

Assessment and recommendations

People have different perceptions of the informal economy. Some focus on the survivalist aspects – and there are many – believing informal workers have no choice but to run unproductive small businesses or work in jobs characterised by lack of social benefits, poor working conditions and lower rates of remuneration and productivity. Others consider informality a drag on economic and social development associated with tax evasion, disrespect for the rule of law and unfair competition between formal and informal enterprises. Others recognise its potential to support the livelihoods of workers willing to trade formalisation for informal employment. The reality of informality is often less obvious than it seems. Two things are certain: informality is part of the daily lives of most workers in the world, and it often comes with risks and vulnerabilities that constitute a formidable policy challenge.

In recent years, a number of steps have been taken to recognise the reality of the informal economy and address some of its adverse effects on well-being. The adoption in June 2015 of the ILO Recommendation No. 204 concerning the transition from the informal economy to the formal economy, the inclusion of a direct reference to formalisation in Target 8.3 of the UN Sustainable Development Goals, and the global commitment to implement nationally appropriate social protection systems and measures for all, including floors as set out in Target 1.3, are the most recent examples. In-depth information on the distinct patterns of informality and its contribution to the development process is needed to convince governments and taxpayers to invest in the protection of informal economy workers and help inform policy guidance on formalisation.

Tackling Vulnerability in the Informal Economy reviews approaches taken so far and explores new ideas to improve the lives of men and women in the informal economy and support their transition to formality. It places human well-being at the forefront of the analysis and asks what public policies are needed to secure the livelihoods of workers and families who rely on the informal economy – the vast majority in developing and emerging countries. The report shows that the human experience of informality is more diverse than usually captured through traditional individual or firm indicators of informality. Informality has very different meanings and faces, depending on whether it is portrayed at the individual, firm or household level.

The report pursues a path of policy-oriented research that, until now, has been little investigated in informality studies. Reflection on the vulnerability challenge in the informal economy is enriched in three important ways. First, by highlighting informal economy workers' positive contributions to indirect taxes and society at large through skills provision and economic output, the study makes the case for investing in the protection of informal economy workers and supporting their transition to formality. Second, it adds the household dimension to the profiling of informal workers for the first time. This sheds new light on both the way workers' vulnerability in the informal economy affects household members, particularly children and older individuals, and the various channels through which social protection can reach informal workers. Third, the

study's unique cross-country comparative dimension identifies a number of common trends, as well as regional and country specificities, using of a broad set of micro and macro data, particularly recent ILO individual-based indicators of informality, available for 119 developing and developed countries, and the new OECD Key Indicators of Informality based on Individuals and their Household (KIIbIH), available for 27 developing countries.

Portraits of informality

More than ever, there is a need for comprehensive portraits of informality that capture the heterogeneity of informal economy workers and take into account the broader context of their households. Profiles derive from ILO and OECD indicators of informality and refer 1) to the ILO's broad concept of the informal economy, which encompasses all economic activities by workers and economic units that are, in law or in practice, not covered or insufficiently covered by formal arrangements; and 2) to the ILO's definitions of informal employment and informal sector. The informal sector is a subset of household enterprises (not constituted as separate legal entities independently of their owners) that produce for sale in the market, even if partly, and that do not have a complete set of accounts and/or are not registered under national legislation. Employment in the informal economy includes all workers in the informal sector and workers in informal employment outside the informal sector (i.e. in the formal sector and in households).

Informality affects most workers in the world

Most of the world's employed population is in informal employment: 2 billion workers, representing about 61% of all workers including agriculture and 50% excluding agriculture. Informality occurs in all types of employment and, globally, includes above 4 of 5 own-account workers, 1 of 2 employers, 2 of 5 employees and all contributing family workers (by definition considered informal). Informality has a strong rural dimension, with about 3 of 5 informal workers living in rural areas. The agriculture and industry sectors are the most exposed to informality: nearly 94% of agriculture workers and 57% of industry workers are informal. Informal jobs also have specific characteristics. Workers in temporary or part-time employment and in micro and small enterprises are particularly exposed to informality, although informal employment still constitutes a significant share of employment in large formal enterprises.

