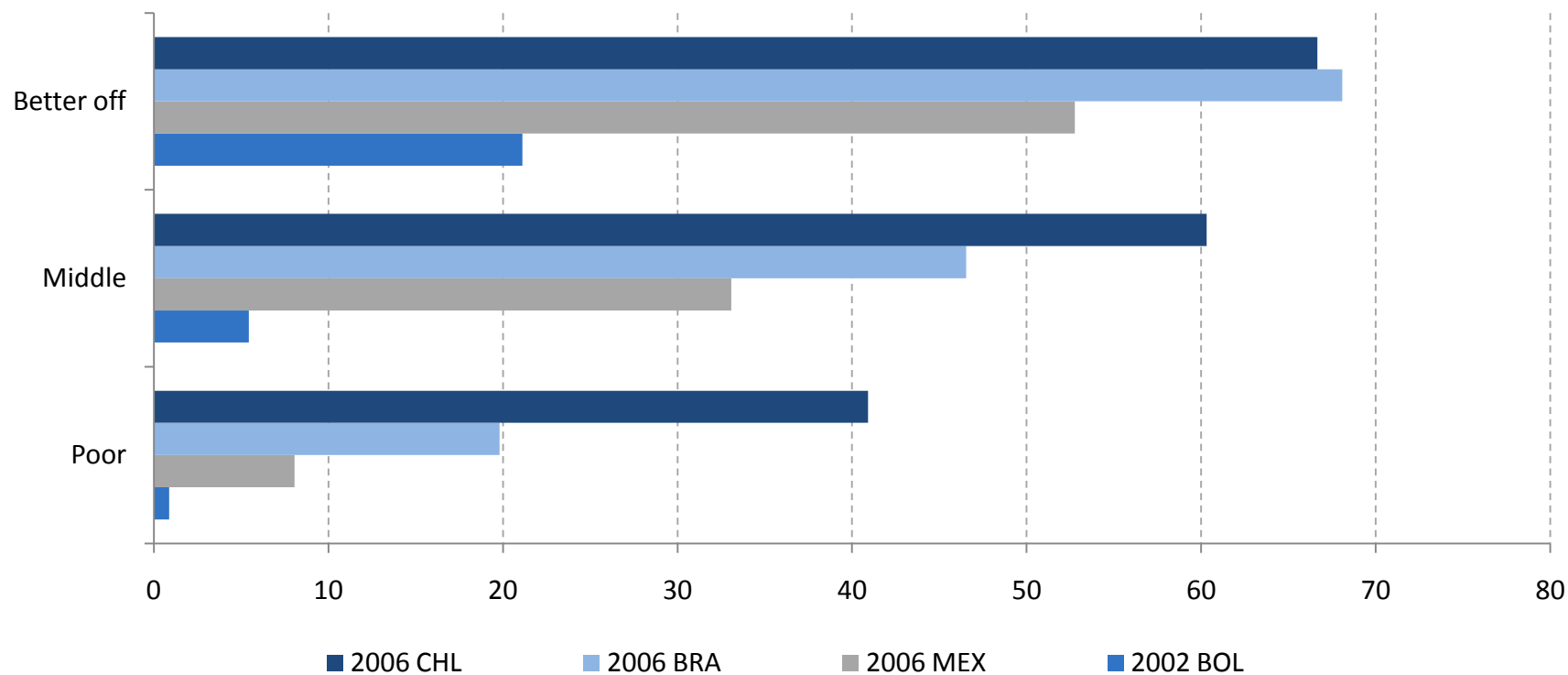
Annex



Share of Self-Employment in Total Non-Agricultural



The challenge of coverage: Pensions



