



# Breaking the Vicious Circles of Informal Employment and Low-Paying Work





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# Foreword

The topic of informality has been at the heart of the OECD Development Centre's research and policy work since its creation. Two recent milestones include the 2019 report *Tackling Vulnerability in the Informal Economy* published jointly with the International Labour Organization (ILO), and the 2023 report *Informality and Globalisation: In Search of a New Social Contract*. Both reports were based on the OECD Key Indicators of Informality based on Individuals and their Household (KIIbIH) – the OECD Development Centre's innovative and comparative data on informal employment. These reports have served as a tool to inform actors in various fora at national and international levels, including the Global Partnership for Universal Social Protection (USP2030) and the standard settings at the ILO.

This latest report adds two additional perspectives on informal employment. First, it highlights the inter-generational aspect of informal employment and describes the various channels through which the vulnerability challenge of informal workers is being passed on to their children in the absence of adequate education, skills and social protection policy. Second, it underscores the double burden of informality and low-paying work that a large majority of workers in the informal economy carry, and as such calls for policy solutions that go beyond the formalisation agenda and embrace the goal of social justice.

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# Editorial

Six years ahead of the 2030 deadline for the Sustainable Development Goals (SDGs), the prospects of ending poverty in all its forms everywhere (Goal 1), or ensuring inclusive and equitable quality education and promoting lifelong learning opportunities for all (Goal 4) remain daunting. Progress on the formalisation agenda (Goal 8.3) is also slow.

This stems, in part, from the protracted difficulty for governments to significantly and sustainably address the vulnerability of workers in informal employment. Today, nearly 60% of all workers in the world remain informal, most of them maintained in poverty by low-paying jobs and very limited access to skill development and social protection.

One major achievement of this report is to disassemble the mechanics of those deleterious links between informality, poverty and low skills, by showing the many ways in which vulnerability is being passed on from one generation to the next: poor, informally working parents are often unable to dedicate enough time or money to the schooling of their children; they need their working hands for the household; and they do not have the social networks to help them obtain a good job. What policy makers are confronted with, therefore, are combined, vicious, inter-temporal circles of informality and low-paying work.

Policy makers can break those circles, this report argues. Tailored solutions for skill development, as well as recognising the skills of informal workers, can go a long way in closing the gap between formal job offers and the abundant informal workforce. Taking better account of the different needs of informal workers when investing in social protection can also enhance the benefits considerably. For the poorest and their children, the best strategy is to ensure that they are adequately covered by labour laws; to include them in available non-contributory social protection schemes; and to subsidise their participation in contributory schemes. For the better-off informal workers, wider incentives to participate in contributory schemes are needed, but also better compliance with tax and other relevant regulations.

We hope that this report, and the original database that underpins it, will help governments shed new light on the informality challenge at home, and identify their own policy solutions to address the double burden of informality and low-paying work which the majority of workers in developing and emerging economies have been carrying.

**Ragnheiður Elín Árnadóttir**

Director, OECD Development Centre

# Abbreviations and acronyms

<b>ASEAN</b>	Association of Southeast Asian Nations
<b>CAF</b>	Corporación Andino de Fomento (Development Bank of Latin America)
<b>CASNOS</b>	Caisse Nationale de Sécurité Sociale des Non-Salariés
<b>CCSS</b>	Caja Costarricense De Seguro Social
<b>CIT</b>	Corporate Income Tax
<b>CNSS</b>	Caisse Nationale de Sécurité Sociale
<b>COVID-19</b>	Coronavirus 2019
<b>CTPA</b>	Centre for Tax Policy and Administration
<b>ECA</b>	Europe and Central Asia
<b>ECIS</b>	Extension of Coverage to the Informal Sector
<b>ECLAC</b>	United Nations Economic Commission for Latin America and the Caribbean
<b>ENAH0</b>	Encuesta Nacional de Hogares
<b>ETF</b>	European Training Foundation
<b>FAO</b>	Food and Agriculture Organization
<b>GDP</b>	Gross Domestic Product
<b>HIC</b>	High-Income Country
<b>ICLS</b>	International Conference of Labour Statisticians
<b>ICSE</b>	International Classification of Status in Employment
<b>ICSaW</b>	International Classification of Status at Work
<b>IFLS</b>	Indonesian Family Life Survey
<b>ILO</b>	International Labour Organization
<b>IMF</b>	International Monetary Fund
<b>IMSS</b>	Instituto Mexicano de Seguridad Social
<b>ISCED</b>	International Standard Classification of Education
<b>ISCO</b>	International Standard Classification of Occupations
<b>ISSA</b>	International Social Security Association
<b>KIIBIH</b>	Key Indicators of Informality based on Individuals and their Household

<b>LAC</b>	Latin America and the Caribbean
<b>LAYS</b>	Learning Adjusted Years of Schooling
<b>LIC</b>	Low-Income Country
<b>LMIC</b>	Lower Middle-Income Country
<b>MIHS</b>	Malawi Integrated Household Survey
<b>MOOCs</b>	Massive Open Online Courses
<b>MSMEs</b>	Micro, Small and Medium-sized Enterprises
<b>NAPSA</b>	National Pension Scheme Authority (Zambia)
<b>NEET</b>	Not in Education, Employment, or Training (Youth)
<b>NGO</b>	Non-Governmental Organisation
<b>NIDS</b>	National Income Dynamics Study
<b>NSFAS</b>	National Student Financial Aid Scheme
<b>ODI</b>	Overseas Development Institute
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>OLS</b>	Ordinary Least Squares
<b>PIAAC</b>	Programme for the International Assessment of Adult Competencies
<b>PISA</b>	Programme for International Student Assessment
<b>PIT</b>	Personal Income Tax
<b>PPPs</b>	Purchasing Power Parities
<b>REMPE</b>	Regime Especial das Micro e Pequenas
<b>RPL</b>	Recognition of Prior Learning
<b>SALDRU</b>	Southern Africa Labour Development Research Unit
<b>SDGs</b>	Sustainable Development Goals
<b>Sida</b>	Swedish International Development Cooperation Agency
<b>SMEs</b>	Small and Medium-sized Enterprise
<b>SP</b>	Seguro Popular
<b>SPIREWORK</b>	Social Protection Plan for the Informal Economy and Rural Workers
<b>SPTR</b>	Social Protection Tax Revenue
<b>SRD</b>	Social Relief of Distress
<b>SSC</b>	Social Security Contribution
<b>STEM</b>	Science, Technology, Engineering and Mathematics
<b>THB</b>	Thai Baht
<b>TVET</b>	Technical and Vocational Education and Training
<b>UHC</b>	Universal Health Coverage
<b>UIF</b>	Unemployment Insurance Fund

<b>UMIC</b>	Upper Middle-Income Country
<b>UNDP</b>	United Nations Development Programme
<b>UNESCO</b>	United Nations Educational, Scientific and Cultural Organization
<b>UNWTO</b>	United Nations World Tourism Organization
<b>USD</b>	United States Dollar
<b>USP2030</b>	Global Partnership for Universal Social Protection to Achieve the Sustainable Development Goals by 2030
<b>VAT</b>	Value-Added Tax
<b>VET</b>	Vocational Education and Training
<b>WEF</b>	World Economic Forum
<b>WHO</b>	World Health Organization
<b>WIEGO</b>	Women in Informal Employment Globalizing and Organizing

# Executive summary

## Most workers in developing and emerging economies carry a double burden of informal employment and low-paying work

Informal workers make up nearly 60% of the workforce globally, and 90% in low-income countries. New evidence from the *Key Indicators of Informality based on Individuals and their Household* (KIIbIH) shows that, despite widespread heterogeneity, informality often displays a two-tier structure. The *lower tier* comprises workers with earnings below 50% of the median earnings of their country: they are the majority of the global informal workforce, at 54% on average, and up to 80% in some countries. A relatively small number of workers in the *upper tier* enjoy relatively higher earnings; they are also more skilled and more productive. Compared to both formal workers and upper-tier informal workers, those in the lower tier, as well as their household members, face a greater probability of falling into poverty, and encounter greater health-related and old-age hardships. They carry a double burden of low-paying work and informality.

## Transitions between formal and informal employment remain limited, and the benefits of formalisation can be disappointing for some workers in the lower tier

The combination of informality and low-paying work is particularly persistent, as manifested by the extremely infrequent transitions towards formal employment. Even when they happen, such transitions do not necessarily result in income improvements for the poorest workers. By contrast, workers in the upper tier of informality find it easier to access formal jobs and improve their incomes, largely because of their higher education levels.

## Informal workers have few opportunities to upgrade their skills and transition to formal jobs

Close to 45% of informal workers have at best a primary level of education, compared to 7% of those in formal employment. Conversely, the share of informal employment among workers with no education is 94% globally, and 85% among those with primary education only. Informal workers also have very limited opportunities to upgrade their skills, whether through employer-provided training, public programmes or other forms of learning, typically because those are not adapted to their needs. This compounds the persistence of informality and low-paying employment, as formal economy employers generally look for skills that informal workers either do not have, or cannot prove having. As a result, economies with large informal employment display sizeable skill mismatches. This hampers the adoption of new technologies and productivity, perpetuating informal employment and a vicious, intragenerational circle of informality.

## Children of low-paid, informal workers inherit their vulnerability

Informality and low-paying work are path-dependent: children in households where all family members are informally employed have a lower chance of securing a formal job as they grow up. This is because their school attendance, from primary level onwards, is lower than that of children with formally working parents; less financial resources and parental time are devoted to their education; and school-to-work transitions are longer and more uncertain for them.

## Social protection gaps in the informal economy can be filled, but this demands a more detailed understanding of workers' situations

The vicious circle of informality, especially for workers in the lower tier and for their children, can be broken by extending social protection coverage to all workers and their household members. Globally, social protection coverage is often inconsistent and sparse, with large gaps between formal and informal workers. This is mainly due to gaps in contributory schemes, which tend to benefit relatively better-off informal workers in the upper tier, while non-contributory schemes benefit poorer workers in the lower tier. Extending social protection to informal economy workers is possible, with i) a combination of contributory and non-contributory schemes, based on a granular analysis of the situations of different groups of workers, the risks they face and their contributory capacities, and ii) the mobilisation of additional revenues from carefully identified sources, through strengthened tax compliance and enforcement, in ways that do not increase the cost of formalisation unreasonably.

## Policy recommendations

The two-tier feature of informal employment begs for differentiated policy actions to ease transitions between these tiers and towards formal jobs.

### ***For workers in the lower tier and their children: Alleviate the double burden of informality and low-paying work, and invest in human capital***

Informal workers in the lower tier would particularly benefit from specific solutions to break the inter- and intra-generational circles of informality and low-paying work.

Skill development policies are one such solution. For informal workers, it is critical to create more specific opportunities of employer-sponsored training and public skills development programmes tailored to their needs. It is also necessary to recognise the skills they acquire through informal work. To improve the skills of children, the would-be workers, governments should continue investing in accessible, equitable, quality education; prevent school drop-outs; and smoothen school-to-work transitions.

Another, parallel, solution is social protection. Countries should consider better including lower-tier, informal workers in non-contributory social protection schemes, and subsidising their participation in contributory schemes, which should be seen as an investment into poverty alleviation.

In addition, policy makers should recognise that certain workers will never be able to move out of low-paid, informal jobs. Where such jobs help sustain livelihoods, and may therefore be considered as essential and socially desirable, the priority should be to alleviate the double burden of informal employment and low-paid work through: remuneration policies that address inequality; effective minimum wages; and measures to improve the bargaining power of low-paid informal workers.

***For workers in the upper tier: Encourage formalisation***

For workers in the upper tier, who are more likely to respond positively to standard formalisation policies, additional measures should be considered, such as ensuring adequate coverage by labour laws, social security and tax regulations, as well as enforcing compliance with these regulations by workers and by employers.



# 1 Overview

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This overview summarises the key findings and policy recommendations of the report.

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Tackling the vulnerability challenge in the informal economy has been on the policy agenda since the mid-20th century (OECD/ILO, 2019<sup>[11]</sup>). Despite numerous commitments by many countries, progress towards the sustainable formalisation of economies is slow. Informal employment is extremely persistent and, for a large majority of workers in the informal economy, is often associated with low-paying work. In contrast, meagre formalisation gains are often reverted by national, regional and global crises, such as the COVID-19 pandemic (OECD, 2023<sup>[2]</sup>). Still today, nearly 2 billion workers, representing close to 60% of the world's employed population, are in informal jobs and the majority are low-paid (OECD, 2023<sup>[2]</sup>).

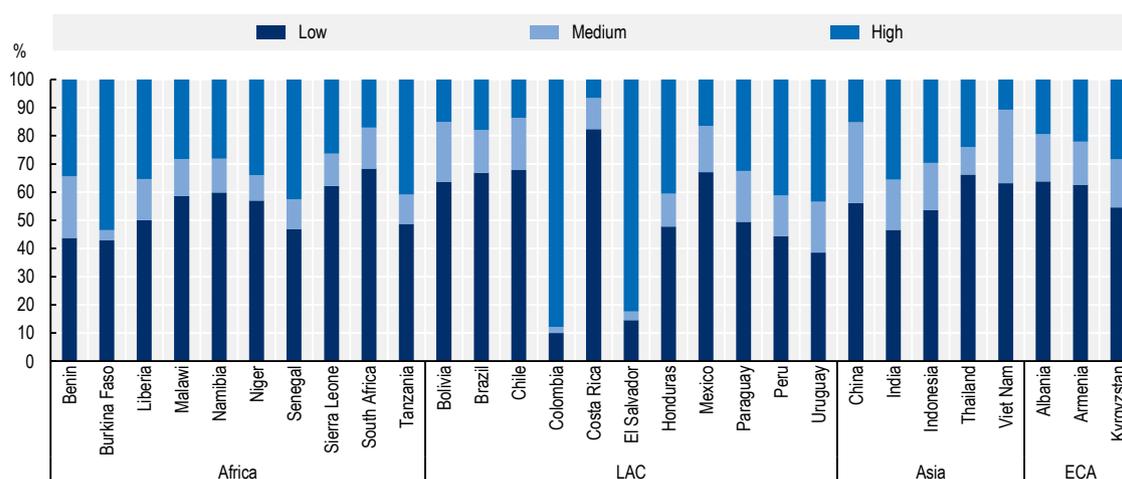
This report investigates why the vulnerability challenge in informal employment is so persistent. It highlights the specific types of risks that make it difficult for informal workers and their children to break free from informal employment and build better lives. In particular, it shows that the combination of low-paying work and informality makes the mere formalisation of jobs unlikely to eliminate on its own the vulnerability challenge of a large majority of informal workers. As this report argues, alleviating the double burden of informal employment and low-paying work is critical and calls for policy solutions that go beyond the formalisation agenda and embrace the goal of social justice.

## Most informal workers carry the double burden of informal employment and low-paying work

Informal employment is highly heterogeneous (OECD/ILO, 2019<sup>[11]</sup>). In many countries, it features multiple tiers, but quite often, it has just a two-tier structure. The upper tier is composed of workers who are relatively productive (possibly due to higher skills) and who enjoy higher earnings. The lower tier is composed of workers engaged in low-productivity, low-paying work, possibly due to a lack of skills but also due to the lack of opportunities elsewhere and, sometimes, to unfair remuneration practices.

**Figure 1.1. Distribution of informal workers by size of labour earnings**

Percentage of informal workers by earnings category



Note: Earnings categories are defined based on the total earnings distribution: low earnings are from the bottom of the distribution to 50% of the median earnings level; medium earnings are from 50% of the median to 150% of the median; and high earnings are 150% of the median and above. LAC – Latin America and the Caribbean; ECA – Europe and Central Asia; Bolivia – Plurinational State of Bolivia (hereafter Bolivia); China – People's Republic of China (hereafter China).

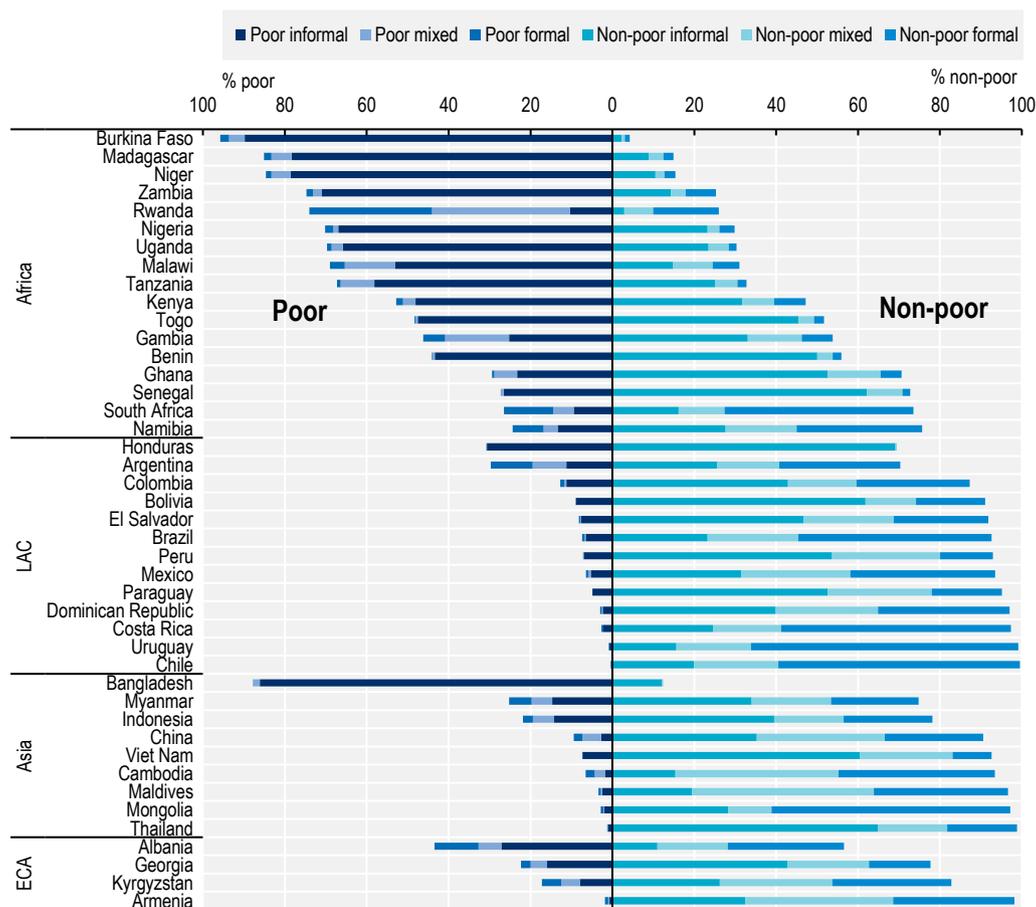
Source: Authors' calculations based on (OECD, 2021<sup>[3]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/key-indicators-informality-individuals-household-kiibih.htm>.

In the vast majority of countries with available data, the lower tier is larger in size than the upper tier if judged by earnings, whereas what could constitute a middle tier is quite compressed. Across countries with available data, an average of 54.0% of informal workers earn less than 50.0% of the median earnings level, and as such can be considered in the low tier of informal employment. The percentage of such workers is as high as 80.0% in Costa Rica (Figure 1.1).

While all informal workers grapple with more socio-economic risks than workers in formal employment, those in the lower tier of informal employment, along with their household members, are particularly vulnerable. They have a heightened risk of household poverty (Figure 1.2), and are also particularly vulnerable to health problems, poverty in old age and poorer educational outcomes for their children. In the absence of adequate social protection, upskilling opportunities, and measures against unduly low pay, they lack the means to mitigate these risks independently. When considered collectively, these risks and the sub-par outcomes experienced by most informal workers highlight the substantial societal and individual costs associated with informal employment and low-paying work.

**Figure 1.2. Household poverty risk increases with households' degree of informality**

Distribution of people by the poverty and informality status of their households



Note: Poor households are those that fall below the international poverty line of USD 3.20 (United States dollars) Purchasing Power Parities (PPPs). LAC – Latin American and the Caribbean; ECA – Europe and Central Asia.

Source: Authors' calculations based on (OECD, 2021<sup>[3]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/key-indicators-informality-individuals-household-kiibih.htm>.

## For informal workers in the lower tier, moving into formal employment is difficult and does not guarantee a better income

The two-tier nature of informal employment is best illustrated by the extremely low number of transitions out of informal employment. When workers change their employment status, they are most likely to move between informal jobs and non-employment, with lower chances of transitioning to formal employment. Workers with the highest chances of accessing formal employment are employees and workers living in urban areas. Moreover, a higher level of education is the best guarantee of accessing and remaining in formal employment.

When they do occur, transitions from informal to formal jobs do not guarantee income improvements for all workers. Switching to formal employment has the greatest potential to improve the incomes of those workers who are already high earners – in the upper tier of informal employment – but not of the poorest workers in the lower tier. Moreover, in some countries, formalisation does not lift the poorest workers out of the lowest income quantile, possibly because of the generally low pay in some occupations, but also due to the absence of a statutory minimum wage. In contrast, transitions to informal employment generally worsen earnings and, in some settings, increase the likelihood of slipping into poverty.

## The difficulty of acquiring and updating skills and subsequent skills mismatches constitute a significant challenge for workers in the informal economy

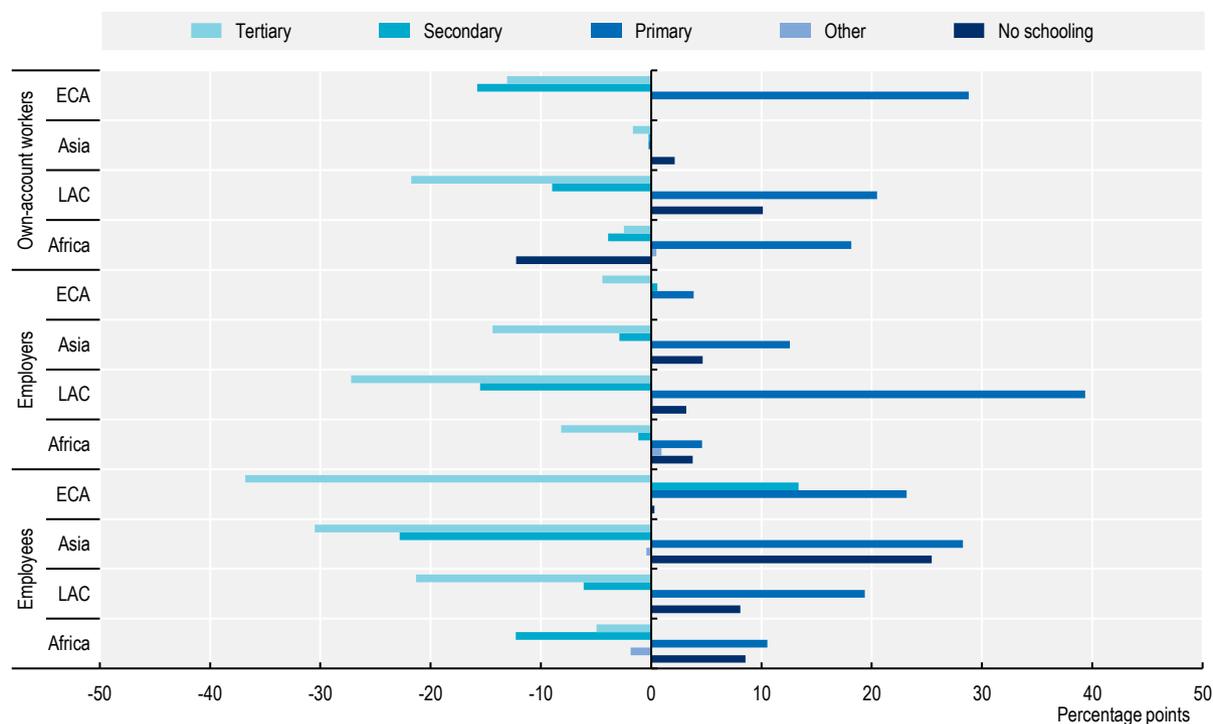
One significant barrier for informal workers seeking formal jobs is the lack of skills. Most informal workers, especially those in the lower tier, not only have low levels of education but they also have fewer opportunities than formal workers to develop their skills. This significantly affects their prospects for formalisation and better pay.

### ***Informal workers have lower levels of education compared with formal workers***

Approximately 45.0% of informal workers globally have only primary education or less, whereas this figure is only 7.0% for formal workers. In almost all regions and employment statuses, a higher percentage of informal workers has limited or no schooling, or only primary schooling, whereas formal workers tend to have higher levels of secondary and tertiary education (Figure 1.3). Conversely, informal employment is particularly prevalent among individuals with no education, accounting for 94.0% of such cases globally, with variations between regions. The share of informal employment decreases slightly to 85.2% among those with primary education and drops further to 52.1% for those with secondary education. Still, even among individuals with tertiary education, 24.2% are found in informal employment.

**Figure 1.3. Education gaps between informal and formal workers**

Difference in the distribution of informal and formal workers in various employment statuses, by educational attainment (circa 2019)



Note: Contributing family workers are not represented, as all of them are considered to be in informal employment.<sup>1</sup> LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: (OECD, 2021<sup>[3]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>.

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### **Informal workers also have lower chances of upgrading their skills**

Outside the education system, workers can upgrade their skills either through employer-provided training, public training programmes, or other formal or non-formal forms of learning.

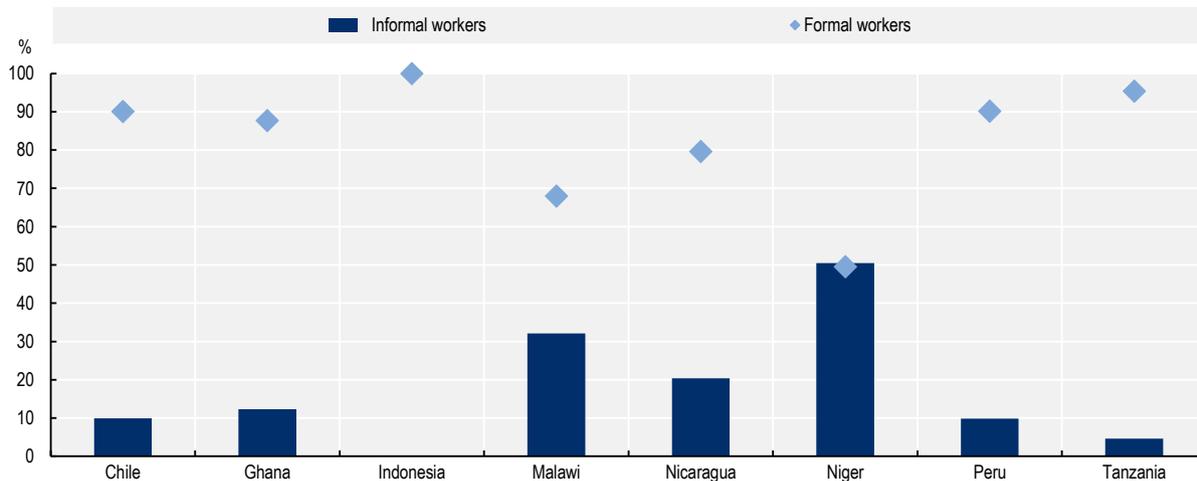
Evidence from African francophone countries shows that, in 8 out of 11 countries surveyed, at most 5% of workers in informal employment participated in job-related professional training in the last 12 months, financed by their enterprise or a partner. This proportion is 3-15 times lower than that of workers in formal employment. The situation among women is the most critical, as they face more limited access to training regardless of the formal or informal nature of their employment.

Training options differ across sectors of activity and types of enterprise. Enterprises in the services sector, as well as enterprises that were formal when they began operations (as opposed to informal enterprises that only became formalised at a later stage) have higher chances of offering training to their employees.

Informal workers are also less likely to benefit from training and skills programmes provided through public labour market programmes. For example, in Indonesia, 100% of such labour market beneficiaries are formal workers. In Chile, Ghana, Peru and Tanzania, around 90% of such labour programme beneficiaries are formal workers (Figure 1.4). In Niger, state-provided labour market programmes such as vocational training or skills development are provided equally to formal and informal workers. However, to the extent

that there is a larger share of informal workers than formal workers in the economy, in order to attain equity (rather than equality), more training needs to be provided to informal workers also in Niger.

**Figure 1.4. Share of workers who benefitted from vocational training or a skills development programme, by formality status**



Source: (OECD, 2021<sup>[3]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIbIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIbIH.htm>.

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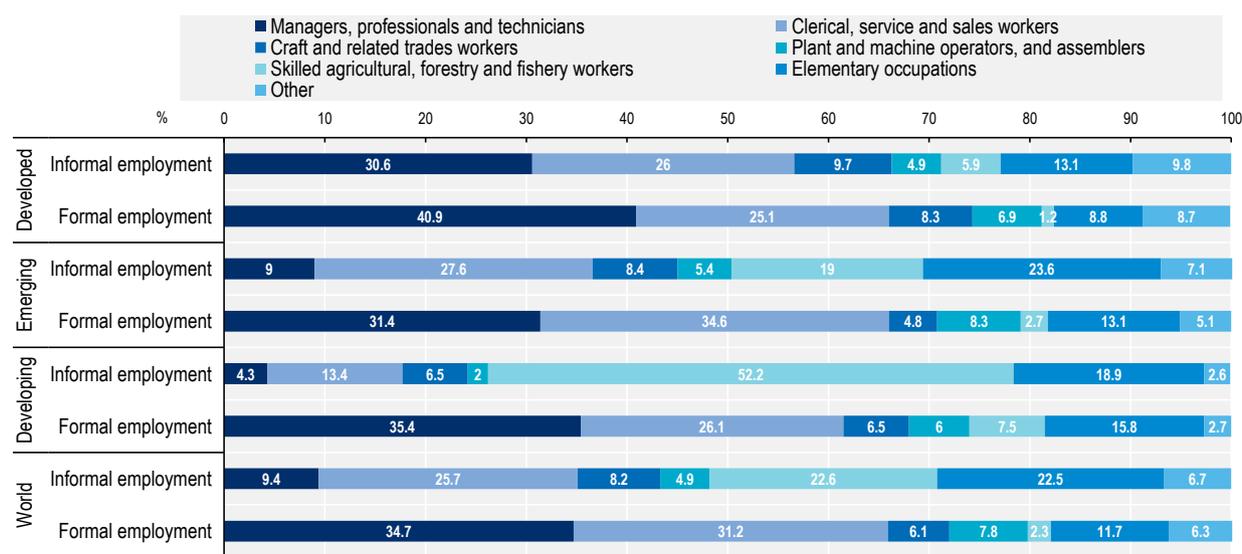
In addition, learning on the job remains limited for informal workers. When on-the-job learning does happen, the lack of official certification makes it difficult for informal workers to prove their skills when they aspire to transition into formal employment.

While the advent of digital technologies created many opportunities for learning in general, including for workers in the informal economy, it remains to be seen whether the completion rates and certificate uptake are sufficient to help informal workers progress in the labour market, and how the obtained skills can be recognised and validated.

### ***Even if informal employment cuts across all occupations and skill levels, formal jobs typically require higher-level skills and qualifications***

Globally, among workers in informal employment, there are higher shares of workers in elementary occupations, of craft and related trades workers, and of skilled agricultural, forestry and fishery workers, than among workers in formal employment (Figure 1.5). Among workers in formal employment, there is a higher share of managers, professionals and technicians, as well as clerical, service and sales workers, than among workers in informal employment. These jobs typically require a different (often higher) order of a wide range of skills. These differences are observed among countries at all stages of development, but they are especially pronounced in developing and emerging economies.

**Figure 1.5. Distribution of formal and informal employment by occupation**



Note: International Standard Classification of Occupations (ISCO-88) classification of occupations. Global and regional estimates based on data for 144 countries representing 92.4% of the world's employed population. Harmonised definition of informal employment and employment in the informal economy. Latest available year.

Source: (ILO, 2023<sup>[4]</sup>), *Women and men in the informal economy: A statistical update*.

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In countries with high levels of informal employment, the problem is not simply the absence of formal jobs, but that formal jobs are hard to fill. This is because, often, available formal jobs require skills that informal workers do not have, or cannot prove they have. According to the World Bank Enterprise Survey, which is carried out regularly in more than 100 countries at the enterprise level, countries in which employers believe that the practices of the informal sector are an important obstacle affecting the operation of their business are also countries where a lack of skills in the workforce is the main obstacle.

### ***Skills mismatches affect both formal and informal workers, but in different ways***

As a result of these differences in skills supply of informal workers and skills demand in formal jobs, economies with a large share of informal employment face sizeable skills shortages and mismatches. The types of skills mismatches vary across formal and informal workers. Workers in informal employment are particularly prone to undereducation in the majority of countries with available data. The incidence of undereducation is twice as high for informal workers as it is for formal workers in Brazil, El Salvador and Paraguay, and it is three times as high in the Plurinational State of Bolivia (hereafter Bolivia), Nigeria and Zambia. Underqualification of informal workers is proof that they acquire skills in the informal economy, but such skills are not backed by formal credentials. Formal workers, in contrast, are more likely to experience overeducation in all countries with available data. Among formal workers, the incidence of overeducation ranges between 11% in Nigeria and 56% in Zambia. In contrast, in Zambia, 10% of informal workers are overeducated; this is also the average rate of overeducation among informal workers in countries with available data. These patterns hold true for both men and women.

These mismatches aggravate the unemployment problem, hamper productivity and impede socio-economic development. They also become major barriers to public and private sector strategies for formal job creation and the adoption of new technologies, eventually perpetuating the intragenerational cycle of informal employment.

## The vulnerability challenge of informal workers is being passed on to their children

The vicious circle of informal employment and low pay is not only intragenerational but also intergenerational. Children of informal workers, especially children of those in the lower tier of informal employment, inherit their parents' vulnerabilities in the world of work. This happens through at least four channels.

### ***More children live in households characterised as entirely informal than in mixed or fully formal households***

In developing and emerging economies, the majority of children live in poorer households where all family members are working informally, as opposed to households where at least one family member is working formally. As such, children are disproportionately exposed to informal employment and low-paid parents, as well as the underlying causes of this situation, including lower levels of education and parents' poorer networks and connections to the world of formal work.

### ***The school attendance gap between children from fully informal, mixed and formal households widens as they proceed to higher levels of education***

School attendance of children is another indicator that correlates with informality of parents. In some countries, differences in school attendance between children from fully informal households compared with those from mixed or fully formal households are evident from as early as primary and lower secondary schooling, and widen significantly at the upper secondary and post-secondary non-tertiary levels of education. They continue widening, although at a lower rate, at the level of tertiary education (Figure 1.6).

### ***Households with formally working members devote more private resources to educating their children***

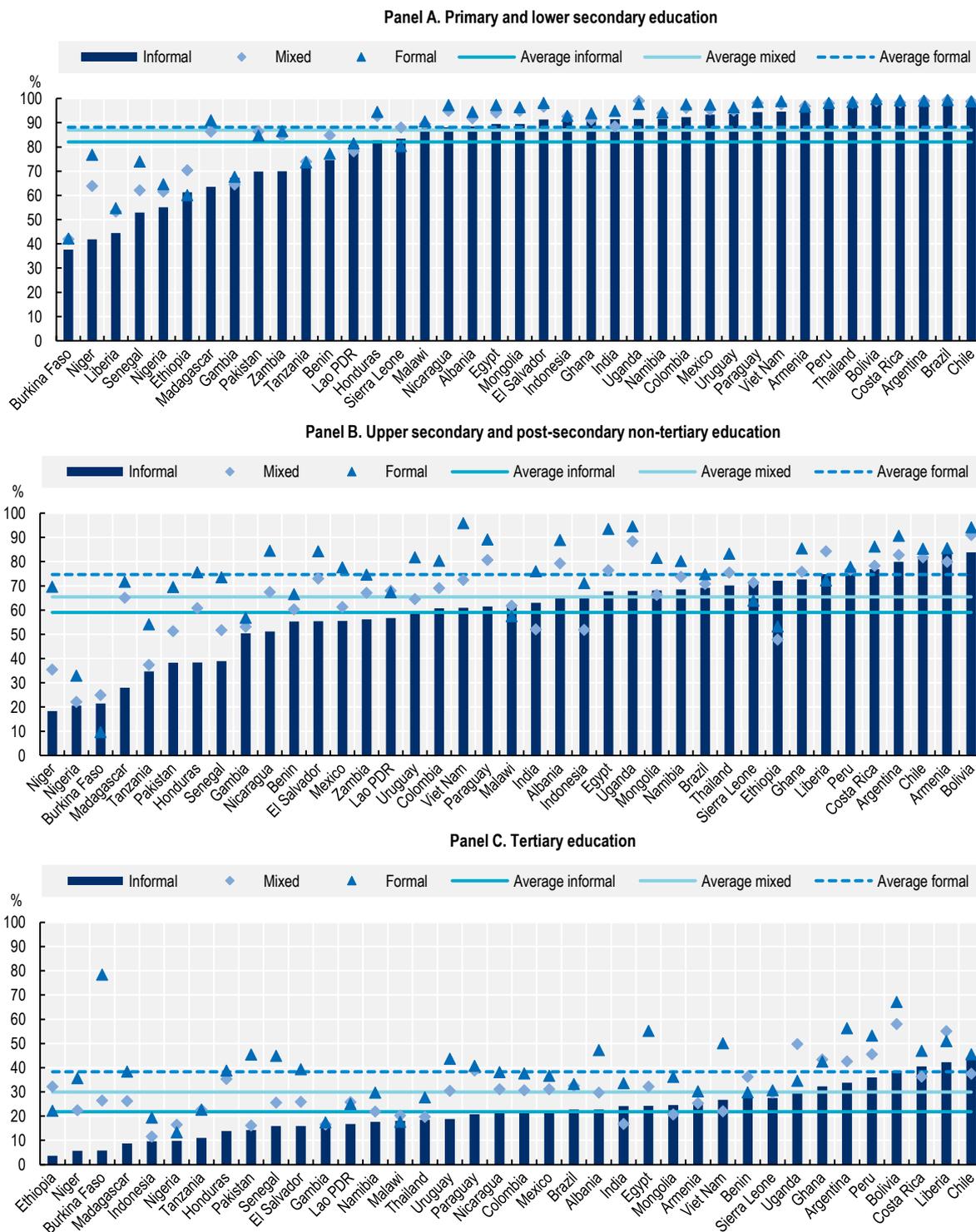
Formally working parents also have more private financial resources to devote to their children's education compared with informally working parents, especially those in the lower tier of informal employment. Moreover, during the lockdowns implemented during the COVID-19 crisis, formally working parents were able to dedicate more parental time to their children's education, sometimes overcompensating for the negative effects of school closures. Financial and time resources contribute to exacerbating inequalities among children from formal and informal households.

