Executive Summary

The financial and economic crisis that started in 2008 is bound to have profound implications for employment across the planet. As economic growth slows down, capital flows dry up and export markets weaken in many developing countries, it appears certain that both jobs and wage levels will suffer. This volume shows that most workers in the developing world are employed informally: without access to developed social security mechanisms, they are particularly vulnerable and face increasingly severe risks. Their numbers are likely to grow in times of economic crisis, as informal employment plays the role of a buffer, providing families with an alternative source of income.

In the context of the unfolding crisis it is important that the commitment to poverty reduction – as stated in the Millennium Development Goals (MDGs) – is maintained. To make employment work to reduce poverty, the challenge is not only to create jobs, but also to create better jobs: those that offer adequate pay and a sufficient level of social protection. Jobs in the informal sector frequently fail to offer just that. In many parts of the world, being employed informally constitutes the norm, not the exception. 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. On a worldwide average, more than half of all jobs in the non-agricultural sector can be considered informal. In some regions, including sub-Saharan Africa and South Asia, this rate reaches at least 80 per cent. As shown in this study, informal employment constitutes a large and growing segment of the world's labour markets. Its persistence limits the effectiveness of employment as a tool for poverty reduction and has serious repercussions on social and economic development.

For developing countries, high rates of informal employment mean narrow tax bases and insufficient capacity to address pressing social objectives such as the provision of health and unemployment protection. They also imply an inadequate use of available human resources as informal jobs are believed to be associated with lower efficiency and productivity. For individuals, being informally employed often means being locked in low-paid, high-risk and precarious activities – a situation particularly challenging in the developing world considering that labour is by far the most important productive asset of the world's poor.

IS INFORMAL NORMAL?

When informal employment was first recognised in the 1970s, the discussion focused on a small set of low-income countries. Inefficient public institutions, cumbersome registration processes and a general distrust of the government – all factors that spur the creation of a market outside a country's formal structures – were seen as the epitome of under-development. Furthermore, it was assumed that these factors – and hence informal employment – would disappear in the course of economic development.

The reality today looks different. Informality is increasingly becoming normal, not least in middle and even high-income countries. In some cases, the share of jobs performed outside a country's formal structures may be more than half of all non-agricultural jobs, and up to

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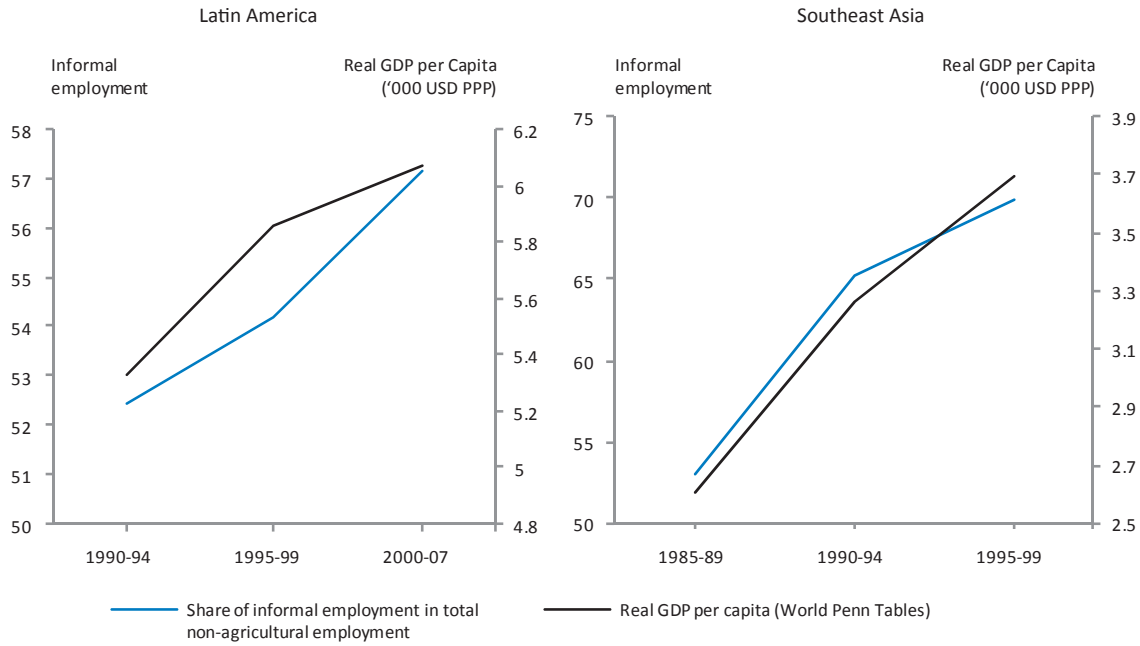
90 per cent if agricultural jobs are included – in spite of economic growth. The development in selected countries in Southeast Asia and Latin America is telling in this respect: over the last 30 years, growth in these countries was accompanied by increasing, not falling, informal employment (see Figure 0.1).

