



Globalisation and informal jobs in developing countries

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MOTIVATION

- **Growing informality is a concern from the perspective of the distribution of the gains from globalization**
 - **More generally, it is also a concern from the perspective of economic efficiency and growth, as the informal economy constitutes a drag on the capacity to foster high value-added production and compete in the world economy.**
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OUTLINE

- **Informality: Key concepts and facts**
 - **Trade opening and the informal economy**
 - **Consequences of informality for trade and growth**
 - **Policies**
 - **Open issues**
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I

Informality: Key concepts and facts

The informal economy comprises...

- **Remunerative work that is not recognized, regulated or protected by existing legal or regulatory frameworks**
 - Plus non remunerative work in income producing enterprises
 - **Informal employment in both informal and formal enterprises**
 - Self employment and wage employment
 - Employers and employees
 - **Small productive firms operated by entrepreneurs and survival activities**
 - Independent or subordinated to larger (formal) firms
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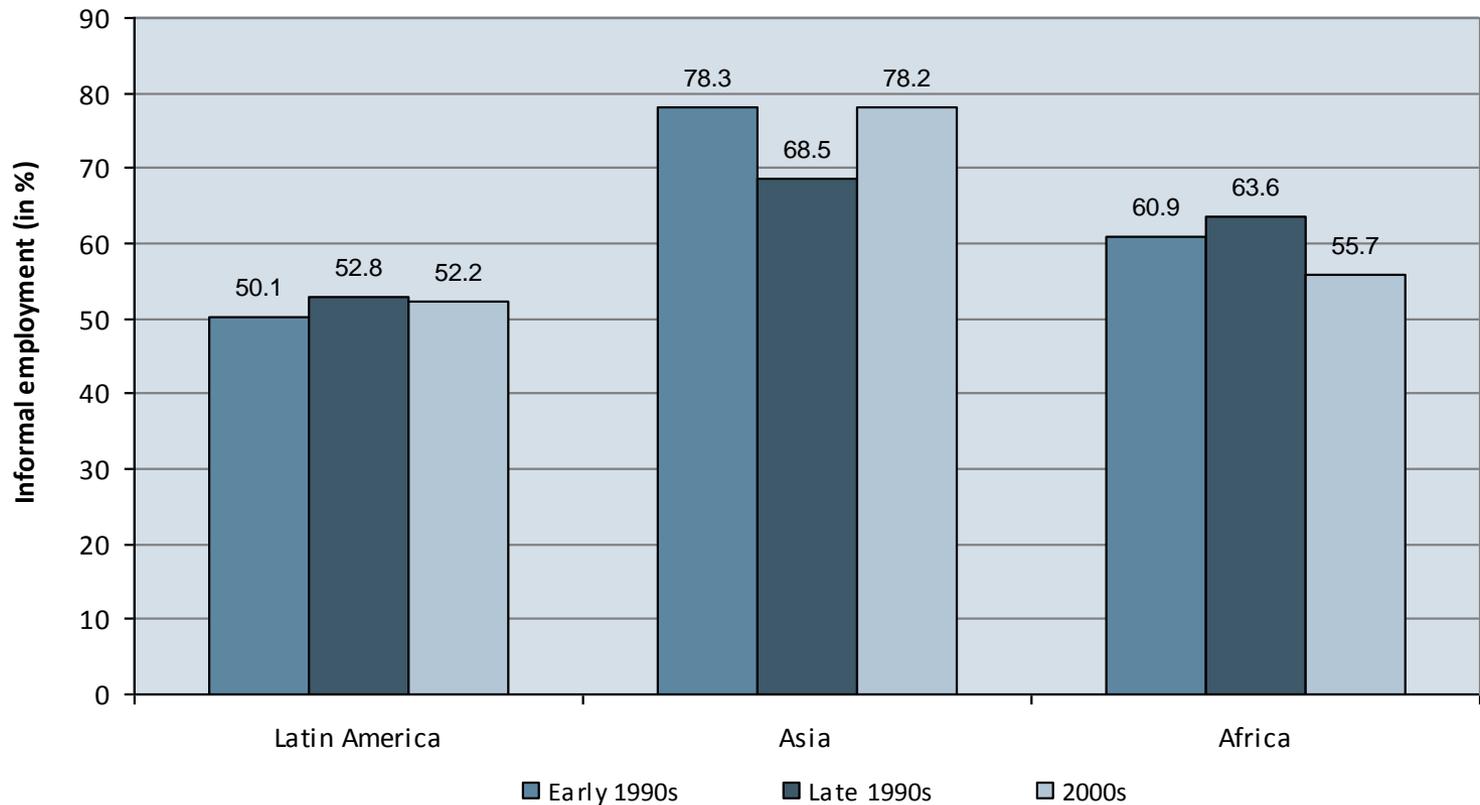
This diversity is reflected in a heterogeneity of views