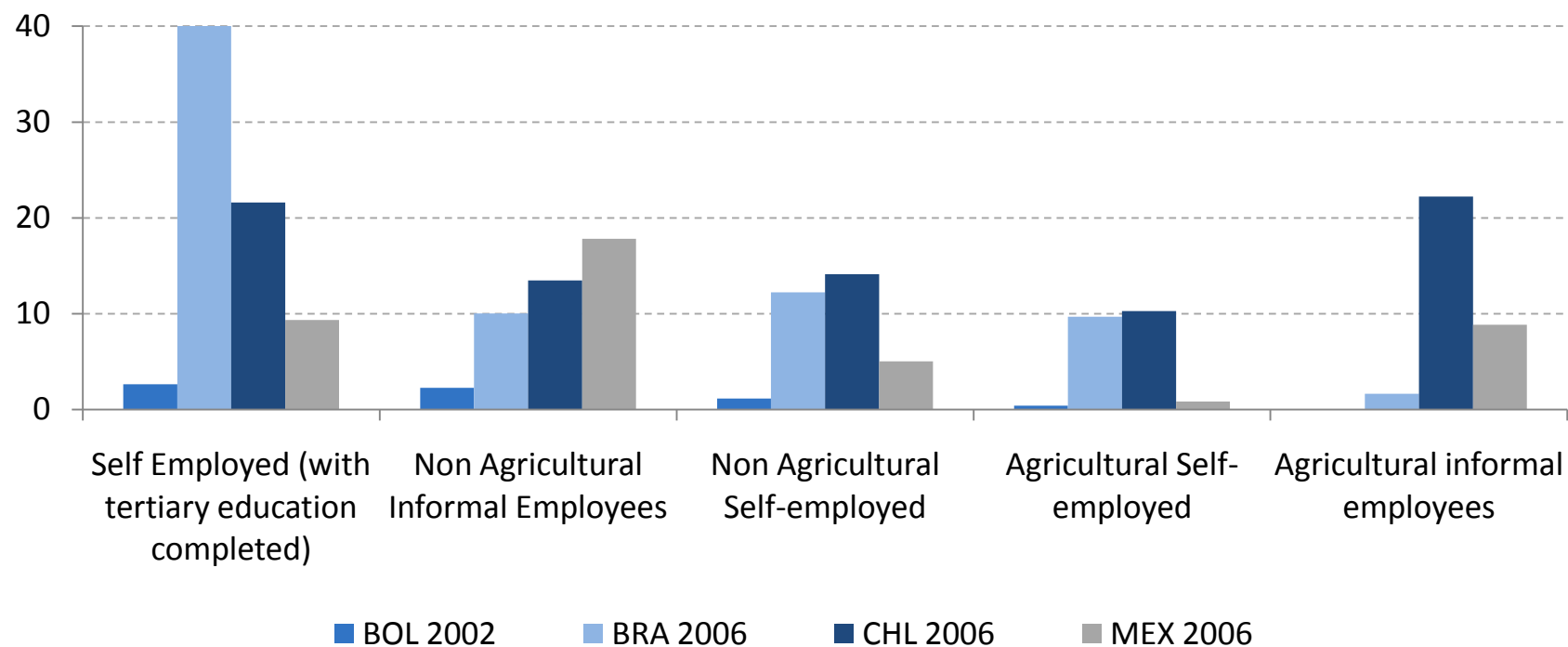
Source: OECD Latin American Economic Outlook 2011, *forthcoming*