### ***Young people from informal households are more likely to be NEET and face longer and more uncertain school-to-work transitions***

The educational disadvantage of children from informal households translates into a clear disadvantage for young people. They are more likely to not be in education, employment or training (NEET) and face longer and more uncertain school-to-work transitions. When they undergo apprenticeships, these are likely to be informal. Likewise, the first work experience of young people from informal households is more likely to be informal than formal, thus perpetuating the vicious intergenerational circle of informal employment.

Figure 1.6. School attendance is higher for children living in formal households

School attendance rate, by level of education and household type



Note: Data refer to young people aged 6-24 years. Panel A: International Standard Classification of Education (ISCED) levels 1 and 2; Panel B: ISCED levels 3 and 4; Panel C: ISCED levels 5, 6 and 7. Lao People's Democratic Republic (hereafter Lao PDR).

Source: (OECD, 2021<sup>[3]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>.

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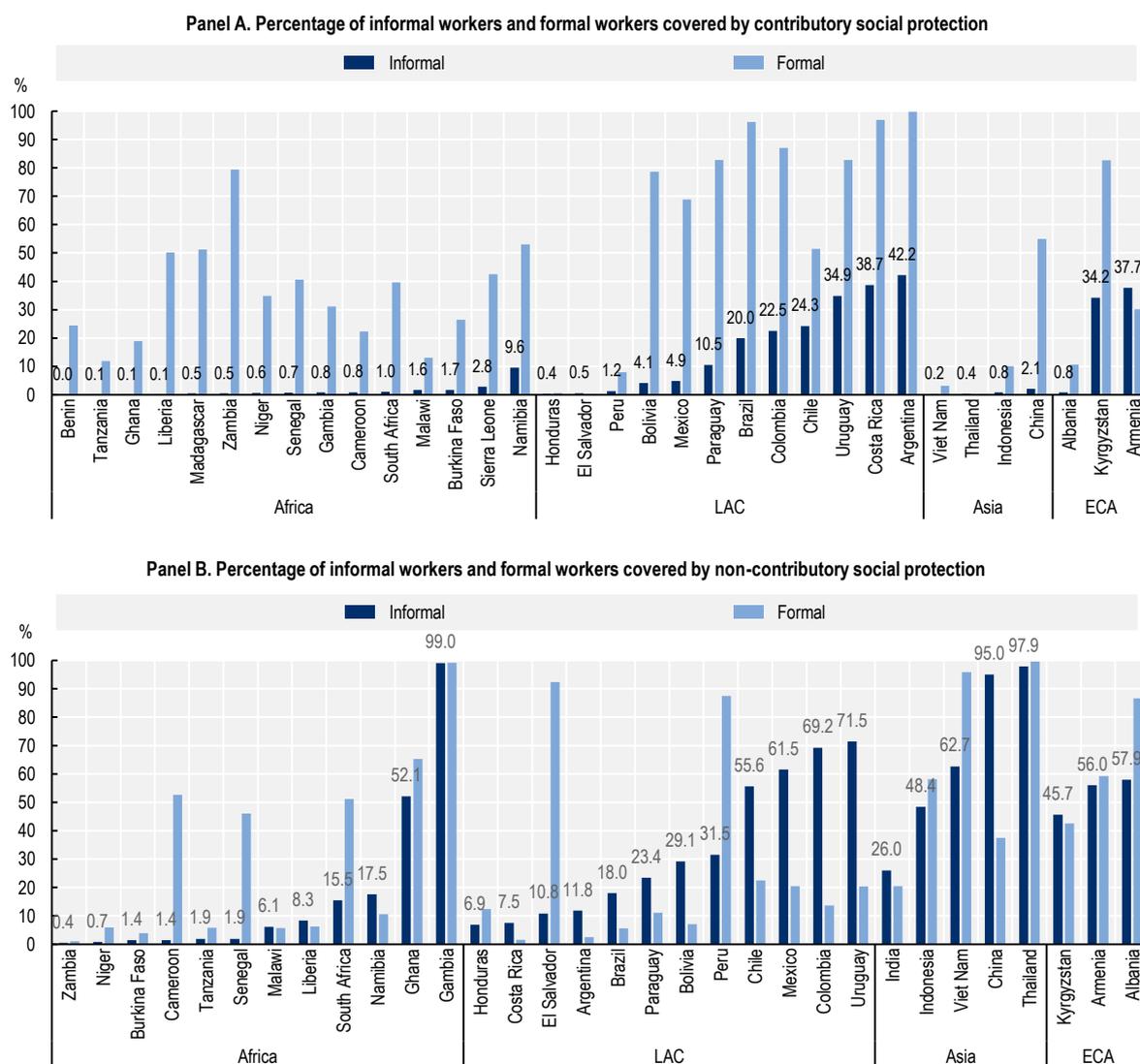
## Informality is a major obstacle to universal social protection

One common challenge in most developing and emerging economies with a large informal economy is to remove the many legal, economic and institutional constraints that informal workers face in accessing social protection, and implementing funding mechanisms that are appropriate, fair, efficient and sustainable. To increase the social protection of informal workers and devise informed policies on formalisation, governments, enterprises and workers need in-depth information that captures the heterogeneity of informal workers and takes into account the broader context of their households.

### ***For most workers in the informal economy, social protection coverage is particularly low***

Throughout the world, social protection coverage for workers is often inconsistent and sparse. In most countries, informal workers experience a social protection gap. The OECD KIIbIH data show that the large social protection gap between formal and informal workers is largely due to a gap in contributory schemes (Figure 1.7). Remarkably, contributory schemes tend to benefit relatively better-off informal workers, whereas non-contributory schemes typically benefit poorer informal workers. Moreover, urban informal workers tend to have better access to contributory programmes, whereas rural informal workers are better covered by non-contributory programmes.

Figure 1.7. Social protection coverage for formal and informal workers



Note: Contributory social protection programmes include contributory pensions, employment-based health insurance, unemployment insurance. Coverage rates are calculated for direct and indirect beneficiaries of social protection programmes and contributors to social insurance programmes. Surveys for some countries do not include specific questions on all the programmes, and this can affect cross-country comparisons. Non-contributory social protection programmes include universal health programmes, unconditional and conditional cash transfers (including non-contributory pensions). Coverage rates are calculated for direct and indirect beneficiaries of social protection programmes and contributors to social insurance programmes. Surveys for some countries do not include specific questions on all the programmes, and this can affect cross-country comparisons. LAC – Latin America and the Caribbean; ECA – Europe and Central Asia.

Source: (OECD, 2021<sup>[3]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>.

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### Extending social protection requires a mix of contributory and non-contributory schemes

Extending social protection to informal workers – including by means of formalisation – is possible and requires a combination of contributory and non-contributory schemes. To be successful, such expansion must also be rooted in a comprehensive understanding of the situations of different groups of workers, the risks they face, and the different factors contributing to the lack of coverage.

Looking at the distribution of informal workers by household income categories yields useful information with which to determine the appropriate mix of schemes in social protection extension strategies. This is especially important for deciding on the delivery mechanism of means-tested social assistance schemes and other contributory and non-contributory programmes. Strategies to extend social protection to informal workers may be articulated around two pillars: i) extending the coverage of social protection to the large majority of poor informal workers through non-contributory schemes, and ii) extending contributory schemes to non-poor informal workers through a mix of subsidised schemes for the near poor and non-subsidised schemes for those who can contribute.

Moreover, the data show that, in most of the countries covered by the KILBIH, the extension of more universal tax-financed programmes – such as those providing child benefits and social pensions – could disproportionately benefit workers in the informal economy and their families, especially the most vulnerable. This points to the centrality of child benefits and social pensions as a way to extend non-contributory schemes to informal workers and to reduce the vulnerability of informal workers' households without having to resort to detailed targeting mechanisms.

### ***There are important avenues for the extension of contributory schemes***

As countries look at ways in which to extend contributory schemes to informal workers, they need to make several policy choices. One question is whether the extension of contributory schemes can be linked to an identifiable employment relationship between an employer and a dependent worker. Another question is whether informal workers can afford to enrol in contributory schemes. Relatedly, to what extent can the extension of contributory schemes be best achieved through voluntary or mandatory enrolment, and through law enforcement? These are not easy questions to answer, but the KILBIH data provide new information and insights.

On the one hand, the findings point to a large segment of informal workers with limited capacity to pay. For such informal workers, subsidised contributory schemes may well be the only option if they cannot qualify for means-tested social assistance or benefit from a co-payment through an employer's contribution.

On the other hand, the results show that for a significant share of the informal worker population, the extension of contributory schemes can be linked to an identifiable employment relationship between an employer and an employee. Moreover, in some countries, a sizeable proportion of informal employees has some capacity to contribute to social insurance schemes and is already close to the formal economy. For such categories of informal workers, a realistic option could be to promote co-payments from both employers and employees, and to create incentives for formalisation.

The results also indicate that the development of contributory schemes should include programmes that can be attractive to large segments of informal own-account workers who have the capacity to pay but no co-payment possibilities. Still, one of the policy choices that governments need to make for those with the capacity to pay is whether the extension of contributory coverage should be mandatory or voluntary.

### ***Options exist for building sustainably funded social protection systems amidst high levels of informality***

Spending on social protection remains very low in developing and emerging economies and significant additional revenues will have to be mobilised in order to finance universal social protection. There is a significant potential to increase revenues in developing and emerging economies, however. Fulfilling that potential requires careful tax reforms, based on the identification of the most suitable tax revenue sources, and with tax compliance and enforcement as core objectives. Finally, while social security contributions can play a key role in financing social protection systems, greater financing for social protection systems should not increase the cost of formalisation.

## Policy recommendations

Since informal employment features two tiers, and the workers in each of these tiers have different characteristics and different outcomes (such as pay and exposure to different risks), addressing informal employment requires differentiated policies.

### ***Policies for workers in the lower tier of informal employment and their children***

The low availability of formal jobs is probably one of the most important barriers to workers in the lower tier of informal employment to access formal jobs. Alleviating the double burden of informality and low-paying work demands that poverty eradication and job-rich growth be more central in policy making. A first step is to identify the potential of job creation in various occupations and sectors, including those requiring low levels of skill.

Other more micro-level factors make it difficult for informal workers in the lower tier to access more productive jobs. One of these factors is a lack of skills. In view of the prevalence of large unequal opportunities for skills upgrading of informal workers, this report recommends to:

- encourage employer-provided training for formal and informal workers
- make public programmes more inclusive for informal workers and their needs
- recognise prior learning of informal workers.

To help improve the match between the skills supply of informal workers and the skills demand of formal jobs, governments should additionally:

- anticipate change in skills demand, and prepare the workforce accordingly
- strengthen opportunities for all types of learning, including non-formal.

To break the intergenerational cycle of informal employment and low pay, it is also necessary to promote the skills of children by:

- investing in accessible, quality education in order to equip future workers with solid foundational skills that will serve as a basis for future learning
- devoting sufficient resources to education and providing equitable education opportunities
- preventing school drop-outs by improving the quality of schooling, eradicating child labour and combating gender stereotypes
- facilitating school-to-work transitions for young people, especially for those from informal households.

In addition, policy makers should recognise that certain workers will never be able to move into more productive and/or high-paying jobs. Yet, these jobs help sustain livelihoods, and in certain cases may be considered as essential, socially desirable jobs. For these workers, priority should be given to policies that improve overall working conditions and alleviate poverty-related risks. These include:

- setting and enforcing minimum wages
- addressing inequality in remuneration policies
- extending contributory and non-contributory social protection schemes
- improving bargaining power and raising the capacity of low-paid informal workers to influence policy making.

### ***Policies for workers in the upper tier of informal employment***

For workers in the upper tier of informal employment, the policies mentioned above may also apply, but the priorities are somewhat different. The characteristics of upper-tier informally employed workers make them more disposed to respond to standard formalisation policies, and their ability to access formal employment is also higher. As a result, they would benefit from additional policy measures, including:

- ensuring adequate legal coverage for informal workers with contributory capacity
- enforcing compliance with labour laws and social security regulations among informal workers who are close to the formal economy.

### **Notes**

<sup>1</sup> These computations were made before the adoption of the new Resolution concerning statistics on the informal economy by the 21st ICLS (2023), which changes the classification of contributing family members, and prescribes that they can be informal or formal.

### **References**

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# 2 The double burden of informal employment and low-paying work

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This chapter demonstrates that informal workers and their family members often encounter a broader spectrum of risks compared with formal workers. These risks stem from weaker labour and social protection. Informal workers earn less than formal workers, even in comparable jobs. Moreover, in many countries, informal employment comprises a two-tier structure. The lower tier consists of workers earning modest incomes, while the upper tier consists of informal workers with higher earnings. The lower tier is often substantially larger than the upper tier, meaning that a compelling number of informal workers face a risk of individual but also household poverty.

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Informal employment has been on the policy agenda since around the 1960s. Despite many countries' numerous commitments to take a proactive stance on informal employment, progress towards the sustainable formalisation of economies is slow. Informal employment is extremely persistent. In contrast, the meagre formalisation gains are often reverted by an array of forces, including national, regional and global crises, such as the COVID-19 pandemic. Still today, nearly 2 billion workers, representing close to 60% of the world's employed population, are in informal jobs (OECD, 2023<sup>[1]</sup>).

## Informal workers are more vulnerable than formal workers in the face of various risks

Informal employment is a concern in many countries around the world for a number of reasons. One of the key reasons is that, by definition (Box 2.1), informal workers throughout the world lack social protection and enjoy fewer rights at work (OECD/ILO, 2019<sup>[2]</sup>). As will be shown in this report, they have fewer opportunities to upgrade their skills that could help them access formal jobs.

### Box 2.1. Differentiating between the informal economy and informal employment

The informal economy refers to all economic activities (excluding illicit activities) by workers and economic units that are, in law or in practice, not covered or insufficiently covered by formal arrangements (ILO, 2015<sup>[3]</sup>).

The definition of informal employment used in this report differentiates between three groups of workers: i) employees, ii) employers and own-account workers, and iii) contributing family members. These are further explained as follows:

- i. Employees are considered to have informal jobs if their employment relationship is, in law or in practice, not subject to national labour legislation, income taxation, social protection or entitlement to certain employment benefits (advance notice of dismissal, severance pay, paid annual or sick leave, etc.). In statistical terms, employees are considered informally employed if their employer does not contribute to social security on their behalf or, in the case of a missing answer, if they do not benefit from paid annual leave or sick leave.
- ii. Employers (with hired workers) and own-account workers (without hired workers) are considered informally employed if they run an economic unit in the informal sector (a non-incorporated private enterprise without a formal bookkeeping system or that is not registered with relevant national authorities). In the case of the question not asked or a missing answer, the enterprise is considered part of the informal sector if there is no fixed place of work or it employs five employees or fewer. This threshold can vary, depending on the reporting structure of country questionnaires.
- iii. Contributing family members are informally employed by definition, regardless of whether they work in formal or informal sector enterprises.

Estimates of informal employment presented in this report follow the *Resolution concerning statistics of employment in the informal sector* (ILO, 1993<sup>[4]</sup>) and the *Guidelines concerning a statistical definition of informal employment* (ILO, 2003<sup>[5]</sup>). Some adjustments to the definition of informal employment were discussed at the time of writing of this report, for adoption during the International Conference of Labour Statisticians (ICLS) in October 2023. The revised definition takes into account the introduction of the broad concept of work and the more restricted definition of employment in the 19th ICLS resolution (ILO, 2013<sup>[6]</sup>). In addition, it considers the different categories of status in employment, as defined by

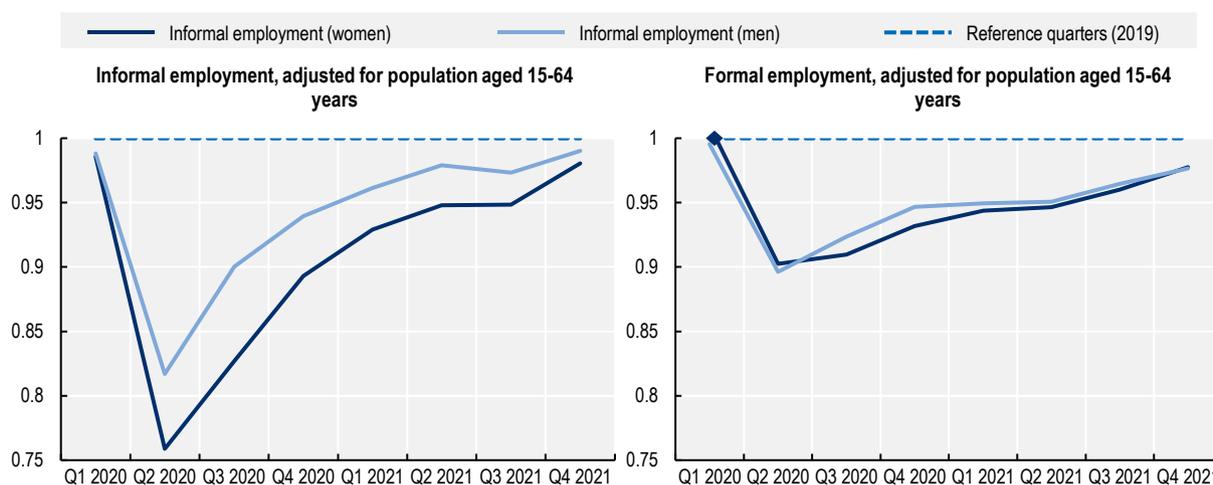
the International Classification of Status in Employment (ICSE-18) (ILO, 2018<sup>[7]</sup>), such as the new category: dependent contractors.

Source: (OECD, 2023<sup>[1]</sup>), *Informality and Globalisation: In Search of a New Social Contract*.

Another reason why informal employment is a concern is that informal workers can also be more vulnerable to different types of crises, which is often the result of a lack of social protection. For example, during the COVID-19 crisis, the informal economy did not play the traditional “cushioning” countercyclical role of absorbing workers who had been displaced from the formal economy (OECD, 2023<sup>[1]</sup>). During the 2020-21 period, informal workers were more likely than formal workers to lose their jobs or be forced into inactivity because of the prevalence of informal employment in sectors that were heavily affected by lockdown and containment measures; limited possibilities to telework; the relative ease of terminating informal employment relationships; and a higher proportion of informal workers in smaller enterprises, which struggled to survive longer periods of inactivity and had less (or no) access to support measures, including worker retention schemes (ILO, 2020<sup>[8]</sup>; ILO, 2020<sup>[9]</sup>; ILO, 2022<sup>[10]</sup>; OECD, 2023<sup>[1]</sup>). Informally employed women were disproportionately affected (Figure 2.1), not only exacerbating workers’ vulnerability to COVID-19-related policy measures but also widening gender employment gaps during the pandemic.

**Figure 2.1. Evolution of informal and formal employment during the COVID-19 crisis, by sex**

Reference quarters in 2019 = 1



Note: Estimates are based on trends in the number of formal and informal jobs in Argentina, Plurinational State of Bolivia (hereafter: Bolivia), Brazil, Chile, Costa Rica, Dominican Republic, Ecuador, Guyana, Mexico, Republic of North Macedonia, Palestinian Authority, Paraguay, Peru, Saint Lucia, South Africa, Uruguay and Viet Nam. See individual country results in (ILO, 2020<sup>[8]</sup>). *A review of country data. Impact of the Covid-19 pandemic on informality: Has informal employment increased or decreased?* Missing observations are imputed using time-fixed effects in a panel regression of countries without missing observations.

Source: Courtesy of the International Labour Organization (ILO); (OECD, 2023<sup>[1]</sup>), *Informality and Globalisation: In Search of a New Social Contract*.

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## Many informal workers typically earn lower incomes compared with formal workers

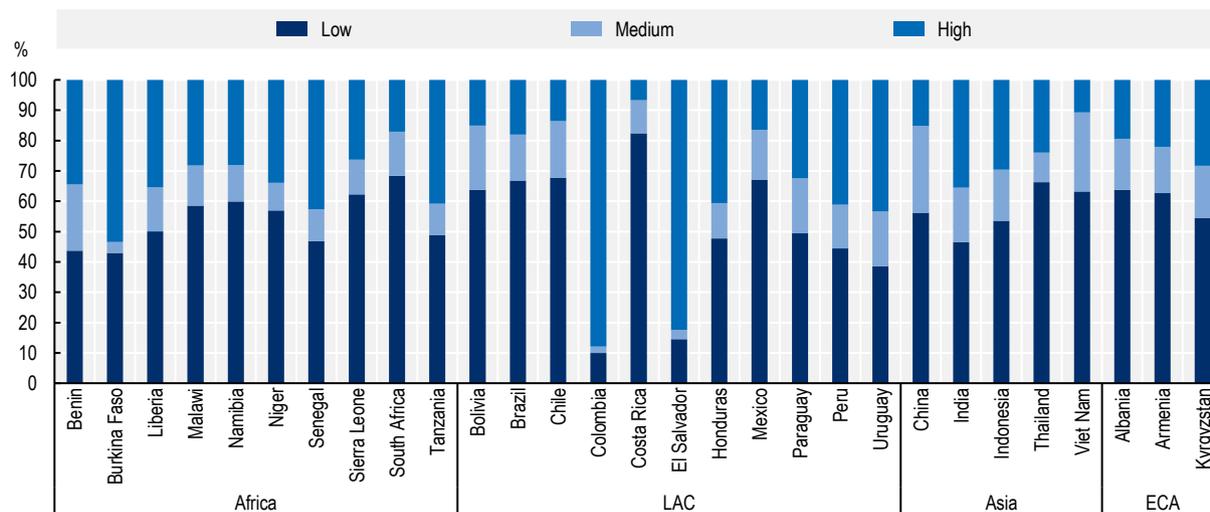
Another concern with informal employment is the fact that many informal workers earn low labour incomes.

### ***There is a greater share of informal workers who are low earners rather than high earners***

Evidence from the Organisation for Economic Co-operation and Development's (OECD's) *Key Indicators of Informality based on Individuals and their Households (KIIBIH)* database confirms a well-known feature of informal employment: in many countries, it follows a two-tier structure (Jütting and de Laiglesia, 2009<sup>[11]</sup>; Tonin, 2013<sup>[12]</sup>; Fields, 2020<sup>[13]</sup>; Fields et al., 2023<sup>[14]</sup>). Workers in the upper tier are more productive (possibly due to higher-level skills relative to workers in the lower tier) and enjoy higher earnings than those in the lower tier. Workers in the lower tier are engaged in low-productivity activities (possibly due to a lack of skills, but also due to the lack of opportunities elsewhere) and have low earnings. “Middle” earners are relatively few among informal workers. The lower tier is larger in size than the upper tier in the vast majority of countries with available data. Across countries with available data, nearly 54% of informal workers on average have earnings below 50% of the median earnings level; this proportion exceeds 80% in Costa Rica (Figure 2.2).

**Figure 2.2. Distribution of informal workers by the size of labour earnings**

Percentage of informal workers by earnings category



Note: Earnings categories are defined based on the total earnings distribution: low earnings are from the bottom of the distribution to 50% of the median earnings level; medium earnings are from 50% of the median to 150% of the median; and high earnings are 150% of the median and above. LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Authors' calculations based on (OECD, 2021<sup>[15]</sup>), *OECD Key Indicators of Informality based on Individuals and their Household (KIIBIH)*, <https://www.oecd.org/dev/key-indicators-informality-individuals-household-kiibih.htm>.

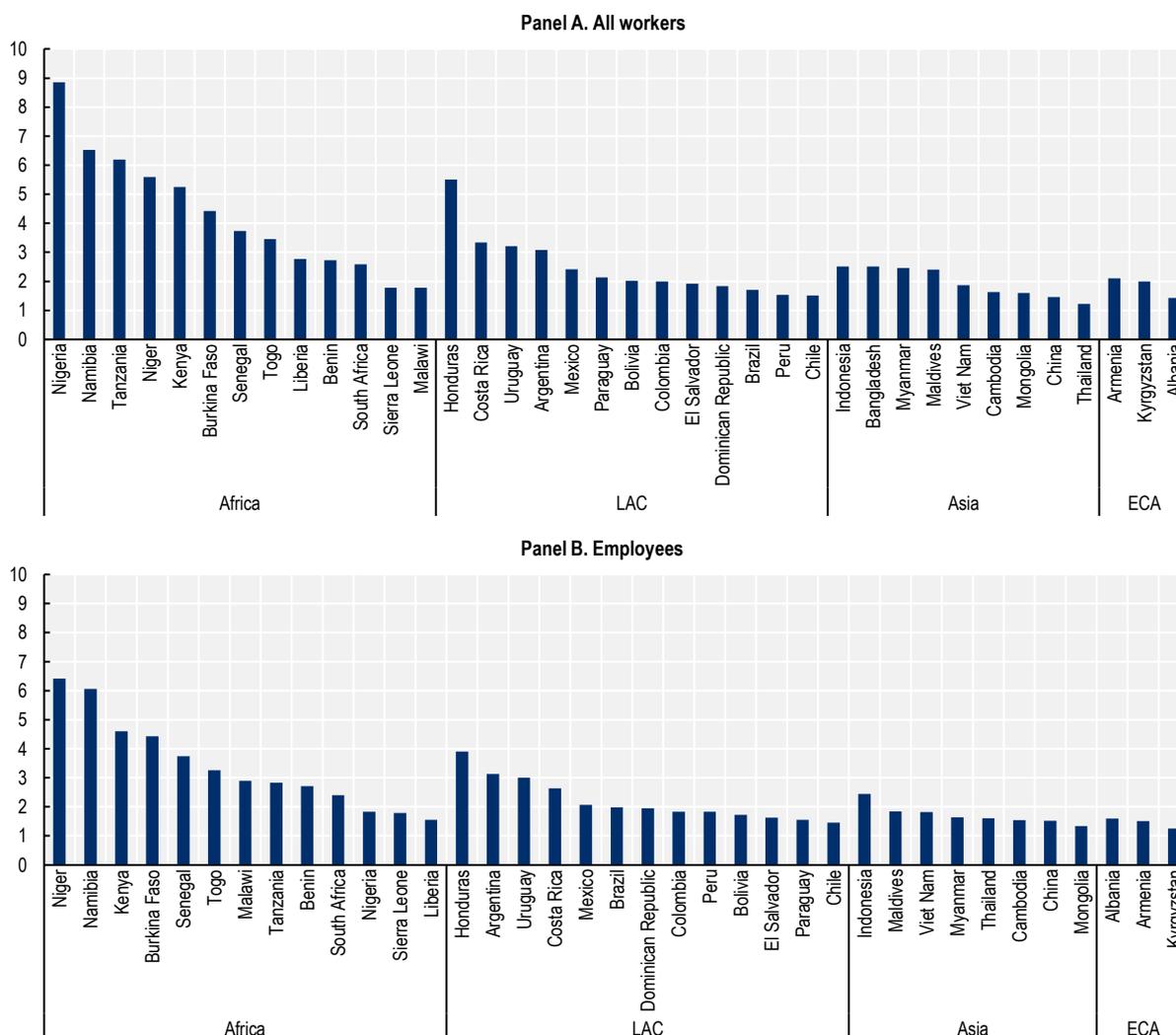
StatLink  <https://stat.link/gui0ma>

If these results are not new, what is “distressing”, in the words of (Rodrik, 2014<sup>[16]</sup>), is that in many developing and emerging economies, the proportion of lower-tier informal earners is not shrinking; on the contrary, in many cases, it is expanding, as particularly witnessed during the COVID-19 crisis (OECD, 2023<sup>[11]</sup>).

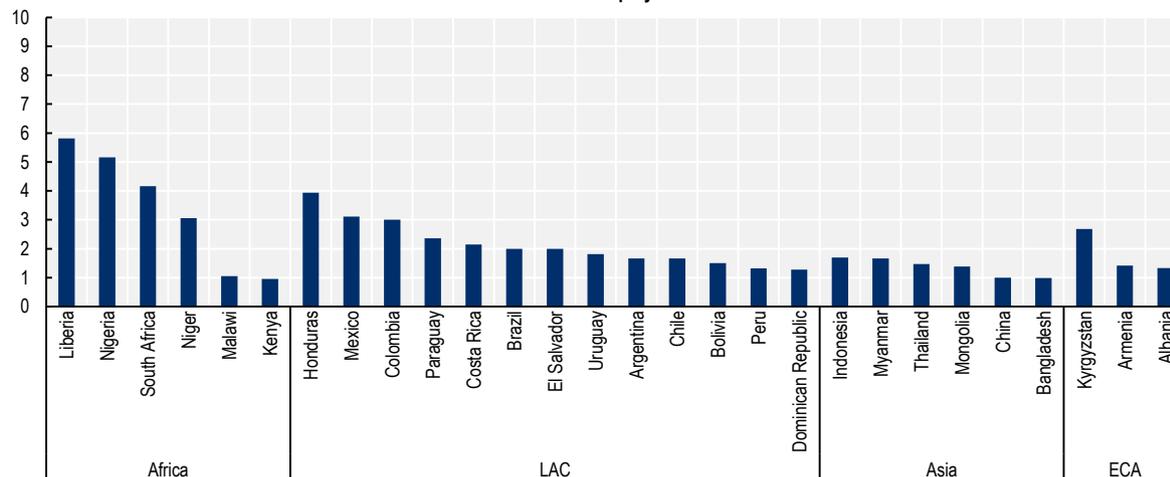
### Informal workers are earning less than formal workers, even in similar jobs

The median individual monthly labour earnings of informal workers are also substantially lower than the median individual monthly earnings of formal workers. Individual monthly labour earnings are composed of wages for employees, and labour incomes for employers and own-account workers. Comparing the median earnings of all workers (Figure 2.3, Panel A), informal workers are earning 9.0 times less than formal workers in Nigeria, 5.5 times less in Honduras, and 2.5 times less in Indonesia. There are sizeable differences in the formal-to-informal median individual monthly labour earnings across and within regions, with the greatest disparity between countries being observed in Africa. Informal workers of all statuses in employment, whether employees (Figure 2.3, Panel B), employers (Figure 2.3, Panel C) or own-account workers (Figure 2.3, Panels D and E), are affected by this earnings penalty. Excluding agricultural workers somewhat narrows (but does not eliminate) the gap, especially in countries where the size of the agricultural sector is relatively large compared with other sectors, and where informal employment is largely confined to the agricultural sector (Figure 2.3, Panels D and E).

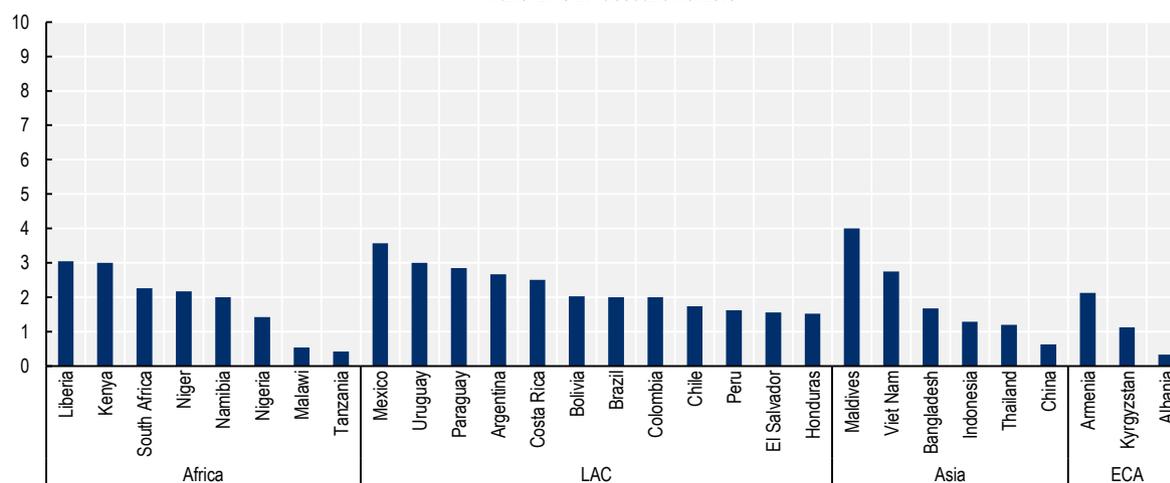
Figure 2.3. Ratio of individual monthly labour earnings of formal to informal workers (median), by country



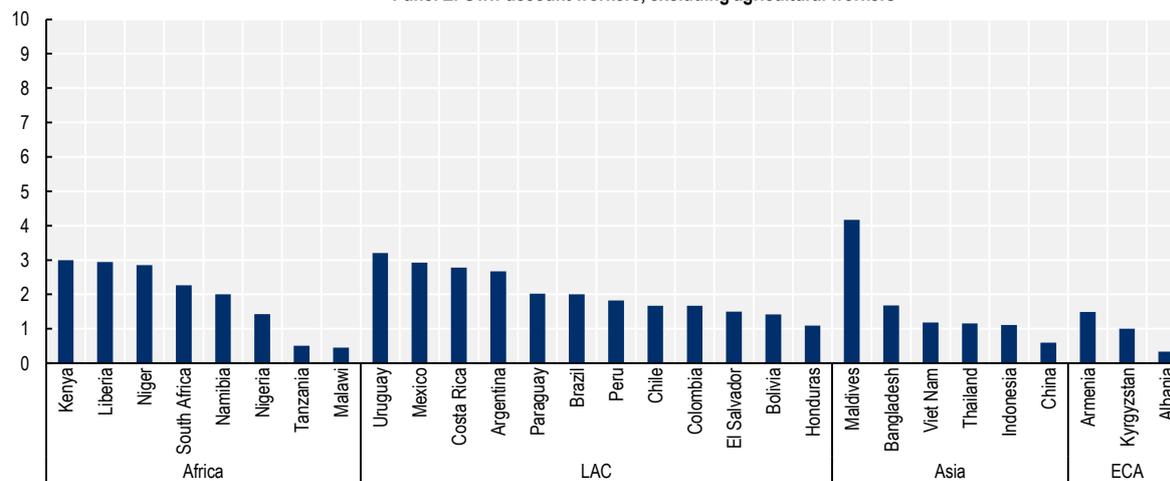
Panel C. Employers



Panel D. Own-account workers



Panel E. Own-account workers, excluding agricultural workers



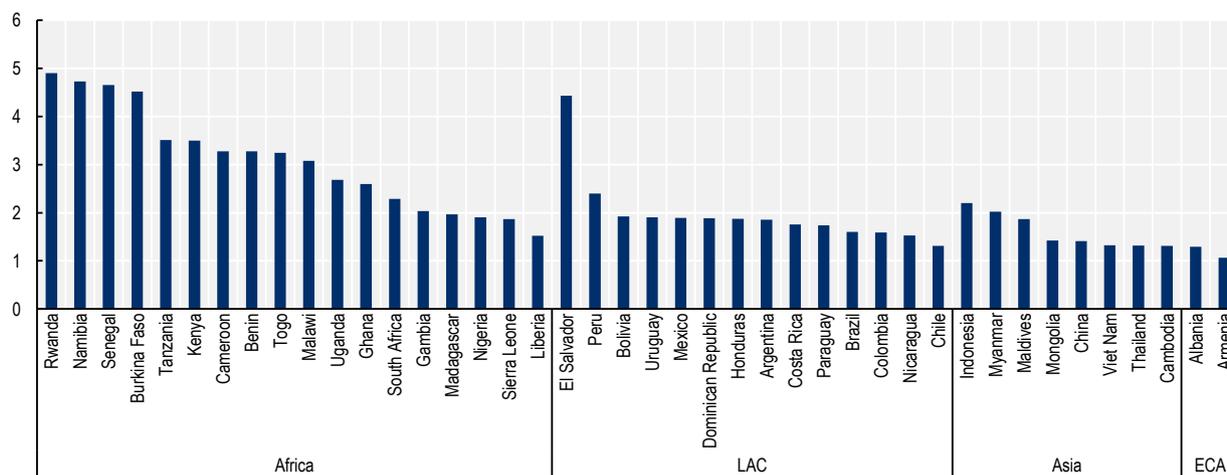
Note: The data refer to the ratio of the median formal over the median informal individual monthly labour earnings of workers. Individual monthly labour earnings consist of wages for employees, and labour incomes for employers and own-account workers. Some countries do not provide sufficient disaggregation of workers by all statuses in employment. Data are from the latest available year for countries within the KIIbIH database. LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Authors' calculations based on (OECD, 2021<sup>[15]</sup>), *OECD Key Indicators of Informality based on Individuals and their Household (KIIbIH)*, <https://www.oecd.org/dev/key-indicators-informality-individuals-household-kiibih.htm>.