Informality is the norm in developing and emerging countries

Informality represents 70% of all employment in developing and emerging countries, compared with about 18% in developed countries. There is also substantial variation across regions, from 86% in Africa to around 68% in the Arab States and Asia and the Pacific, 40% in the Americas and 25% in Europe and Central Asia. Globally, 81% of all enterprises is informal.

Some demographics are more exposed to informality

The informal economy refers to an extremely diverse group of workers and enterprises operating informally. Globally, informal employment is a greater source of employment for men, but in a small majority of countries, the share of women is higher. The level of informal employment also varies substantially over the lifecycle, with youth and older workers more exposed. Informal employment absorbs less-educated workers: globally,

about 94% of workers with no education are in informal employment, compared with 52% of those with secondary education and 24% of those with tertiary education.

A majority of working households rely solely on informal employment

Within households, working individuals may be informally or formally employed. Households with more than one employed member may therefore have varying levels of informality. A majority of households are completely informal (all working members in informal employment) in a majority of countries for which data are available. There are also large disparities in completely informal households across countries and regions, from 3% in Chile to 92% in Burkina Faso. Mixed household estimates range from 5% in the United Republic of Tanzania to 46% in Argentina.

Most children and older individuals live in completely informal households

A large number of children and older individuals are indirectly exposed to informality: on average, around 60% of all children (under age 15) and older individuals (over age 60) in developing and emerging countries live in completely informal households. The figure is 80% or above in some African countries.

Informality in the development process

The heterogeneity of the informal economy triggers various, sometimes opposing views, on its drivers and its role in the development process. Contrasting interpretations suggest that the interrelation between informality and development deserves more attention.

Links between informality and development are complex

Macro data analysis sheds light on the links between informality and development. Controlling for a number of factors, the prevalence of informality across countries correlates with key development outcomes. Econometric analysis finds a negative association between level of informal employment and gross domestic product (GDP), the Human Development Index and labour productivity, and a positive correlation with poverty. Some of these associations disappear over time within countries. Moreover, although a reduction in informality is generally associated with a decline in poverty, such is not always the case. Some countries, including Honduras and South Africa, have seen a concomitant decline in informality and rise in poverty. In other countries, such as Egypt and Pakistan, informal employment expanded while poverty declined. In many countries, long-term GDP growth did not necessarily lead to a reduction in informality and this has led some countries to develop formalisation strategies. South Africa, for instance, in addition to economic growth, implemented several formalisation policies, including the National Informal Business Upliftment Strategy, increased enforcement measures, recognition of prior learning and increased access to social security. Such measures contributed to the overall decline in informality, together with the effect of other factors, such as urbanisation, unemployment, taxes, costs of compliance associated with formality, enforcement power of government regulations, corruption, education level and flexible work hours.

Informality mirrors various development patterns

The type of growth seems a great determinant of trends in informality. Multivariate analysis of the relationship between informal employment and the sectoral composition of

GDP shows a positive partial correlation with the share of agriculture in value added, a negative association with the share of services and no association with the share of industry. In other words, in countries where the growth performance is largely driven by manufacturing and agriculture, informality may persist or even increase.

Drivers of informality are diverse and vary across countries, periods, types of firms and segments of the informal economy

There are many drivers of informality, from structural to institutional and behavioural. Cross-country analysis reveals that the pressure exerted by the surplus of low-skilled young labour market entrants was and is a major driver in many developing countries. Another factor relates to new business practices that, in the context of global trade, investment liberalisation and increased global competition, have sought to establish more-flexible production systems. Institutional factors, such as regulatory complexity, high taxes and weak law enforcement, matter as well, as they influence both the costs and benefits of informality. Besides variation across countries, the relative importance of these factors may also vary across periods, types of firms and types of informal economic activity.