- **The *dualist* school focuses on survival activities**
 - informal sector is the residual of a dual labour market with no direct link to the formal economy...
 - ... and it exists because the performance of the formal sector is too weak
 - **The *structuralist* school focuses on the interdependence**
 - informal economy comprises small firms subordinated to larger ones
 - **The *legalist/orthodox* school focuses on small entrepreneurs**
 - Informal economy comprises micro-entrepreneurs who prefer to operate informally to avoid the costs associated with registration and regulations
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A unifying approach is emerging

- **All 3 approaches can claim validity in explaining parts of the informal economy**
 - **Informal economy comprises different segments populated by different types of agents:**
 - households engaged in survival activities,
 - micro-entrepreneurs, and
 - workers or firms subordinated to larger formal firms
 - **The relative size of each of these segments varies by region and country**
 - **Challenge: measuring relative size and explaining the transitions**
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The informal economy is large and in many countries it has been growing



Source: ILS estimates based on the ILS Informality Database.

II

Trade opening and the informal economy

Empirical evidence on the effect of trade opening

- **Early evidence for Morocco, Mexico and Egypt tends to suggest that trade liberalization pushes workers towards low-paid temporary work, or informal salaried work**
 - **Colombia (2003): trade variables have a significant effect on the probability of informal employment but the effect is small in magnitude**
 - A 1% reduction of the tariff raises the probability of informality by 0.1%
 - **India (2005): anecdotal evidence of increased subcontracting following liberalization**
 - **Brazil (2007): weakly significant increase in informal employment following trade liberalization**
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Is scarce and mostly country specific