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There are many reasons why median individual monthly labour earnings vary across formal and informal workers. One of them may be the unequal number of hours that formal and informal workers devote to productive activities. The information on hours worked is available for wage employees only in selected countries. Taking these data into account, one can see that the gap between formal and informal earnings is still present in all countries, although it is different from the monthly earnings gap: it is lower in some countries, but higher in others. Across 41 countries for which data are available, the ratio of median formal to informal individual hourly earnings is 2.3; it ranges from 1.1 in Armenia to 4.9 in Rwanda (Figure 2.4). In some countries, such as Kenya, the gap between the median formal and informal hourly wage for employees is smaller than the gap between the median formal and informal monthly wage (Figure 2.3, Panel B), while in others, such as Senegal, it is larger, suggesting that, depending on the country, informal workers may work more or fewer hours per month compared with formal workers. Other factors that explain this earnings penalty include the generally lower level of education among informal workers, informal workers' lower level of productivity, and informal workers' over-representation in occupations and sectors that generally pay lower wages (OECD/ILO, 2019<sup>[2]</sup>).

**Figure 2.4. Ratio of individual hourly earnings of formal to informal employees (median), by country, latest available year**



Note: The data refer to the ratio of the median formal over the median informal hourly wage of employees in their primary job. Data are from the latest available year for countries within the KIIbIH database. LAC - Latin America and the Caribbean. ECA - Europe and Central Asia.

Source: Authors' calculations based on (OECD, 2021<sup>[15]</sup>), *OECD Key Indicators of Informality based on Individuals and their Household (KIIbIH)*, <https://www.oecd.org/dev/key-indicators-informality-individuals-household-kiibih.htm>.

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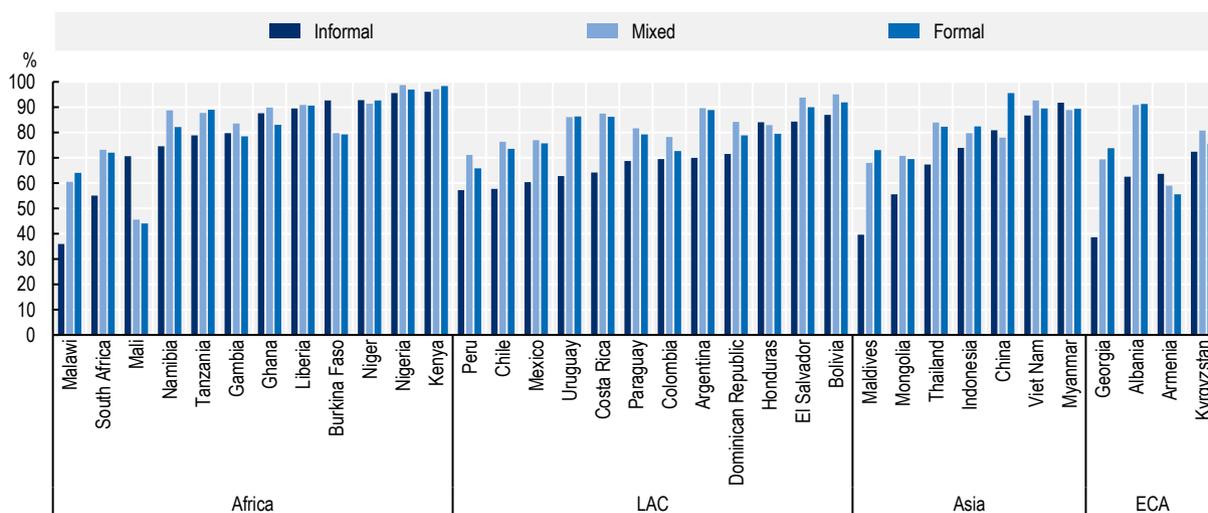
Empirical evidence – which takes into account other job-related and worker characteristics, including workers' age, gender, education, employment status, sector of activity and occupation – also confirms that informal jobs usually pay lower wages and incomes, even in similar formal jobs (Bertranou et al., 2014<sup>[17]</sup>; Reich, 2008<sup>[18]</sup>; Peña, 2013<sup>[19]</sup>; Pratap and Quintin, 2006<sup>[20]</sup>; Nordman, Rakotomanana and Roubaud, 2016<sup>[21]</sup>; Xue, Gao and Guo, 2014<sup>[22]</sup>; Bargain and Kwenda, 2014<sup>[23]</sup>; Tansel and Acar, 2016<sup>[24]</sup>). Informally working women are usually penalised more than men (Wirba, Akem and Baye, 2021<sup>[25]</sup>). For employees, enterprise characteristics – including enterprise size – also affect earnings (Nordman, Rakotomanana and Roubaud, 2016<sup>[21]</sup>).

## Informal workers and their households are at greater risk of poverty, health problems and old-age hardships

Individual earnings typically contribute significantly to household income. Indeed, the average share of household income from labour as a percentage of total household income per capita, across countries with available data, stands at 72.0% among informal households, 81.5% among mixed households and 80.5% among formal households; it exceeds 95.0% for all types of households in Kenya and Nigeria (Figure 2.5).

**Figure 2.5. Employment is the main source of income for most households**

Share of income from work as a percentage of household income per capita, by households' level of informality



Note: LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Authors' calculations based on (OECD, 2021<sup>[15]</sup>), *OECD Key Indicators of Informality based on Individuals and their Household (KIIBIH)*, <https://www.oecd.org/dev/key-indicators-informality-individuals-household-kiibih.htm>.

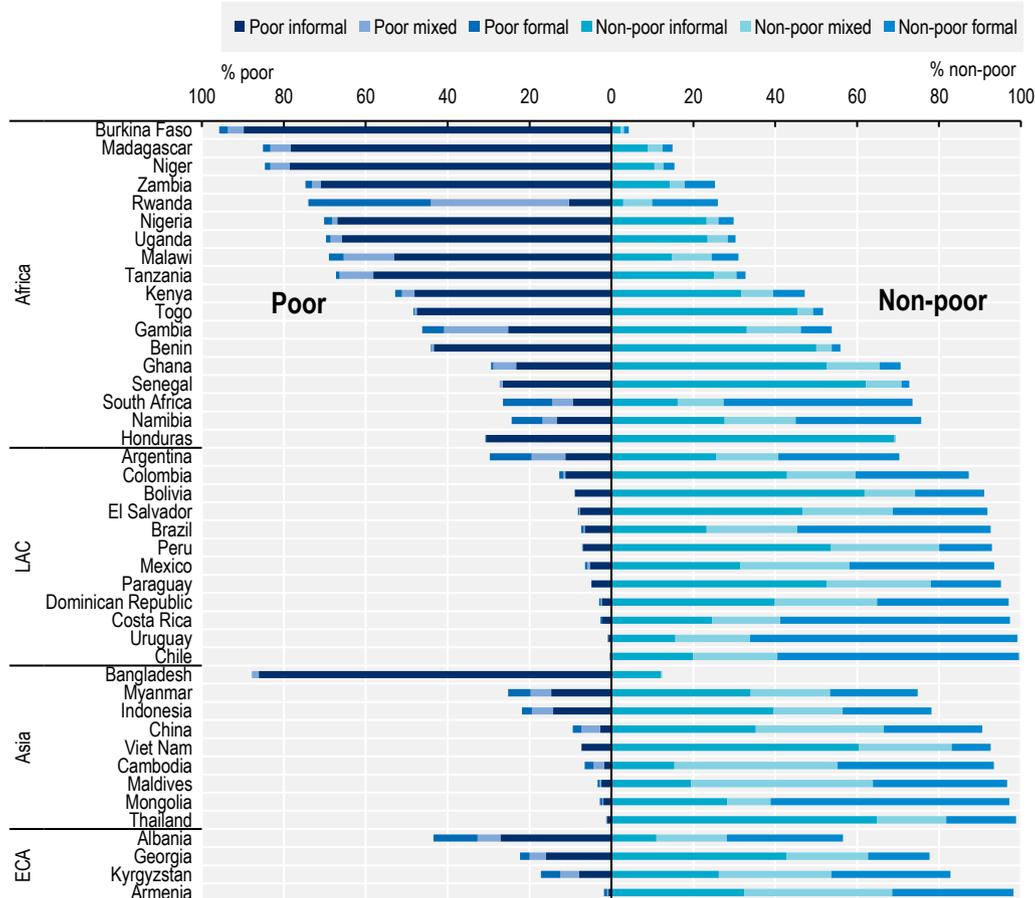
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Because informal workers' earnings are generally lower than those of formal workers, the formal to informal earnings disparity often makes informal workers more susceptible to falling into low-wage and poverty traps (Pham, 2022<sup>[26]</sup>; Amuedo-Dorantes, 2004<sup>[27]</sup>; Devicienti, Groisman and Poggi, 2010<sup>[28]</sup>; Tassot, Pellerano and La, 2019<sup>[29]</sup>). This is especially true for workers who are in the lower tier of informal employment, making poverty and informal employment intimately interrelated (OECD/ILO, 2019<sup>[2]</sup>; Kanbur, 2017<sup>[30]</sup>).

Moreover, depending on the composition of workers in the household, low pay for informal workers can be a determinant of not only individual but also household poverty. Indeed, the association between households' degree of informality and the incidence of household poverty seems to be quite strong in several countries, especially in African countries, in Bangladesh, and in Albania (Figure 2.6). More generally, households with lower income levels are significantly more likely to be completely informal.

**Figure 2.6. Household poverty risk increases with households' degree of informality**

Distribution of people by the poverty and informality status of their households



Note: Poor households are those that fall below the international poverty line of USD 3.20 (United States dollars) Purchasing Power Parities (PPPs). LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Authors' calculations based on (OECD, 2021<sup>[15]</sup>), *OECD Key Indicators of Informality based on Individuals and their Household (KIIBIH)*, <https://www.oecd.org/dev/key-indicators-informality-individuals-household-kiibih.htm>.

StatLink  <https://stat.link/bvjcs0>

The lower earnings of informal workers, coupled with the fact that labour earnings are often their only source of income, exacerbates informal workers' vulnerability to various other risks. For example, unexpected out-of-pocket medical expenses may simply be unaffordable to poor informal workers, preventing them from seeking the necessary healthcare (Oliveira, Islam and Nuruzzaman, 2019<sup>[31]</sup>; OECD, 2023<sup>[11]</sup>). Lower earnings also disproportionately increase the risk of income insecurity and income poverty in old age, because of both the lack of pension social protection and an inability to save for retirement (OECD, 2019<sup>[32]</sup>). These risks are especially pronounced for women.

Low pay for informal workers also reduces potential economic resources available to other household members. As such, it can influence choices for other household members such as education (as shown in subsequent chapters), labour market participation, healthcare and retirement. It can also translate into limited social capital, as well as limited educational and labour market opportunities for household members (Domínguez and Watkins, 2003<sup>[33]</sup>).

Moreover, both poverty and informal employment are highly persistent circumstances that can reinforce each other. Past poverty can determine current informal employment, and past informal employment, in turn, can lead to higher chances of current poverty (Devicienti, Groisman and Poggi, 2010<sup>[28]</sup>). This opens space for specific policies to break the poverty–informal employment cycle for informal workers, especially for those in the lower tier of informal employment, as well as for their families.

## Key policy messages

This chapter has shown that informal workers and their family members often face a greater range of risks compared with formal workers. These include risks associated with poorer protection by labour laws and absent or inadequate social protection. As the recent COVID-19 crisis has shown, informal workers may also face higher risks of losing their job. Informal workers also tend to earn lower incomes compared with formal workers. Moreover, informal employment in the majority of developing and emerging economies with available data features two tiers. The lower tier, often comprising the greatest number of workers, is composed of low-skilled, low-productivity workers earning low incomes; the upper tier, which is usually relatively small, is composed of informal workers with higher-level skills and earning high incomes. If all informal workers face a greater range of socio-economic risks, workers in the lower tier, as well as their household members, are particularly vulnerable to poverty because, in the absence of social protection, they cannot afford to cover these risks on their own. Taken together, these risks and poorer outcomes of the majority of informal workers point to the high costs that informal employment presents to individuals and to society.

The next chapter shows that opportunities to transition from informal to formal employment remain quite limited. Moreover, such transitions have a potential to increase labour income only for those workers who are already high earners, confirming the two-tier view of informal employment.

As will be argued later in this report, the two-tier nature of the informal employment sector begs for different policy actions for each of the two tiers.

One type of action concerns the skills development of informally employed adults and of their children in order to equip them with higher-order skills, and thus allow them to break the skills barrier of the lower tier of informal employment that features low productivity. Chapters 4 and 5 inquire into the specificities of such potential policy actions.

Another type of action concerns redistribution and social protection. Indeed, informal workers' individual earnings are one of the key indicators that can help identify social protection extension strategies, as discussed in Chapter 6.

On the one hand, informal workers in the lower tier lack the contributory capacity to pay for social protection. For these workers, informal employment is most likely not a choice, but the outcome of a lack of formal employment opportunities. With this lack of social protection, informal work is also often the only option to survive (OECD/ILO, 2019<sup>[2]</sup>; Banerjee and Duflo, 2011<sup>[34]</sup>; Margolis, 2014<sup>[35]</sup>; Günther and Launov, 2012<sup>[36]</sup>; La Porta and Shleifer, 2014<sup>[37]</sup>). As such, informal employment earnings do play a role in reducing poverty when the alternative is no earnings at all, and in a certain sense already substitute for nonexistent social protection. It is therefore important to recognise the role that the informal economy is playing in sustaining people's livelihoods. For informal workers, contributory social protection schemes would have to be either subsidised by the government and/or complemented with employer contributions when possible. Some of these schemes should also include other vulnerable household members of informal workers, such as children or elderly family members. This subsidisation of lower-tier informal workers and their families should be seen as an investment into a more inclusive growth process and as a way to break the poverty–informal employment cycle (OECD, 2019<sup>[32]</sup>).

On the other hand, informal workers in the upper tier actually do have some individual capacity to contribute to social insurance schemes. As such, there is scope for including them in the existing schemes, either by extending coverage or by improving access, compliance and enforcement.

More broadly, since income is an important determinant of general well-being, life satisfaction, political engagement and social cohesion (Frank-Borge, Wietzke and McLeod, 2013<sup>[38]</sup>), lower pay of informal workers presents broader social limitations to these workers, making the case for continued efforts to create more formal employment opportunities and decent, better-paying jobs at all levels of skill, and in all sectors and occupations.

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# **3** Transitions to and from formal employment and income dynamics

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Formalisation provides social security and labour law protection; but does it also improve earnings and lift workers out of low-paying work? This chapter analyses four issues. First, it inquires into how common transitions to formal employment are. Second, it analyses whether the chances of transitioning to formal jobs are the same for all types of informal workers. Third, it investigates whether formalisation is indeed accompanied by income improvements for workers, and conversely, whether transitions into informal employment are accompanied by income losses. Finally, it inquires into whether the potential benefits of formalisation accrue to all workers.

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Since the 1990s, many countries have achieved certain progress in formalising their workforces. Yet, formalisation gains are often considered to come too slowly. Moreover, progress appears to be regularly challenged or even reversed by various global shocks, such as the COVID-19 pandemic, wars and conflicts, international trade disruptions, innovative disruptions and the development of new forms of work (OECD, 2023<sup>[1]</sup>).

Given this, it is instructive to look not only at changes in stocks but also at flows (in other words, transitions) between formal and informal employment over both short and long periods of time, including their magnitude and the types of workers affected by these transitions. What types of workers are more likely to experience transitions into, and out of, formal employment? Importantly, does formalisation provide tangible financial benefits, in terms of better wages and profits, in addition to the longer-term (and sometimes less tangible) benefits of social protection and protection by labour laws? And do such potential benefits from formalisation accrue to all workers? Answering these questions can help shape formalisation policies, as well as broader labour market and social protection policies, with a view to better targeting them towards workers who cannot formalise, for whom formal employment is not sustainable, or who do not enjoy all the benefits of formalisation.

To answer these questions, this chapter uses panel data for four developing and emerging economies: Indonesia, Malawi, Peru and South Africa. These countries were chosen because of the availability of panel data and because they represent examples from different continents and that are at different stages of development. The longitudinal data for these countries were collected during different time periods: the Indonesian data used were collected every seven years between 2000 and 2014; Malawian data were collected every three years between 2010 and 2019; Peruvian data were collected every year between 2016 and 2020; and South African data were collected every two years between 2008 and 2016 (for further details about the data, see Annex 3.A Data description). Because data collection was carried out during different periods across these four countries, and the lengths of time between panel data collection waves differ by country, the results are not directly comparable between the countries analysed. Despite these differences in data collection, several common observations emerge.

## Transitions between formal and informal employment remain relatively limited

As a start, this chapter provides an overview of transitions between three labour market states in Indonesia, Malawi, Peru and South Africa: employment in informal jobs, employment in formal jobs and non-employment (which includes both unemployment and economic inactivity) for individuals of working age (15-65 years). Figure 3.1 shows that formal employment remains limited and is enjoyed by the smallest group of workers in Indonesia, Malawi and Peru. In South Africa, the size of the formal and informal employment groups is relatively similar. The data show that, in all four countries, the stock of formal employment has slightly increased over time, consistent with the general patterns observed in these four countries (OECD, 2023<sup>[1]</sup>).

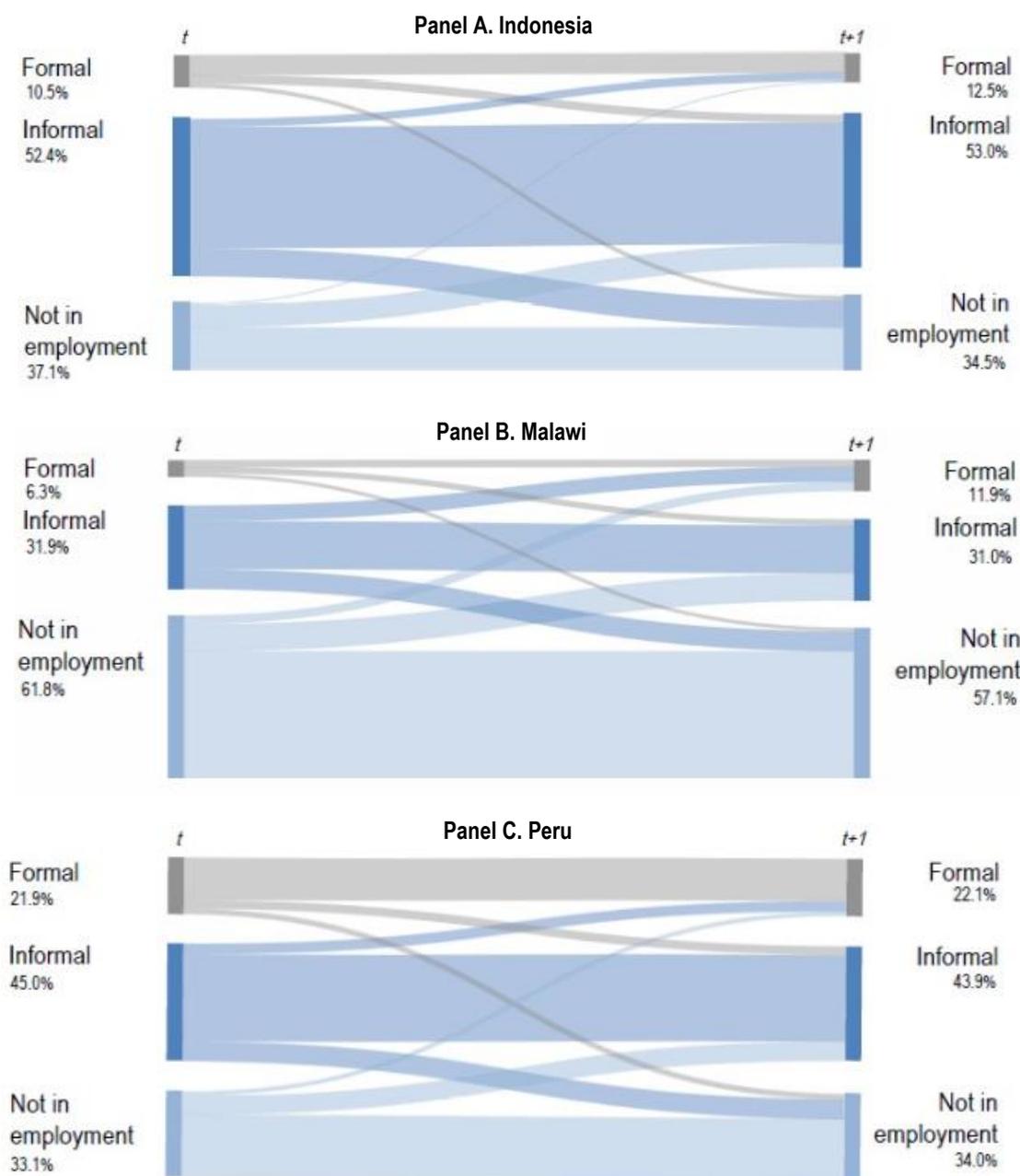
Regarding labour market transitions between the labour market states, three observations emerge.

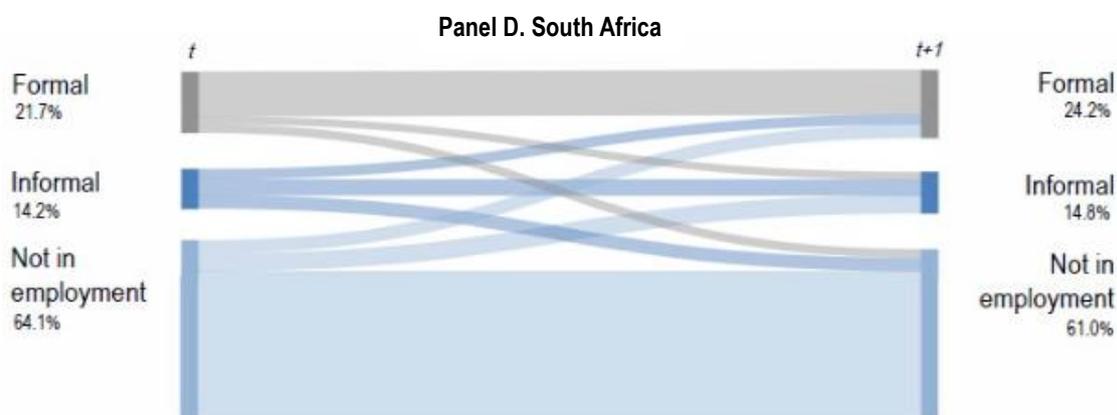
First, in Indonesia, Malawi, Peru and South Africa, the labour market transitions between the three employment states were observed in all three directions: not only did workers move towards formal employment (a general policy objective) but also towards informal employment, and to non-employment (Figure 3.1).

Second, despite these dynamics, the vast majority of workers were not observed transitioning between data collection time periods, whether they were in formal, informal or non-employment.<sup>1</sup> In other words, immobility remains the norm, and the three employment states are relatively stable. Yet, in Indonesia and Malawi, over relatively long periods, formal employment is the least stable state of all: in relative terms, fewer workers remain in formal employment compared with the other states over any studied period.

Third, flows towards formal employment are also the smallest compared with flows between the other states. By far the largest volume of transitions occur between informal employment and non-employment. Of the informal workers who transitioned out of informal employment, more than two-thirds transitioned into non-employment. This was especially prevalent in Indonesia and Malawi, where 75.8% of workers in Indonesia and 61.2% of workers in Malawi who transitioned out of informal employment went into non-employment. At the same time, those who move out of unemployment or economic inactivity tend to take up primarily informal jobs. Also, workers who exit formal employment primarily move to informal employment rather than to non-employment. This suggests that informal employment is not only an important entry point into the labour market but also a labour market segment that absorbs workers who cannot find or keep formal jobs.

**Figure 3.1. Transitions between three employment states, by country**





Note: Data refer to seven-year time periods for Indonesia (three waves covering 2000-14); three-year time periods for Malawi (four waves covering 2010-19); one-year time periods for Peru (five waves covering 2016-20); and two-year time periods for South Africa (five waves covering 2008-16). Estimates are generated for transitions between two consecutive time periods (e.g. 2000-07 and 2007-14 for Indonesia); the average for all time periods by country is reported. Wave-to-wave transitions are reported in Annex 3.B.

Source: Authors' calculations based on data from the RAND Institute (2000<sup>[2]</sup>; 2007<sup>[3]</sup>; 2015<sup>[4]</sup>) (the Indonesian Family Life Survey 2000, 2007 and 2014); the Malawi National Statistical Office (2010<sup>[5]</sup>; 2013<sup>[6]</sup>; 2016<sup>[7]</sup>; 2019<sup>[8]</sup>) (the Malawi Integrated Household Survey 2010, 2013, 2016 and 2019); Peru's National Institute of Statistics and Information (2020<sup>[9]</sup>) (Encuesta Nacional de Hogares (ENAHO) Panel 2016, 2017, 2018, 2019 and 2020); and the Southern Africa Labour and Development Research Unit (SALDRU) (2008<sup>[10]</sup>; 2010<sup>[11]</sup>; 2012<sup>[12]</sup>; 2014<sup>[13]</sup>; 2016<sup>[14]</sup>) (National Income Dynamics Study (NIDS) 2008, 2010, 2012, 2014 and 2016).

### ***In Indonesia...***

More than one-half of workers did not change their employment state over any given seven-year period between 2000 and 2014. Formal employment is the least stable state: only 55.9% of formal workers (compared with 72.3% of informal workers and 59.1% of those in non-employment) remained in the same state (Figure 3.1, Panel A). At the same time, 28.7% of formal workers transitioned into informal work, and 15.3% of formal workers transitioned into non-employment; conversely, 6.8% of informal workers transitioned into formal employment, and 20.9% of informal workers transitioned into non-employment. Only 8.2% of non-employed persons transitioned into formal employment, while 32.6% of non-employed persons transitioned into informal employment.

### ***In Malawi...***

While many workers remained stationary over the three-year time periods from 2010 to 2019, there was also much activity (Figure 3.1, Panel B). Here, too, formal employment was the least stable state. While 42.0% of formal workers remained in this state, 36.2% became informal and 21.8% transitioned into non-employment; meanwhile, 57.5% of informal workers remained informal, while 18.4% formalised and 24.1% transitioned into non-employment. Among non-employed persons, 77.7% remained in the same state, while 16.9% became informal workers and 5.4% became formal workers.

### ***In Peru...***

Year-to-year transitions between 2016 and 2020 were relatively frequent: on average, around 27.0% of persons transitioned into a new employment state (Figure 3.1, Panel C); 74.6% of formal workers remained formal, 73.9% of informal workers remained informal, and 72.9% of non-employed persons remained in non-employment. The majority of persons who changed their employment state transitioned between informal employment and non-employment: 17.1% of informal workers transitioned into non-employment (compared with 9.0% who transitioned into formal work), and 22.2% of persons in non-employment

transitioned into informal work (compared with 4.9% who transitioned into formal work). Among formal workers, 15.3% transitioned into informal employment, and 10.1% transitioned into non-employment.

### ***In South Africa...***

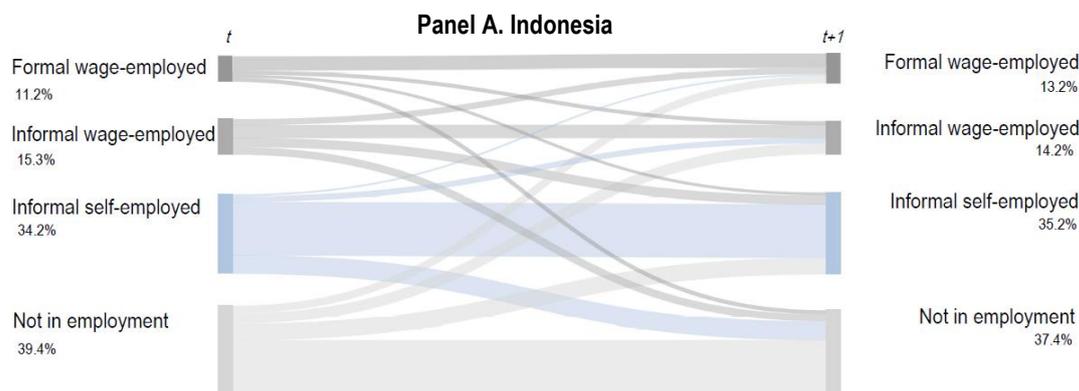
Biannual transitions between 2008 and 2016 show that informal workers were the most likely to change their employment state, with formal workers and those out of employment being much less likely to change their state between data collection periods (Figure 3.1, Panel D). On average, 73.0% of formal workers remained in formal employment, while 12.7% took up informal work and 14.3% transitioned into non-employment. Meanwhile, 82.8% of those not in employment remained in this state, while 10.0% switched to informal work and 7.2% transitioned into formal employment. Comparatively, only 39.7% of informal workers remained informal, and those who changed employment state had nearly equal chances of transitioning to formal employment (26.3%) or into non-employment (34.0%).

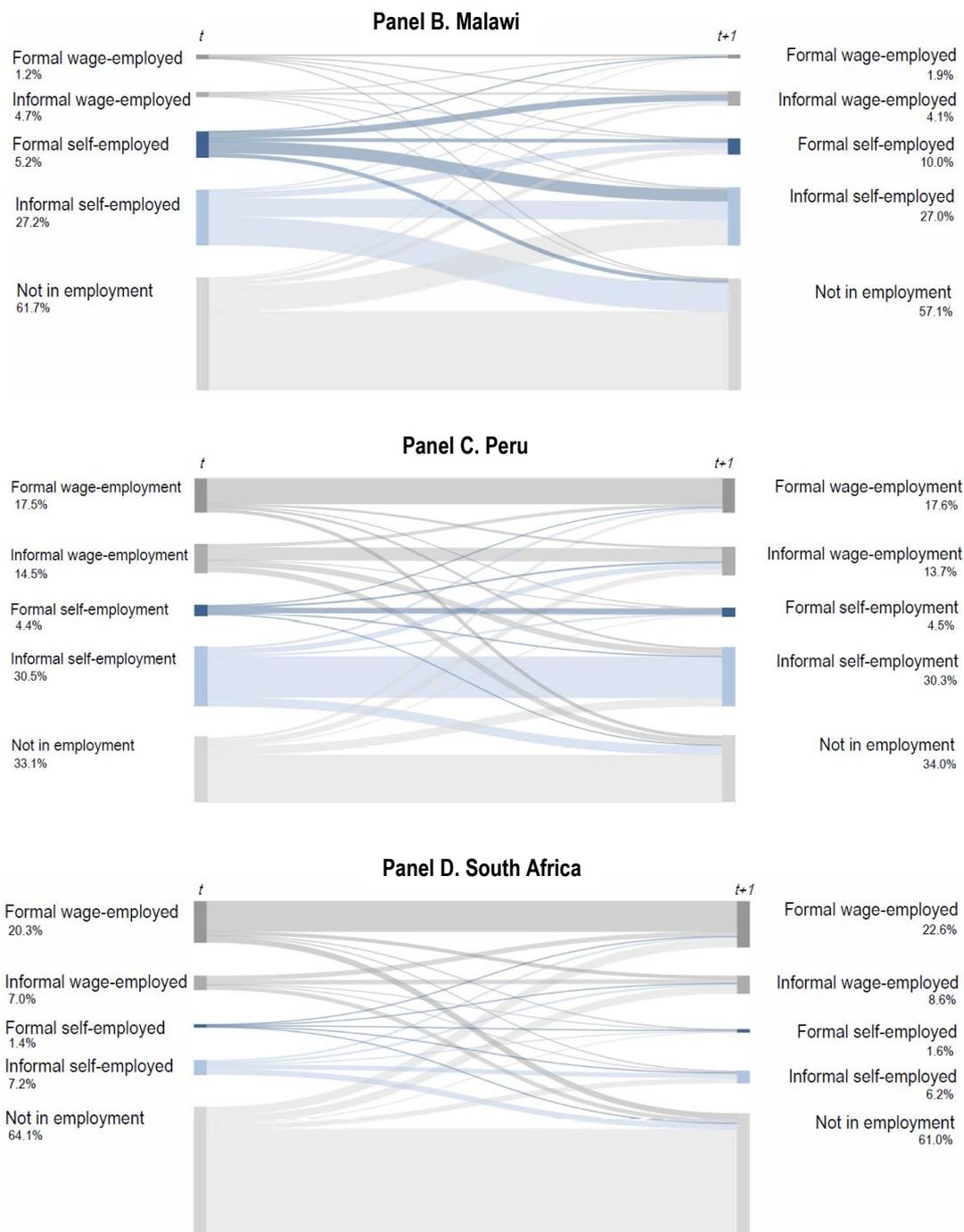
## **Transition into formal employment is most difficult for those outside of wage employment**

Status in employment<sup>2</sup> is one of the key sources of heterogeneity among workers, whether formal or informal. Self-employed workers have typically been considered more vulnerable to shocks, as they do not benefit from the standard protections and employment benefits that formal employees have. For them, informal employment is most often not a choice, but a constrained outcome; some of these workers cannot afford not to work but may be continuously looking for formal employment opportunities. In this regard, it is instructive to examine transitions not only between informal and formal employment but also between different employment statuses within informal and formal employment and between employment and non-employment.

Figure 3.2 disaggregates transitions between two consecutive periods of time for employees and for self-employed workers in Indonesia, Malawi, Peru and South Africa. At the start of any given time period, the share of those in formal wage employment is greater than the share of those in informal self-employment only in South Africa; in the three other countries, informal self-employment is the largest segment of the labour market. The figure shows that those in informal self-employment and non-employment have the lowest probability of changing status between data collection periods. By contrast, informal employees have the highest chances of transitioning to formal jobs compared with other types of workers.

**Figure 3.2. Transitions between five employment states, by country**





Note: In Indonesia, the formal self-employment category is not shown, as the data for these workers are not available. Data refer to seven-year time periods for Indonesia (three waves covering 2000-14); three-year time periods for Malawi (four waves covering 2010-19); one-year time periods for Peru (five waves covering 2016-20); and two-year time periods for South Africa (five waves covering 2008-16). Estimates are generated for transitions between two consecutive time periods (e.g. 2000-07 and 2007-14 for Indonesia); the average for all time periods by country is reported.

Source: Authors' calculations based on data from the RAND Institute (2000<sup>[2]</sup>; 2007<sup>[3]</sup>; 2015<sup>[4]</sup>) (the Indonesian Family Life Survey 2000, 2007 and 2014); the Malawi National Statistical Office (2010<sup>[5]</sup>; 2013<sup>[6]</sup>; 2016<sup>[7]</sup>; 2019<sup>[8]</sup>) (the Malawi Integrated Household Survey 2010, 2013, 2016 and 2019); Peru's National Institute of Statistics and Information (2020<sup>[9]</sup>) (Encuesta Nacional de Hogares Panel 2016, 2017, 2018, 2019 and 2020); and SALDRU (2008<sup>[10]</sup>; 2010<sup>[11]</sup>; 2012<sup>[12]</sup>; 2014<sup>[13]</sup>; 2016<sup>[14]</sup>) (National Income Dynamics Study (NIDS) 2008, 2010, 2012, 2014 and 2016).

### ***In Indonesia...***

Among informal self-employed individuals, the majority remained in that employment state (66.7%) over any given seven-year interval (Figure 3.2, Panel A). When informal self-employed individuals did change employment states, they were most likely to go into non-employment (23.7%) rather than into informal wage employment (7.3%) or formal wage employment (2.3%).

Almost one-half of formal employees left the formal economy or workforce between data collection periods: only 57.5% remained in formal employment, while those who left formal employment had similar chances of transitioning to informal self-employment (11.5%), informal wage employment (15.2%) or non-employment (15.9%).

Informal employees had the highest chances of transitioning to a different employment state between data collection periods: only 35.4% retained employment as informal employees. 17.4% of informal employees transitioned to formal wage employment, 25.9% transitioned to informal self-employment, and 21.3% transitioned to non-employment.

Lastly, those in non-employment largely remained in non-employment (61.7%). When non-employed individuals transitioned to work, they were more likely to start an informal self-employment activity (18.2%) than to become an informal employee (11.7%) or a formal employee (8.4%).

The formal self-employed category could not be analysed for Indonesia, as the data for these workers are not available.

### ***In Malawi...***

The formal self-employed were most likely to transition to either informal self-employment or non-employment: while 14.7% did not transition out of formal self-employment between three-year periods, 58.9% turned to informal self-employment and 20.2% transitioned into non-employment in the next period (Figure 3.2, Panel B). There was an extremely low probability of transitioning to formal wage employment: only 0.6% of formal self-employed individuals secured such a position between data collection periods.

In contrast, informal self-employed individuals had the highest chances of all worker types to fall into non-employment: 51.3% of informal self-employed individuals became unemployed or economically inactive between data collection periods. They were more likely to fall into non-employment than to retain their informal self-employment activity: only 33.5% did not transition to a different state between data collection periods. Informal self-employed individuals were even less likely to formalise or to switch into wage employment: only 2.5% became informal employees, 12.1% became formally self-employed, and 0.5% became formal employees.