The informal sector is less productive and absorbs more unskilled workers in most countries

New analysis undertaken for this report confirms that, in developing and emerging countries, the informal sector exhibits low productivity and largely absorbs low-skilled workers, relative to the formal sector. It is estimated that, globally, two workers in the informal sector are needed to reach the same output as one worker in the formal sector. Yet, this global average hides important disparities across levels of development. The particularly low productivity in the informal sector in developing and emerging countries does not hold in more advanced countries, where it may even exceed that of the formal sector. In all parts of the world and across all comparable employment statuses, the informal economy absorbs more unskilled labour; however, the formal-informal economy education or skills gap is much less pronounced in more advanced countries.

Negative connotations of low tax revenue from informality seem weakly justified empirically

Taxation of the informal economy has received increased attention in recent years. Often, the focus is on perceived large-scale tax evasion and a corrosive effect on tax morale. However, cross-country analysis shows that the assumed negative relationship between informal employment and tax revenue is not verified empirically when controlling for level of development and other factors. One explanation is that, contrary to common belief, informal workers and firms contribute to tax collection efforts both directly, through indirect taxes and presumptive taxes, and indirectly, through the links between formal and informal outputs. With regard to direct tax, it is assumed that the formalisation of enterprises and jobs will lead to an increase of the tax collected. Nevertheless, it should be kept in mind that most concerned enterprises and individuals will be of low income, at least in the short term, and their contribution to tax payment will remain limited. Besides formal taxes, there is also evidence that, in developing countries, informal economy workers often support other taxes outside the formal tax system that contribute to the provision and maintenance of local public goods. Such contributions to tax collection are not well recognised or understood.

Informal economy workers contribute to skills acquisition and GDP growth

In many developing countries, where formal vocational training systems cater to the minority of workers in formal employment, a very high proportion of people working in informal enterprises, and a proportion working outside it, are trained within the sector. This is particularly the case for the majority of low-educated young people. The informal economy also contributes to economic growth in several direct and indirect ways that go unrecognised, including the systematic transfer of hidden subsidies to the formal economy. Recent estimates point to a large contribution by the informal sector to GDP: as high as 30% with agriculture and 17% without agriculture.

Risks and vulnerabilities in the informal economy

Risks and vulnerabilities faced by workers and their families appear in proportion to level of informal employment and availability and breadth of risk management systems. The gender dimension is particularly important. Risks and vulnerabilities in the informal economy must be understood before steps can be taken to address them.

Informal economy workers face high risks of poverty

Worldwide, informal economy workers often face a greater range of general and occupational risks than formal economy workers, reflecting their largely unprotected status and, in many instances, inferior working conditions. In developing and emerging countries, in-work poverty risk is twice as high among informal economy workers. In countries for which data are available, nearly 42% of informal workers including agriculture and 31% of workers excluding agriculture live in poverty. Workers in completely informal households are most at risk. Employment status also matters: contributing family workers and own-account workers face the highest risk of in-work poverty. The importance of low productivity agricultural activities in informal employment, a large informal-formal wage gap among employees and a higher percentage of low-paid informal wage employees relative to formal ones help explain the higher incidence of poverty among informal economy workers.

There is no simple link between changes in income poverty and movements into and out of informality

Examining how labour market transitions associate with changes in living conditions is crucial to forecasting the benefits of the formalisation agenda. While as indicated before, informal employment is often associated with a higher level of poverty, new empirical evidence from Indonesia, South Africa and Peru using panel data suggests no simple relationship between income poverty dynamics and formalisation. With the necessary caution related to the limited number of cases considered, getting a formal job is not associated with the strongest reduction in poverty in any of the countries studied, even though formal jobs are systematically associated with lower poverty levels in the three countries. Indeed in these three countries, the decline in poverty is more pronounced for those who remain in the informal economy than for those who transition to or remain in formal jobs. From an income poverty perspective, the lack of a simple relationship between poverty dynamics and transitions into and out of informality suggests that the full benefit of formalisation requires a medium-term perspective, including with possible costs in the short run (e.g. paying pension scheme contributions). This also suggests that factors beyond formalisation such as level of labour productivity and wages in both

formal and informal jobs, employment status, sector of activity and existence of specific programmes for informal workers, matter.