- **Brazil (2003, 2005): no significant relationship between the probability of informal employment and tariffs, import penetration or export orientation**
 - **Mexico (2006): reductions in tariff (NAFTA) reduce significantly the likelihood of informality in the tradables sector**
 - **Only one multi-country study (2008) with mixed results**
 - Results differ depending on the type of informality data used and on the econometric framework
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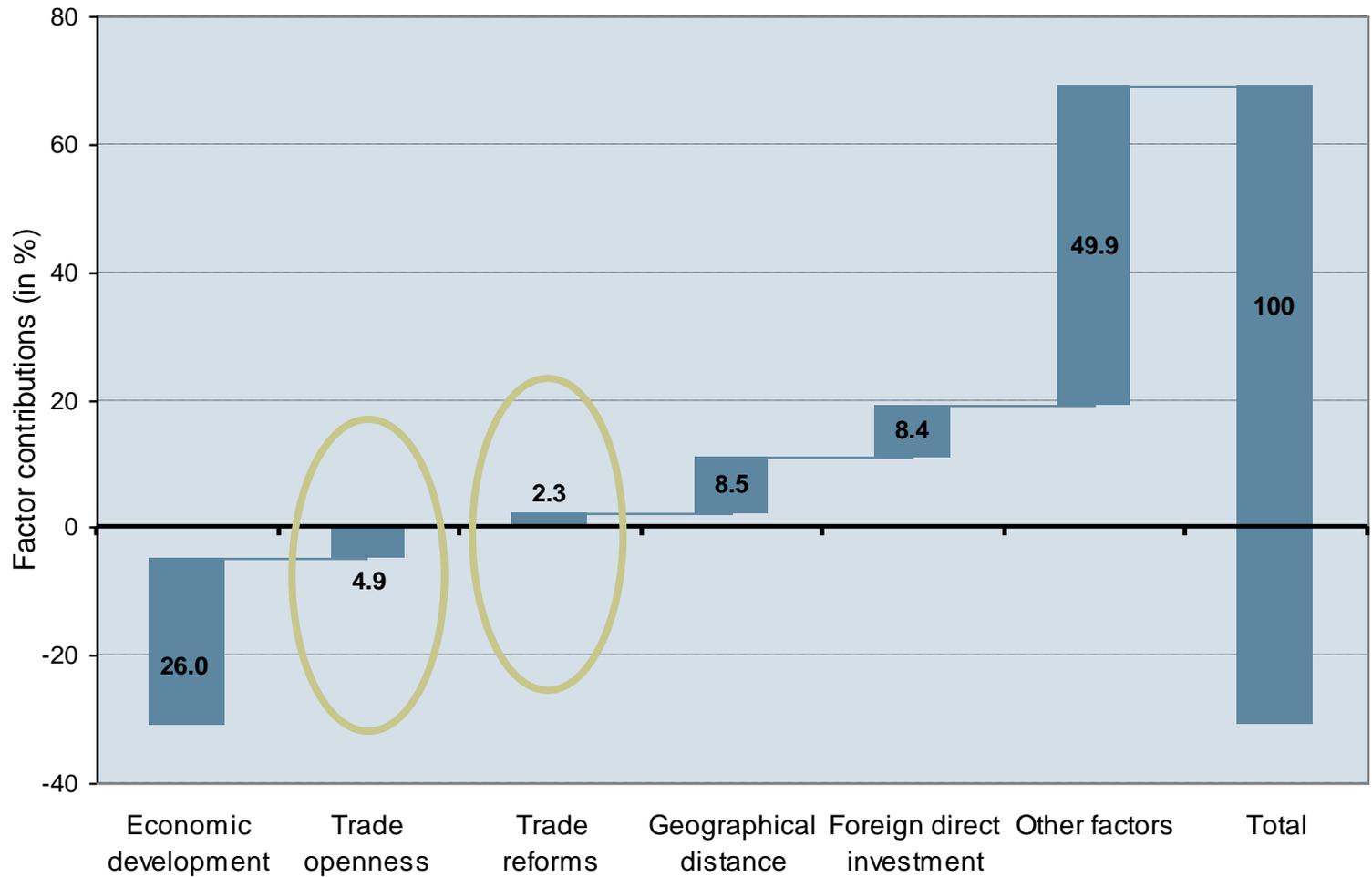
..but labour market characteristics seem to matter.

- **Colombia (2003): tariff cuts increase informal employment only in the presence of badly-designed labour regulations**
 - **Brazil (2007): effect of trade liberalization is less important than effect of labour market legislation**
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Evidence on wages is even more limited and it is also mixed

- **India (2003):**
 - Informal real wage has grown between the pre- and the post-reform period
 - Results support the idea that trade liberalization raised informal wages in manufacturing via capital reallocation from the formal to the informal sector
 - **Brazil (2005): some evidence that opening narrowed the formal-informal wage gap**
 - **Mexico (2006): trade opening widened the formal-informal wage gap**
 - In line with the finding of an increase in the skill premium in the literature on the distributional effect of trade reforms
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Effect of globalization on informality