Informal employees had similar chances of transitioning to other forms of work if they did not remain in their current employment status (28.4%) or fall into non-employment (12.4%): 19.0% became formal employees, 19.1% began formal self-employment activities and 21.1% began informal self-employment activities.

Formal employees were comparatively the least likely to fall into non-employment (8.3%) and were more likely to retain their status as employees, whether formal (32.3%) or informal (34.2%). When formal employees transitioned out of wage employment, they were more likely to turn to informal self-employment (20.9%) than to formal self-employment (4.3%).

While those in non-employment were most likely to remain in non-employment (69.4%), transitioning to employment usually meant starting their own informal self-employment activities (22.6%). They had very low chances of breaking into the labour force beyond that: 4.5% started their own formal self-employment activities, while 2.8% became informal employees and 0.7% became formal employees.

***In Peru...***

With the exception of informal employees, the majority of workers in the Peruvian sample did not transition to a different state between data collection time periods (Figure 3.2, Panel C).

Informal employees had a 44.7% probability of remaining in informal wage employment; where they did transition to a different state, they were most likely to transition to either informal self-employment (21.2%) or non-employment (20.3%). Otherwise, 11.8% transitioned into formal paid employment, while 2.0% had started formal self-employment activities by the next data collection period.

The formal self-employed largely remained in formal self-employment (59.5%). When they did transition, they were most likely to go into informal self-employment (16.5%) or non-employment (11.2%), rather than informal wage employment (6.2%) or formal wage employment (6.6%).

The informal self-employed also largely remained in this category of activity (68.4%) between data collection time periods, and when they did change state, they were more likely to transition to non-employment (15.6%) than to formal self-employment (3.1%), informal wage employment (9.3%) or formal wage employment (3.7%).

Formal employees were the most likely to retain their activity type (74.8%) between data collection time periods, although those who did change state had higher chances of falling into non-employment (9.8%) than transitioning to other categories of activity: 6.7% became informal employees, 6.7% became informal self-employed individuals, and only 2.0% became formal self-employed individuals.

Those in non-employment also faced a high probability of remaining in this state (72.9%) between data collection time periods, and like in the other countries, were most likely to transition to informal self-employment (13.3%) when they were able. They had low chances of transitioning to informal wage employment (8.9%), formal wage employment (4.2%) and formal self-employment (0.7%).

***In South Africa...***

Again, informal employees had the highest probability of transitioning to a different state rather than remaining informal employees: while 27.4% remained in informal wage employment, 34.0% moved into formal wage employment and 29.1% transitioned into non-employment (Figure 3.2, Panel D). There was a relatively lower chance that they moved into formal self-employment (2.4%) or informal self-employment (7.1%).

Similarly, those in formal and informal self-employment were highly likely to change their employment states as well. Only 35.1% of formal self-employed workers remained in this category of activity, with similar chances of moving into formal wage employment (17.4%), informal self-employment (20.3%) or non-employment (20.2%). Only 7.0% became informal employees. Informal self-employed individuals faced a similar retention rate (31.0%), but were far more likely to transition into non-employment (38.8%) than into other types of employment. They had similarly low chances of transitioning to formal wage employment (12.4%), informal wage employment (13.8%) and formal self-employment (4.1%).

Formal employees and those in non-employment had the lowest probability of changing their employment state. Among formal employees, 72.9% remained in this employment state between data collection time periods. The most probable transition out of formal wage employment was to non-employment (13.9%) compared with informal wage employment (8.9%), informal self-employment (2.8%) or formal self-employment (1.5%) wage employment. Persons in non-employment had an even higher probability of remaining in unemployment or economic inactivity (82.8%), and very low chances of becoming formal employees (6.7%), informal employees (5.9%), informally self-employed (4.1%) or formally self-employed (0.5%).

## Transition probabilities also differ depending on individual characteristics and location

Looking beyond status in employment, several other factors can affect transitions between employment states.

### ***Labour markets are segmented not only by informal employment but also by gender***

One such factor is gender. Many countries have gendered societal expectations around work (OECD, 2019<sub>[15]</sub>), which often limit women's job-seeking behaviour and reduce opportunities for women to find or create their own employment.

At the start of any transition period in all four countries considered in this chapter, there is a greater share of women not in employment compared with men. When women do work, they are also less likely than men to work formally. The percentage point difference in formal employment rates between women and men ranges from 7.2 percentage points in Malawi to 8.9 percentage points in Indonesia, 11.8 percentage points in Peru and 13.9 percentage points in South Africa (Figure 3.3 to Figure 3.6).

When looking at labour market transitions, two observations emerge (Figure 3.3 to Figure 3.6).

First, there is a greater share of women, compared with men, who change their labour market state over a given period in all four countries. More men than women remain in the same labour market state.

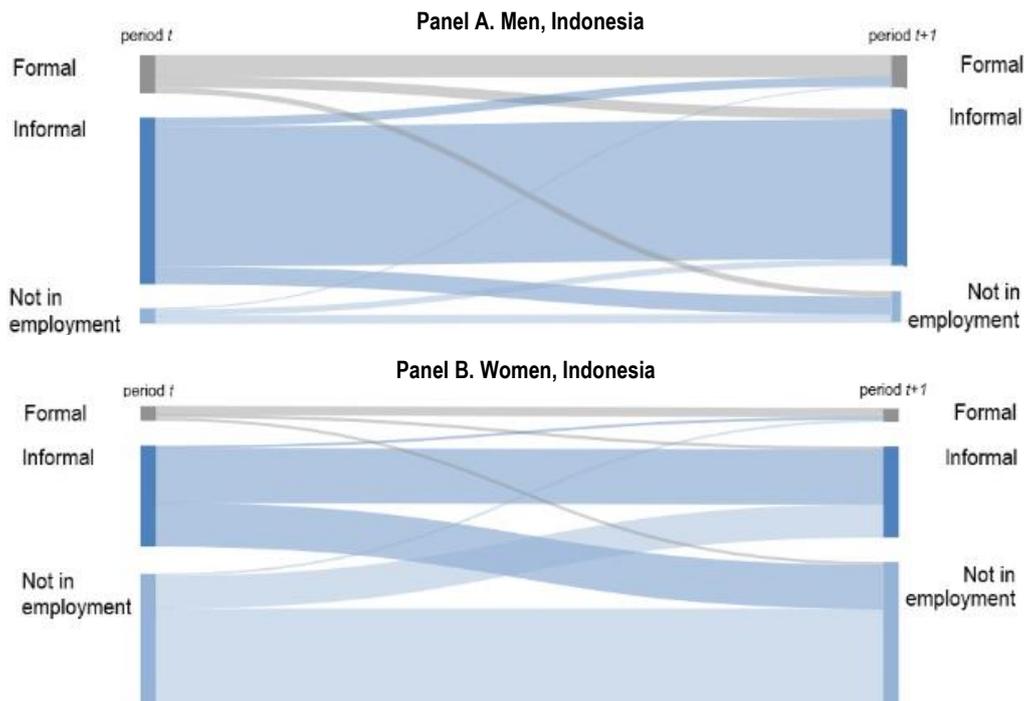
Second, the most likely transitions for women are between informal work and non-employment (in both directions), rather than between either of these and formal jobs.

In particular, women have lower chances compared with men of moving to formal employment from any other status (whether informal employment or non-employment), in any country and over any given period. At the same time, women have greater chances compared with men of moving to non-employment from any other employment state in any country and over any given period.

When women move to formal employment, they are more likely to make this transition from informal employment rather than from non-employment. This suggests that, even if these possibilities are limited, some informal jobs can represent a stepping stone into formal employment for women. For men, this pattern is observed only in South Africa, but not in the other three countries examined in this chapter.

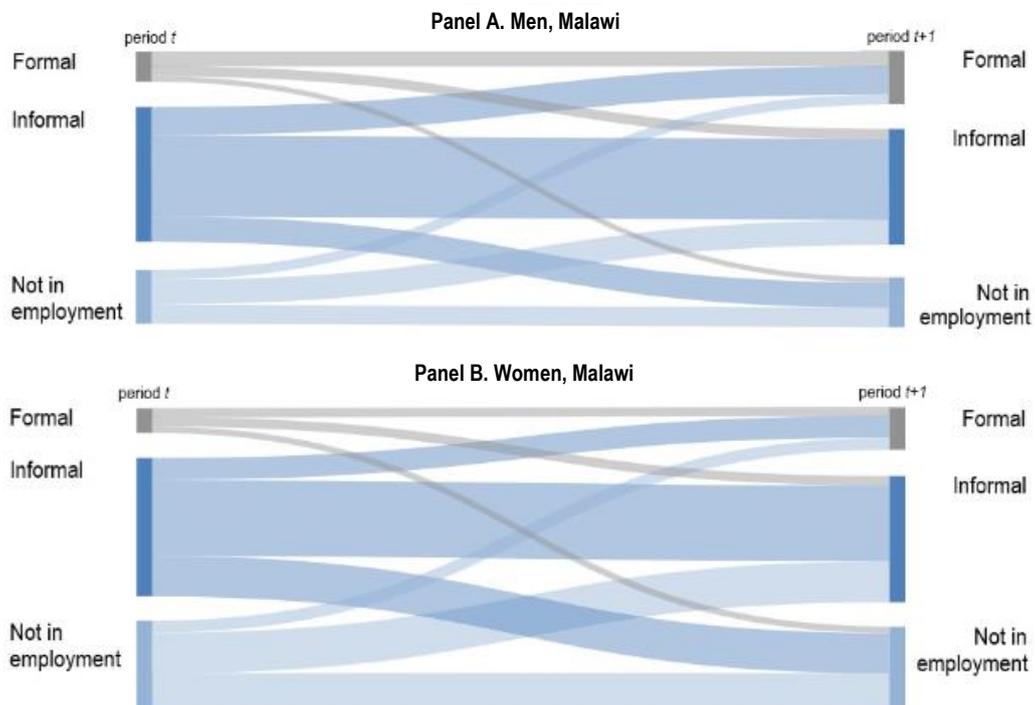
Finally, when women move out of informal employment, they are more likely to transition to non-employment rather than to a formal job. This pattern does not hold for men in Malawi, Peru and South Africa, who are equally likely to move from informal employment into non-employment or to a formal job.

Figure 3.3. Labour market transitions in Indonesia, by gender



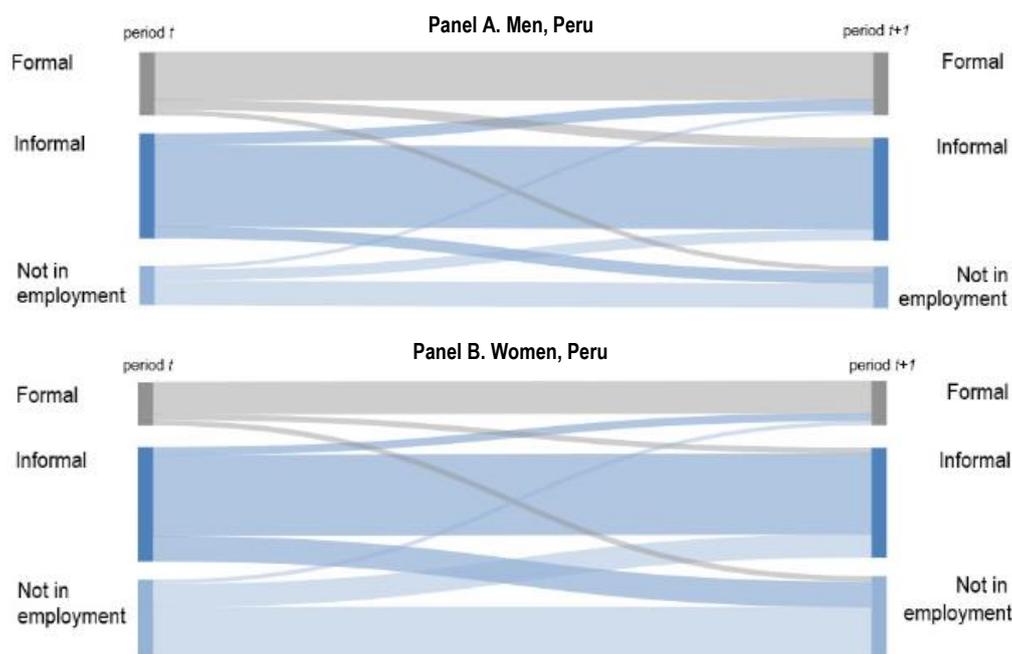
Note: Pooled labour market transitions by gender. Data refer to seven-year time periods for Indonesia (three waves covering 2000-14).  
 Source: Authors' calculations based on data from the RAND Institute (2000<sup>[2]</sup>; 2007<sup>[3]</sup>; 2015<sup>[4]</sup>) (the Indonesian Family Life Survey 2000, 2007 and 2014).

Figure 3.4. Labour market transitions in Malawi, by gender



Note: Pooled labour market transitions by gender. Data refer to three-year time periods for Malawi (four waves covering 2010-19).  
 Source: Authors' calculations based on data from the Malawi National Statistical Office (2010<sup>[5]</sup>; 2013<sup>[6]</sup>; 2016<sup>[7]</sup>; 2019<sup>[8]</sup>) (the Malawi Integrated Household Survey 2010, 2013, 2016 and 2019).

**Figure 3.5. Labour market transitions in Peru, by gender**



Note: Pooled labour market transitions by gender. Data refer to one-year time periods for Peru (five waves covering 2016-20).  
 Source: Authors' calculations based on data from Peru's National Institute of Statistics and Information (2020<sup>[9]</sup>) (Encuesta Nacional de Hogares (ENAHOG) Panel 2016, 2017, 2018, 2019 and 2020).

**Figure 3.6. Labour market transitions in South Africa, by gender**



Note: Pooled labour market transitions by gender. Data refer to two-year time periods for South Africa (five waves covering 2008-16).  
 Source: Authors' calculations based on data from SALDRU (2008<sub>[10]</sub>; 2010<sub>[11]</sub>; 2012<sub>[12]</sub>; 2014<sub>[13]</sub>; 2016<sub>[14]</sub>) (National Income Dynamics Study (NIDS) 2008, 2010, 2012, 2014 and 2016).

### ***Other worker characteristics – including educational attainment and place of residence – affect transitions***

Besides status in employment and gender, many other factors affect labour market transitions. For example, it is well known that young workers (aged 15-24 years), workers living in rural areas and workers in some specific sectors (such as agriculture) are particularly vulnerable to informal employment (OECD, 2023<sup>[1]</sup>). Moreover, several factors can reinforce each other, such that workers in rural areas and in agriculture would not only have a particularly high risk of working informally but also the lowest probability of moving out of informal employment and into formal employment.

Multivariate analysis can help with understanding which individual worker characteristics have an independent significant effect on the probability of workers making certain transitions. It shows that, in Indonesia, Malawi, Peru and South Africa, in addition to working as an employee, having higher educational attainment and living in an urban area substantially increase one's chances of transitioning to formal employment (Box 3.1). Age and sector of activity can play either a favourable or an unfavourable role, depending on the country. These factors have an almost symmetric (and opposite) effect on an individual's probability of transitioning from formal employment into informal employment. The best guarantee of remaining in formal employment is to work as an employee, have higher educational attainment and live in an urban area.

The results presented in this chapter complement evidence from other country studies, which also suggests that transitions do not affect all workers equally. For example, in Nigeria, where transitions to and from formal employment are quite frequent, the probability of moving from informal to formal employment is substantially higher for relatively well-paid wage workers compared with lower-income workers (Folawewo and Orija, 2020<sup>[16]</sup>).

#### **Box 3.1. Who is more likely to experience transitions into and out of informal employment?**

Labour market transitions to and from informal employment are possible. However, the probability of making these transitions is not the same for all workers.

Multivariate analysis of panel data from Indonesia, Malawi, Peru and South Africa shows that education is among the key determinants of transitions. Workers with secondary and tertiary education in all four countries are significantly more likely to move to formal jobs than workers with no schooling are (Table 3.1, columns 1-4). Moreover, the effect of tertiary education on the probability of making such transitions is twice as high in magnitude compared with the effect of secondary education. In South Africa, even primary schooling makes a difference compared with no schooling at all: workers with primary schooling have a significantly higher chance of transitioning to a formal job than workers with no education. In all four included countries, employees have a greater chance of becoming formalised (with either the same or a different employer) compared with self-employed workers. Also, in all four countries, living in urban areas substantially increases the probability of making a transition to a formal job compared with living in rural areas. Women have a significantly lower chance of transitioning to formal jobs compared with men in all countries except Malawi, where gender does not seem to play a role in the likelihood of this transition. Age and sector of activity can play either a favourable or an unfavourable role, depending on the country. All of these factors have an almost symmetric (and opposite) effect on the probability of transitioning from formal jobs into informal employment. Better education remains the best insurance against informal employment, as does working as an employee or living in an urban area (Table 3.1, columns 5-8).

**Table 3.1. Estimation coefficients from logistic regressions examining determinants of transitions**

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Indonesia	Malawi	Peru	South Africa	Indonesia	Malawi	Peru	South Africa
	Transitions from informal to formal jobs				Transitions from formal to informal jobs			
Dependent variables								
Age	-0.026*** (0.007)	0.016** (0.007)	0.004 (0.005)	-0.013** (0.005)	0.055*** (0.009)	0.001 (0.014)	-0.015*** (0.006)	-0.018*** (0.004)
Female gender	-0.370*** (0.141)	0.115 (0.147)	-0.431*** (0.120)	-0.298*** (0.086)	-0.116 (0.164)	0.180 (0.249)	-0.047 (0.127)	0.136* (0.070)
Primary schooling	0.313 (0.436)	0.194 (0.206)	0.247 (0.212)	0.490*** (0.185)	-1.359 (0.838)	-0.015 (0.415)	0.413 (0.277)	-0.735*** (0.182)
Secondary education	1.277*** (0.434)	0.494*** (0.175)	1.205*** (0.202)	0.889*** (0.181)	-1.630* (0.833)	0.035 (0.334)	-0.023 (0.269)	-1.456*** (0.178)
Tertiary education	2.300*** (0.445)	1.232*** (0.317)	2.121*** (0.223)	2.530*** (0.390)	-2.382*** (0.836)	-0.432 (0.480)	-0.890*** (0.282)	-2.093*** (0.238)
Urban residence	0.500*** (0.127)	0.630*** (0.166)	0.958*** (0.145)	0.646*** (0.087)	-0.056 (0.144)	-0.898*** (0.280)	-0.373** (0.172)	-0.329*** (0.075)
Employee	1.684*** (0.125)	0.523** (0.231)	0.472*** (0.114)	1.218*** (0.152)	-1.648* (0.933)	-0.096 (0.347)	-0.698*** (0.131)	-1.562*** (0.159)
Industry	-0.112 (0.428)	-0.551* (0.295)	0.649*** (0.180)	-0.314** (0.138)	1.157*** (0.372)	0.608** (0.306)	0.197 (0.210)	0.207* (0.112)
Services	1.176*** (0.309)	-0.169 (0.239)	0.550*** (0.157)	-0.377*** (0.123)	0.425 (0.323)	-0.257 (0.399)	-0.205 (0.196)	-0.008 (0.098)
Observations	6,053	1,444	5,282	2,805	1,122	352	2,586	7,072
Pseudo R-squared	0.236	0.0700	0.150	0.0790	0.0652	0.0786	0.0833	0.0467

Note: In columns 1-4, the samples are restricted to workers who were informal in the initial year of the longitudinal data collection. Dependent variables: dummy equal to 1 if transition to a formal job occurred, and 0 otherwise. In columns 5-8, the samples are restricted to those workers who were formal in the initial year of the longitudinal data collection. Dependent variables: dummy equal to 1 if transition to an informal job occurred, and 0 otherwise. Estimation method: logistic regression. All regressions include additional controls for civil status and household size. Coefficients for these variables are insignificant and not reported to save space. Reference categories are as follows: male (for female); no schooling (for primary, secondary and tertiary); rural (for urban); self-employed (for employee); and agriculture and mining (for industry and services). Standard errors are in parentheses. The symbol (\*\*\*) represents statistical significance at  $p < 0.01$ , (\*\*) represents statistical significance at  $p < 0.05$  and (\*) represents statistical significance at  $p < 0.1$ .

Source: Authors' calculations based on data from the RAND Institute (2000<sup>[2]</sup>; 2007<sup>[3]</sup>; 2015<sup>[4]</sup>) (the Indonesian Family Life Survey 2000, 2007 and 2014); the Malawi National Statistical Office (2010<sup>[5]</sup>; 2013<sup>[6]</sup>; 2016<sup>[7]</sup>; 2019<sup>[8]</sup>) (the Malawi Integrated Household Survey 2010, 2013, 2016 and 2019); Peru's National Institute of Statistics and Information (2020<sup>[9]</sup>) (Encuesta Nacional de Hogares (ENAHO) Panel 2016, 2017, 2018, 2019 and 2020); and SALDRU (2008<sup>[10]</sup>; 2010<sup>[11]</sup>; 2012<sup>[12]</sup>; 2014<sup>[13]</sup>; 2016<sup>[14]</sup>) (National Income Dynamics Study (NIDS) 2008, 2010, 2012, 2014 and 2016).

In Ghana, South Africa, Tanzania and Uganda, there is a high degree of persistence in the lower income segment of informal employment, with low-paid self-employed workers having particularly low chances of moving not only to formal jobs but also to better-paid informal jobs. If better-paid workers are relatively more mobile, for the vast majority of workers, informal employment is predominant in lower-paid jobs, and hence represents a dead end. Formal employment is also persistent, suggesting a strong duality of the labour market (Danquah, Schotte and Sen, 2019<sup>[17]</sup>).

In the People's Republic of China (hereafter: China), informal employment is most common among rural migrant workers. Because these workers usually have a very low level of skills and human capital, and also face the *hukou* system, transitions to formal employment remain infrequent (Lin, Ye and Zhang, 2020<sup>[18]</sup>).

In India, there is a strong segmentation of the labour market, manifested by a high persistence of both formal wage employment and low-income informal wage employment. If nearly one-half of all workers change their employment state over a seven-year period, most of this mobility happens either within self-employment (from formal to informal and vice versa) or within wage employment, but not between wage employment and self-employment. Moreover, there is also a substantially higher risk of informal workers moving from the upper to the lower tier of income distribution rather than to formal employment (Natarajan, Schotte and Sen, 2020<sup>[19]</sup>). The persistence of informal employment among the lowest-earning informal wage workers also suggests that those with limited human capital and low skills are the least mobile. The Indian labour market is also still characterised by a strong gender- and caste-based labour market segmentation (Michiels, Nordman and Seetahul, 2021<sup>[20]</sup>), wherein women, workers in lower castes, workers with less formal education and rural workers are less likely to formalise compared with men, those in upper castes, workers with more education and urban workers (Natarajan, Schotte and Sen, 2020<sup>[19]</sup>).

### Formalisation improves incomes, although not for the lowest-paid workers

Formalisation brings with it the protection of labour laws and social protection, at least for employees. But does it help lift workers out of low-paid work? And if so, do all workers experience the benefits of formalisation in the same way?

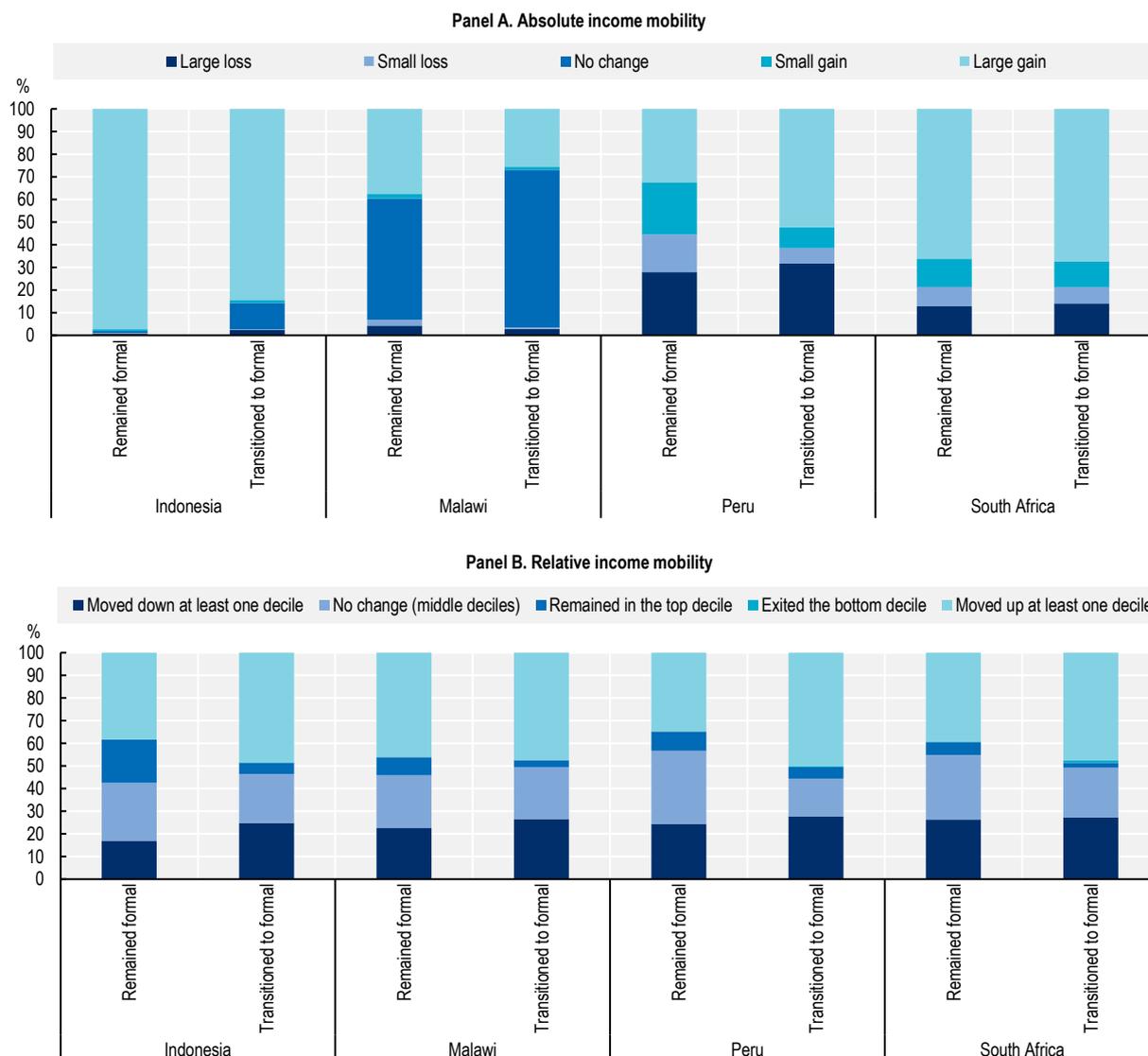
Data for Indonesia, Malawi, Peru and South Africa allow the linking of transitions from informal to formal jobs with various measures of absolute and relative income mobility (see Box 3.2 for definitions). To understand labour income mobility, labour earnings have been analysed in real values and indexed to 2010 values. They include wages for employees and earnings for self-employed individuals.

#### Box 3.2. Measuring income mobility

There are different ways to measure income mobility. Income mobility can be intergenerational (between parents, children and grandchildren) or intragenerational (changes for the same individual over time). Income mobility can also be absolute or relative. “Absolute mobility” refers to changes in one’s own income compared with oneself or with the previous generation. “Relative mobility” refers to changes in income compared with others within the same generation; it reflects one’s own changes in position in terms of income distribution. One way to measure absolute mobility is to look at income gains and income losses. Following the existing literature, an income gain/loss is considered here to be “large” if it represents an income increase/decrease of 20% or more compared with a previous period. Conversely, an income gain/loss is considered to be “small” if it represents an income increase/decrease of less than 20% compared with a previous period. Relative mobility can be measured by examining positional changes in income distribution for each individual between two consecutive periods. Upward mobility takes place when an individual moves to an upper income quantile. Conversely, downward mobility takes place when an individual moves to a lower income quantile. In addition, from a policy perspective, it may be worthwhile to separately consider the persistence of staying in the bottom quantile (referred to as “sticky floors”), as well as the persistence of staying in the top quantile of income distribution (referred to as a “sticky ceiling”). The persistence of low incomes may have a considerable long-term effect on material deprivation and health, and it may affect skills development and enhance intergenerational transmission of poverty. Coupled with the persistence of high incomes, it may exacerbate inequality and be a threat to social cohesion.

Source: Adapted from OECD (2018<sup>[21]</sup>), *A Broken Social Elevator? How to Promote Social Mobility*, <https://www.oecd.org/social/broken-elevator-how-to-promote-social-mobility-9789264301085-en.htm>.

**Figure 3.7. Percentage of workers who experienced income mobility when transitioning to formal employment, or remaining in formal employment, from one period to another**



Note: Income data have been indexed to 2010 values (real). Data refer to seven-year time periods for Indonesia (three waves covering 2000-14); three-year time periods for Malawi (four waves covering 2010-19); one-year time periods for Peru (five waves covering 2016-20); and two-year time periods for South Africa (five waves covering 2008-16). Estimates are generated for transitions between two consecutive time periods (e.g. 2000-07 and 2007-14 for Indonesia); the average for the full time period by country is reported.

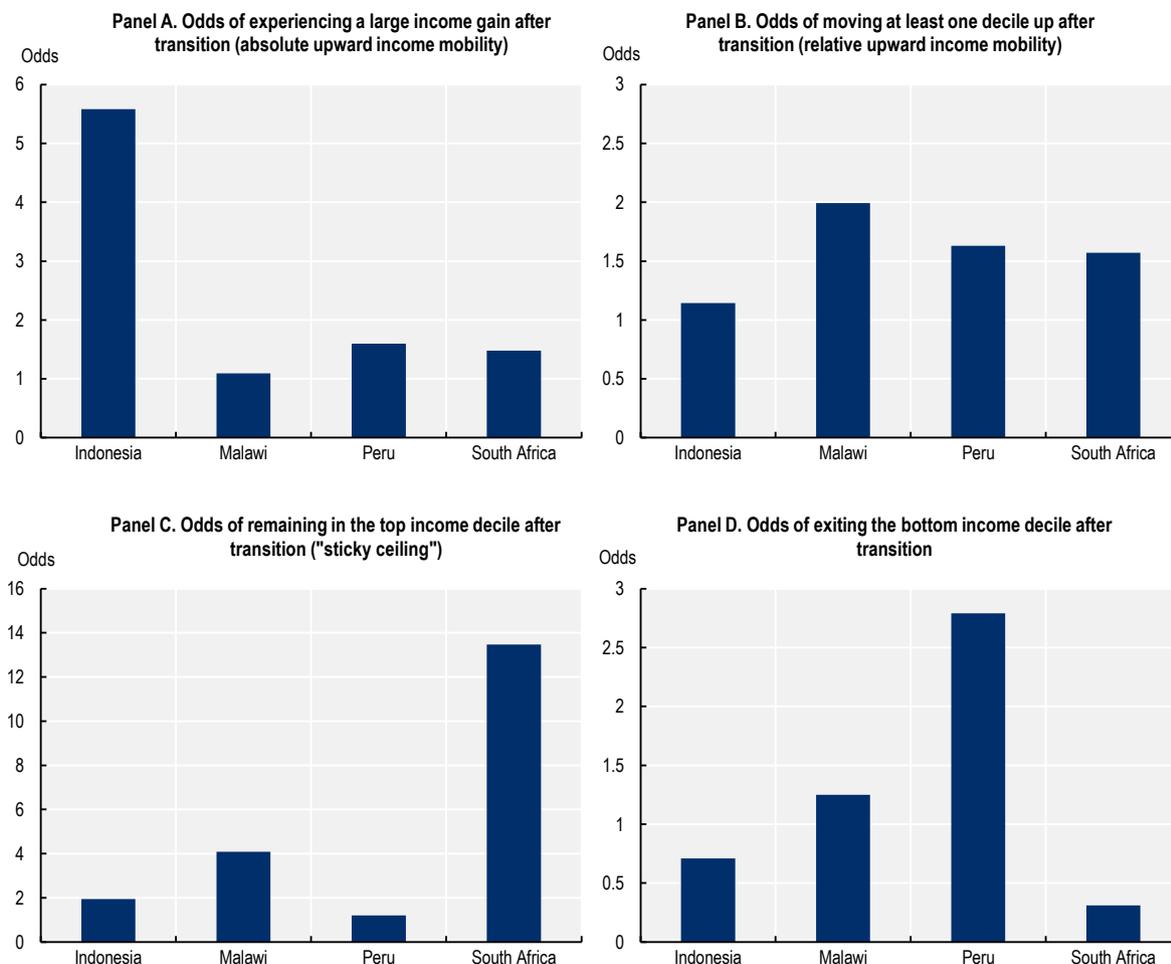
Source: Authors' calculations based on data from the RAND Institute (2000<sup>[2]</sup>; 2007<sup>[3]</sup>; 2015<sup>[4]</sup>) (the Indonesian Family Life Survey 2000, 2007 and 2014); the Malawi National Statistical Office (2010<sup>[5]</sup>; 2013<sup>[6]</sup>; 2016<sup>[7]</sup>; 2019<sup>[8]</sup>) (the Malawi Integrated Household Survey 2010, 2013, 2016 and 2019); Peru's National Institute of Statistics and Information (2020<sup>[9]</sup>) (Encuesta Nacional de Hogares (ENAHO) Panel 2016, 2017, 2018, 2019 and 2020); and SALDRU (2008<sup>[10]</sup>; 2010<sup>[11]</sup>; 2012<sup>[12]</sup>; 2014<sup>[13]</sup>; 2016<sup>[14]</sup>) (National Income Dynamics Study (NIDS) 2008, 2010, 2012, 2014 and 2016).

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At the aggregate level, data from Indonesia, Malawi, Peru and South Africa show that workers who transitioned from informal to formal employment are likely to experience both absolute and relative upward income mobility. Figure 3.7 shows the percentage of workers who experienced an income change following either a transition to formal employment or remaining in formal employment between data collection periods. In all four countries, there is a higher percentage of workers who saw an improvement in their income after a move to formal employment compared with those who remained informal. Figure 3.7,

Panel A shows that, overall, a higher percentage of workers experienced either a small or a large income gain, rather than a loss or no change in income, when moving to formal employment or remaining in it from one period to another. Figure 3.7, Panel B also shows that, in all four countries, a higher percentage of workers moved up at least one income decile, rather than moving down, after transitioning to formal employment. At the same time, the percentage of workers who exited the bottom income decile following formalisation remained extremely small in all four countries. Moreover, some workers remained in the top tier of income distribution; this percentage was greater among workers who remained in formal employment compared with those who moved from informal to formal employment.

**Figure 3.8. Impact of transitions from informal to formal jobs on income mobility**



Note: A large income gain is measured as an income increase of 20% or more from one period to the next. Figures shown are estimated odds ratios of experiencing an income change when a transition from an informal to a formal job occurs, all other variables being equal. They report odds ratios (rather than the estimation coefficients) of experiencing the outcome. Control variables include sex, education, age, number of household members, marital status, status in employment, sector of economic activity and place of residence (urban or rural). Income data have been indexed to 2010 values (real). See detailed results in (Aleksynska, La and Manfredi, 2023<sup>[22]</sup>). Data refer to seven-year time periods for Indonesia (1993-2014); three-year time periods for Malawi (2010-19); one-year time periods for Peru (2016-20); and two-year time periods for South Africa (2008-16).

Source: Authors' calculations based on data from the RAND Institute (2000<sup>[2]</sup>; 2007<sup>[3]</sup>; 2015<sup>[4]</sup>) (the Indonesian Family Life Survey 2000, 2007 and 2014); the Malawi National Statistical Office (2010<sup>[5]</sup>; 2013<sup>[6]</sup>; 2016<sup>[7]</sup>; 2019<sup>[8]</sup>) (the Malawi Integrated Household Survey 2010, 2013, 2016 and 2019); Peru's National Institute of Statistics and Information (2020<sup>[9]</sup>) (Encuesta Nacional de Hogares (ENAHO) Panel 2016, 2017, 2018, 2019 and 2020); and SALDRU (2008<sup>[10]</sup>; 2010<sup>[11]</sup>; 2012<sup>[12]</sup>; 2014<sup>[13]</sup>; 2016<sup>[14]</sup>) (National Income Dynamics Study (NIDS) 2008, 2010, 2012, 2014 and 2016). For details, see also (Aleksynska, La and Manfredi, 2023<sup>[22]</sup>).

These aggregate results are also verified by regression analysis at the individual level, which controls for the worker's age, gender, education, marital status, number of household members, employment status, sector of economic activity and place of residence (urban or rural). They show that moving from informal to formal employment significantly increases the odds of large absolute income gains in Indonesia, Peru and South Africa (Figure 3.8, Panel A).<sup>3</sup> Moreover, formalisation is also associated with relative income mobility: workers switching to formal jobs also have greater chances of moving up by at least one income decile in Indonesia, Malawi, Peru and South Africa (Figure 3.8, Panel B).

Similar findings are also reported in other studies: transitions from informal to formal jobs are associated with improvements in earnings in India (Natarajan, Schotte and Sen, 2020<sup>[19]</sup>); China (Lin, Ye and Zhang, 2020<sup>[18]</sup>); Costa Rica and Nicaragua (Alaniz et al., 2020<sup>[23]</sup>); and Ghana, South Africa, Tanzania and Uganda (Danquah, Schotte and Sen, 2019<sup>[17]</sup>). For more details of these studies, see Table 3.2.