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

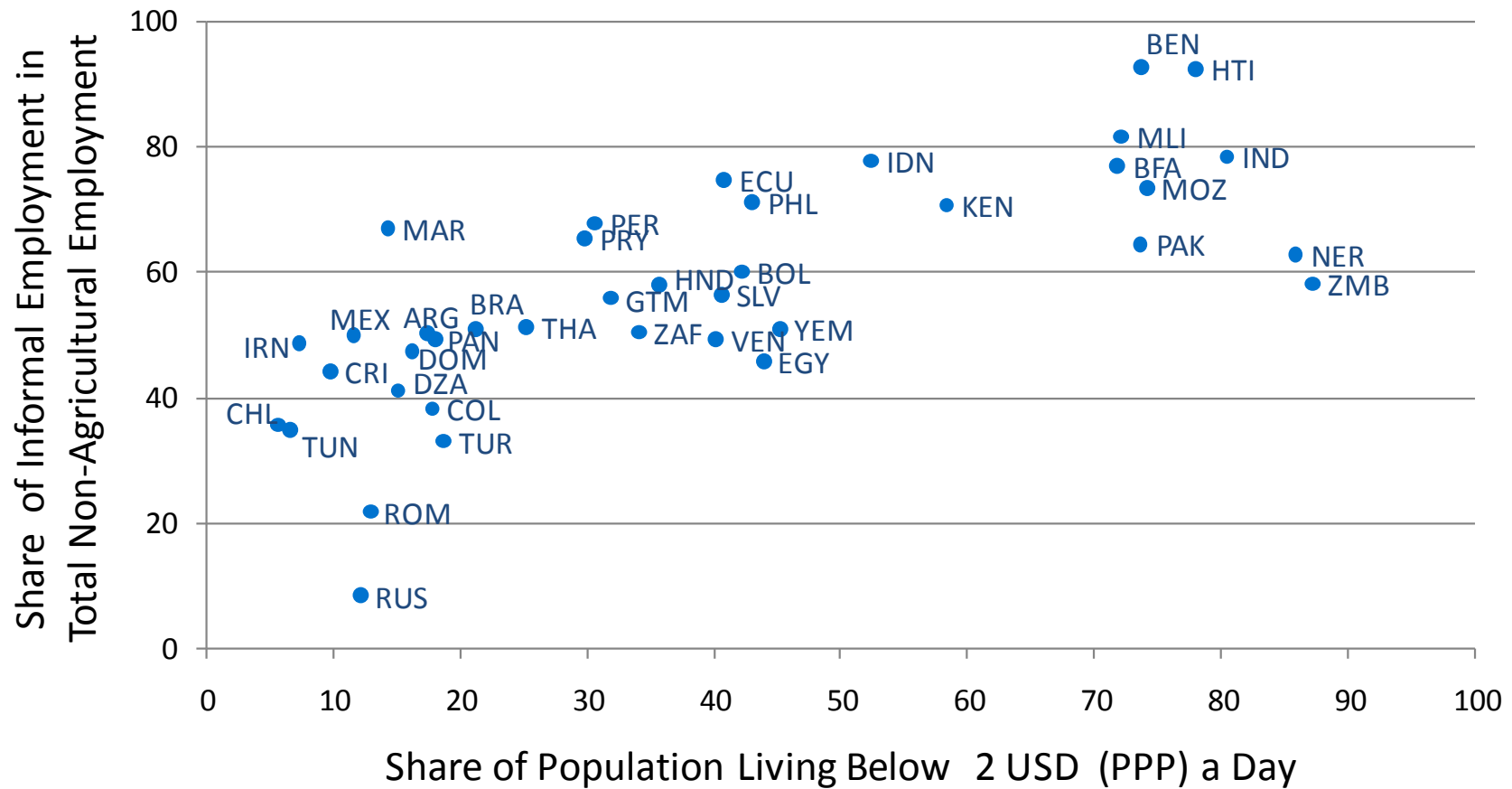


Why is persistent informality worrying?

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!