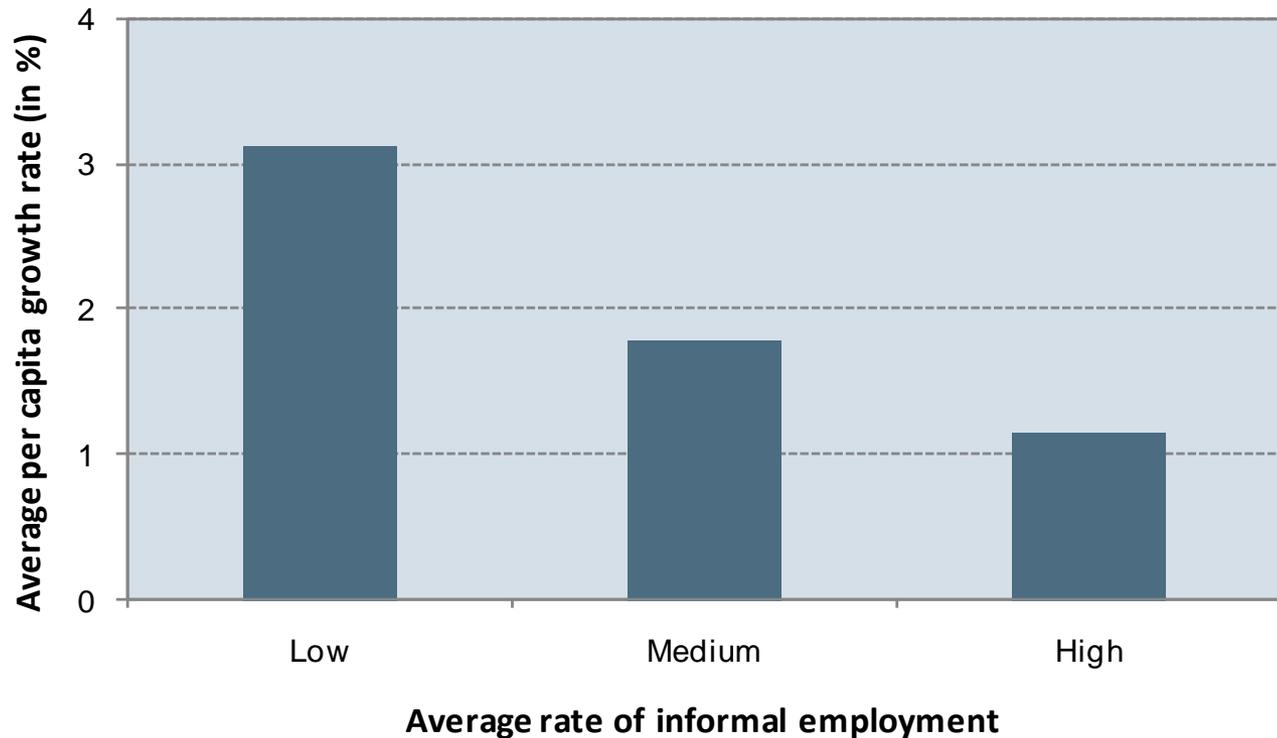


III

Consequences of informality for trade and growth