Informal economy workers face high occupational risks

Monitoring OSH in developing countries is often a challenge. OSH registers are usually absent or incomplete in the informal economy, where most workers operate. The knowledge base on OSH outcomes (occupational injuries and illnesses) and causes (unsafe and unhealthy working conditions) is therefore limited. Available evidence nonetheless shows that poor OSH conditions prevail in the informal economy and come with high social and economic costs.

Inferior working conditions are reflected in a large informal-formal job satisfaction gap

Indicators of job satisfaction are increasingly used when assessing vulnerability in employment. Self-reported measures of job satisfaction are closely tied to overall working conditions. Their main advantage is that they capture multi-faceted aspects of the working environment that are often not well reported, especially in the informal economy, where occupational accidents and diseases are hardly registered. New evidence on Colombia, Costa Rica, Ghana and the United Republic of Tanzania points to a lower level of job satisfaction among informal economy workers. Detailed econometric analysis of the determinants of job satisfaction further shows that the predicted probability of job satisfaction in the informal economy is significantly lower for employees and even more so for contributing family workers, compared with other employment statuses.

Absence of adequate risk management instruments makes informal economy workers and their families particularly vulnerable

Informal economy workers and their families face high exposure to risks but lack access to appropriate risk-management instruments. Two sets of inter-related factors usually explain the difficulty for informal workers to benefit from prevention and protection measures against general and work-related risks: their largely unorganised status and their *de facto* exclusion from regulations and benefit from public policy, particularly in relation to social protection, OSH, skills policies and social dialogue. New indicators of informality reveal that, in the absence of effective policies to manage risks in the informal economy, the vulnerability of informal economy workers will continue to be passed on to large segments of the population, particularly children and older individuals, who disproportionately live in informal households in developing countries.

Risks and vulnerabilities are particularly high for women in the informal economy

Informality affects men and women differently. While more men work in the informal economy globally, in a majority of countries women are more exposed. In most countries, moreover, women are more often found in the most vulnerable forms of informal employment, such as contributing family workers, which affects their employment outcomes. Women in the informal economy are more exposed to short hours of paid work, and in most countries, they face an even more pronounced gender pay gap than in the formal economy. Several factors affect gender disparities and the gender pattern of informal employment outcomes. Some are explicitly based on gender (e.g. the role of gender-based discriminatory institutions, as measured by the Social Institutions and

Gender Index, which correlates positively with the share of women in informal employment). Others apply to both women and men but are more accentuated for women.

Protecting informal economy workers and their families

For most developing countries, tackling vulnerability in the informal economy and facilitating transitions to formality remain formidable policy challenges. Yet lessons from recent country examples and information from new indicators of informality show that policy solutions exist. In addition to the respect of human rights and the fundamental principles and rights at work, they require an integrated approach, including actions on five broad fronts: 1) extending social protection to informal economy workers; 2) improving OSH; 3) raising labour productivity and therefore earnings and wages among informal workers; 4) creating a balanced policy mix to incentivise formalisation of enterprises and workers, remove barriers to formalisation and enforce compliance; and 5) empowering informal economy workers and economic units, including by extending worker and employer organisations' services and promoting participation in social dialogue and collective bargaining following ILO Recommendation 204.

Extending social protection to informal economy workers is key for inclusive development

Much can be learned from the experience of some developing countries in extending coverage of contributory social protection schemes to informal economy workers. Reasons for success include a number of measures governments should consider, such as combining measures to support the formalisation of enterprises with access to social protection; extending statutory coverage to previously uncovered workers; adapting benefits, contributions and administrative procedures to reflect the needs of informal workers; and subsidising contributions for those with very low incomes. In addition, several countries expanded the fiscal space needed to scale up social protection programmes financed through government revenue. These efforts have significantly contributed to building social protection floors that guarantee universal health coverage and at least basic income security throughout the lifecycle, for instance through tax-financed pensions, disability benefits, child benefits, maternity benefits or employment guarantee schemes.