**Table 3.2. Findings from empirical studies linking income mobility and transitions into and out of informal employment**

Country/region	Year of data collection	Source	Findings on transitions into and out of informal employment	Transitions to formal employment are associated with
Costa Rica	2011-18	Alaniz et al. (2020 <sup>[23]</sup> )	Forty-one percent of lower-tier informal workers move to upper-tier informal jobs or to formal jobs from one year to another. Such transitions are more common for those with higher-level skills and vocational training.	Improved earnings for all workers, except for those who move from upper-tier informal jobs (for whom formalisation does not affect earnings).
China	2014-18	Lin, Ye and Zhang (2020 <sup>[18]</sup> )	Transitions to formal employment are infrequent, and are inhibited by the <i>hukou</i> system and low skills.	Improved earnings for men and women, agricultural and non-agricultural workers, and local and migrant workers.
El Salvador	1991-92	Funkhouser (1997 <sup>[24]</sup> )	Chances of transitioning to formal employment are the highest for prime-age skilled workers.	A 66.9% increase in wages for men, and a 55.6% increase for women. Moves to informal employment lead to income losses for women and small gains for men.
Ghana	2016, 2019	Danquah, Schotte and Sen (2019 <sup>[17]</sup> )	Twenty percent of lower-tier informal employees move to a better employment state between data collection periods.	Improved earnings, especially for lower-tier informal workers.
India	2004-05; 2011-12	Natarajan, Schotte and Sen (2020 <sup>[19]</sup> )	There is a high degree of persistence of formal wage employment and lower-tier informal wage employment.	A 33-63% increase in earnings.
Nicaragua	2009-17	Alaniz et al. (2020 <sup>[23]</sup> )	Twenty-five percent of lower-tier informal workers move to upper-tier informal jobs or to formal jobs between data collection periods.	Improved earnings, whether for employees or for self-employed individuals.
Nigeria	2010-16	Folawewo and Orija (2020 <sup>[16]</sup> )	Transitions to formal employment are common (over 50%), but mainly occur among workers with upper-tier income.	Potentially improved earnings, as formal workers earn more than informal workers.
South Africa	2018	Danquah, Schotte and Sen (2019 <sup>[17]</sup> )	Around 80% of formal workers remained in formal employment from one survey wave to the next.	Improved earnings, especially for lower-tier informal workers.
Tanzania	2012, 2015	Danquah, Schotte and Sen (2019 <sup>[17]</sup> )	Segmented market: transitions out of lower-tier informal employment are infrequent.	Improved earnings, especially for lower-tier informal workers.
Uganda	2014	Danquah, Schotte and Sen (2019 <sup>[17]</sup> )	Segmented market: transitions out of lower-tier informal employment are infrequent.	Improved earnings, especially for lower-tier informal workers.

Note: In a series of papers discussed in this table, analysis of transitions is done not only between formal and informal jobs but also within the category of informal jobs, looking at transitions between upper-tier and lower-tier informal jobs. While definitions vary across these papers, upper-tier informal jobs are considered to offer at least some protection and generally require higher skills compared with lower-tier informal jobs.

Source: Authors' compilation.

Despite the overall trend of upward income mobility, the benefits of formalisation do not accrue to all workers. The results of the regression analysis for the four countries examined in this chapter show that “sticky ceilings” benefit the highest-paid workers, while “sticky floors” appear to trap the lowest-paid workers.

“Sticky ceilings” are observed in Indonesia, Malawi and South Africa, wherein well-paid formal jobs are taken up by individuals who are already relatively advantaged in terms of income in the informal economy (Figure 3.8, Panel C). Workers who transition from informal to formal employment and land a well-paid job between data collection periods are often already situated at the top end of income distribution before changing employment state.

In addition, “sticky floors” trap the lowest-paid workers in Indonesia, Malawi and South Africa: formalisation does not significantly improve the incomes of those in the bottom income decile. Even more worrisome, in Indonesia and South Africa, it is unlikely that formalisation will result in exiting the bottom decile of income distribution (Figure 3.8, Panel D; odds are below one). Only in Peru do income mobility and formalisation go hand in hand: when workers in the bottom income decile formalise, they are very likely to exit the bottom decile by the next data collection period, as opposed to workers in the other countries with available data.

These findings can have several explanations. One reason for the “sticky ceilings” is that formal jobs are probably not accessible to everyone. To the extent that these results are obtained from the regression analysis, comparing individuals with similar education, richer individuals typically have more advantageous networks and other forms of social capital that provide them with an edge in the labour market (Cleaver, 2005<sup>[25]</sup>; Rungo and Pena-López, 2018<sup>[26]</sup>). Thanks to these networks, they may not only get better access to formal jobs but also learn about the benefits of formalisation from their peers and look more proactively for formal jobs. Another explanation is that formal jobs do not exist in abundance across all sectors and occupations. For example, agriculture is a typical example where informal employment is ubiquitous (OECD, 2023<sup>[11]</sup>).

In addition to this, in order for the self-employed to fully benefit from formalisation, they should first have a substantial endowment of resources, or access to savings and capital. Only under these conditions can formalising their business be attractive and potentially even more profitable.

Finally, the fact that the lowest-paid workers hardly benefit financially from formalisation may also be related to unobservable characteristics of each occupation. Some occupations, such as domestic work or waste picking, may feature low earnings irrespective of whether they are formal or not. In these occupations, formalisation may bring other benefits, such as better working conditions and social protection. Yet, the absence of financial improvement may mean that low-paid informal workers remain stuck in low-paid formal employment, while their employers may also have little financial capacity to raise their income.

## Transitioning to informal jobs worsens incomes, suggesting that it is rarely a choice

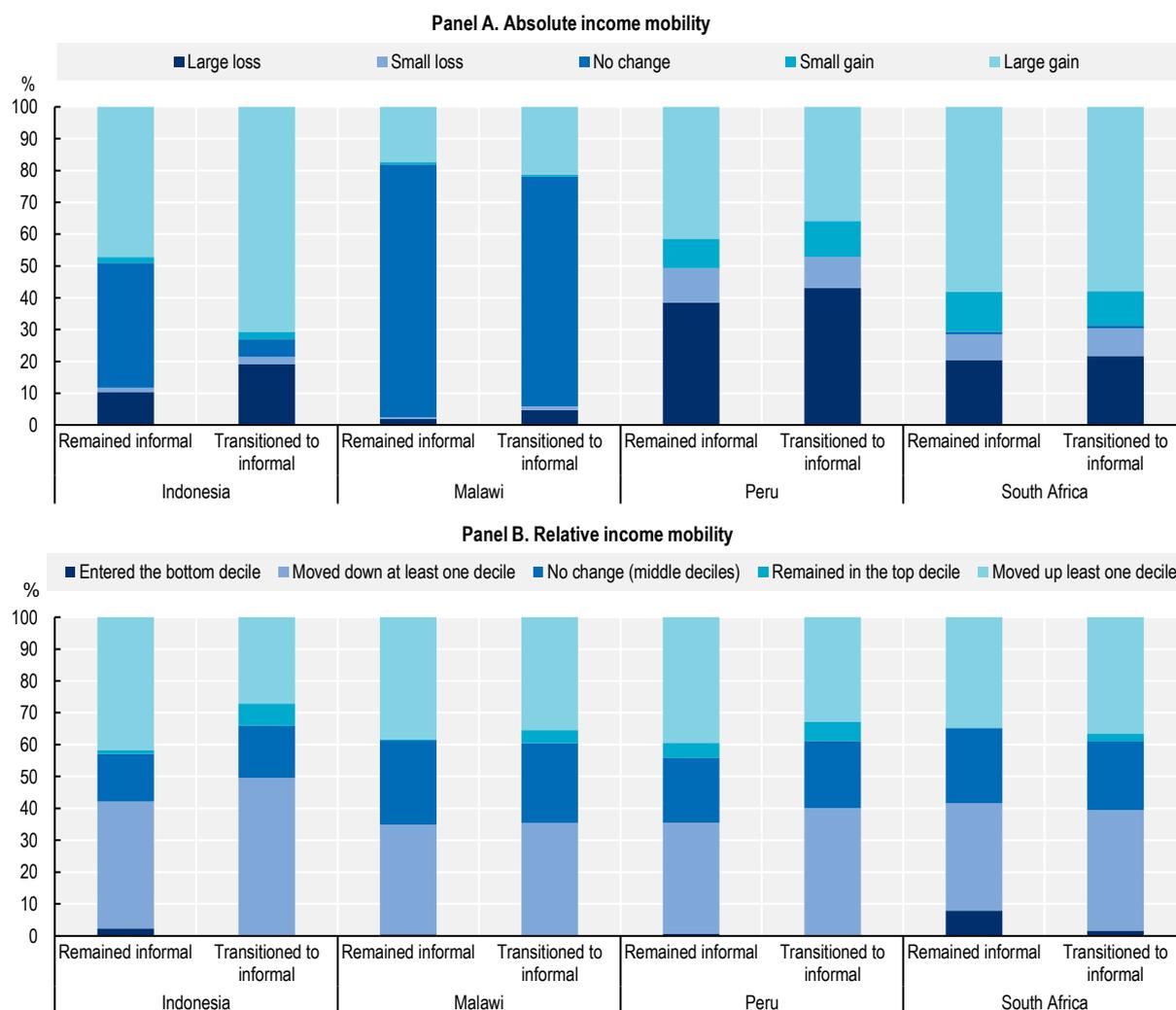
In many developed countries, labour market transitions affect the likelihood of income gains to a greater extent than they affect the likelihood of income losses. This is because developed countries typically have social protection and other safety nets that can cushion the effects of job loss (OECD, 2018<sup>[21]</sup>).

In developing and emerging economies, however, where most workers are informal and rarely enjoy income protection when they lose their jobs, becoming unemployed or economically inactive would mean the loss of income. Unemployment compensation may be limited in magnitude and duration, and in some countries may not be provided to workers who lose their jobs. In these cases, taking up informal jobs can act as a means of survival for workers who cannot afford to go without income.

The analysis of panel data for Indonesia, Malawi, Peru and South Africa shows that, on the whole, workers who transition from formal to informal employment are likely to experience both absolute and relative downward income mobility. Figure 3.9, Panel A shows that absolute small and large losses are more

prevalent than gains for workers transitioning to informal employment in Peru and South Africa. Limited absolute income changes are observed in Malawi. In Indonesia, workers transitioning to informal employment are likely to enjoy absolute income gains; however, the results for Indonesia are shown over a relatively long (seven-year) period, during which the country as a whole experienced economic growth (OECD, 2021<sup>[27]</sup>). Even if some workers experienced absolute income gains when moving to informal employment, the percentage of such workers is still lower than among workers moving to formal employment (shown in Figure 3.9, Panel A).

**Figure 3.9. Absolute and relative income mobility for workers remaining in or transitioning into informal employment**



Note: Income data has been indexed to 2010 values (real). Data refer to seven-year time periods for Indonesia (three waves covering 2000-14); three-year time periods for Malawi (four waves covering 2010-19); one-year time periods for Peru (five waves covering 2016-20); and two-year time periods for South Africa (five waves covering 2008-16). Estimates are generated for transitions between two consecutive time periods (e.g. 2000-07 and 2007-14 for Indonesia); the average for the full time period by country is reported.

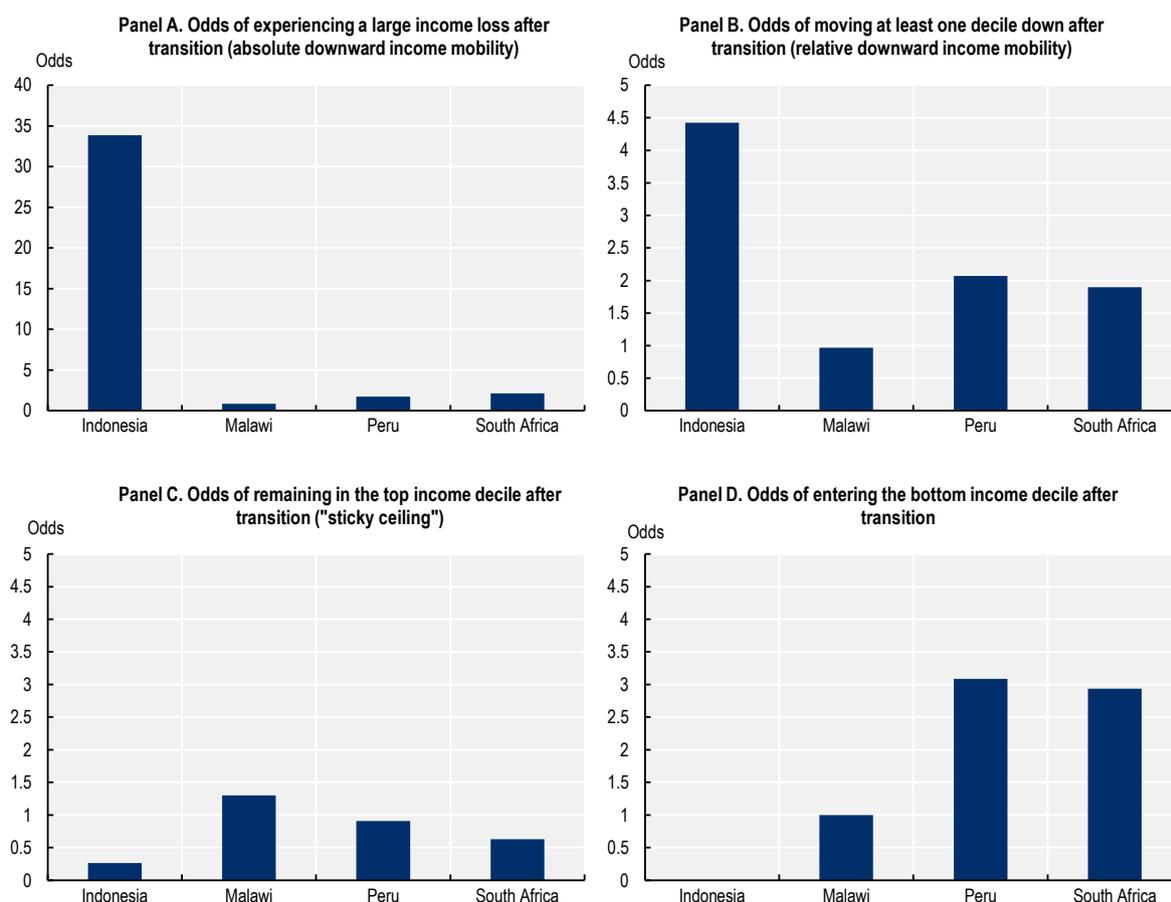
Source: Authors' calculations based on data from the RAND Institute (2000<sup>[2]</sup>; 2007<sup>[3]</sup>; 2015<sup>[4]</sup>) (the Indonesian Family Life Survey 2000, 2007 and 2014); the Malawi National Statistical Office (2010<sup>[5]</sup>; 2013<sup>[6]</sup>; 2016<sup>[7]</sup>; 2019<sup>[8]</sup>) (the Malawi Integrated Household Survey 2010, 2013, 2016 and 2019); Peru's National Institute of Statistics and Information (2020<sup>[9]</sup>) (Encuesta Nacional de Hogares (ENAHOG) Panel 2016, 2017, 2018, 2019 and 2020); and SALDRU (2008<sup>[10]</sup>; 2010<sup>[11]</sup>; 2012<sup>[12]</sup>; 2014<sup>[13]</sup>; 2016<sup>[14]</sup>) (National Income Dynamics Study (NIDS) 2008, 2010, 2012, 2014 and 2016).

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Figure 3.9, Panel B also shows that, among workers who experienced informalisation, there is a greater percentage of workers moving down at least one income decile compared with those moving up at least one decile. Moreover, in all countries, some workers entered the bottom income decile following informalisation.

These results are again verified in the regression analysis at the individual level, which controls for the same worker's characteristics as the regressions (in Box 3.1), i.e. age, gender, education, marital status, number of household members, employment status, sector of economic activity and place of residence (urban or rural). They show that workers switching to informal employment are indeed more likely to experience a large income loss, especially in Indonesia (Figure 3.10, Panel A), or move down at least one income decile in income distribution in Indonesia, Peru and South Africa (Figure 3.10, Panel B). They are unlikely to remain in the top income decile in Indonesia, Peru, and South Africa (Figure 3.10, Panel C). They also have higher chances of entering the bottom decile of income distribution in Peru and South Africa (Figure 3.10, Panel D).<sup>4</sup>

**Figure 3.10. Impact of transitions from formal to informal jobs on income mobility**



Note: A large income loss is measured as an income decrease of 20% or more from one period to the next. Figures shown are estimated odds ratios of experiencing an income change when a transition from a formal to informal job occurs, all other variables being equal. Control variables include sex, education, age, number of household members, marital status, status in employment, sector of economic activity and place of residence (urban or rural). Income data have been indexed to 2010 values (real). See detailed results in (Aleksynska, La and Manfredi, 2023<sup>[22]</sup>). Data refer to seven-year time periods for Indonesia (2000-2014); three-year time periods for Malawi (2010-19); one-year time periods for Peru (2016-20); and two-year time periods for South Africa (2008-16).

Source: Authors' calculations based on data from the RAND Institute (2000<sup>[2]</sup>; 2007<sup>[3]</sup>; 2015<sup>[4]</sup>) (the Indonesian Family Life Survey 2000, 2007 and 2014); the Malawi National Statistical Office (2010<sup>[5]</sup>; 2013<sup>[6]</sup>; 2016<sup>[7]</sup>; 2019<sup>[8]</sup>) (the Malawi Integrated Household Survey 2010, 2013, 2016 and 2019); Peru's National Institute of Statistics and Information (2020<sup>[9]</sup>) (Encuesta Nacional de Hogares (ENAHO) Panel 2016, 2017, 2018, 2019 and 2020); and SALDRU (2008<sup>[10]</sup>; 2010<sup>[11]</sup>; 2012<sup>[12]</sup>; 2014<sup>[13]</sup>; 2016<sup>[14]</sup>) (National Income Dynamics Study (NIDS) 2008, 2010, 2012, 2014 and 2016). For details, see also (Aleksynska, La and Manfredi, 2023<sup>[22]</sup>).

Part of what explains these losses is that informal jobs typically pay less than formal jobs. As seen earlier in this report, the ratio of formal earnings to informal earnings can range from 1.3 to 4.5 in Key Indicators of Informality based on Individuals and their Households (KIIbIH) countries. These losses are also likely due to the fact that, in the absence of social protection, workers who lose formal jobs take any informal job that is available, often with a poor match to their skills and below their productive capacity. They may also switch sector or occupation, downgrading to lower-paid ones.

### The benefits of formalisation vary for different groups of workers and by country

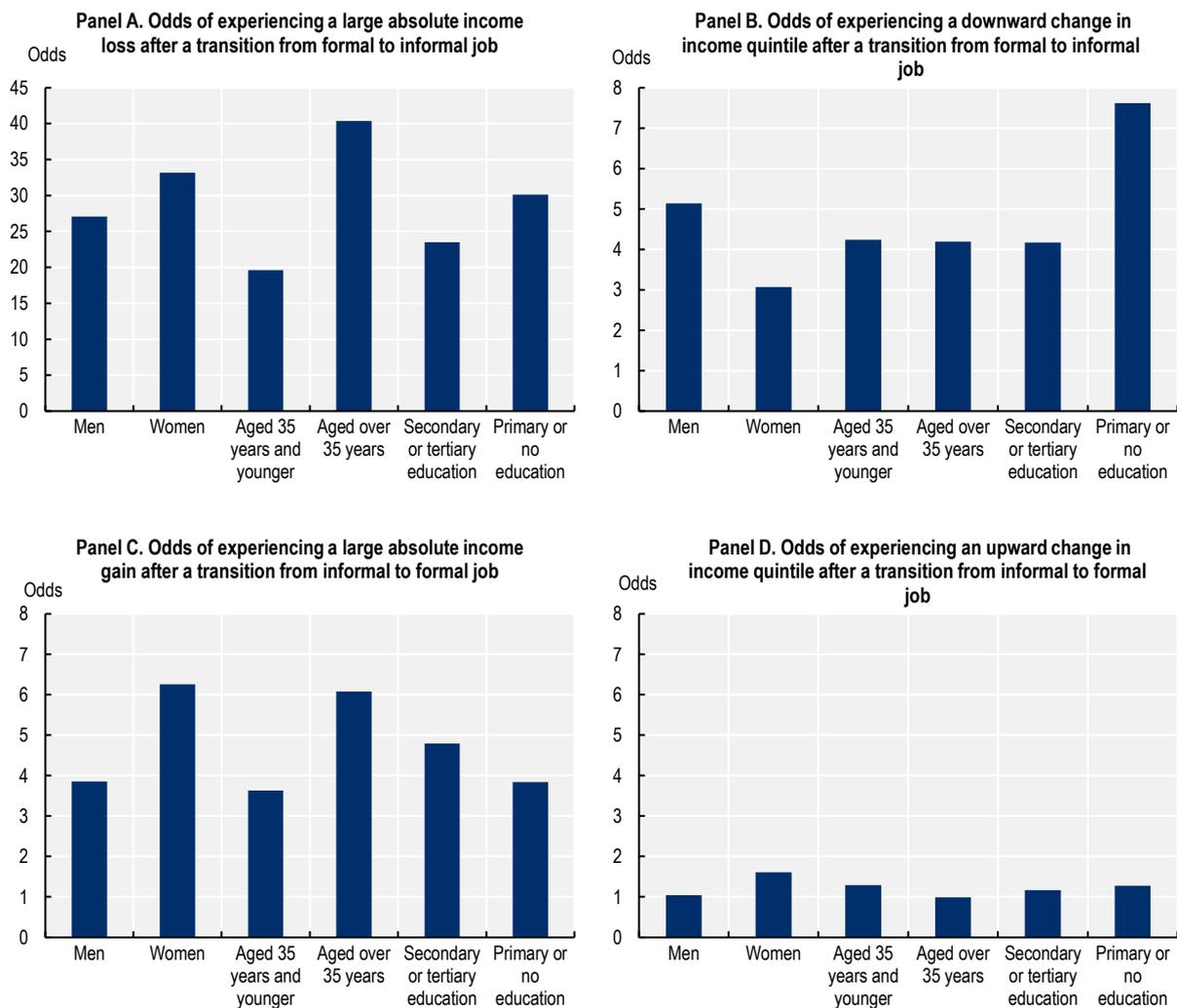
Workers with different characteristics do not necessarily benefit from transitions to formal employment in the same way. Gender, age and level of education may not only affect transitions to formal employment differently, as shown earlier in this chapter, but they may also affect the distribution of income gains and losses in the process of (in)formalisation. Indeed, a more disaggregated regression analysis is possible for Indonesia, Peru and South Africa. It shows the following findings for different groups of workers.

First, women are likely to have a higher magnitude of benefits and losses in absolute income, compared with men, following a transition between formal employment and informal employment. When transitioning to informal employment, women have higher odds of experiencing large absolute income losses compared with men (in Indonesia, Peru and South Africa, as depicted in Figure 3.11 to Figure 3.13, Panel A in each figure). When transitioning to formal employment, they are also more likely than men to experience a large absolute income gain (this holds for Indonesia and Peru, although not for South Africa; Panel C in each figure). However, men have higher odds of experiencing a downward change in income quintile when transitioning from a formal to informal job in Indonesia and South Africa, although not in Peru (Panel B in each figure).

Second, different income mobility patterns were also found across age groups. The probability of absolute labour income losses and gains, as well as of relative income mobility, is more amplified for younger workers than for older workers in Peru (Figure 3.12) and in South Africa (Figure 3.13). The opposite is true in Indonesia: transitions into and out of formal employment have greater income effects for older workers than for younger workers (Figure 3.11).

Finally, with regard to educational attainment, the results differ substantially across countries. In Indonesia, workers with no education or only primary education have significantly greater chances of experiencing absolute and relative income losses when transitioning to informal employment compared with more educated workers (Figure 3.11). Workers with secondary or tertiary education have higher chances of improving their absolute income when transitioning to a formal job compared with workers with less schooling. In Peru, workers with secondary or tertiary education compared with workers with no schooling have greater chances of both income gains and losses, in both absolute and relative terms, when experiencing transitions (Figure 3.12). In South Africa, workers with more education have greater chances of experiencing income losses when transitioning to informal employment, while workers with less education have greater chances of experiencing income gains after formalising (Figure 3.13).

**Figure 3.11. Distribution of benefits and losses from (in)formality transitions across different profiles of workers: Indonesia**

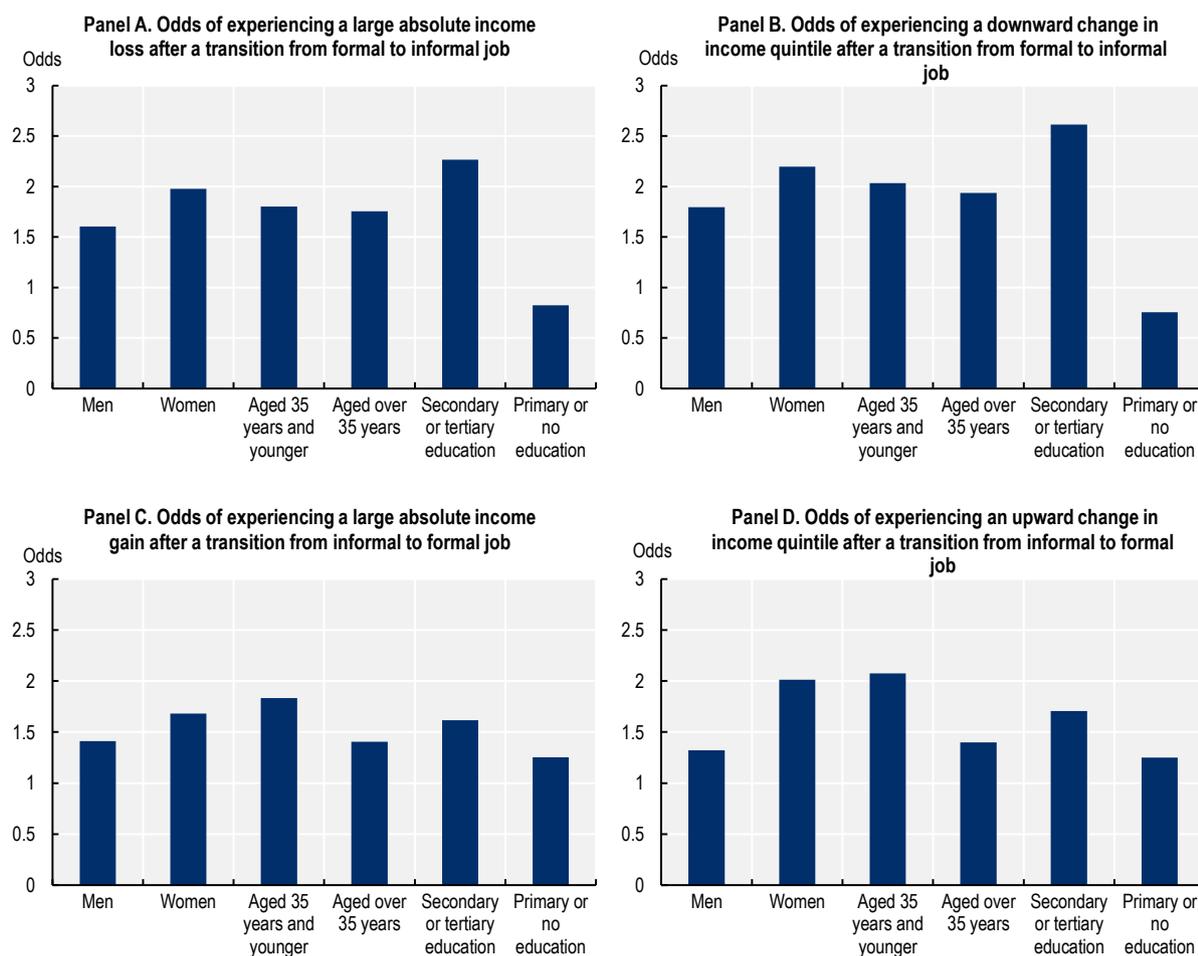


Note: A large income gain/loss is measured as an income increase/decrease of 20% or more from one period to the next. Figures shown are estimated odds ratios of experiencing an income change when a transition from an informal to formal (or from a formal to informal) job occurs, all other variables being equal. Control variables include sex, education, age, number of household members, marital status, status in employment, sector of economic activity and place of residence (urban or rural). See detailed results in (Aleksynska, La and Manfredi, 2023<sup>[22]</sup>). Data refer to seven-year time periods (2000-14).

Source: Authors' calculations based on data from the RAND Institute (2000<sup>[2]</sup>; 2007<sup>[3]</sup>; 2015<sup>[4]</sup>) (the Indonesian Family Life Survey 2000, 2007 and 2014).

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**Figure 3.12. Distribution of benefits and losses from (in)formality transitions across different profiles of workers: Peru**

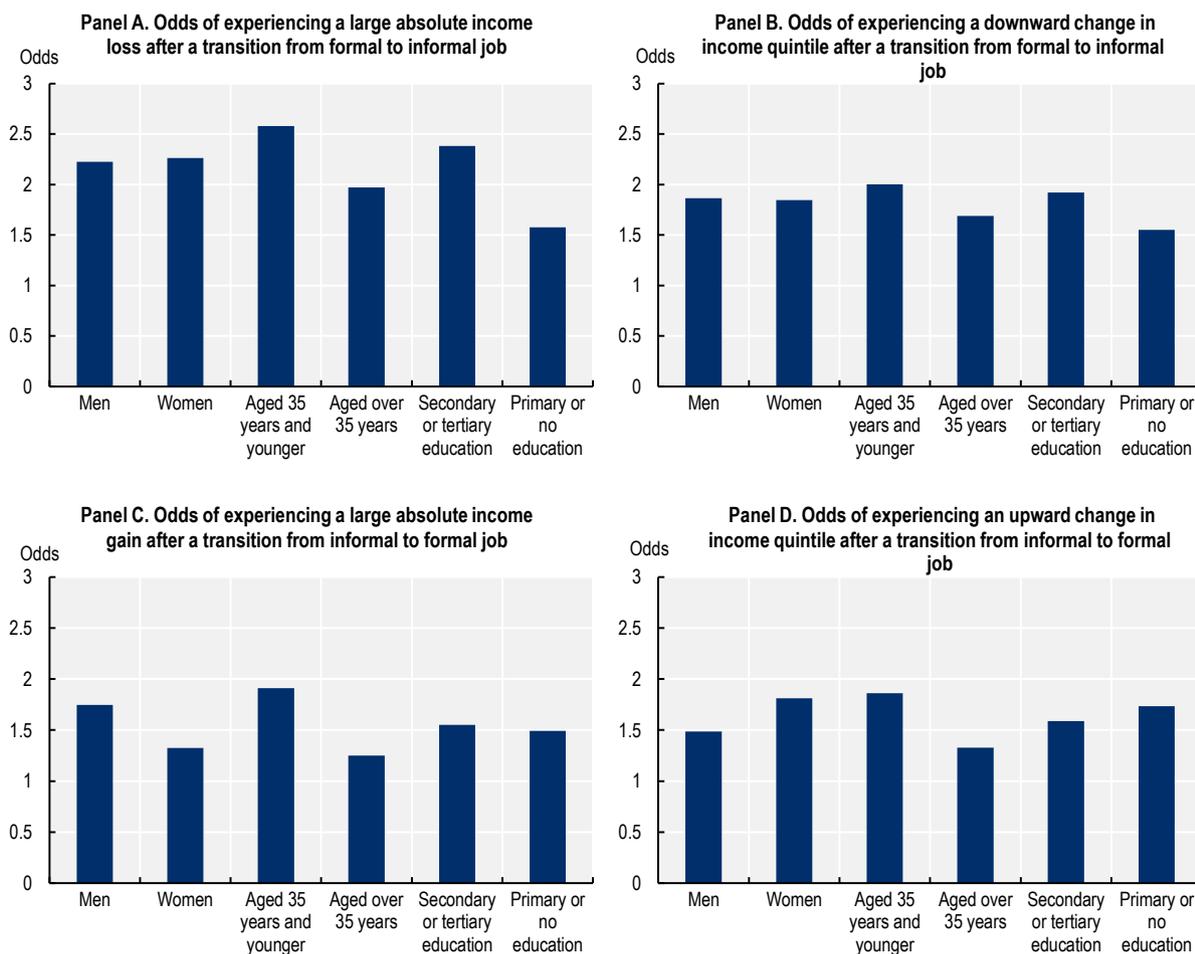


Note: A large income gain/loss is measured as an income increase/decrease of 20% or more from one period to the next. Figures shown are estimated odds ratios of experiencing an income change when a transition from an informal to formal (or from a formal to informal) job occurs, all other variables being equal. Control variables include sex, education, age, number of household members, marital status, status in employment, sector of economic activity and place of residence (urban or rural). See detailed results in (Aleksynska, La and Manfredi, 2023<sup>[22]</sup>). Data refer to one-year time periods (2016-20).

Source: Authors' calculations based on data from Peru's National Institute of Statistics and Information (2020<sup>[9]</sup>) (Encuesta Nacional de Hogares (ENAHO) Panel 2016, 2017, 2018, 2019 and 2020).

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**Figure 3.13. Distribution of benefits and losses from (in)formality transitions across different profiles of workers: South Africa**



Note: A large income gain/loss is measured as an income increase/decrease of 20% or more from one period to the next. Figures shown are estimated odds ratios of experiencing an income change when a transition from an informal to formal (or from a formal to informal) job occurs, all other variables being equal. Control variables include sex, education, age, number of household members, marital status, status in employment, sector of economic activity and place of residence (urban or rural). See detailed results in (Aleksynska, La and Manfredi, 2023<sup>[22]</sup>). Data refer to two-year time periods (2008-16).

Source: Authors' calculations based on data from SALDRU (2008<sub>[10]</sub>; 2010<sub>[11]</sub>; 2012<sub>[12]</sub>; 2014<sub>[13]</sub>; 2016<sub>[14]</sub>) (National Income Dynamics Study (NIDS) 2008, 2010, 2012, 2014 and 2016).

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## Policy discussion

This chapter presented, and in some cases reiterated, several findings regarding labour market transitions and subsequent income mobility transitions. These findings call for several policy recommendations.

### *In terms of labour market transitions...*

This chapter has shown that most individuals do not change their employment state between consecutive periods of observation, whether they are formally employed, informally employed or non-employed. This

suggests that, at least in the four countries examined in this chapter, there is strong labour market segmentation, with barriers existing between various employment states. Immobility rates among these three employment states are by far the highest compared with transition rates for any given state.

When workers do transition, they are most likely to move between informal jobs and non-employment, with lower chances of transitioning to formal employment. This suggests that informal employment represents an important possibility for participating in the world of work, especially when formal employment opportunities are scarce, and staying out of employment does not enable people to sustain a living.

In order of magnitude, flows towards formal jobs are smallest when compared with flows to other employment states. Formal employment is especially difficult to retain in countries with lower levels of development, and over longer periods of time. In Indonesia and Malawi, over relatively long periods, more formal workers transitioned into informal employment or non-employment than remained in formal employment. In contrast, retention of formal workers was relatively higher in Peru and South Africa, albeit over shorter periods of time. In all countries with available data, flows from all states to informal employment are most frequent. These findings explain why, on aggregate, in many developing and emerging economies the stock of informal employment decreases very slowly, if at all.

Employees, workers with more schooling and those living in urban areas have the highest chances of moving to formal employment. In some countries, even having just primary schooling, compared with no schooling at all, substantially increases the probability of transitioning to formal jobs. Workers with higher education have the greatest chances of transitioning to formal employment, and the lowest chances of transitioning back to informal employment. Self-employed informal workers, workers in rural areas and workers with no schooling have the lowest chances of formalisation.

Based on these findings, four policy recommendations can be drawn.

1. Governments should continue striving towards the creation of more formal jobs, and especially of wage employment, with better pay in all sectors and occupations. For this, a range of policy actions can be envisaged, in line with the International Labour Organization (ILO) *Transition from the Informal to the Formal Economy Recommendation, 2015 (No. 204)*. This includes creating enabling environments for the development of formal employment through a range of co-ordinated policies to support innovation, formal enterprise and formal job creation, access to credit, labour mobility, and increasing employability of the workforce. Governments and private actors should be encouraged to create more formal employment opportunities in rural areas and across the full range of sectors and occupations, with the possibility to enable access to these formal employment opportunities by the poorest workers (who are likely to have the lowest level of skills).
2. Acknowledging the important role played by the informal economy in providing incomes, governments and other civil actors should not stigmatise the informal economy. Formalisation of an economy may be a long process; as such, enabling workers in the informal economy to access at least some formal employment arrangements, even if they are not fully formalised, should be considered an important outcome in the overall process of formalisation. In addition, poverty eradication and inclusive growth should be seen as the ultimate objective, whereas formalisation should be seen as a means to help achieve these goals but not necessarily an end in itself.
3. Since education remains a key “insurance” mechanism against informal employment, continuous efforts should be dedicated to providing universal and affordable access to education for all children, to ensuring that children remain in school, and to ensuring equal opportunities for children of all backgrounds to access secondary and tertiary education. These efforts are also important in order to break the intergenerational cycle of informal employment (Chapter 5), and should be made in parallel with efforts to create more formal employment opportunities at all skill levels.
4. Given that some workers will never transition to formal jobs, specific targeted actions should be developed for these workers, either to help them transition to formal jobs or to sustain their incomes.