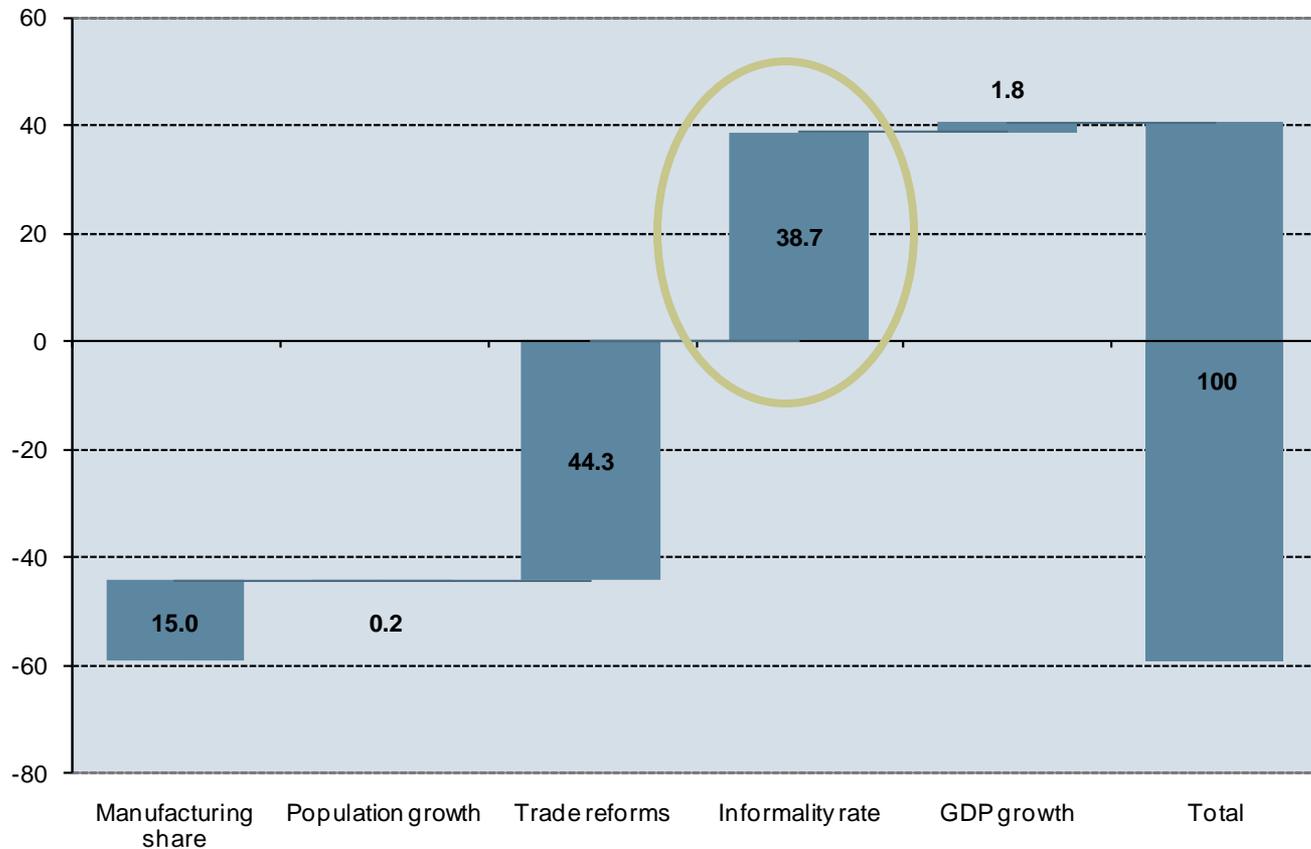
Informality is associated with lower GDP growth...