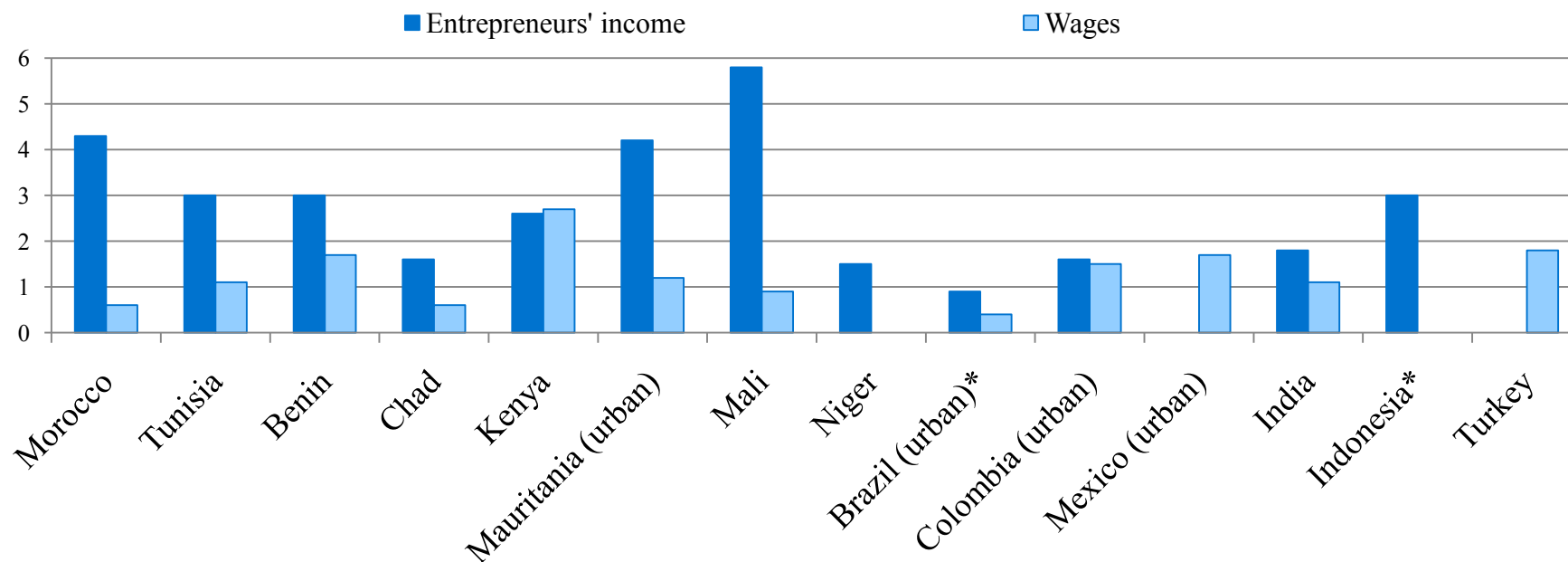
Informal employment is strongly correlated with



Source: Is Informal Normal? and World Bank Group (2007).

Earnings in informal work: low and heterogeneous