### ***In terms of income mobility...***

Transitions to formality are found to generally improve labour incomes, whereas transitions to informal employment are found to worsen them. This can be seen as an expected result, as prior research has similarly found that the labour earnings of informal workers are generally lower than the labour earnings of formal workers. Yet – and this is a new and more nuanced finding – labour income gains from formalisation are not spread evenly. In several countries, formalisation is unlikely to significantly improve the incomes of the lowest-paid workers. In contrast, formalisation helps richer workers to remain in the top income quantile. Informalisation, in turn, increases the likelihood of entering into the lowest income decile in Peru and South Africa.

These findings confirm that informal employment has two tiers, as shown in Chapter 2: a lower tier that is characterised by low earnings, and an upper tier characterised by relatively higher earnings. It is transitions from the upper tier of informal employment to formal employment that are most likely to improve incomes.

Labour income gains from formalisation (and losses from informalisation) also differ for men and women, workers with different skills, and workers of different ages, although results vary across countries. In several instances, income losses from informalisation are significantly greater than income gains from formalisation. Of course, informal earnings do play a role in reducing poverty when the alternative is no earnings at all; but these earnings, on aggregate, are clearly lower compared with earnings in formal employment.

The persistence of low incomes for some workers, despite formalisation, may have a considerable long-term effect on workers' well-being. It may affect skills development, negatively affect the accumulation of social capital and enhance the intergenerational transmission of poverty. In addition, in the absence of substantial income improvement, formalisation may not be a sufficiently attractive option for those workers who can choose between remaining informal or becoming formal. Coupled with a persistence of high incomes for some other workers despite their employment status, these dynamics may exacerbate inequality, promote social exclusion and become a threat to social cohesion.

These findings also have several policy implications, which can be summarised as follows:

1. Transition from a formal to an informal job – at least to the informal jobs in the lower tier of informal employment – is unlikely to be a choice. As such, governments should not place too much hope in policies aimed at creating incentives to remain in formal employment. Rather, they should promote the development of adequate unemployment support and other social safety nets. The fact that income losses from informalisation are significantly greater than income gains from formalisation provides the basis for a solid economic argument in favour of developing and strengthening unemployment benefit systems as a way of avoiding workers slipping into involuntary informal employment. Active labour market policies should also be developed to reskill workers, redirect them to formal jobs and support relocation.
2. There is a need to promote greater mobility not only from informal to formal jobs but also from low-paying to higher-paying jobs. Several avenues of policy action can be pursued for this. On the one hand, there is a need to create more formal employment opportunities in the higher-paying sectors and occupations. Cultivating a fertile environment for enterprise creation and scaling up in these sectors of activity is one of the potential ways forward. Another area is improving access to credit for informal self-employed workers, including scaling up micro-credit programmes, with the objective of enabling self-employed workers to upgrade their products and services, increase revenue, and expand their production. Workers should be equipped with the right skills in order to access these jobs. Developing skills and accompanying workers in reskilling is thus another avenue, and is discussed in chapters 4 and 5.
3. Other barriers, such as the lack of adequate social capital and networks, make it difficult for low-paid workers to experience large gains from formalisation. Supporting low-paid workers to access

better-paid formal jobs may therefore require other additional measures in order for these workers to build their social capital, such as creating more social mixing opportunities (including in education and in housing) in order to increase their chances of networking with the providers of formal jobs.

4. The fact that certain jobs do not lift workers out of low-paid work, whether they are informal or formal, may also be related to the fact that some countries do not have a minimum wage, or that it is not enforced. Indeed, over the time period that is covered by the data presented in this chapter, South Africa did not have a national minimum wage. Sectoral minimum wage existed, but it did not cover all sectors, and because of the differences across sectors, enforcement was weak. The absence or the weak enforcement of a minimum wage might have meant that employers had few incentives to increase wages when formalising workers. In such settings, setting minimum wages, regularly reviewing them jointly with social partners (including informal workers' associations) so that they reflect well the minimum living standards, and enforcing them, is also one of the ways to ensure that formalisation financially benefits the poorest workers (Berg, 2015<sup>[28]</sup>). At the same time, care should be exercised not to set the minimum wage too high, so that formalisation can be affordable (OECD, 2008<sup>[29]</sup>; ILO, 2015<sup>[30]</sup>).
5. Some workers perform “essential jobs” (such as waste pickers) whose conditions are difficult to improve: it is challenging to increase their work-related earnings, and moving them to other occupations may not be socially desirable. For such workers specifically, redistributive programmes and policies must be put in place to improve their incomes and protect them in case of economic shocks.
6. Finally, the findings in this chapter suggest that, in addition to pay, there is a need to ensure decent employment conditions for all workers. In some occupations, workers may remain low paid, but there should be a general understanding that formalisation can still bring other benefits, such as social security protection, which would benefit not only these workers but also other family members.

## Notes

<sup>1</sup> This does not mean that workers did not change jobs.

<sup>2</sup> Following the 20th International Conference of Labour Statisticians (ICLS), a new definition of International Classification of Status in Employment (ICSE 18) as well as an International Classification of Status at Work (ICSaW 18) reorganised previously used categories of self-employment and paid employment into two new categories: independent and dependent workers. The data presented in this section were collected prior to the adoption of these new definitions. For this reason, the old classifications are used here: self-employment, which includes employers, own-account workers and contributing family workers; and paid employment, which includes employees. The figures presented in this section examine five employment states: i) workers in formal paid employment, ii) workers in informal paid employment, iii) formal self-employed individuals, iv) informal self-employed individuals and v) non-employed individuals.

<sup>3</sup> Figure 3.8 reports the odds ratios. The odds ratios are the likelihood that an event will occur, compared with the likelihood that it will not occur, if the condition (measured by the independent variable transitions between labour market states), is met. As such, odds ratios are always positive. Odds ratios greater than

one indicate that the event is more likely to occur than it is to not occur. Odds ratios below one indicate that the event is less likely to occur than it is to not occur.

<sup>4</sup> Figures presented here show the odds ratios. Statistically, the odds ratio is the probability of the event occurring divided by the probability of the event not occurring. It indicates how likely an event is to occur relative to it not happening. To convert from odds to a probability, one needs to divide the odds by one plus the odds. For example, the odds ratio of experiencing a large income gain after transitioning to formal employment in Indonesia is equal to 5.48. This is the same as saying that the probability of experiencing a large income gain is 0.84 (out of 1), which is quite a likely event. In contrast, the odds ratio of exiting the bottom income decile in Indonesia after transitioning to formal employment is 0.72. This is the same as saying that the probability is 0.41 (out of 1), which means that the event is unlikely to happen.

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## Annex 3.A. Data description

The analysis of this paper is based on the panel data available for four developing and emerging economies: Indonesia, Malawi, Peru and South Africa. For Indonesia, the Indonesian Family Life Survey (IFLS) is used, with three waves, IFLS-3 (2000), IFLS-4 (2007-08) and IFLS-5 (2014-15); the interval between each wave is seven years. For Malawi, the Malawi Integrated Household Panel Survey (IHPS) is used, with waves collected in 2010, 2013, 2016 and 2019; the interval between each wave is three years. For Peru, the Peruvian National Household Survey (Encuesta Nacional de Hogares (ENAHO) Panel) is used, with five waves and a one-year interval between each wave, spanning the period from 2016 to 2020. For South Africa, the National Income Dynamics Study (NIDS) is used, with data collected between 2008 and 2017 over five waves and at intervals of two years.

**Annex Table 3.A.1. General data description**

Country	Time frame	Intervals between waves	Number of waves	Total number of observations (N pooled)	Total number of unique individuals	Average wave-to-wave attrition rate
Indonesia	2000-14	seven-year periods	3	33 488	16 360	19.7%
Malawi	2010-19	Three-year periods	4	4 102	1 798	15.9%
Peru	2016-20	One-year periods	5	10 926	2 835	30.6%
South Africa	2008-16	Two-year periods	5	15 807	6 366	17.8%

Source: Authors' calculations.

The four panel datasets used are unbalanced, meaning that individuals are observed inconsistently from one survey wave to another, and over the entire period covered by all waves. The average wave-to-wave attrition rate ranges from 15.9% in Malawi to 30.6% in Peru, with the average attrition rates lower in the subsamples of the working-age population compared with the general population. They are quite standard (or even lower) compared with other panel data available in developing and emerging economies (Alderman et al., 2001<sup>[31]</sup>; Dercon and Shapiro, 2007<sup>[32]</sup>). In contrast, the attrition rates over the total time span of each panel dataset are substantial, thus precluding the use of standard longitudinal analysis techniques, such as survival or duration analysis. Instead, the analysis shows the averages of wave-to-wave pooled data.

Because each country has a different number of survey waves, and a different interval between each wave, we have treated the data for each country separately. Nevertheless, the same principles have been applied for the rest of the analysis.

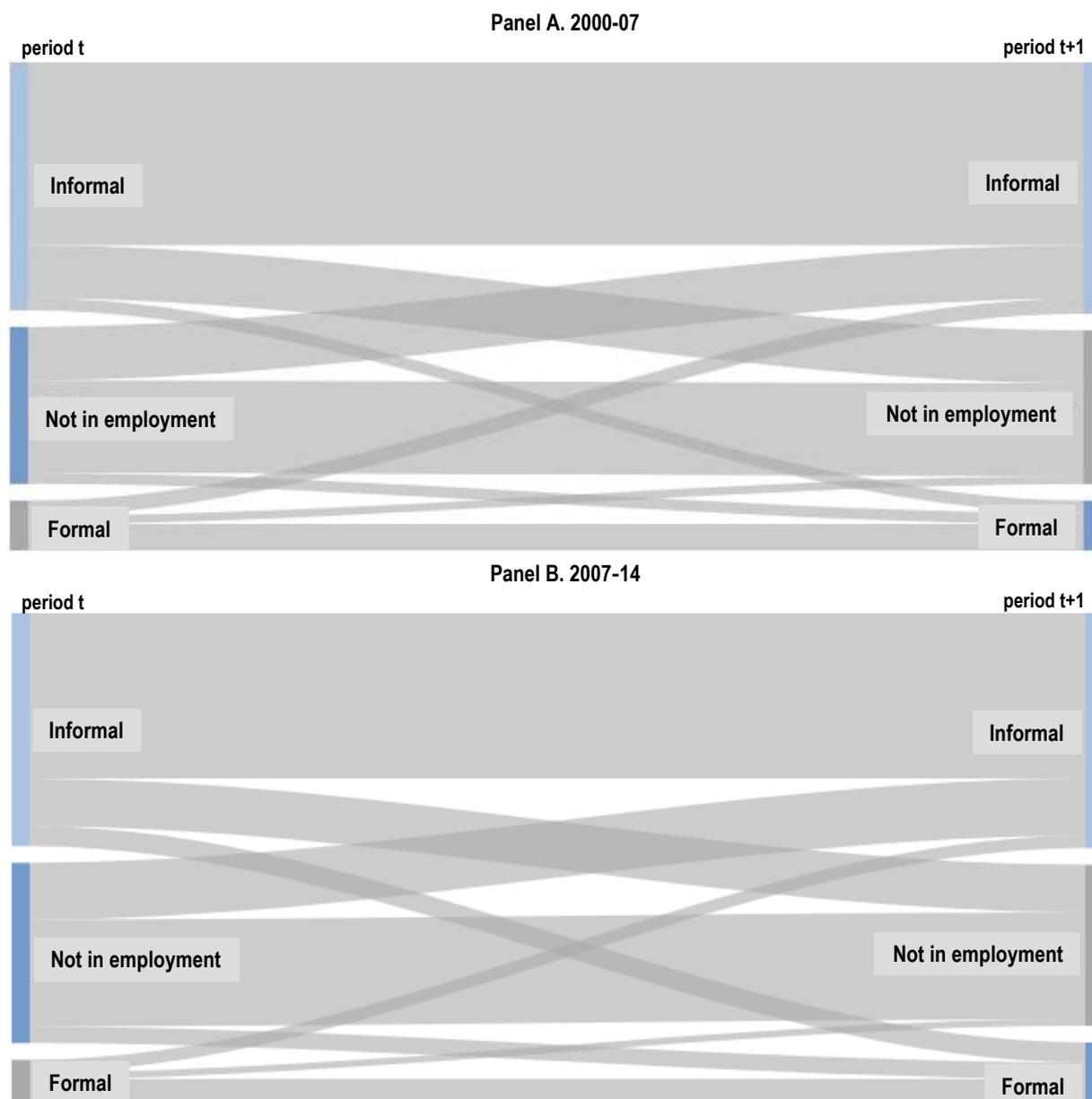
Workers included in this sample reported information on their employment status at the beginning and at the end of the relevant data collection time period. Given that labour market transitions are the subject of this study, only working-age individuals (aged 15-65 years) are considered for the analysis. Individuals close to retirement age are included in the Sankey graphs, with some of them moving to the “out of employment” category at the end of any studied period. If these workers remain in employment at the end of the period, they are also included in the regression analysis, but they are automatically excluded from the regression analysis if they move to the “out of employment” category for any reason, including retirement. Samples in the regression analysis are restricted to the employed. The restriction is necessitated by the fact that the information about labour incomes is only available for working individuals and is not available for those not in employment. Consequently, the regression analysis only considers

moves between formal and informal employment statuses, disregarding moves into and out of employment. In each country, this sample is further restricted to the individuals with available data on employment status and labour income at the beginning and at the end of each data collection time period, as well as to individuals with non-missing data on other socio-economic characteristics, including age, gender, education, civil status, number of household members, status in employment (employee or self-employed), sector of economic activity and place of residence (urban or rural).

For more details, see (Aleksynska, La and Manfredi, 2023<sup>[22]</sup>).

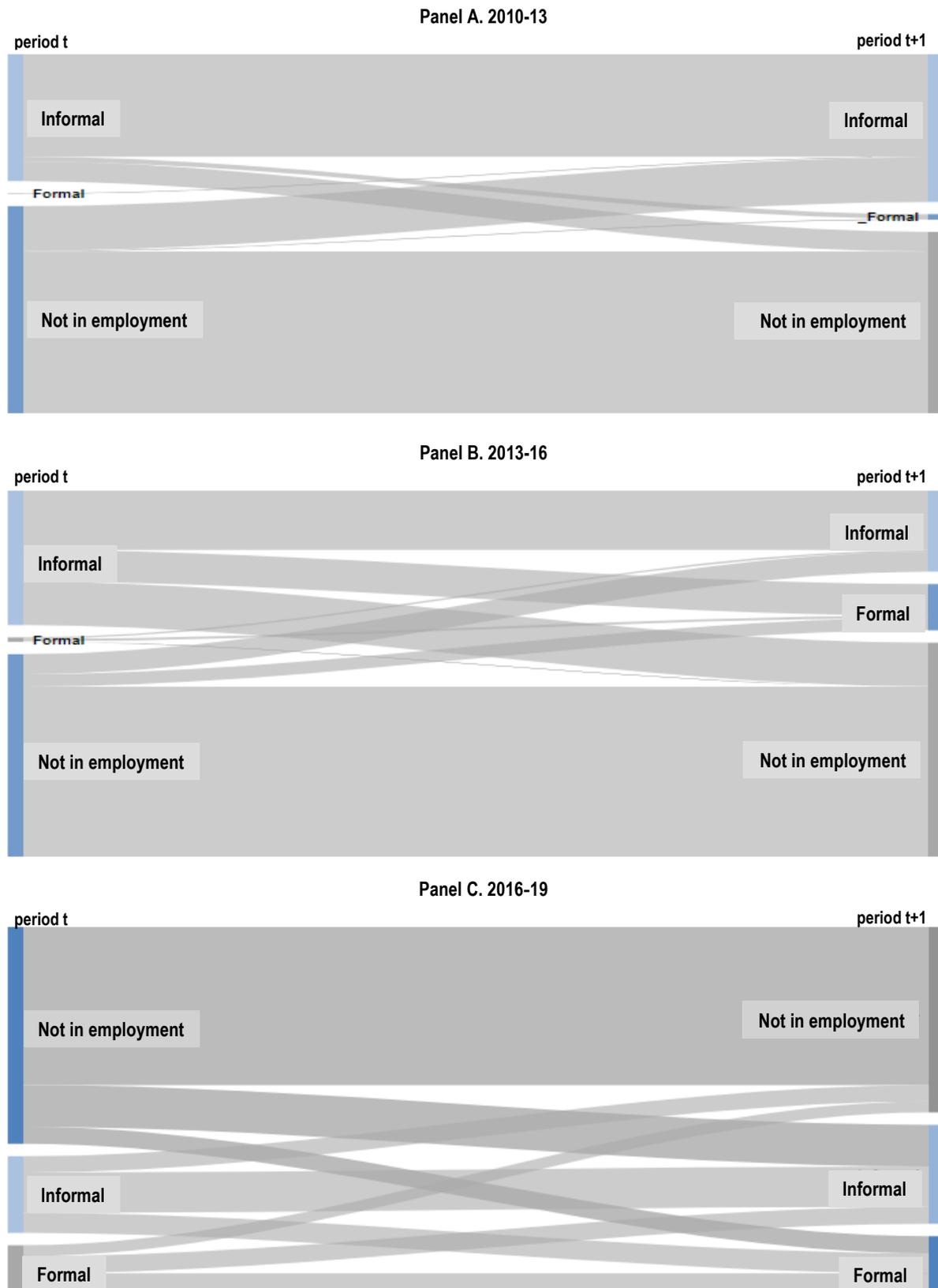
## Annex 3.B. Transitions between two consecutive waves of data

Annex Figure 3.B.1. Transitions between three employment states, Indonesia



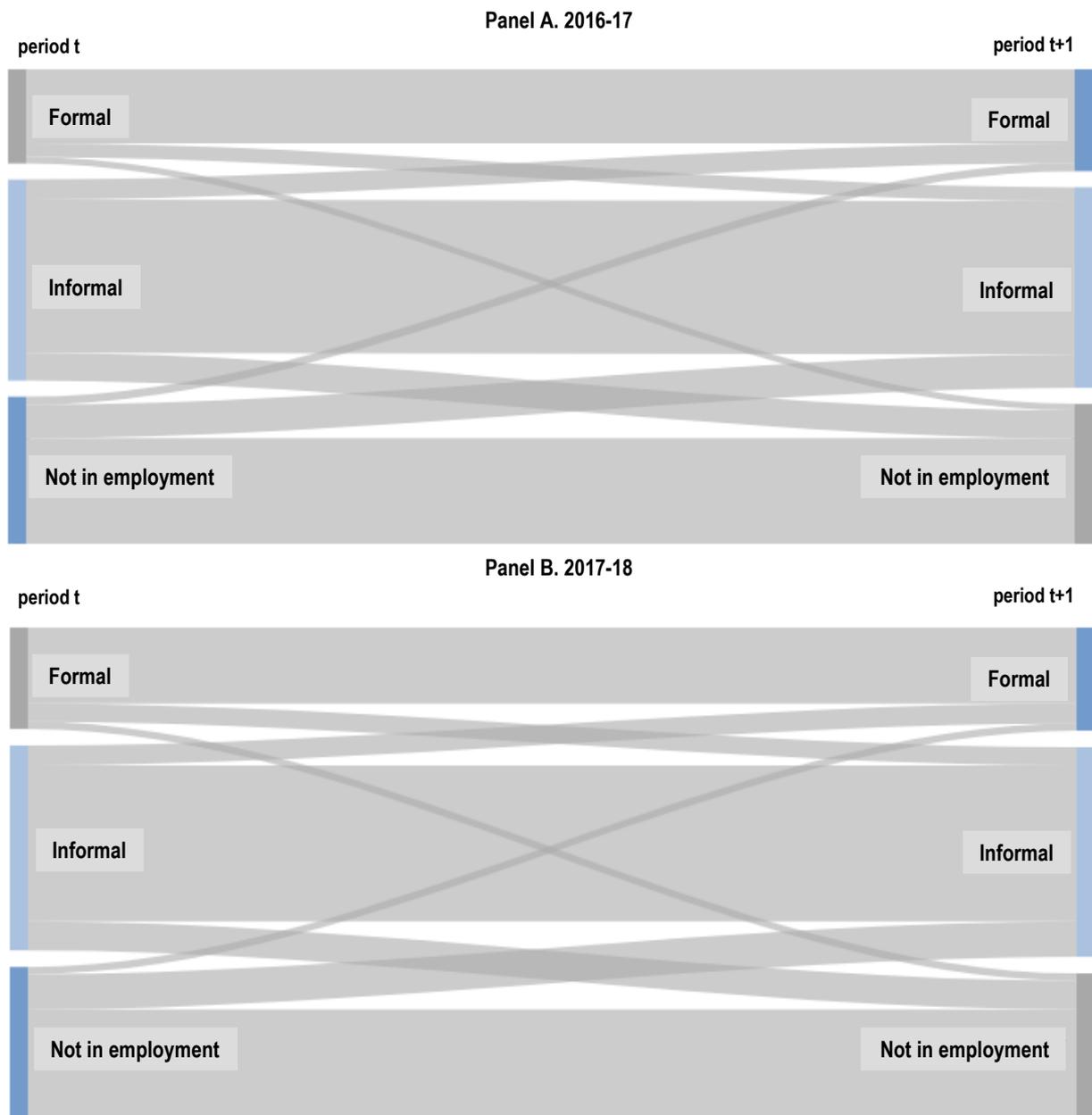
Source: Authors' calculations based on data from the RAND Institute (2000<sup>[2]</sup>; 2007<sup>[3]</sup>; 2015<sup>[4]</sup>) (the Indonesian Family Life Survey 2000, 2007 and 2014).

## Annex Figure 3.B.2. Transitions between three employment states, Malawi

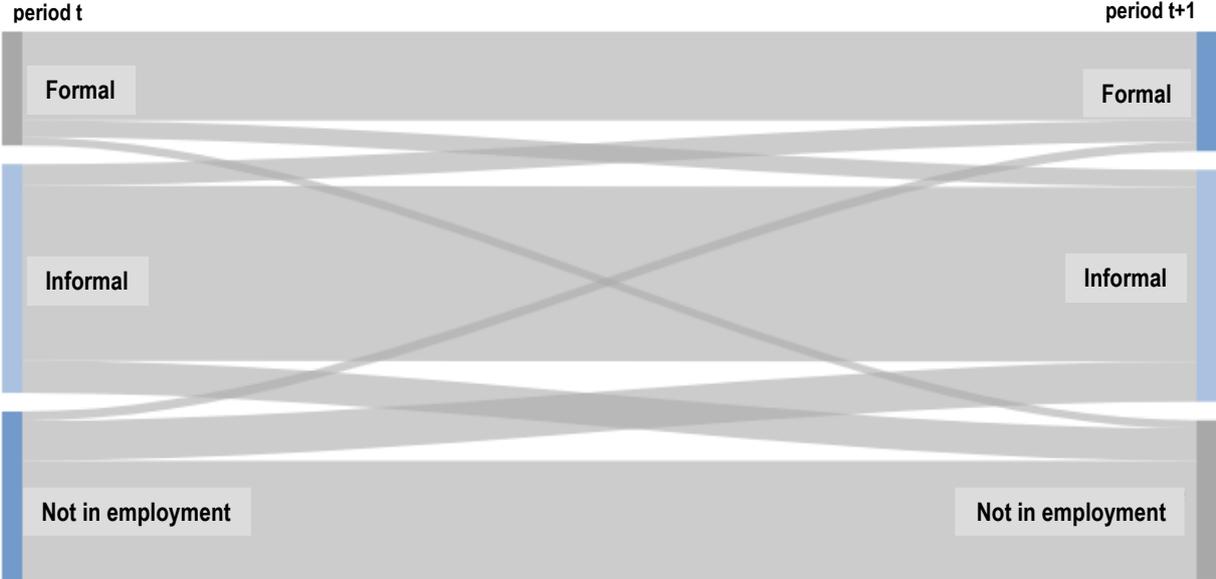


Source: Authors' calculations based on data from the Malawi National Statistical Office (2010<sub>[5]</sub>; 2013<sub>[6]</sub>; 2016<sub>[7]</sub>; 2019<sub>[8]</sub>) (the Malawi Integrated Household Survey 2010, 2013, 2016 and 2019).

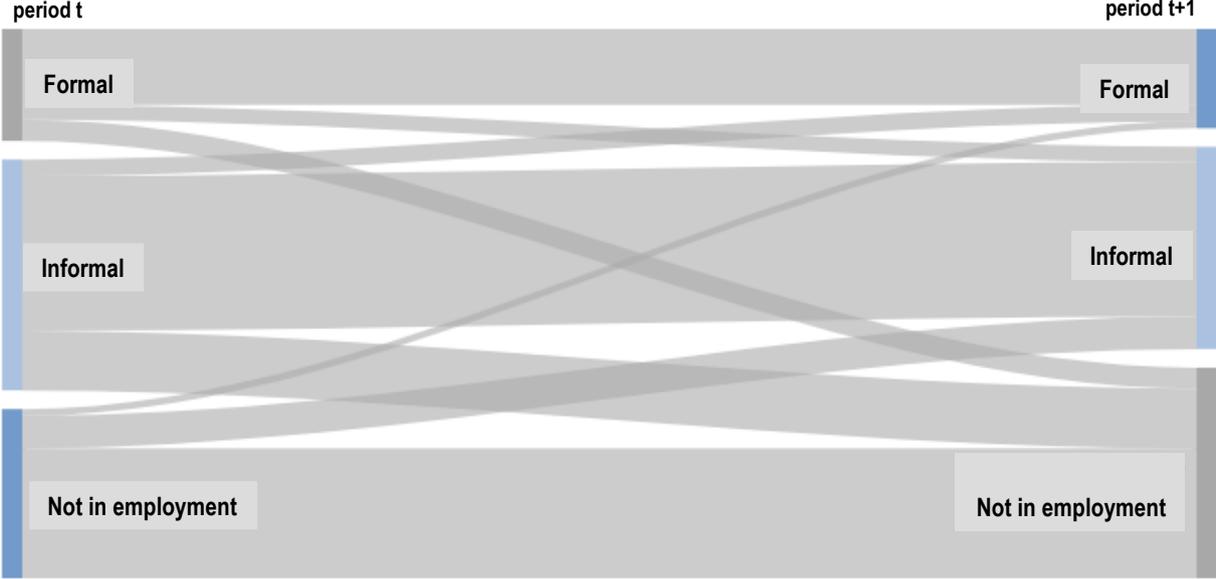
Annex Figure 3.B.3. Transitions between three employment states, Peru



Panel C. 2018-19

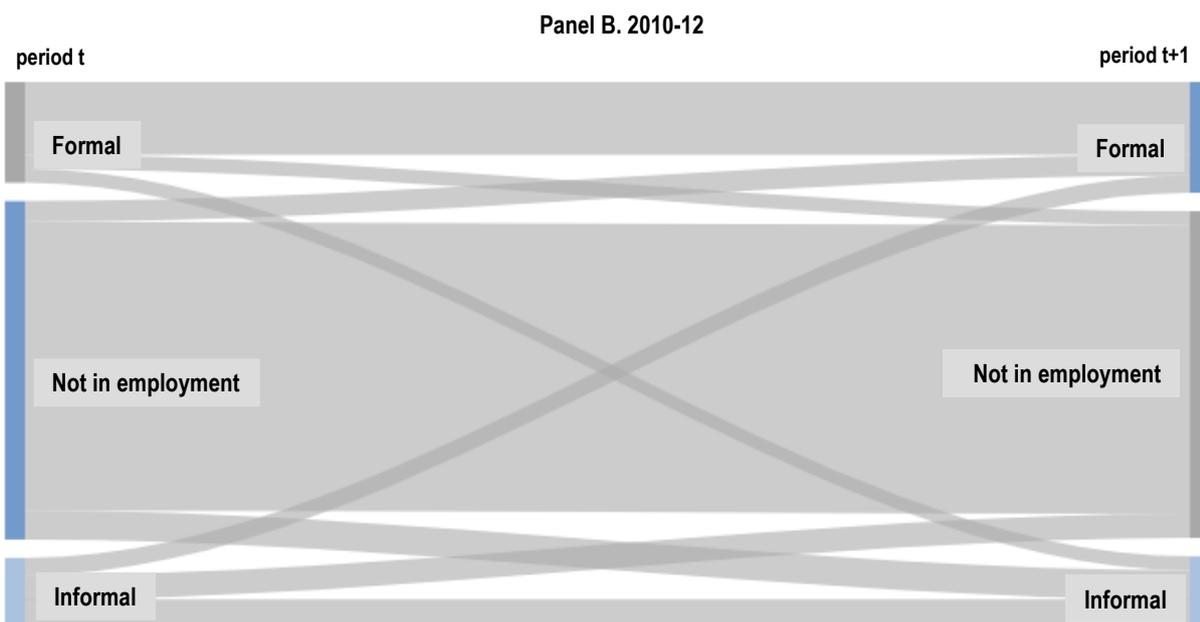
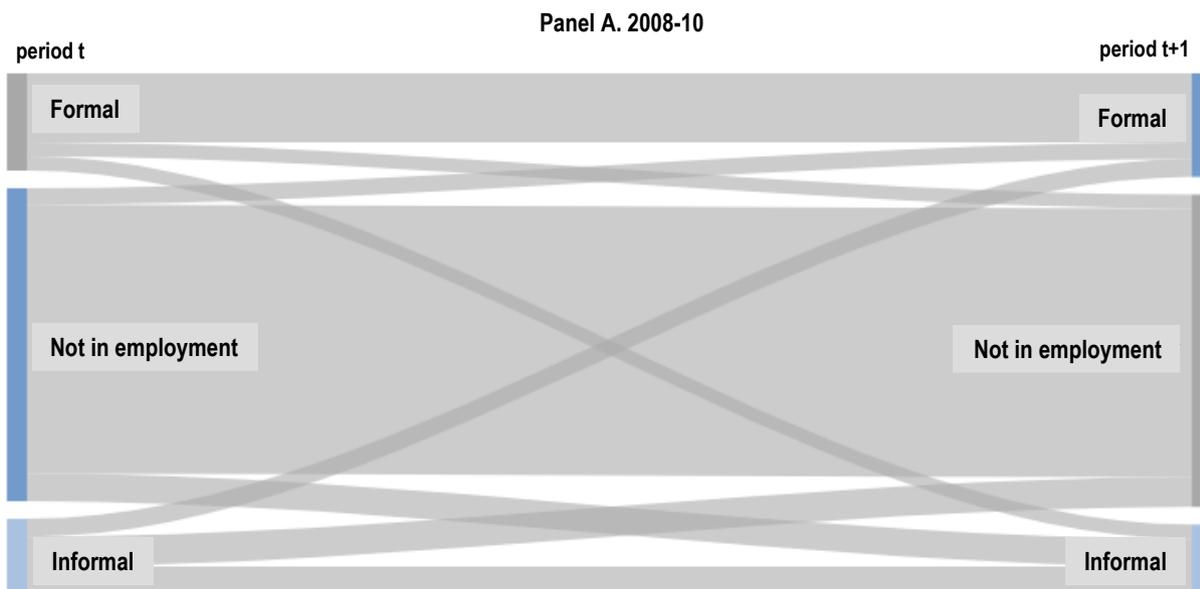


Panel D. 2019-20

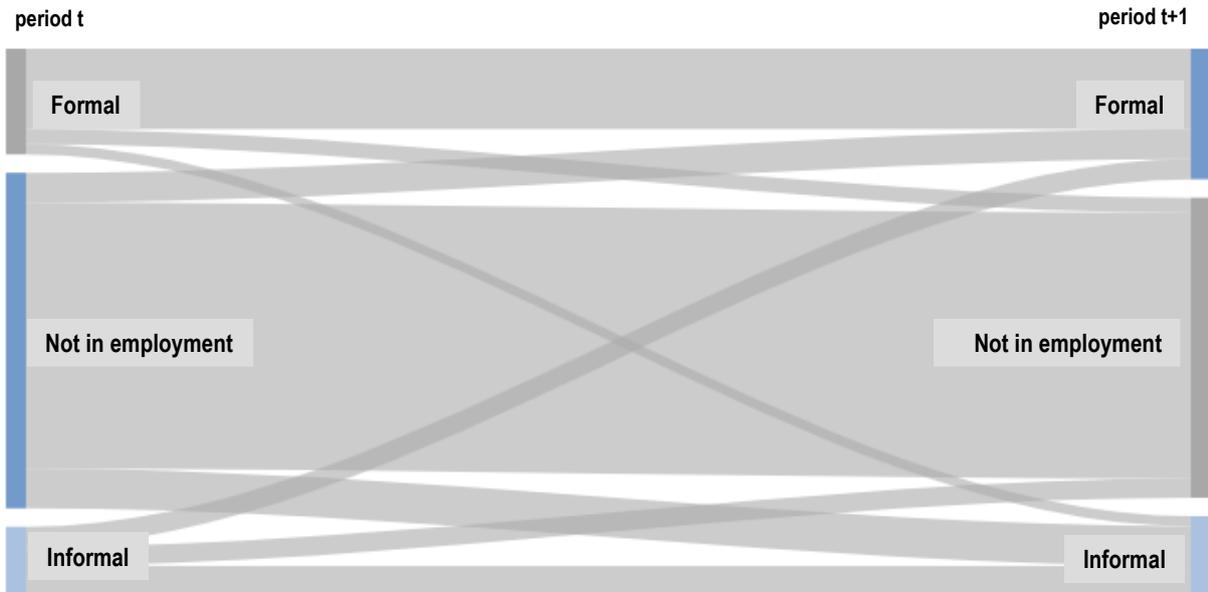


Source: Authors' calculations based on data from Peru's National Institute of Statistics and Information (2020<sup>[9]</sup>) (Encuesta Nacional de Hogares (ENAHO) Panel 2016, 2017, 2018, 2019 and 2020).

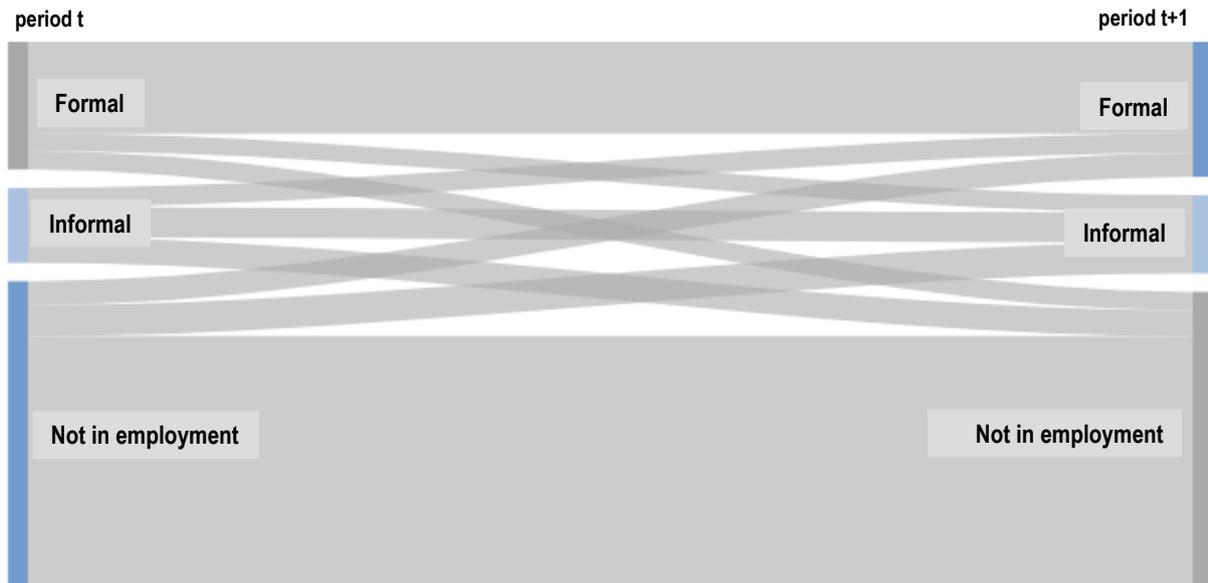
Annex Figure 3.B.4. Transitions between three employment states, South Africa



Panel C. 2012-14



Panel D. 2014-16



Source: Authors' calculations based on data from SALDRU (2008<sub>[10]</sub>; 2010<sub>[11]</sub>; 2012<sub>[12]</sub>; 2014<sub>[13]</sub>; 2016<sub>[14]</sub>) (National Income Dynamics Study (NIDS) 2008, 2010, 2012, 2014 and 2016).

# **4 Education and skills challenges in the context of informal employment**

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This chapter examines the skills supply of informal workers and the skills demand for workers in formal and informal jobs. It shows that not only informal workers often have substantially lower levels of schooling compared with formal workers but they also have more limited opportunities to upgrade their skills, whether through employer-provided training, public training programmes or other forms of learning. Moreover, skills recognition remains an important challenge for informal workers. However, formal economy employers generally demand higher-order skills. As a result, economies with a large share of informal employment face sizeable skills mismatches.

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When examining the question of skills, one needs to consider the supply of skills, the demand for skills, and how they match each other. The supply of skills essentially tells us about the skills that workers – formal or informal – possess. The demand for skills is the needs that employers – formal or informal – have in order to produce and deliver their goods and services. A good match of skills supply and demand enables economies to function optimally, and creates the potential to improve the socio-economic well-being of workers and their families.