- Informal employment is associated with lower economic performance of a country



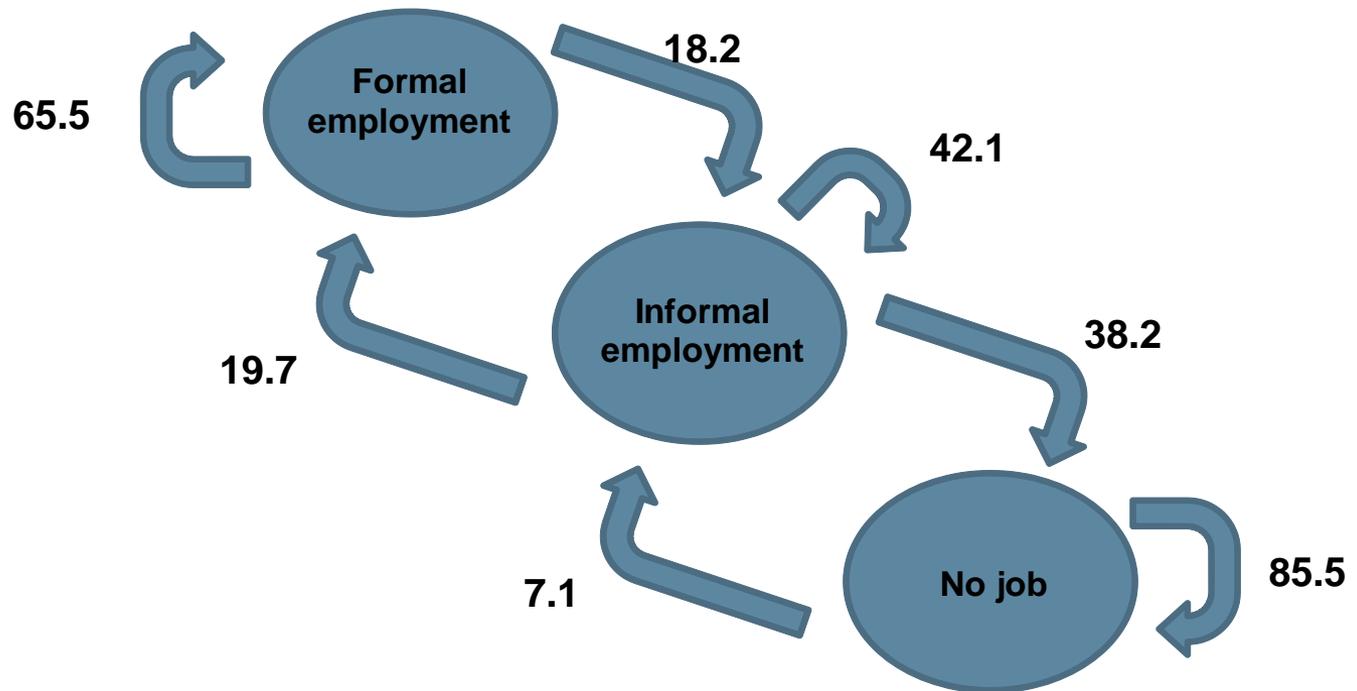
...as export chances are diminished...

- **Export performance suffers from a concentration on a limited number of products and services**