Extending social protection should be done through a gender lens

As countries consider measures to tackle vulnerability in the informal economy, especially through the extension of social protection to informal economy workers, it is critical that they address gender-related risks. The needs of women workers in the informal economy are often neglected in the design and implementation of social protection strategies. Often, the role of women as workers is not adequately recognised in social assistance programmes, which tend to target female recipients and reinforce their role as caregivers. Gender inequalities in employment, such as possible interruptions in paid employment, longer periods devoted to caring for others, lower labour market participation, more part-time work and persistent gender wage gaps tend to be reflected in contributory schemes, unless specific measures are taken to close gender gaps, e.g. through care credits in pension schemes. More attention is needed to better adapt social insurance schemes to women's needs and work patterns, especially when it comes to pension and maternity benefits. While in some countries, the extension of pension, care services and maternity coverage has been instrumental in better protecting women

workers, much remains to be done to make the extension of social protection to the informal economy fully beneficial to women.

Extending the coverage of social protection systems should take into account informal support mechanisms

With persistent social protection coverage gaps, the critical role that informal support mechanisms play for informal workers and their households should be better recognised and taken into account in extension strategies. This most matters because research shows that social protection systems and informal support mechanisms can reinforce each other.

Equity and sustainability in financing the extension of social protection require careful assessment

Recent trends show that the extension of social protection coverage often occurs through the development of both contributory and non-contributory schemes. Many countries rely largely on public resources and donor funds, including for subsidising contributions, which puts growing pressure on government budgets. In most developing countries, the funding gap to extend social protection to informal economy workers remains particularly pronounced. Expanding fiscal space to finance extension requires careful assessment to avoid the regressive forms of taxation (e.g. regressive consumption taxes) in many of these countries that reduce the redistributive impact of social protection.

A number of policy options exist to address the equity and sustainability dimensions of financing

Several measures can address equity and sustainability issues related to financing the extension of social protection. Reinforcing the progressivity of taxation while expanding the tax base has the potential to expand social insurance coverage, promote fiscal equity and generate higher revenues. There is also significant potential to improve taxation of natural resources, fight tax evasion and tax avoidance including by transnational firms and, in the case of disguised employment relationships, re-emphasise the line of responsibility between employer and worker so that *de facto* employers honour their obligation to contribute to financing the social protection of their workers.

Social insurance needs to adapt to the situation of workers in different types of employment and facilitate labour market transitions

Efforts to extend social protection to informal workers need to take their large heterogeneity into account, especially when it comes to variation in work-related risks, potential eligibility for social protection programmes, capacity to build up entitlements and the existence of disguised employment relationships. Robust social protection systems must also recognise frequent movements among various forms of employment and ensure continued coverage. This can be achieved through better co-ordination of social insurance schemes and efforts to facilitate portability of entitlements between schemes.

The household dimension is essential in identifying the right mix of interventions and developing an integrated policy package

As countries look to extend social protection to informal economy workers, it is essential to take into account their household contexts and monitor informality at both the

individual and household levels. The KIIbIH, currently available for 27 developing countries, shows that an average of 33% of informal workers live in poor households and could be *a priori* covered by social assistance extended to all eligible households. Another 40% live in food secure households and could *a priori* afford to enrol in contributory social protection schemes, while 24% live in mixed households and could *a priori* have access to health insurance as dependants of formally employed household members.

Extending social protection needs to be complemented with measures to tackle OSH in the informal economy

Improving OSH in the informal economy is a huge challenge for developing countries, but it is not impossible and should be addressed as a matter of priority.¹ Most occupational injuries and illnesses could be avoided through effective implementation of prevention, reporting and labour inspection mechanisms, combined with investments in basic infrastructure services. One common approach, to inform effective prevention strategies, is to encourage reporting of occupational accidents and diseases that include uncovered workers. Another important area is working with local authorities to overcome the lack of awareness of work-related hazards in the informal economy. Labour inspections and other authorities such as public health providers could go beyond their traditional role to provide the advisory, support and training services most needed in the informal economy. Greater compliance and accountability in global value chains are also essential to protect workers, including through the application of guidance derived from international instruments of Responsible Business Conduct/Corporate Social Responsibility, such as the OECD Guidelines for Multinational Enterprises and ILO's Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy.