The COVID-19 crisis has added to the uncertainty that education and training systems on the one hand, and labour markets on the other hand, were already facing. On the labour demand side, the crisis has adversely affected the level of production and the rate of economic growth. Lockdowns, social distancing measures, and reductions in the movement of people, goods and services meant that enterprises had to adjust to the contraction of their activities, introduce new methods and practices at work, and modify their activities. Informal enterprises and informal workers have suffered disproportionately, as they are often concentrated in the sectors that were most strongly impacted by the lockdowns and did not always benefit from government support measures. As the world recovers, there is increasing demand for new skills, including those related to telework and new health and safety regulations. On the labour supply side, the social distancing measures adopted during the crisis and the downsizing of economic production that followed have inflicted an unprecedented shock on both young people's education enrolment, school attendance and learning, and on adults' skills development. The crisis has also increased the size and complexity of the challenge to leverage the availability of skills and match them better with the changing nature of work.

As the world faces new challenges (such as those associated with the wars and military conflicts throughout the world and the resulting influx of refugees and children in other countries, the disruption of global food supply chains, and climate change), skills development systems must contribute to filling important gaps. Not only do they need to recover from the setbacks of the COVID-19 crisis but they also need to pave the way for a productive “new normal”, including for informal workers.

### **On the skills supply side, informal workers have lower education levels and fewer chances to upgrade their skills than formal workers do**

Workers in the informal economy can acquire skills both before they start working in the informal economy and through their practical experience gained at work in the informal environment. Many informal workers have experienced periods of formal education and training of varying duration and quality, and will bring these skills to work. The quantity and quality of their initial education and training will determine not only their chances of becoming employed – formally or informally – but also their subsequent capacity and opportunities to learn and acquire new skills as working adults in a world with constantly changing skills demands. This, in turn, will also influence the education outcomes of future generations, determining whether or not they are able to break the intergenerational cycle of informal employment.

#### ***A static analysis at informal workers' education levels reveals their disadvantages compared with formal workers***

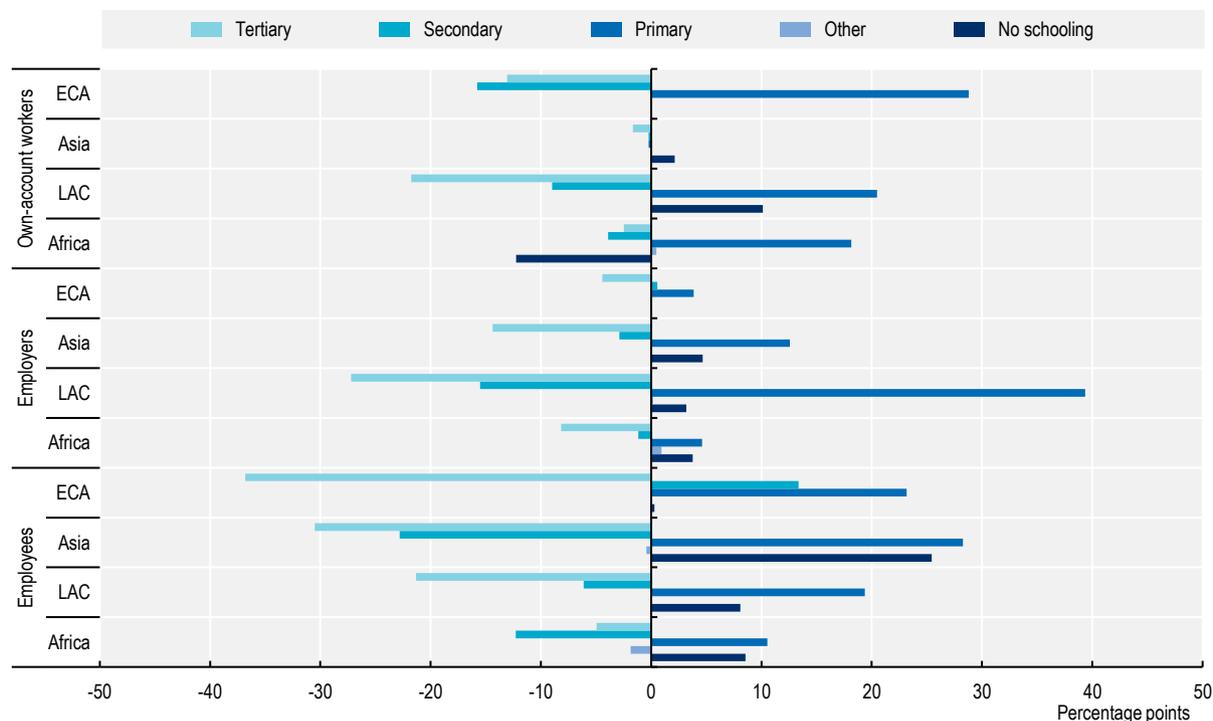
Education received in school is the main way to acquire foundational skills, such as reading, writing and numeracy, and is the base on which all other technical, work-specific and job-specific skills can be built. These are the skills that make further learning possible.

Informal workers have a considerably lower level of schooling when compared with formal workers. Globally, close to 45.0% of informal workers have at best a primary level of education, whereas the comparable figure for workers in formal employment is 7.0%. By contrast, a minority of informal workers have tertiary education (less than 7.0% globally but close to one-third in developed countries) compared

with one-third among their formally employed counterparts (ILO, 2023<sup>[1]</sup>). In the vast majority of regions and statuses in employment, there is a significantly higher share of informal workers with primary schooling, or no schooling, compared with formal workers. By contrast, in the vast majority of regions and statuses in employment, there is a higher share of formal workers with secondary and tertiary education compared with informal workers (Figure 4.1).

**Figure 4.1. Education gaps between informal and formal workers**

Difference in the distribution of informal and formal workers in various employment statuses, by educational attainment (circa 2019)



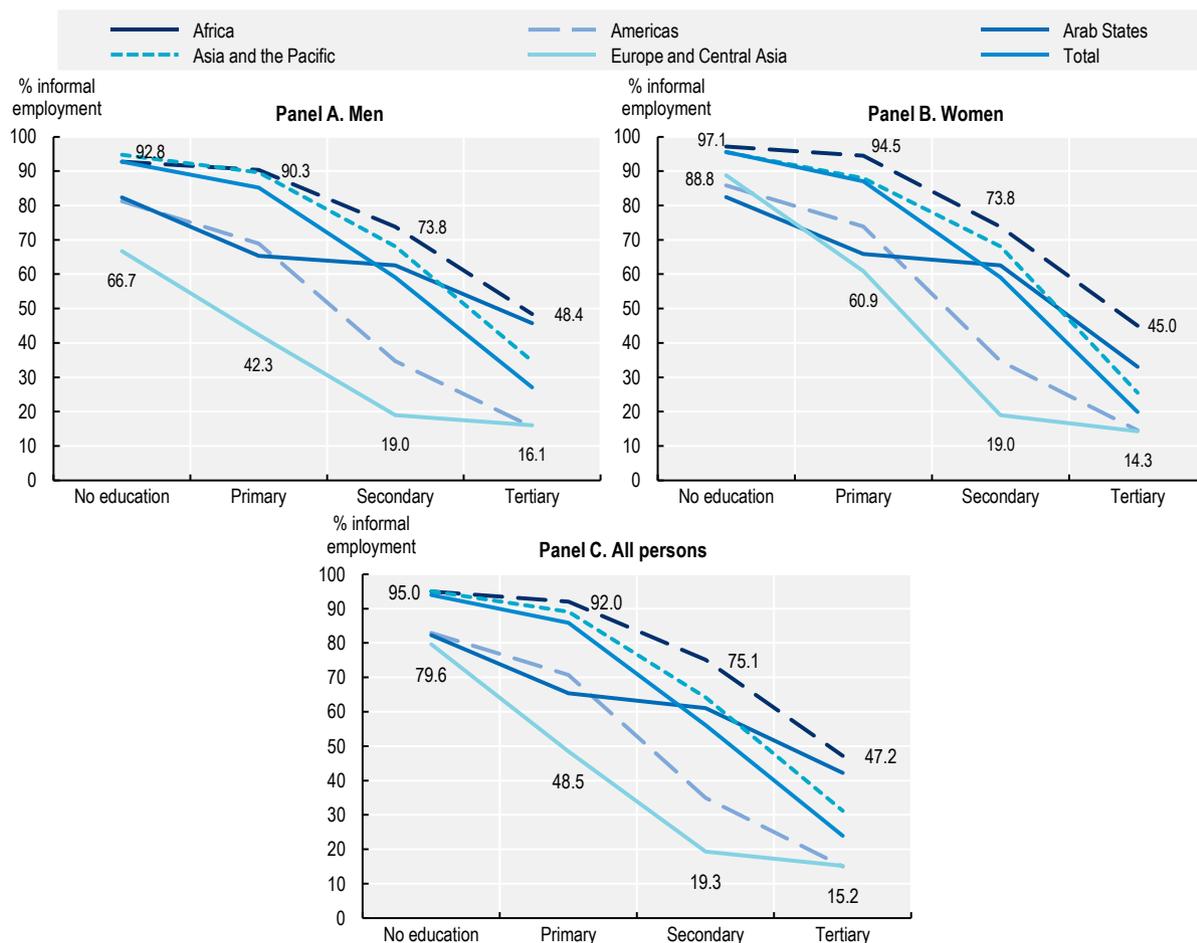
Note: Contributing family workers not represented, as all of them are considered to be part of the informal economy. LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: (OECD, 2021<sup>[2]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>.

StatLink  <https://stat.link/xk15j4>

Conversely, the share of informal employment among workers with no education is 94.0% globally.<sup>1</sup> It stands at 95.0% in Africa and 79.6% in Europe and Central Asia (Panel C of Figure 4.2), although in Europe and Central Asia, the absolute numbers are very small. The share of informal employment falls, but only slightly, to 85.2% among those with primary education. It is significantly lower, at 52.1%, among those with secondary education. The share is lower but does not disappear among those with tertiary education, of whom 24% are found to be in informal employment. Women and men are also affected differently. There is a higher share of informal employment among women with no education or with only primary education compared with men (Panels A and B of Figure 4.2). The share of informal employment between men and women with secondary education is nearly identical; the share of informal employment among women with tertiary education is slightly lower than among men with the same level of education.

Figure 4.2. Share of informal employment by level of education



Note: Global and regional estimates based on data for 144 countries representing 92.4% of the world's employed population. Harmonised definition of informal employment and employment in the informal sector.

Source: (ILO, 2023<sup>[1]</sup>), *Women and Men in the Informal Economy: A Statistical Update*.

StatLink  <https://stat.link/vg1j4t>

Schooling “is only a proxy for the skills mastered at the moment of completion of an educational programme” (ILO, 2018<sup>[3]</sup>). Workers with the same amount of formal schooling may also display different degrees of ability and competency to perform the same job (Fialho, Quintini and Vandeweyer, 2019<sup>[4]</sup>). Thus, ideally, the amount of schooling also needs to be considered in conjunction with its quality, while simultaneously considering measures of work-related professional skills. Evidence on this, for formal and informal workers, is rare. Where it does exist, it indicates that informal workers also have poorer literacy, numeracy and problem-solving skills compared with formal workers (Jaramillo and Escobar, 2022<sup>[5]</sup>).<sup>2</sup>

### **Informal workers also face challenges to upgrading their skills compared with formal workers**

The supply of skills in any given economy is dynamic. It is affected by structural factors, such as demographic changes including migration, or increasing labour force participation of women. It is also affected by various forms of lifelong learning, including non-formal training and informal learning.

- **Training provided by the employer is less frequently available for informal workers**

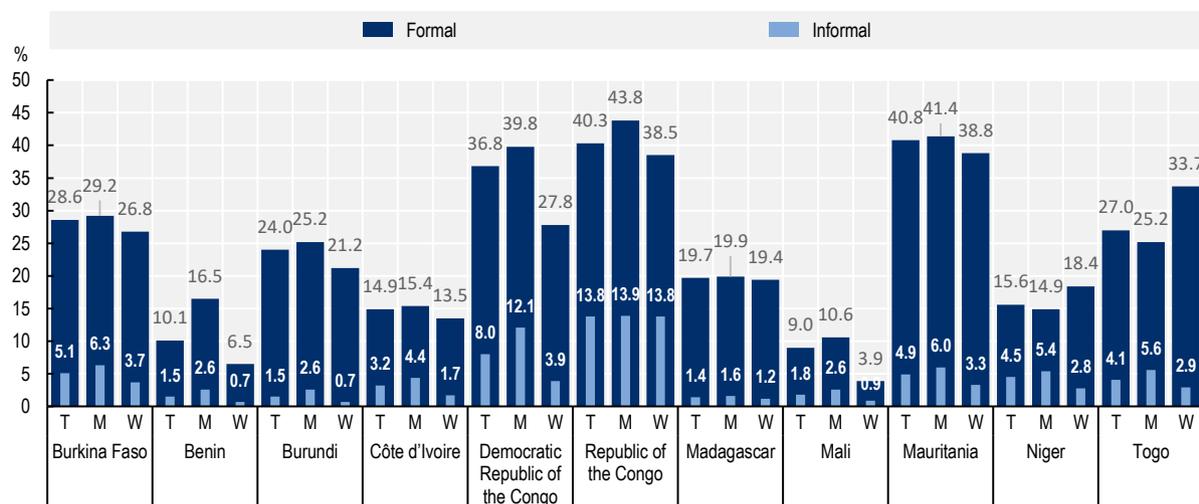
In what concerns employees, enterprises are a natural place to equip workers with the right technical skills. This is particularly true in sectors requiring relatively new types of skills that may be enterprise specific. Indeed, across OECD member countries, the main provider of reskilling and upskilling opportunities for adults is the employer (OECD, 2021<sup>[6]</sup>). In some countries, governments provide subsidies and other financial incentives to encourage employers to facilitate training provision and provide access to training for their employees.

The situation is different in developing and emerging economies, where such incentives may be absent, and where employers may have fewer resources to provide training. This is especially true of informally operating enterprises. As a result, informal workers are more vulnerable than formal workers to a “low-skill trap”: not only are they more likely to have a low level of initial education and as a result occupy low-skill, low-level positions but they also have more difficulties accessing training to upgrade and acquire higher-order skills.

Available evidence from 11 African Francophone countries shows that participation in job-related professional training in the last 12 months, financed by the enterprise or one of its partners, concerns at most 5% of workers in informal employment in 8 of the 11 countries considered. This proportion is 3-15 times lower than that of workers in formal employment. The situation among women is the most critical, as they face more limited access to training regardless of the formal or informal nature of their employment. Moreover, the gap in access to employer-sponsored training between workers in informal and formal employment is greater among women than among their male counterparts (Figure 4.3).

**Figure 4.3. Training courses financed by enterprises**

Percentage of workers having taken a professional/retraining course relevant to their main job, financed by their enterprise or one of its partners, in the last 12 months



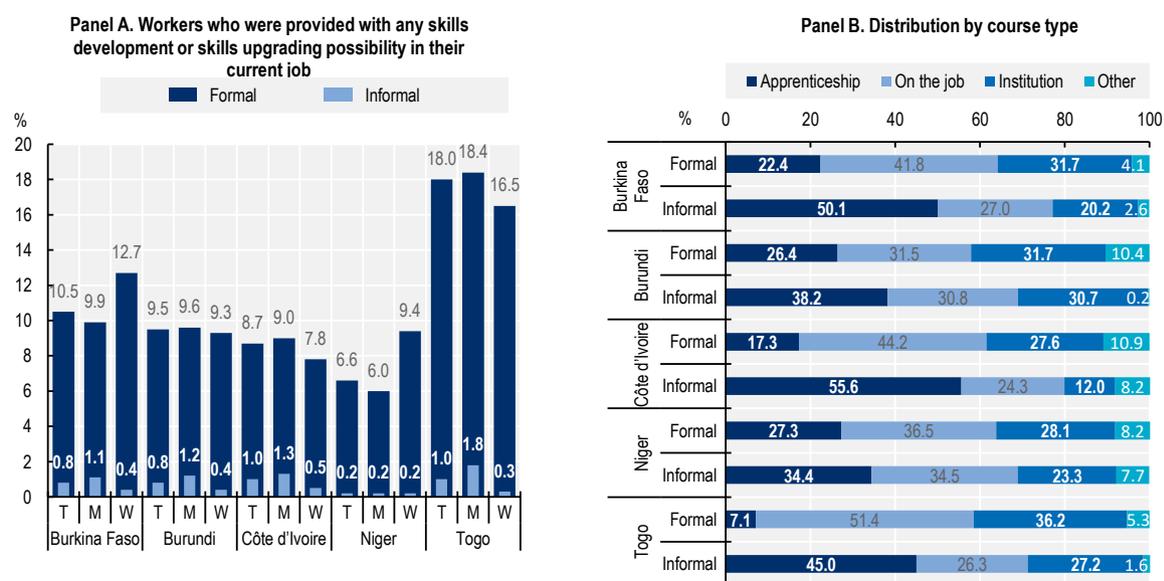
Note: T – total, M – men, W – women.

Source: Courtesy of the International Labour Organization (ILO). Calculations based on national household survey data: Burkina Faso, Côte d'Ivoire, Niger and Togo (Enquête régionale intégrée sur l'emploi et le secteur informel, 2017-2018); Benin (Enquête Modulaire Intégrée sur les Conditions de Vie, 2011); Burundi (Enquête sur les conditions de vie des ménages, 2014); Democratic Republic of the Congo (Enquête nationale sur l'emploi et le secteur informel, 2012); Republic of the Congo (Enquête nationale sur l'emploi et le secteur informel, 2009); Madagascar (Enquête nationale sur l'emploi et le secteur informel, 2015); Mali (Enquête modulaire et permanente auprès des ménages, 2018); Mauritania (Enquête nationale sur l'emploi et le secteur informel, 2017).

With regard to the possibility of further developing their skills and upgrading them, the gap in access to further training between informal and formal workers since entering their current job is even more pronounced. Among the five countries with similar information on this issue (Figure 4.4), between 0.2% of informally employed workers in Niger and 1.0% of informally employed workers in Côte d'Ivoire and Togo benefitted from this opportunity. The corresponding proportions among their formally employed counterparts range from 6.6% in Niger to 18.0% in Togo. Only a tiny minority of women in informal employment had this opportunity.

The few workers who were able to access further training did so in different ways depending on the formal or informal nature of their job. Apprenticeship is the most common modality among workers in informal employment in Francophone African countries to develop work-related skills (ranging from 34% in Niger to more than 50% in Burkina Faso and Côte d'Ivoire among those who received retraining). The corresponding proportions in formal employment range from 7% in Togo to 27% in Niger. On-the-job retraining appears to occur in both formal and informal employment, although at very different rates. Finally, retraining within an educational institution is more likely to benefit workers in formal employment.

**Figure 4.4. Skills development and skills upgrading possibilities for formal and informal workers**



Note: T – total, M – men, W – women. Apprenticeships include formal and informal apprenticeships, the latter being particularly widespread in the study countries (Werquin, 2021<sup>[7]</sup>).

Source: Courtesy of the ILO. ILO calculations based on national household survey data: Burkina Faso, Côte d'Ivoire, Niger and Togo (Enquête régionale intégrée sur l'emploi et le secteur informel, 2017-2018); Burundi (Enquête sur les conditions de vie des ménages, 2014).

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Similar evidence is available for LAC countries, such as Mexico and Peru. There, informal employees (with informality measured by the absence of a written work contract) have a significant gap in participation in any type of on-the-job training when compared with formal workers (Jaramillo and Escobar, 2022<sup>[5]</sup>).

Available training for employees within enterprises greatly depends on enterprise characteristics, and notably whether the enterprise itself is formal. Evidence from more than 70 countries suggests that enterprises “born formal”, as opposed to enterprises that were informal at the time of their establishment and later became formalised, have a significantly higher probability of providing training to their employees, and also of training more staff (Box 4.1). It is possible that enterprises that were informal from the outset were more resource constrained, and as a result did not have skills upgrading as a priority in their business model. This business model might persist to a certain extent even after such enterprises formalise.

### Box 4.1. Enterprises “born formal” offer more training to more staff

Does training offered by enterprises vary across formal and informal enterprises? To answer this question, one would need enterprise survey data covering formal and informal enterprises as well as questions about training offered. Such data are hard to find. Nevertheless, the World Bank Enterprise Survey enables us to get as close as possible to answering this question.

The World Bank Enterprise Survey is conducted among formal, registered enterprises. However, the questionnaire contains a question on whether the establishment was formally registered when it began its operations. In other words, it allows distinguishing between enterprises “born formal” and enterprises that were informal when they began operations and that only became formalised at a later stage. It is well known that such enterprises may be very different from each other, including in their *raison d’être*, their resource constraints, their management style and the approach of their workforce. One of the questions also inquires whether, over the last fiscal year, the establishment had formal training programmes for its permanent, full-time employees. The two questions together facilitate investigation of whether “formally born” enterprises have a different propensity to offer training to their staff compared with enterprises that were initially informal but became formalised after they began operations.

The World Bank Enterprise Survey is a representative enterprise-level survey in developing and emerging economies. The survey data are collected from face-to-face interviews with top managers and business owners of enterprises with five or more employees, operating in the manufacturing and services sectors. The survey covers a broad range of questions on other enterprise-level characteristics, business environment topics and characteristics of the enterprise’s workforce, thus enabling researchers to better identify the relationship between past informality status of the enterprise and the training it offers, and separating it from a range of other factors.

Using the data collected between 2006 and 2014, and restricting the sample to enterprises containing non-missing answers to these questions and other key enterprise characteristics, the sample is reduced to 30 537 observations in 74 countries. Most countries are surveyed twice.

Regression results show that establishments that were formally registered when they began operations have significantly greater chances of offering training to their staff than establishments that were not registered (first column of Table 4.1). Moreover, they train significantly more staff (second column). The results also show that enterprises that are more likely to offer training are also larger in size, are older, serve national or international markets (as opposed to serving only local markets, the reference category), and are more efficient (efficiency is defined as sales per employee). They also have a higher share of skilled production workers among total employees than unskilled workers (measured by the variable skill production mix). Enterprises with domestic private ownership tend to offer fewer training options compared with domestic publicly owned establishments (the reference category), while foreign private enterprises do not differ from domestic publicly owned establishments in this regard.

**Table 4.1. Enterprises “born formal” more systematically offer training to their staff, and train a higher share of staff: results from a regression analysis**

	Training offered? (probit model)		Share of trained staff (OLS model)	
	Coefficients	Standard errors	Coefficients	Standard errors
“Born formal”	0.171***	(0.028)	1.390***	(0.304)
Total number of employees	0.001***	(0.000)	-0.001	(0.001)
Enterprise age	0.005***	(0.001)	-0.066***	(0.019)
Ownership: private domestic	-0.254***	(0.050)	0.896	(1.703)
Ownership: private foreign	-0.011	(0.058)	2.834	(1.941)

Market served: national	0.245***	(0.018)	-0.563	(0.737)
Market served: international	0.347***	(0.031)	1.183	(1.092)
Efficiency	0.109***	(0.007)	-0.355	(0.253)
Skill production mix	0.010*	(0.006)	11.209***	(1.056)
Number of observations	30 573		12 776	
R-squared				0.186

Note: The table presents the results of the regression analysis (estimation of a probit model and of an ordinary least squares (OLS) model). In the probit model, the dependent variable is equal to 1 when the enterprise offers any training to its workers, and 0 otherwise. In the OLS model, the dependent variable is continuous, and shows the share of trained staff compared with the total number of workers. All regressions include additional controls for sectors, countries and year of survey. The symbol (\*\*\*) represents statistical significance at  $p < 0.01$ , (\*\*) represents statistical significance at  $p < 0.05$  and (\*) represents statistical significance at  $p < 0.1$ .

Source: Authors' computations based on the World Bank Enterprise Surveys.

The COVID-19 crisis put a strain on private sector financing for skills development. Many enterprises found themselves unable to allocate resources for training due to a contraction of sales, closures and lockdowns.

A global survey of enterprises in mid-2021 found that four out of five enterprises had completely or partially suspended their operations in the midst of lockdowns. As a result, globally, training was interrupted for 90.0% of employees, 86.0% of apprentices and 83.0% of interns and trainees, with micro-, small and medium-sized enterprises (MSMEs) (most often informal) affected the most (ILO, World Bank and UNESCO, 2021<sup>[8]</sup>).<sup>3</sup> Nearly one-half of enterprises stopped paying a stipend or wages to apprentices and interns/trainees. Although online learning increased following the lockdowns and social distancing measures, training delivery faced considerable challenges arising mainly from infrastructure issues (inadequate Internet connectivity and poor access to computers). Other factors were limited digital literacy among users (particularly among low-skilled informal workers); a lack of adapted training programmes and resources; and the difficulty of delivering practical training online (particularly in low-income countries, but also in middle-income countries in remote rural areas).

The availability and type of training also greatly depends on the sector of activity, occupation and size of the enterprise – all of which tend to correlate with the extent of informal employment. For example, findings from the comparative study of rapid assessments of reskilling and upskilling needs due to the COVID-19 crisis in nine African countries show that, on average, 58.0% of surveyed employers responded that they provided training to their existing employees during the COVID-19 pandemic. However, employers in the services sector were more likely to provide training to their employees, whereas agricultural enterprises were less likely to provide training during the pandemic (ILO, 2021<sup>[9]</sup>). Where training was taking place, 87.7% of the surveyed employers focused on health and safety training, 43.6% focused on the use of digital technologies for communication, and 28.0% focused on the use of digital technologies for Internet connection. The latter two training areas were given a special priority by larger establishments and those in the services, industrial and construction sectors, but not in the agricultural sector.

- **Few informal workers benefit from quality learning on the job and other learning opportunities**

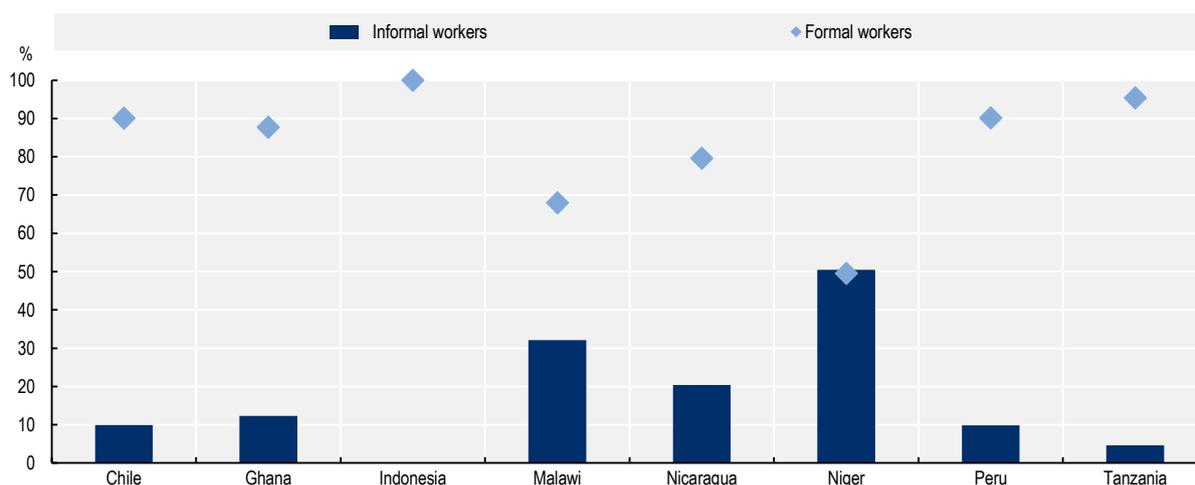
One of the important ways to acquire knowledge and skills is to learn on the job, from observation and learning by doing. Many informal workers – especially when their informal job is not a choice – perform elementary jobs or those requiring little skill. As a result, informal learning on the job is limited. Workers do not develop advanced skills, and when they do, these skills are often non-transferable to formal jobs. There is also evidence that informal workers are less likely than formal workers to acquire good-quality informal learning on the job, suggesting that they are not acquiring enough skills to compensate for the lack of formal on-the-job training, and which could help them with moving into formal jobs (Jaramillo and Escobar, 2022<sup>[5]</sup>). When learning happens, it is often not recognised and not certified, thus impeding informal workers from proving their skills when they wish to apply for formal jobs.

- **Informal workers also tend to be excluded from public training and skills upgrading programmes**

When skills upgrading and reskilling are less frequently available through the employer or in the workplace, the role of public programmes of skills upgrading can become critical.

Yet, informal workers are also less likely to benefit from training and skills programmes provided through public labour market programmes. For example, in Indonesia, due to regulation of access, 100% of such labour market programme beneficiaries are formal workers. In Chile, Ghana, Peru and Tanzania, around 90% of such labour programme beneficiaries are formal workers (Figure 4.5). In Niger, state-provided labour market programmes such as vocational training or skills development are provided equally to formal and informal workers. However, to the extent that there is a larger share of informal workers than formal workers in the economy, in order to attain equity (rather than equality), more training needs to be provided to informal workers in Niger.

**Figure 4.5. Share of workers who benefitted from vocational training or a skills development programme, by formality status**



Source: (OECD, 2021<sup>[2]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIbIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIbIH.htm>.

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- **Informal workers may upgrade their skills, or reskill, in ways that are different from formal workers, but which are not always well understood, developed or supported**

The majority of informal workers are own-account workers (OECD, 2023<sup>[10]</sup>); they have to provide their own training. In reality, such training is rare, not least because most workers – especially informal low-skilled workers with low pay – cannot afford to forego even one day’s earnings (OECD, 2019<sup>[11]</sup>). As a result, they cannot engage in formal training that might be organised far from their workplace and require time and monetary resources.

Many own-account workers do, however, engage in non-formal learning, defined as forms of learning that are “intentional or deliberate but may not be institutionalised” (UNESCO, 2016<sup>[12]</sup>). In some countries, informal learning options, with direct relevance to work needs and easier access, are offered to own-account workers in agriculture by farm extension services, agricultural advisory services, and/or farmers’ organisations and co-operatives (Ryan, 2023<sup>[13]</sup>). Yet, in many other developing countries, such learning

possibilities remain underdeveloped. They lack resources and content, and information about such possibilities is not distributed widely.

The advent of digital technologies created many opportunities for learning in general, and for non-formal learning specifically. Along with e-learning and open educational resources, open learning through massive open online courses (MOOCs) emerged as a modern way of acquiring skills (ILO, 2021<sup>[14]</sup>). By 2016, there were more than 100 specialised platform providers offering MOOCs in co-operation with educational institutions (Music and Vincent-Lancrin, 2016<sup>[15]</sup>). MOOCs – online distance courses that can be accessed by everyone without entry requirements – opened up access to training anytime, anywhere. However, questions increasingly are focused on the completion rates of such programmes, certificate uptake, and the recognition and validation of credentials obtained through such learning platforms. Moreover, the traditional models of credential evaluation are being challenged, as both for-profit and non-profit verification agencies step into the field, calling for new standards in credentialing (ibid.).

Despite these concerns, the emergence of MOOCs and other online facilities democratised learning, including for informal workers. For informal workers in services and creative professions, MOOCs became an important means to gain up-to-date and highly demanded knowledge and skills. In addition, YouTube, Instagram, Facebook or Telegram (among others) channels and “how-to” videos also allowed many workers, regardless of their status, to learn about new tools and work techniques, equipping them with skills and knowledge on demand. Even informal workers working in agriculture and living in rural areas are increasingly using these tools, such as, for example, in order to get advice on new and more resistant seeds, or to learn how to operate and repair drones used in agriculture (ILO, 2021<sup>[14]</sup>). The COVID-19 crisis has further spurred not only demand for these resources but also their supply: they are often provided by informal workers themselves as a new means of earning their livelihood. The true role of these new tools of knowledge for informal workers has yet to be assessed in the coming years.

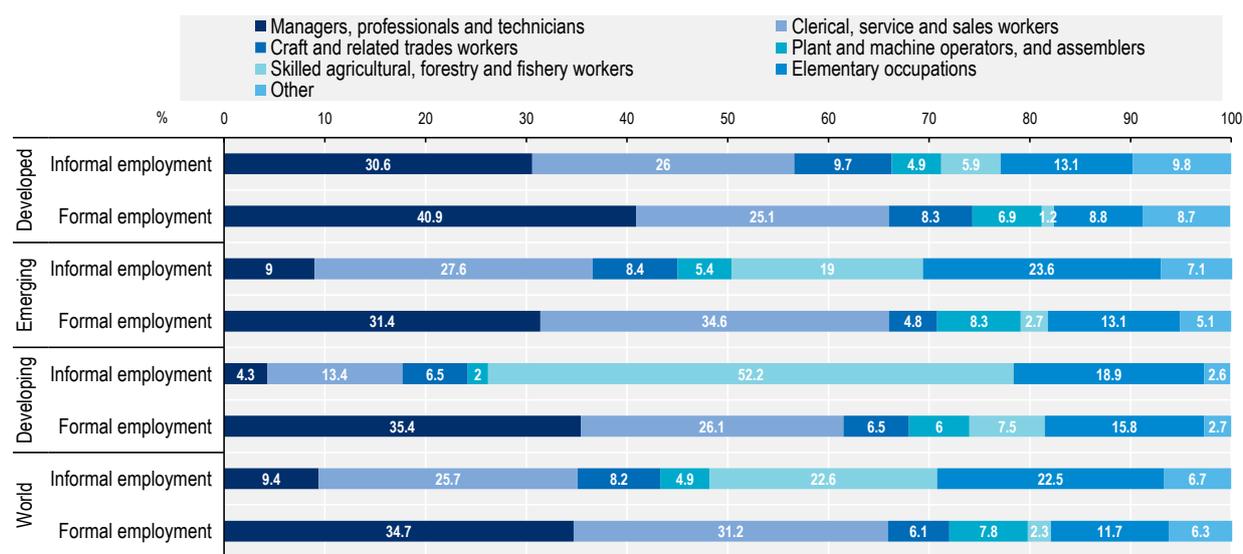
### **On the skills demand side, informality cuts across all occupations and skills, yet formal jobs generally require higher-level skills and qualifications**

The proper functioning of an economy depends on the ability of production units (enterprises as well as own-account workers) to produce and deliver the goods and services that are in demand. This ability, in turn, depends on the availability of the right skills among workers.

- **There are important disparities in the distribution of occupations between formal and informal jobs**

Globally, among workers in informal employment, there is a higher share of workers in elementary occupations, of and related trades workers, and of skilled agricultural, forestry and fishery workers, than among workers in formal employment (Figure 4.6). Among workers in formal employment, there is a higher share of managers, professionals, and technicians, as well as clerical, service, and sales workers, than among workers in informal employment. These differences are observed among countries at all stages of development, but they are especially pronounced in developing and emerging economies. It is also remarkable that, in some settings, informal employment is so widespread that it cuts across all occupations and is not uniquely an elementary occupations phenomenon (although in developed countries, the shares of informal employment are low).

Figure 4.6. Distribution of formal and informal employment by occupation



Note: International Standard Classification of Occupations (ISCO-88) classification of occupations. Global and regional estimates based on data for 144 countries representing 92.4% of the world's employed population. Harmonised definition of informal employment and employment in the informal economy. Latest available year.

Source: (ILO, 2023<sup>[1]</sup>), *Women and Men in the Informal Economy: A Statistical Update*.

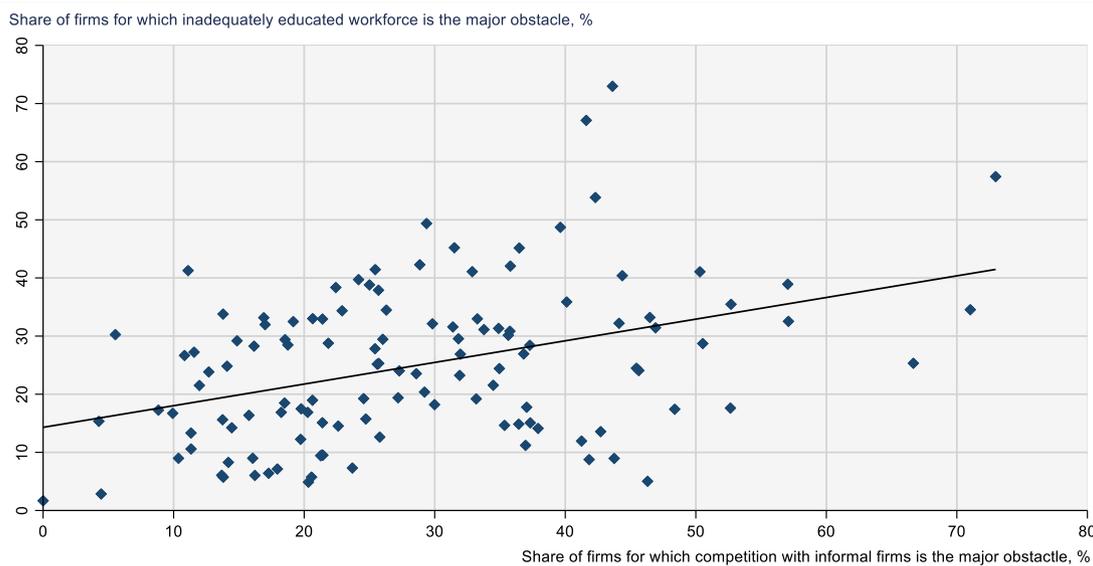
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- **Formal jobs may be hard to fill because they require skills that informal workers do not have or cannot prove having**

One problem with the current distribution of employment across occupations and skill level, however, is that it reflects only that portion of demand that is satisfied by the current supply of skills. It does not tell us much about skills shortages in specific occupations. The latter may be inferred from the information about job vacancies, which can be collected by public agencies and by private enterprises. It can also be inferred from employers' own assessments of skills shortages.