 - Almost 40% of observed export concentration can be associated with large informality rates



...adjustment processes are impaired...

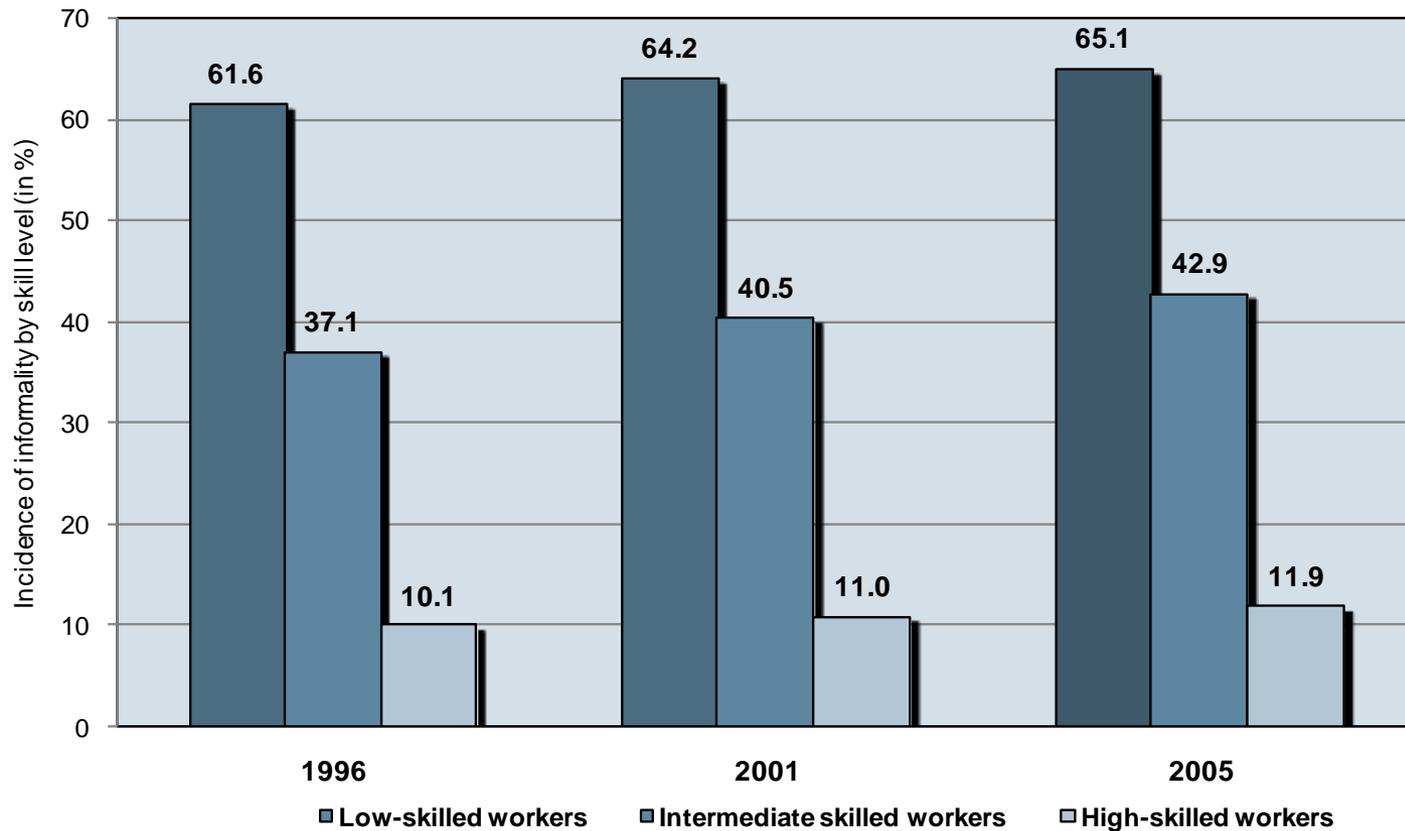
- **Persistence in informality is high**
 - Chances for upward mobility are low, while risk of downward mobility is high in informal jobs