Extending social protection should be complemented with measures to raise productivity and labour income and empower informal workers

In recent years, initiatives have been undertaken to raise the productivity, earnings and wages of informal economy workers and firms, both to improve working and living conditions and to facilitate sustainable transition to formality. This is all the more important since formalisation may not necessarily provide a way out of poverty. One way to increase wages of informal workers is through an increase of the minimum wage that should take into account workers' needs and economic factors. Skills upgrading through training schemes is another effective policy option. Several countries have also developed programmes to increase access to capital, infrastructure and technology, and to support cross-border trade by informal entrepreneurs to improve the situation of the self-employed. Other important steps have been initiatives to promote and implement core labour standards, such as the enhanced implementation of laws with regard to freedom of association and the right to collective bargaining, and the elimination of child labour, forced labour and discrimination in employment. The effective representation of informal economy workers and economic units in strong, independent organisations is crucial for asserting their labour rights and making the transition to formality. Recent evidence shows that autonomous membership-based organisations of informal workers are expanding at the local, regional and global levels and that some employers' and workers' organisations are expanding their membership and services provision to workers and economic units in the informal economy, in line with ILO Recommendation No. 204 concerning transition to the formal economy. Moreover, to advocate for their rights at the

global level and engage in international fora, several transnational networks of informal economy workers have been formed or consolidated.

An integrated policy mix should seek to reduce the cost and time to register businesses and comply with regulations

Many governments have introduced measures to reduce the administrative bureaucracy and costs of registering a business and declaring workers. These include streamlined procedures, one-stop shops to bring registration offices under one roof, online registration systems and simplified legal formats for micro and small entrepreneurs. The objectives are to make it easier for small enterprises to register and to reduce the administrative burden. Such reforms are more effective when complemented with initiatives that reduce compliance costs of operating in the formal economy. As the formalisation of workers and economic units touches on a wide range of policy domains, it is important to co-ordinate efforts among them and foster an integrated approach to formalisation.

Policies should encourage formalisation of enterprises and their workers

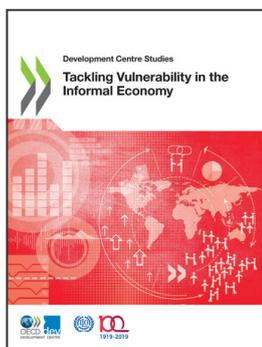
As entrepreneurs compare the expected costs of becoming and remaining formal with the benefits of operating in the formal economy, measures to simplify registration should be complemented with incentives to make formalisation more attractive. When there is no business case for formalisation, many entrepreneurs choose to operate below the radar. Incentives may include increasing access to social security for business owners and their workers and to business services and public procurement for formalised micro and small enterprises. Micro and small enterprises may also formalise when they are integrated into the supply chains of large companies or when they gain access to financial or non-financial services on condition of being (at least partly) formalised.

Productivity enhancement is important to foster enterprise and worker formalisation

Not all enterprises are in a position to formalise. For enterprises with low levels of productivity that generate limited revenues, the benefits of formalisation may not outweigh the costs. Enterprise formalisation initiatives should therefore aim to improve productivity, value addition and revenues so that enterprises are encouraged to formalise and able to cover the related costs and contribution to social security for their employees and reap the benefits of operating in the formal economy. More broadly, creating decent and productive employment requires to incorporate productivity growth as a cross-cutting objective at the forefront of national development strategies. As formalisation of workers and economic units touches on a wide range of policy domains, it is important to co-ordinate efforts among them and foster an integrated approach to formalisation.

Notes

¹ ILO Recommendation No. 204 sets out that countries should “(a) take immediate measures to address the unsafe and unhealthy working conditions that often characterize work in the informal economy; and (b) promote and extend occupational safety and health to employers and workers in the informal economy”.



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