Figure 0.1. Informal Employment and GDP in Latin America and Southeast Asia



Source: Table 1, Chapter 2

StatLink http://dx.doi.org/10.1787/533114034365

Even in OECD countries a growing tendency to an "informalisation" of working conditions creates informal employment, partly because of increasing international competition in the course of globalisation. An example in this respect is the recent phenomenon of "false self-employment", whereby individuals sub-contract every day to the same employer – voluntarily or not – and thus operate as self-employed contractors to bypass the legal requirements of a normal working relationship.

INFORMAL EMPLOYMENT: PROBLEMATIC AT BOTH THE INDIVIDUAL AND SOCIETY LEVELS

Many people depend on informal employment for a living, but informal employment has serious consequences at the levels of both the individual and society. Beyond earning levels, informal employment makes basic rights vulnerable and difficult to defend. As such, it can be a major cause of poverty in dimensions other than income. Most of those who work informally are insufficiently protected from the various risks to which they are exposed: illness or health problems, unsafe working conditions and possible loss of earnings.

At the level of society, pervasive informal employment undermines the ability of the state to ensure that workers have fair working conditions, including appropriate working hours and safety regulations, and receive adequate pay – in the sense of equal pay for equal jobs or skills. Persistently high levels of informality, furthermore, reduce fiscal revenues and the ability to develop social security systems based on taxes and contributions.

In addition, the size and composition of informal employment have an influence of the growth pattern of an economy. Whether or not informal employment represents a "drag on productivity" or could at least temporarily be an "engine of growth" is debatable. For example, many observers argue that a high degree of informal employment may reduce the competitiveness of an economy as informal firms: *i)* prefer to stay small; *ii)* have less access to inputs; and *iii)* cannot engage in formal business relationships, factors which consequently reduce their productivity. Others emphasise that in emerging economies, such as China, informal employment allows the necessary flexibility to produce innovative entrepreneurs who boost growth. Disregarding the validity of these two opposing views – i.e. small firms characterised by low-productivity vs. innovative entrepreneurs with high levels of flexibility – it is widely accepted that informal employment is an important issue to which policy makers need to respond.

INFORMAL EMPLOYMENT IS CLOSELY LINKED TO POVERTY

In spite of its growing importance even in OECD countries, informal employment remains particularly problematic in developing countries. The majority of the 1.7 billion poor in the world depend exclusively on their labour for survival, emphasising the key importance of employment for poverty reduction and economic development.

A general lack of formal employment and the limited coverage and effectiveness of social security systems imply that the poor often have to undertake any type of job in order simply to sustain themselves and their families. Dismissed workers frequently have to move to the first available job even if it is of a lower quality than the one they have just lost.

Moreover, certain groups, such as young people and women, require specific attention as they are over-represented among the informally employed. Women seem to be especially susceptible to informal employment. Until recently researchers and policy makers concentrated chiefly on gender differences in labour market participation and the barriers women face in employment. Although this remains an important concern, a second dimension of labour market outcomes should be added: gender differences in the quality of jobs and inequality in terms of access to good, secure and well-paid jobs. Understanding why women are over-represented in informal work is of primary importance in the design of more effective policies that allow a country's workforce – including women – to engage in productive activities.

Even though it is becoming increasingly the norm in low and middle-income countries, informal employment cannot therefore be accepted from a development perspective. However, simply abolishing micro-enterprises or informal wage work is also not a sustainable policy response. On the contrary, such measures would cause significant social costs and represent a huge challenge for public expenditure.

REASONS FOR INFORMAL EMPLOYMENT

Informal employment occurs in various types and shapes, making it difficult to grasp this complex phenomenon. Similarly, levels of informal employment vary widely across countries, reaching the highest shares in sub-Saharan Africa, followed by Southeast Asia and Latin America.

What are the reasons for this situation? Informal employment can be a result of both people being excluded from formal jobs and people voluntarily opting out of formal structures. In many middle-income countries, for example, incentive structures are conducive to driving individuals and businesses out of the formal sector. In Latin America, formal workers are often required to pay for a mandatory bundle of programmes, some of which they do not even want. Likewise, many businesses opt out of formal structure as a result of inefficiencies in business registration and social security administration.

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Economic development also plays an important role in determining the prevalence of informal employment. Episodes of rapid economic expansion often coincide with sharp increases in informality. However, sustainable economic development can also contribute to the reduction of informal employment. Long-term increasing per capita income, for example, is clearly associated with lower levels of informality. Is economic development therefore driving informality, or is the use of informal channels, conversely, fostering growth? The answers to these questions are complex.