Source: Gagnon (2008)

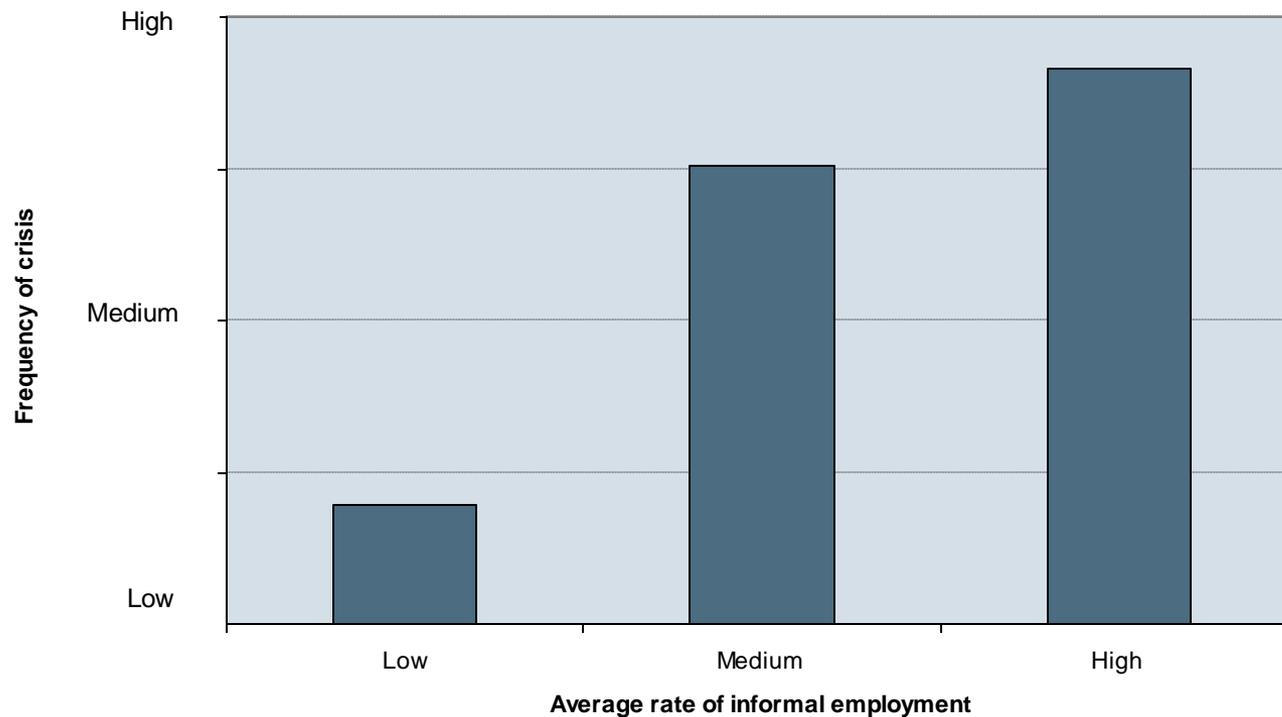
...and lack of skills pervasive

- **Low-skilled workers dominate the informal economy**



Informality is associated with higher vulnerability ...

- **Frequency of crises increases with informality**
 - Countries with large informal economies are hit by shocks more often and have lower sustainable growth rates



...countries have less resources to secure against shocks

- **Policy space is reduced with larger informal economies**
 - Countries have less fiscal resources to insure against external shocks...
 - ...and to invest in higher sustainable growth rates
 - Automatic stabilisers are less effective
 - Investment in proper public infrastructure (transportation, education, etc.) is limited
 - **Informal sector firms are typically small, with little resources to support shocks and to grow**
 - Small firm size lowers potential to increase productivity...
 - ...and to trade internationally
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IV
Policies

Formalization of firms

- **Views diverge on whether governments should pursue active formalization policies, and how such policies should be designed**
 - **Different strategies are grounded in different views of the informal economy**
 - Legalists focus on barriers to formality and access to finance
 - Structuralists focus on strong enforcement of regulation and fight against tax evasion
 - Dualists focus on creation of new formal firms and development of existing formal firms
 - **Best formalization strategy is probably one that combines elements of all three approaches**
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Facilitating adjustment and transition to formal jobs I

- **Active labour market policies need to be developed**
 - Extend public employment services also to the informal economy
 - Job search and matching can be improved when informal workers are being reached as well
 - **Education, also in the informal economy is crucial**
 - Improved education and skills is key for workers to find formal jobs
 - Vocational training systems in the informal economy can provide additional policy leverage
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Facilitating adjustment and transition to formal jobs II

- **Strong social dialogue between employers and workers helps...**
 - ...in the design of measures
 - ...extend the reach to the informal economy
 - **Product market reforms and enhanced governance have a role to play**
 - Red tape should be eliminated and governance improved to lower entry barriers and stimulate firm growth
 - Well-designed taxation helps job creation in the formal economy
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Supporting informal workers

- **Social protection should be supported**
 - A basic social floor helps workers in the informal economy
 - This can improve their bargaining position,...
 - ...avoids exploitation in informality,...
 - ...and procures basic insurance against individual risks.

 - **And core labour standards enforced**
 - Core labour standards can level the playing field across the economy
 - For instance: Minimum wages spill over to informal wages...
 - ...and can help lowering the size of the informal economy
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Promoting employment-friendly trade

- **Carefully designed trade reforms**
 - Credible announcement of reform path
 - Gradual implementation
 - Country-specific trade reforms
 - **Support trade**
 - Aid-for-trade initiative: Least Developed Countries need support to export diversification and export development
 - **Exploit complementarities**
 - Countries reap greater benefits from trade opening when labour markets allow better adjustment of jobs across sectors.
 - Coordination of trade and labour market reforms
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V

Open issues

Issues for future analysis

- **Enhancing policy complementarities between trade reforms and “formalization” policies**
 - Is there an optimal reform path to exploit complementarities between trade and labour market policies?
 - How can trade policies be designed to support the efforts to formalize the labour market?
 - What is the role of initial country conditions?
 - **Economic resilience**
 - How can trade and labour market policies be complemented to reduce a country’s vulnerability to shocks?
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