Income and wages in small informal enterprises Multiples of minimum wage



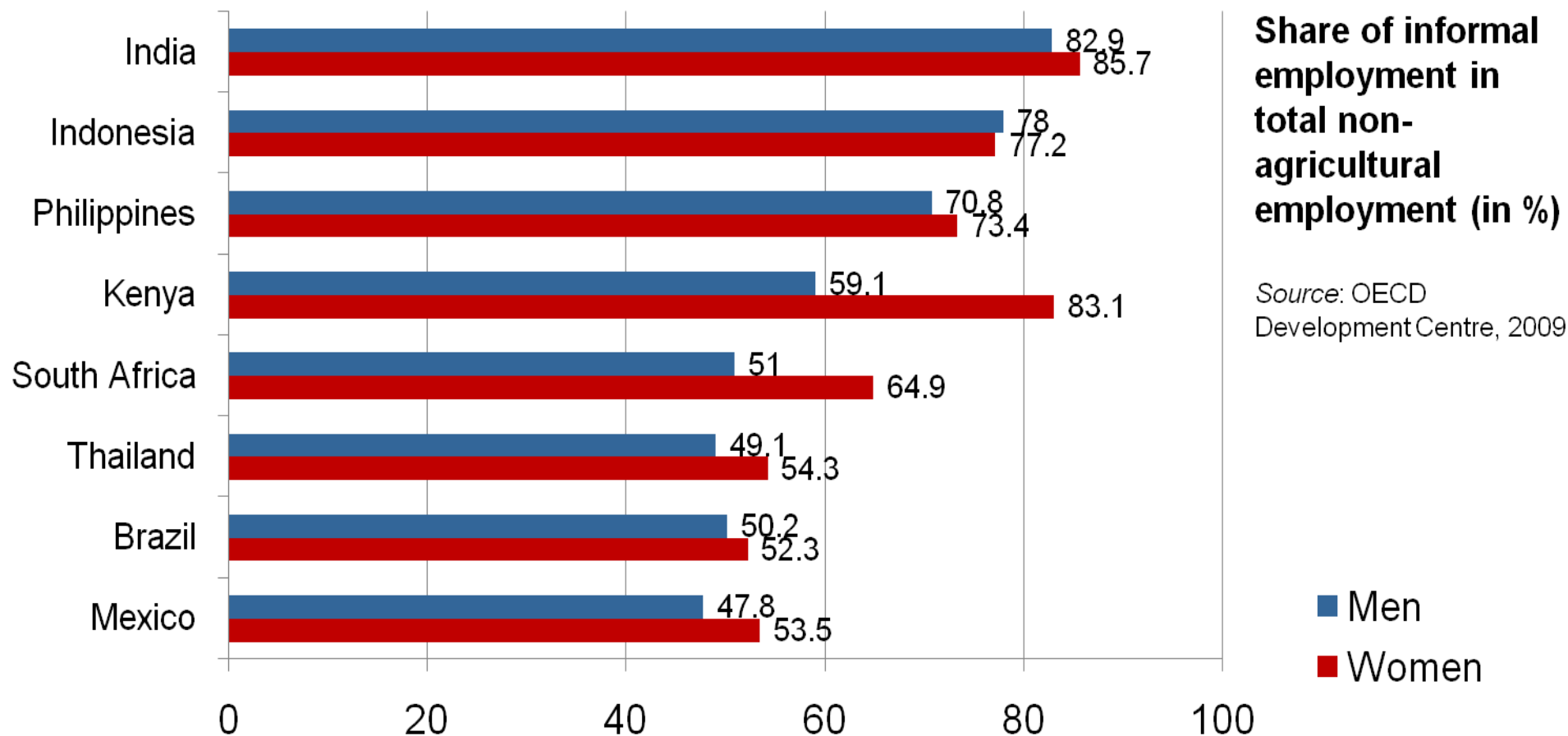
Source: Is Informal Normal?, OECD Development Centre 2009