In some countries, the use of informal channels may indeed have positively affected economic development. If cumbersome registration procedures and other administrative red tape undermine the creation of formal businesses, for example, informality may be a tool to unleash entrepreneurial behaviour. Informal minibuses in South Africa are a prominent example of how the evasion of formal structure (e.g. route concessions, licence requirements, safety regulations) has contributed to the establishment of a multi-million-dollar industry.

In other instances, the use of informal structures may be driven less by a voluntary decision than necessity. For many people informal employment is an important livelihood strategy and thus plays a critical role in order to alleviate poverty and social hardship. Besides the fact that being informally employed usually also means being without adequate social protection, informality also traps people in unproductive and precarious jobs. In these instances, the lack of formal structures is rather a reason for, not the solution to, lagging economic development.

WHAT CAN WE DO?

As suggested in the book's title, informality can be expected to influence labour markets for many years to come. Governments should face this reality and incorporate informal employment into their policy making. The overall focus of policy interventions should rest on providing jobs that are more productive and offer adequate social protection. To better link employment, growth and poverty reduction, the following factors play a crucial role: a macroeconomic framework that guarantees stability, while not toning down public investment, to improve social protection; structural policies aiming at promoting sectors with a high potential for creating formal employment as well as easing mobility; and poverty alleviation policies that provide improved risk management and social protection, in particular for the poor.

TOWARDS A THREE-PRONGED STRATEGY

Effectively addressing informal employment needs to start by reinforcing the advantages of the formal sector. Where people have chosen to leave the formal sector, they need to be given incentives to rejoin it. Benefits should be linked to social contribution levels, while administrative procedures such as business and workers' registrations should be simplified. Apart from positive incentives, reducing informal employment also implies strengthening enforcement mechanisms. However, policies also need adequately to address those who have no choice but to work informally. Such people need a different approach from those who voluntarily opt out of the formal sector. Poverty-alleviation programmes can tide over people whose options for entering the labour market are limited.

A better understanding of the complexity of informal employment and a more nuanced approach to address the specific needs of informal workers are urgently needed. Informal employment comprises different phenomena that require distinct policy approaches. *Is Informal Normal?* therefore calls for a three-pronged strategy that should be adapted depending on the specific situation in a country. The following components can be identified:

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1) For the world's poor, working informally is often the only way to participate in the labour market. Policies should consequently try to unlock these people from their low-productivity activities, enable them to be more productive and provide them with opportunities to climb the social ladder. Specific recommendations include active labour market policies, such as training and skill-development programmes, that reopen the doors to formality.

2) If informal employment is a deliberate choice to avoid taxes or administrative burdens, governments should aim to establish efficient formal structures that have the potential to encourage people to join or rejoin the formal market. Countries should aim to introduce formal structures that can offer the same (or higher) levels of the flexibility and efficiency that informal channels occasionally may provide. In this way, informal workers, who frequently have strong innovation and growth potential, can more effectively contribute to the overall competitiveness of a country. Needless to say, targeting those who voluntarily opt out of the formal sector also involves the establishment of credible enforcement mechanisms. *Is Informal Normal?* therefore advises countries to spend more resources on labour inspections, for example, which will help identify law-breakers and increase compliance with a country's rules and regulations.

3) In many low-income countries, finally, informal employment is mainly a consequence of insufficient job creation in the formal economy. *Is Informal Normal?* thus also recognises the need for a general push for more employment opportunities within the formal sector. Governments should support small businesses to comply with formal requirements and encourage large companies to create formal employment opportunities.

THE BIGGER PICTURE – BUILDING TRUST IN THE STATE

Informal employment is back on the policy agenda after many reforms in the past have failed to deliver successful results. In particular, policies were insufficiently targeted at the different types of informal employment that we can observe today. Clearly, finding the right balance between guaranteeing social security for those who are excluded from formal structures and encouraging those who voluntarily left the formal sector is of primary importance.

Policies can go a long way, but they are no substitute for trust. Informality is above all an expression of the lack of trust in public institutions, the negative perception of the role of the state and the limited understanding of the benefits derived from social security. It is basically a sign of a broken social contract. Long-term sustainable change requires a transformation of people's attitudes and beliefs. More innovative policies, such as information campaigns on the benefits of formal work and the risks of informality, can gradually change people's opinions. While these things will not happen overnight, governments need to pave the road with the right policies and regulations now.

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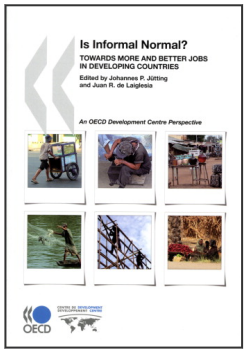

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