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

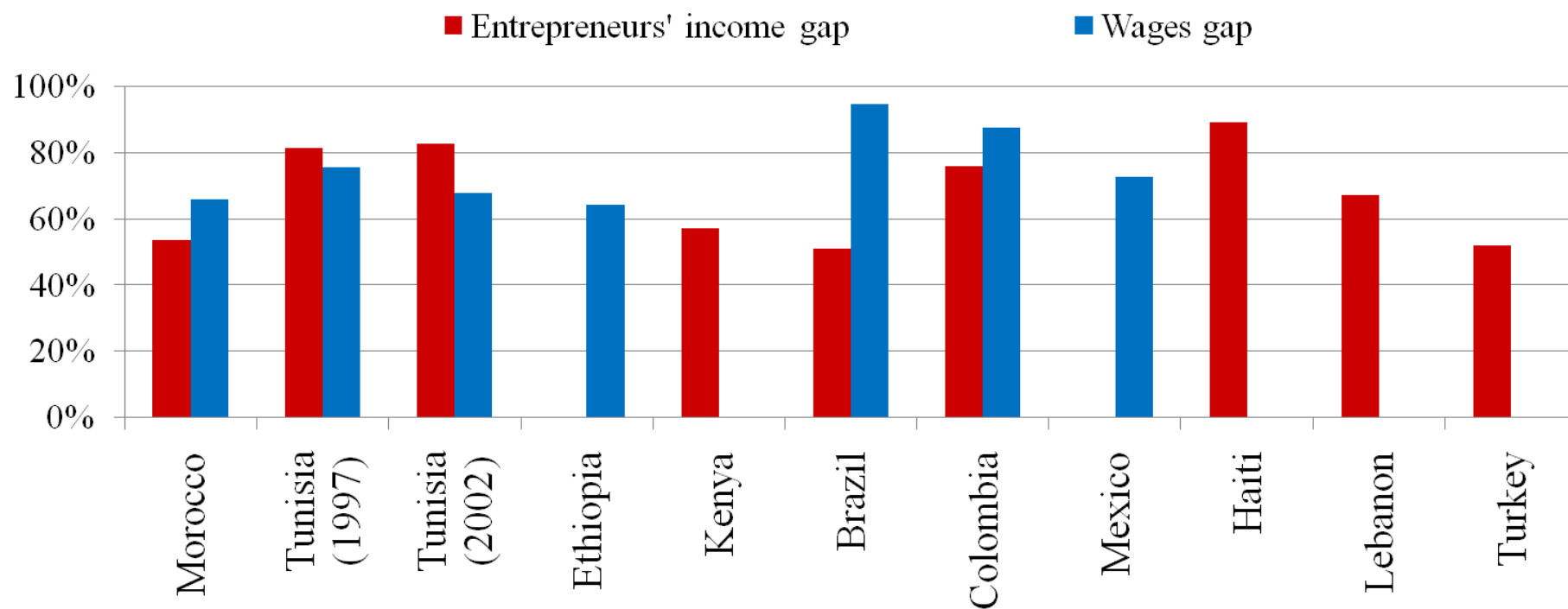


Share of informal employment in total non-agricultural employment (in %)

Source: OECD Development Centre, 2009

■ Men
■ Women

Gender (earnings) gaps in informal employment



Notes: (1) Years and coverage: Morocco (2002), Tunisia (1997 and 2002), Ethiopia (1996), Kenya (1999), Brazil (1997), Colombia (1996), Mexico (1994), Haiti (2004), Lebanon (2004), Turkey (2000).

(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)

Transitions (in % of individuals aged 20 to 60)

in %	2005			
2002	Formal	Informal	Without job	Total
Formal	65.5	18.2	16.3	100
Informal	19.7	42.1	38.2	100
Without job	7.1	7.1	85.5	100
Total	23.9	18.8	57.3	100

Source: Mexican Family Life Survey. First and second waves (2002, 2005)

Transitions in Mexico (by gender)

Men					Women				
2005					2005				
2002	Informal salaried	Formal salaried	Self employed	Not working	2002	Informal salaried	Formal salaried	Self employed	Not working
Informal salaried	46.7	22.3	20.0	10.9	Informal salaried	36.3	14.3	8.4	41.1
Formal salaried	18.9	61.8	9.6	9.7	Formal salaried	14.3	55.3	7.1	23.3
Self-employed	18.6	9.7	62.9	8.9	Self-employed	10.6	2.3	44.5	42.7
Not working	15.1	23.6	20.4	41.0	Not working	5.6	4.5	7.4	82.5
Total	25.5	34.1	26.4	13.9	Total	10.2	11.6	11.9	66.4

Source: Mexican Family Life Survey. First and second waves (2002, 2005)

Transitions in Mexico (by education)

More than 6 years of education					Less than 6 years of education				
2005					2005				
2002	Informal salaried	Formal salaried	Self employed	Not working	2002	Informal salaried	Formal salaried	Self employed	Not working
Informal salaried	41.1	23.4	14.9	20.7	Informal salaried	43.8	14.0	15.6	26.6
Formal salaried	14.9	62.5	8.6	14.0	Formal salaried	26.0	45.7	8.7	19.7
Self-employed	14.5	9.3	54.4	21.8	Self-employed	14.7	2.8	53.2	29.3
Not working	7.5	13.5	8.7	70.3	Not working	5.8	1.2	8.5	84.5
Total	16.0	30.1	16.5	37.4	Total	14.7	7.2	17.1	61.0

Source: Mexican Family Life Survey. First and second waves (2002, 2005)

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

	Brazil (2006)			Chile (2006)		
	I	IV	V	I	IV	V
Income (log)	[0.23***]	[0.14***]		[0.08***]	[0.08***]	
Income * formal			[-0.15***]			[-0.01*]
Income * independent			[0.19***]			[0.14***]
Income * independent (HE)			[0.07***]			[0.11***]
Income * informal salaried			[0.12***]			[0.06***]
Independents		[-0.88***]	[-0.99***]		[-0.84***]	[-0.99***]
Independents (HE)		[-0.64***]	[-0.69***]		[-0.69***]	[-0.75***]
Informal workers		[-0.88***]	[-0.99***]		[-0.77***]	[-0.92***]
Controls for						
Educational attainment	No	Yes	Yes	No	Yes	Yes
Sector	No	Yes	Yes	No	Yes	Yes
Household composition	Yes	Yes	Yes	Yes	Yes	Yes
Pseudo R ²	0.12	0.69	0.69	0.03	0.55	0.55
N	163660	163652	163652	96748	96520	96520