The World Bank Enterprise Survey, which is carried out regularly in more than 100 countries at the enterprise level, contains the following question: "What is the most serious obstacle affecting the operation of your business?" It features, among various answers, the "educated workforce". Availability of workers with the right training is indeed an important obstacle for productive activity in many enterprises. Globally, around 25% of registered enterprises indicate that an inadequately educated workforce is either a major obstacle or a very severe obstacle affecting the operation of their business. Moreover, this obstacle is positively correlated with concerns regarding informality. Evidence from the World Bank Enterprise Survey shows that in settings where formal enterprises are concerned about the practices of their competitors in the informal sector, they are also concerned about an inadequately educated workforce as an obstacle to the current operation of their business (Figure 4.7). For example, in countries with some of the highest levels of informal employment, such as Benin, Chad or Niger, there is also the highest share of formal enterprises that report inadequate skills as the most critical obstacle to the operation of their business. The formal sector may require skills that workers in the large informal sector simply do not have. As a result, the formal enterprises that were surveyed may have particular difficulties in creating and filling formal jobs.

**Figure 4.7. Countries where employers are concerned about the skills of their workforce are also countries where the informal sector affects the operation of their business**



Note: The horizontal axis shows the share of enterprises, by country, which answered that the practices of competitors in the informal sector were either a major obstacle or a very severe obstacle affecting the operation of their business. The vertical axis shows the share of enterprises, by country, which answered that an inadequately educated workforce was either a major obstacle or a very severe obstacle affecting the operation of their business. The sample includes only registered enterprises with five employees or more.

Source: Authors' computation based on the World Bank Enterprise Surveys (2014-20, latest year available for each country), <http://www.enterprisesurveys.org>.

Talent shortage surveys, such as those conducted by the Manpower Group in Colombia, Costa Rica, Guatemala, India, Mexico, Peru, Romania, South Africa and Türkiye in 2022, show that three-quarters of formal sector employers are facing difficulties in hiring. The top three reasons are a lack of experience, a lack of hard skills among applicants and simply a lack of applicants (Manpower Group, 2022<sup>[16]</sup>). Skills gaps in the local labour market and an inability to attract the right talent are also cited by 55% of formal multinational employers as the leading barriers to the adoption of new technologies across the world (World Economic Forum, 2018<sup>[17]</sup>). Given this situation, the critical lack of productive formal employment in countries with a high overall level of informal employment may be at least partly due to the lack of skills and the inability of enterprises to create or fill formal employment positions. Among informal workers, there is a high share of low-skilled workers who do not have the skills needed to obtain jobs in the formal sector, or cannot prove having them.

- **Skills demand is dynamic, and should be anticipated**

The demand for skills is not static and is changing very rapidly due to a wide range of factors, such as structural transformation; technological changes, including digital transformation; climate change; and the sophistication, diversification and disruption of global and regional value chains, and the resulting changes in consumer demand and in enterprise organisation and practices. These changes will affect job availability, the task composition of jobs and the skills required in the labour market. Some current jobs will disappear and some new jobs and tasks will emerge, while most of the existing work tasks within traditional jobs will be modified (OECD, 2016<sup>[18]</sup>; OECD, 2016<sup>[19]</sup>; OECD, 2017<sup>[20]</sup>). However, the effects of these changes will vary according to country context. Effects will also depend on how some of these factors (for example, technology) can either complement, or substitute, workers in these tasks (World Bank Group, 2015<sup>[21]</sup>).

Structural transformation and automation reduce the demand for medium-skilled occupations and create more demand for higher-skilled occupations, which require not only relatively more advanced literacy and numeracy skills but also good interpersonal, analytical, communication and problem-solving skills, as well as skills to adapt and learn. Over time, the skills content of jobs becomes less intensive in terms of routine and manual skills and more intensive in terms of non-routine analytical and interpersonal skills, and this trend is expected to persist in the future (ILO, 2021<sup>[14]</sup>; UNICEF, 2019<sup>[22]</sup>).

This poses additional challenges for informal workers in developing and emerging economies: many of them have jobs requiring mostly routine skills with low analytical and interpersonal skills. This means that these informal workers face a relatively high risk that their job will become automated, and they currently lack the skills needed to transfer to occupations with a lower risk of automation. Even if two occupations are related, it may still take significant reskilling and upskilling to acquire the average skill set to transition to another occupation that may offer more chances for formal employment.

The COVID-19 job disruption has further precipitated the change in skills demand through various channels. First, the COVID-19 crisis highlighted the reliance of economies on “essential workers”, including healthcare workers, carers, delivery personnel, food shop workers and agricultural workers, many of whom are informal. In some of these occupations, the demand for work surged during the COVID-19 pandemic, but so did the need to reskill workers in order to adapt to new work practices and security concerns (World Economic Forum, 2020<sup>[23]</sup>). Second, through lockdowns, closures, and further disruptions in global commerce and tourism, the COVID-19 crisis had a detrimental effect on workers in sectors disproportionately affected by these measures, including retail, hospitality, tourism and travel. A disproportionate share of these workers were also in informal jobs. As these sectors recover from the pandemic, their skills requirements are changing, across both formal and informal sectors (Box 4.2). The speed with which the labour force can adjust to these new skills demands will determine at least in some part the speed of the economic recovery.

#### **Box 4.2. COVID-19, coupled with technological change, modified skills demand in one of the largest economic sectors: Tourism**

The tourism sector encompasses accommodation, food, entertainment, and travel management and activities, as well as activities to serve tourist attractions (ILO, 2022<sup>[24]</sup>). The global tourism sector has experienced almost constant growth and diversification since the 1960s, and by 2020 had become one of the world’s fastest growing and largest economic sectors (ILO, 2022<sup>[24]</sup>). The tourism sector is also one of the most labour intensive. Prior to the COVID-19 pandemic, it accounted for 10.6% of total global employment (ibid.). Women, young workers, migrant workers, and ethnic and cultural minorities are overrepresented in the sector’s labour force.

Globally, the sector also features a high level of informal employment. In Asia and the Pacific, more than 75% of workers in the tourism sector work informally (ILO, 2021<sup>[25]</sup>). In LAC, more than 60% of restaurant and catering workers and more than 25% of hotel workers work informally (ILO, 2021<sup>[26]</sup>). Informal employment in the tourism sector is due to several factors. First, immediately prior to the pandemic, almost one-third of the total tourism sector workforce was employed in micro-enterprises with between two and nine employees. There is a higher share of informality among micro-enterprises than among larger enterprises. Second, even formal economic units have been relying extensively on seasonal, casual, part-time and zero-hour work due to the particular labour needs in the sector – arrangements that feature a significant risk of informal employment. This risk is exacerbated by loopholes in regulations, weak enforcement and poor organisation of labour in this sector. Third, many formal economic units have also been relying on outsourcing and subcontracting as part of their business models, with such models also featuring a higher risk of informal employment. Finally, the sector generates many jobs in related occupations, such as the provision of driving services, cleaning,

tourist guiding, the production and sale of gifts and crafts, and photography – often performed by own-account workers who are not formally registered (ILO, 2016<sup>[27]</sup>).

A large share of jobs even in formal economic units have been performed by low- and medium-skilled workers. This is largely due to the nature of jobs that do not require skills, but also due to the fact that work processes are often highly standardised and simplified – especially within large chains and enterprises operating under franchises (such as hotels and catering) – and require little training. The majority of jobs created indirectly also have low skill requirements. This means that a low level of skill can still be valuable and demanded in this sector, even though these jobs often exhibit significant work quality deficits (ILO, 2021<sup>[14]</sup>).

The global COVID-19 pandemic led to a collapse of the sector (UNWTO, 2021<sup>[28]</sup>), with consequent devastating effects on the labour force. It is estimated that employment supported directly or indirectly by the sector fell 18.5% in 2020 alone, representing a loss of almost 62 million jobs. Global employment in accommodation and food services suffered the largest decline in employment of all sectors. MSMEs were particularly hard hit, with millions of enterprises going bankrupt and millions of workers losing their jobs as a result. More informal workers than formal workers have lost their jobs in absolute terms. Yet, because workers losing formal jobs moved to informal employment, the total share of informal employment increased in some countries, such as Viet Nam (ILO, 2021<sup>[25]</sup>).

As the sector recovers from the crisis, it is becoming apparent that the pandemic has also modified the demand for skills in this industry. Among other issues, it has prompted an acceleration of digitalisation, such as contactless services in hotels and restaurants, as well as registration processes for checking the testing and/or vaccination status of guests – with a surge in demand for at least basic digital skills (ILO, 2022<sup>[24]</sup>). As such, digital skills have become a key determinant of employability, even for generally low-skilled workers, whether formal or informal.

Multinational businesses operating in the sector also have a strong appetite for adopting new technologies. The COVID-19 pandemic precipitated an already growing demand for general and operations managers, data analysts and scientists, sales and marketing professionals, and information security analysts in the tourism sector specifically (World Economic Forum, 2018<sup>[17]</sup>). New developments, such as M-tourism (the use of smartphones throughout the entire customer experience, including to present travel documents, passports and visas, or digital identities, as well as vaccination certificates), require professionals to handle new digital tools; develop, troubleshoot and repair these tools; and facilitate the wide adoption of these devices by businesses and customers. New tasks and occupations in high demand include programming and securing driver-free passenger transportation, as well as managing interactive cobot-operated terminals at airports and train stations. Many of these jobs require either a specialised technical or university education, or substantial retraining (ILO, 2021<sup>[14]</sup>). The extent to which businesses will be able to adopt new technologies and expand formal employment will depend on the availability of such technical skills, as well as medium- and high-level skills in hybrid occupations. A lack of necessary skills will likely to be an impediment for the sector's recovery, especially in terms of formal employment. In recognition of these trends, reskilling, upskilling and enabling workers to develop their skills, especially digital skills, have been an important part of government support for businesses and for unemployed workers in the tourism sector in many countries (UNWTO, 2020<sup>[29]</sup>). In several countries, travel and tourism were designated as a special sector for employment support.

Source: Authors' compilation based on the sources cited in the body of this box.

Third, important shares of workers experienced remote work. The availability of jobs that could be performed remotely – coupled with access to the Internet, computers and mobile phones, as well as the right digital skills – were key in sustaining economies and livelihoods during the pandemic. It is estimated

that the share of jobs that could be performed remotely stood at 33.6% of jobs in high-income economies, 17.8% of jobs in upper middle-income economies, 10.0% of jobs in lower middle-income economies and just 4.0% of jobs in low-income economies; the vast majority of these jobs are formal (World Economic Forum, 2020<sup>[23]</sup>). Notwithstanding sectoral differences, demand for digital skills that are complementary to other professional skills, and that can enable remote work, is expected to continue increasing in all countries.

Finally, the upsurge of digital consumption accelerated by the pandemic is also propelling the expansion of the e-commerce, logistics, digital media and digital financial services sectors, along with the demand for new jobs and related new skills (ILO, 2021<sup>[14]</sup>). Analysis made by LinkedIn of job and skill trends for 2021 in 19 countries around the world, including Brazil, the People's Republic of China, India, Indonesia, Malaysia, Mexico, the Philippines and Thailand, showed that the most in-demand jobs are related to e-commerce and logistics. There is a growing demand for skills in data storage, software development life cycle, social media management, digital marketing and advertising, graphic design, search engine optimisation, warehouse operations, supply chain management and co-ordination, and cybersecurity (LinkedIn, 2021<sup>[30]</sup>). With more working time and life spent in front of screens, there is also an increased demand for workers to provide consumers with digital engagement in terms of knowledge and information sharing, online entertainment, and social networking, all of which were boosted by the measures adopted during the COVID-19 crisis. This has spurred the demand for digital content creators, podcasters, video editors, social media managers, digital marketing specialists and content moderators in many countries. In developing and emerging economies, there is also a surge in demand for digital methods to access financial services and fintech (World Bank and WEF, 2020<sup>[31]</sup>). Many of these skills are required for formal jobs. However, having such digital skills can also improve the general employability of informal workers, especially in settings where new modes of work and work organisation, also boosted by digital innovation, increasingly blur the distinction between formal and informal jobs (OECD, 2023<sup>[10]</sup>).

In summary, in some occupations, skills needs differ across formal and informal jobs, but in others they may be similar. With changing skills demand, and under the pressure of structural factors, job requirements featuring more sophisticated skills may not always be synonymous with a formal job. But having such skills is clearly a guarantee of better employability, and improves the chances of having a formal job.

## Skills mismatches are an important challenge, in particular for informal workers

If labour markets were perfectly competitive, remuneration and employment levels would adjust until the market clears: enterprises would adapt production processes to the available stock of human capital, while workers would instantaneously adapt to new skills requirements (Hartog, 2000<sup>[32]</sup>). In reality, labour markets are far from being perfect. Information asymmetries, the lack of geographical mobility, the industrial structure of an economy, the macroeconomic situation and unattractive working conditions in places that require a particular skill lead to skills mismatches in any labour market (OECD, 2017<sup>[20]</sup>).

What is remarkable, however, is that skills mismatches differ across formal and informal workers.

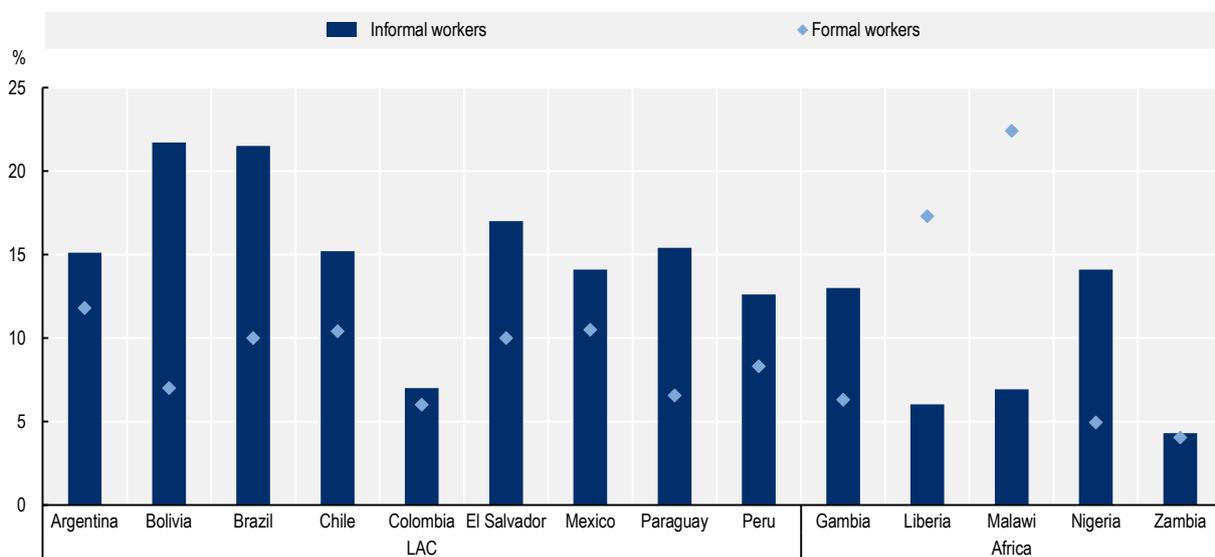
### ***Workers in informal employment are particularly prone to undereducation, compared with workers in formal employment***

Among informal workers in 14 emerging economies with available data, the incidence of undereducation ranges from 4% in Zambia to 22% in Bolivia and Brazil (Figure 4.8).<sup>4</sup> Among formal workers, the incidence of undereducation also ranges from 4% in Zambia to 22% in Malawi. There is a higher incidence of undereducation among informal workers than among formal workers in 11 of the 14 countries with available data. It is twice as high for informal workers compared with formal workers in Brazil, and Paraguay, and it is three times as high in the Plurinational State of Bolivia (hereafter: Bolivia) and Nigeria.

The incidence of undereducation is similar among formal and informal workers in Colombia and Zambia. The only countries where the incidence of undereducation is lower among informal workers than among formal workers are Liberia and Malawi.

Undereducated workers include two types of workers. The first type is workers who do not have the level of formal education that is generally required for this type of jobs. For example, in many developing and emerging economies, limited availability of tertiary-educated workers has meant that employers looking for high-skilled workers in emerging and innovative sectors have had little choice but to hire genuinely underqualified workers who do not fulfil the skills requirements of the job (OECD, 2017<sup>[20]</sup>). The second type is workers who have relatively low levels of education but nonetheless have the right skills, although these skills are not properly recognised (not certified). Among them are workers who did not have access to formal schooling, as well as those whose formal skills became obsolete too quickly. They include those workers whose competencies acquired through informal work experience, as well as informal and non-formal learning are not recognised. Such workers may have particular issues with proving their aptitudes. This, in turn, may hamper their labour market transitions, including to formal jobs. Given this situation, informal economy jobs are generally unproductive because they disproportionately absorb both unskilled and undereducated labour. Improving labour market matching would require different policy solutions for these two types of workers: helping to develop skills for the first group, and helping recognise existing skills for the second group.

**Figure 4.8. Incidence of undereducation among informal and formal workers**



Note: Undereducation is computed as follows: within each country and within each occupation (at 1-digit classification of occupations), the mean and standard deviation of workers' years of education are computed. Then, individuals with years of education that are one standard deviation below the mean are qualified as undereducated. LAC – Latin America and the Caribbean.

Source: Authors' computation based on household data of each respective country. For details, see (Aleksynska and Kolev, 2021<sup>[33]</sup>), "Education-occupation mismatch in the context of informality and development", *OECD Development Centre Working Papers* No. 346.

StatLink  <https://stat.link/2fj7vt>

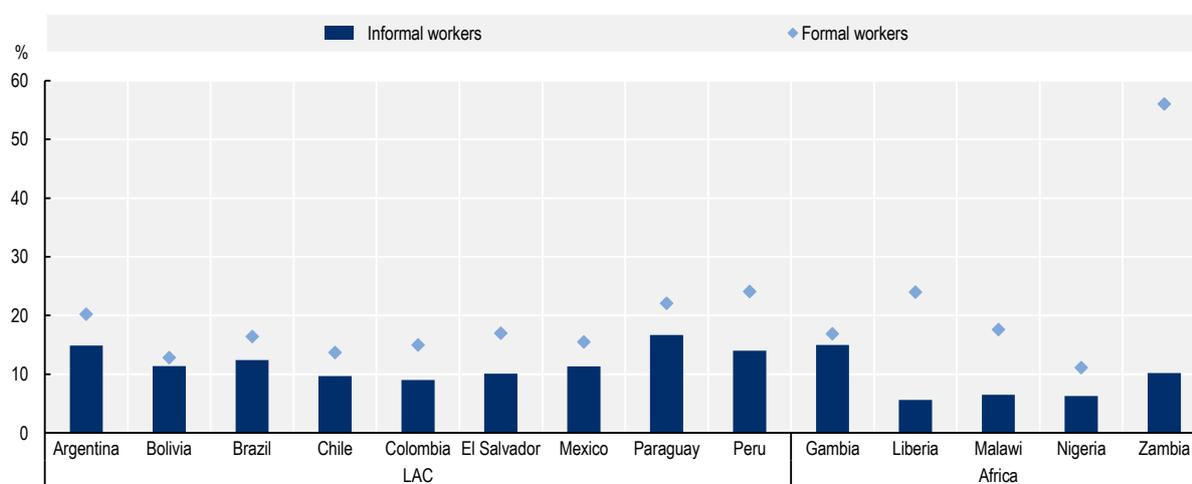
As shown in other studies (e.g. (OECD/ECLAC/CAF, 2016<sup>[34]</sup>)), among young people, the reasons for being undereducated often relate to their family background and the fact that they come from vulnerable households, often with low-qualified parents who are informally employed themselves. In other words, undereducated workers are often trapped in the informal-work, low-skill, low-productivity intergenerational cycle.

### **Formal workers, in contrast, are more likely to experience overeducation**

There is a lower incidence of overeducation among informal workers than among formal workers in all 14 countries with available data (Figure 4.9). Among formal workers, the incidence of overeducation ranges between 11% in Nigeria and 56% in Zambia. In contrast, in Zambia, only 10% of informal workers are overeducated: this is also the average rate of overeducation among informal workers in countries with available data.

The pool of overeducated workers is also heterogeneous. Among overeducated workers in medium- and high-skilled jobs, there are workers who possess more education than what is required for their job, often because competition for such jobs is fierce. In developing and emerging economies in particular, where there are large pools of unemployed secondary school graduates and school dropouts, there is often a displacement of workers without qualifications, as employers looking for low-skilled workers hire secondary school graduates instead, generating overeducation (OECD, 2017<sup>[20]</sup>). Overeducation thus usually means that human resources are not efficiently used: there is an underutilisation of human capital, and workers operate below their productive capacity. This is made all the more challenging as overeducation is a feature of formal employment: it hampers productivity growth in the formal sector and reduces the economy-wide benefits of formalisation.

**Figure 4.9. Incidence of overeducation among informal and formal workers**



Note: Overeducation is computed as follows: within each country and within each occupation (at 1-digit classification of occupations), the mean and standard deviation of workers' years of education are computed. Then, individuals with years of education that are one standard deviation above the mean are qualified as overeducated. LAC – Latin America and the Caribbean.

Source: Authors' computation based on household data of each respective country. For details, see (Aleksynska and Kolev, 2021<sup>[33]</sup>), "Education-occupation mismatch in the context of informality and development", *OECD Development Centre Working Papers* No. 346.

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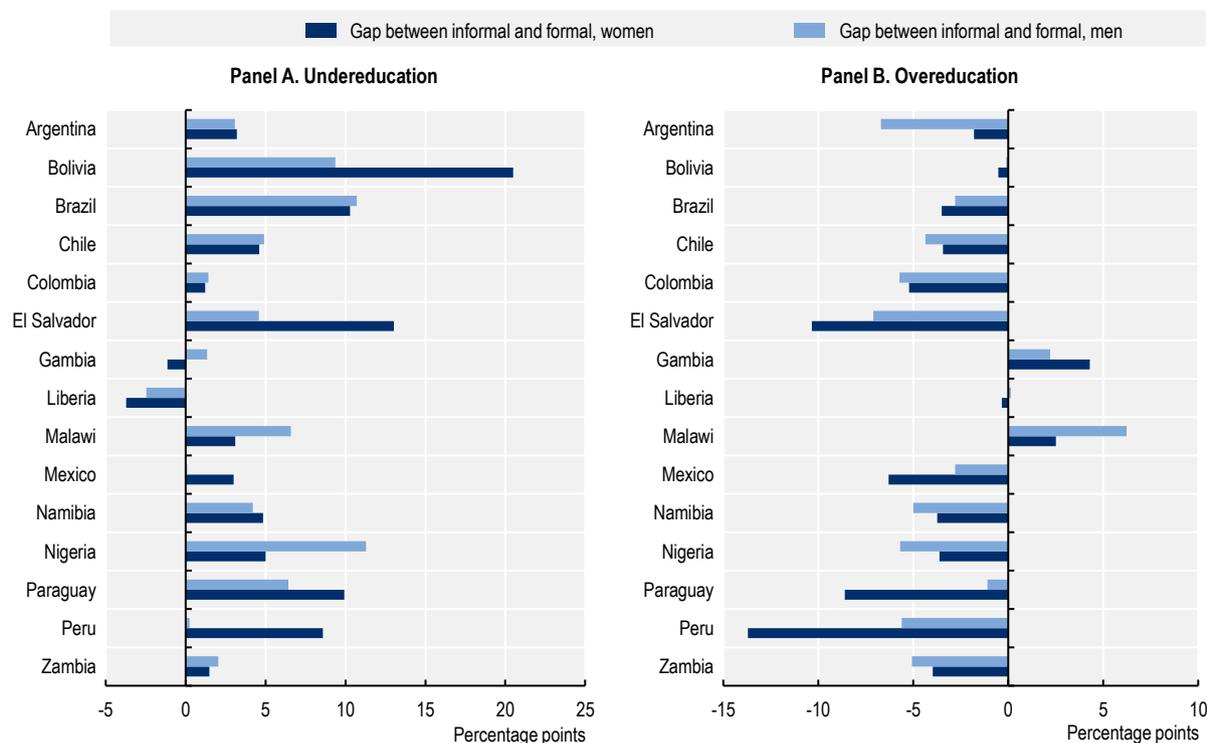
### **The patterns for over- and undereducation hold true for both men and women**

Both men and women working informally are more likely to be undereducated compared with formally employed men and women. Conversely, both men and women working informally are less likely to be overeducated. However, in most countries, the incidence of mismatch is generally more strongly pronounced for women than for men. The gap is substantially higher for women than for men in Bolivia, El Salvador, Mexico, Namibia, Paraguay and Peru (Figure 4.10). For example, in Bolivia, 26% of informally employed women are undereducated, in contrast with 6% of formally employed women (20 percentage

points gap). Among men in Bolivia, the incidence of undereducation is 17% among informally employed, in contrast with 8% of formally employed (9 percentage points gap). Similarly, the incidence of overeducation is greater among formally employed men and women in all countries except Gambia and Malawi; the gap is pronounced stronger for women than for men in Brazil, El Salvador, Mexico, Paraguay and Peru.

**Figure 4.10. Gaps in under- and overeducation between informal and formal workers, by gender**

The sample of all employed; percentage points



Source: Authors' calculations based on country-specific household data. For details, see (Aleksynska and Kolev, 2021<sup>[33]</sup>), "Education-occupation mismatch in the context of informality and development", *OECD Development Centre Working Papers* No. 346.

StatLink  <https://stat.link/06mker>

### **Other types of mismatches are also likely to be found across formal and informal workers**

In addition to education-occupation mismatches, there can be mismatches in qualifications, field of study and various types of skills. Evidence on these mismatches in developing and emerging economies is scarce. Available evidence points to important general qualification and field-of-study mismatches. For example, in Peru, more than 50% of workers have a field-of-study mismatch (OECD, 2017<sup>[20]</sup>). In South Africa, there is a 52% incidence of qualification mismatch, and more than 30% of South African workers are employed in an occupation unrelated to the field of study of the qualification that they hold. The incidence of qualification mismatch is substantially higher in informal jobs than in formal ones: 36% of workers in informal employment are underqualified compared with 27% of those in formal employment. Moreover, among those in informal employment, 55% are mismatched in the field of study, compared with only 28% of those in formal employment. The difference in the probability of being mismatched by field of study remains significant even among individuals with the same gender, age and occupation (Vandeweyer

and Verhagen, 2022<sup>[35]</sup>). In Ghana, in response to the question, “Do you feel that your training/educational qualifications are relevant in performing your present job?”, 75.8% of workers in informal employment declare that they are not relevant, compared with 42.0% of formal workers (own computations based on Labour Force Survey 2015).

## Key policy messages

This chapter has shown that informal workers possess poorer skills compared with formal workers, and also have fewer opportunities to upgrade them. In turn, formal jobs generally require a higher and more sophisticated level of skills than what an abundant informal workforce can provide. As a result, in countries with a widespread level of informal employment, not only are there major skills shortages but skills mismatches in the labour market are also ubiquitous. Moreover, the types of mismatches differ for informal workers (who tend to be undereducated and underskilled for the jobs they perform) and for formal workers (who tend to be overeducated and overskilled), thus creating asymmetric inefficiencies across formal and informal workers. These mismatches aggravate the unemployment problem, hamper productivity and impede socio-economic development. They also become major barriers to public and private sector strategies for formal job creation and adoption of new technologies.

To address these problems, actions on several fronts are needed, with a view to better matching the demand for skills and the supply of skills. Countries should:

- continue raising the general level (in terms of quality and quantity) of schooling in order to strengthen foundational skills as a basis for future learning for all workers
- encourage employer-provided training for formal and informal workers
- make public programmes more inclusive for informal workers and their needs
- recognise prior learning of informal workers
- anticipate change in skills demand, and prepare the workforce accordingly
- strengthen opportunities for more creative learning.

### ***Continue raising the general level (in terms of quality and quantity) of schooling in order to strengthen foundational skills as a basis for future learning for all workers***

As shown in this chapter, informal workers have a disproportionately low level of schooling. Conversely, workers with low levels of schooling (including due to dropping out of school) are found mainly in informal jobs, suggesting that formal employment opportunities remain out of their reach.

Given this situation, countries should continue devoting efforts to increasing the quality and quantity of schooling provided to would-be workers and ensuring that access to education is equal for boys and girls, across urban and rural areas, and for children from vulnerable and non-vulnerable households (UNESCO, 2017<sup>[36]</sup>). Other key areas for action include eradicating child labour by raising and enforcing the minimum age for employment; instituting and enforcing free and compulsory education; providing free education materials and meals; and making quality education available in rural areas (Doepke, 2018<sup>[37]</sup>).

Improving education quality and preventing school dropouts are essential for building basic foundational skills across a larger pool of would-be workers. In addition to these skills, education systems should also be able to deliver skills related to analytical thinking, problem-solving and innovation, particularly for occupations in science, technology, engineering and mathematics (STEM). Social and emotional skills – such as communication, collaboration, teamwork, conflict resolution and negotiation, as well as adaptability, curiosity and a learning mindset – will help students maximise the ability of humans to add value beyond that of machines in the future of work (OECD, 2015<sup>[38]</sup>). These skills will be in particular

demand for all workers as countries undergo structural transformation and adopt new technologies, and as new formal job opportunities emerge.

Beyond secondary schooling, governments should also pay particular attention to improving school-to-work transitions by making the skills obtained in school relevant to the labour market. In this regard, tertiary education delivering relevant labour market skills, technical and vocational education and training (TVET) systems, dual apprenticeship skills, and paid apprenticeship programmes have an important role to play. In order for such initiatives to be successful, they need to engage employers to develop relevant curricula and provide ways to alleviate the financial burden of participation in them for both employers and students (OECD, 2023<sup>[39]</sup>).

Raising the level and the quality of schooling requires substantial resources (UNESCO, 2021<sup>[40]</sup>). Such resources are needed in order to create the conditions necessary to attract qualified individuals to the teaching profession and to improve the quality of teaching. Underinvestment in existing and/or new educational infrastructure and supporting materials also impedes progress in schooling performance (OECD, 2016<sup>[41]</sup>). Often in developing and emerging economies, more spending is devoted to primary schooling than to secondary and tertiary levels. The COVID-19 pandemic has put a strain on public resources, with many countries cutting their public education budgets in its aftermath (Global Education Monitoring Team and World Bank, 2021<sup>[42]</sup>). In this context, it is important that governments devote adequate expenditure to education, reverting to pre-pandemic funding levels or even increasing funding where necessary.

### ***Encourage employer-provided training for formal and informal workers***

Given the mismatches between skills demanded in the formal sector and skills held by workers in the informal economy, greater emphasis should be placed on improving access for informal workers to skills development opportunities with a view to matching them to the demands of the formal sector.

If a lack of skills is an obstacle for enterprises to create more formal job opportunities, employers should play a greater role in equipping workers with the right skills, rather than simply trying to find workers with the relevant skills in the labour market. However, it is important to recognise that skills provision that relies uniquely on employers faces a certain market failure. On the one hand, employers do not always recognise the value of investing in their workers, seeing training costs as a financial burden in the short term. Moreover, employers face the risk that, despite investing in an employee, the employee would not be productive or would leave for another employer. As a result, many enterprises, and especially informal small and medium-sized enterprises (SMEs), usually avoid this burden and do not pay for the training of candidates. On the other hand, employers are willing to pay wage premiums to trained candidates. Yet, workers are often not willing or able to pay for training, although they are willing to pay a recruiting agency to help them find a job. As a result, there is an undersupply of skills provision at the workplace.

One way to address this market failure is to create an environment where employers see the financing of skills development as an investment and where they also have a certain guarantee of receiving a return on this investment. Workers, in turn, should have incentives to acquire skills, not least in the form of a guarantee of getting a formal job. Examples of such approaches may be found in India (Box 4.3). Another (complementary) solution is to provide financial incentives both to employers to provide training and to workers to avail of it. Such incentives may include wage and training subsidies, tax incentives, loans at preferential rates, and individualised learning account schemes transferable across jobs and open to all workers, including own-account workers. Targeted programmes and incentives for informal employers can be created, and programmes can be made available to informal workers who may not be eligible for standard support measures due to their informal status. For informal enterprises, access to such programmes may be conceived in a way that encourages enterprise formalisation and is part of the overall formalisation strategy.

### Box 4.3. Degree apprenticeships as a way to provide skills sought by employers

In India, the skills of adult workers can be improved through degree apprenticeships offered at Skills Universities. The innovative approach of Skills Universities consists of several elements. First, Skills Universities are fully oriented towards employers who design curricula and offer real-world practical training in the industrial and services sector. Employers are involved in the skills assessment and pre-screening of candidates for training. Applicants to the university, in turn, are self-selecting into a future job with the employer. As a result, employers can achieve a faster hiring time, and enjoy lower attrition and higher productivity, while applicants are guaranteed access to a formal job upon completion of training. Second, in contrast to the state-financed TVET programmes, up to 96% of Skills Universities fees are covered by employers and 4% are paid by students, thus ensuring that enterprises see this cost as an investment while also alleviating the financial burden for students. Finally, Skills Universities are established under public-private partnerships with regional governments, thus alleviating the burden on employers in terms of providing training space and staff, and creating quality guarantees for skills acquisition.

However, the caveat is that no student can learn in 3 months what they would normally have learned in 3 years, let alone in 12 years of proper schooling. As a result, the success of Skills Universities can only build on successful universal secondary schooling. Another caveat is that labour laws and taxes should also create enabling environments and incentives for “employed learning” – both for employers and for workers. For this, it is important to involve employers’ associations in the development of such environments and skills qualification frameworks, defining occupation standards, specifying definitions of occupations, and organising the recognition of prior learning.

Yet another caveat is that Skills Universities are mainly aimed at achieving collaboration between public sector entities and formal enterprises. There is still a need for dedicated strategies to reach out to informal SMEs and informal workers specifically. For this, well-targeted vouchers, grants and stipends may incentivise training by reducing training costs for employers, such as training fees, transportation and accommodation fees. Such incentives can be fully or partially funded by governments.

Source: (Singh, 2020<sup>[43]</sup>), “Emergence of Skill Universities in India” in *Emerging Issues in Business Management* as well as discussions at the OECD Expert Meeting on Informality and Skills, fall 2021.

The COVID-19 crisis has seriously disrupted the skilling, upskilling and reskilling of employees, apprentices and interns in all types of enterprises and organisations around the world (ILO, World Bank and UNESCO, 2021<sup>[8]</sup>). Many enterprises have permanently closed their operations. As a result, public support, including through publicly provided skills development programmes, will be particularly important.

### ***Make public programmes more inclusive for informal workers and their needs***

If formal and informal workers receive unequal amounts of training through publicly provided programmes, often it is because many skills development programmes target formal workers (even if only implicitly) by requiring people to have prior formal experience or credentials. Relatedly, public funding for such programmes may only be available for formal workers. Another reason is differences in training uptake: many informal workers do not undertake training even when it is available, either because the solutions are not tailored to their needs, or because the opportunity costs are too high, or because they are not aware of such opportunities. Most informal workers cannot forego a day’s income, and cannot afford the costs of training and foregone income. The opportunity cost of training versus working plays a role. Urban and gender bias of existing offers exacerbate inequalities between formal and informal workers.

In this regard, there is a need to design more inclusive training and skills programmes in order to facilitate access to training, improve information about available training, and improve financial and non-financial incentives for participation. However, public training opportunities specifically for informal workers are among the most difficult to design. Such workers are often the hardest to reach, and are also the most heterogeneous. They include adults who dropped out of school or left the labour force very early, and who lack foundational skills; for these workers, training opportunities would include a package that provides for such skills. This group also includes workers with outdated advanced technical skills who are seeking skills upgrading and more specialisation, and informal workers with skills that are not in demand for formal jobs. Such workers would require conceptually different training, possibly oriented towards the needs of the formal sector.

Effective design and financing of training for these two groups is best realised through training funds and vouchers specifically targeted at informal workers with specific needs, and which can be accessible through non-governmental organisations (NGOs), co-operatives or various associations, including informal workers' associations (Ryan, 2023<sup>[13]</sup>).

It is also important to target not only individuals but specific sectors and occupations where informal employment is widespread and workers are disadvantaged in terms of training (e.g. certain essential workers, waste pickers and agricultural workers). Last but not least, these programmes should be made available where informal workers are located, i.e. predominantly in rural areas and small towns. This would be important in order to enable workers, especially young workers and women, to economise on transportation and accommodation costs, and to boost their participation, especially when secure travel remains challenging (OECD, 2023<sup>[39]</sup>).

A systemic challenge for public training systems has to do with their governance, affected by weak representation and organisation of informal workers and employers (OECD/ILO, 2019<sup>[44]</sup>). Formal governance arrangements (such as training councils, and employers' and workers' organisations) have been created for and are dominated by the formal economy and do not reach the majority of the world's workers, many of whom work in the rural and informal economy. For this reason, it is necessary to engage various actors – workers' and employers' associations, local community actors, and local learning systems – in creating solutions that are most suited to informal workers' needs. Public-private partnerships can also reduce pressure on public funds and increase the relevance of skills. The fact that there is no area of education in which non-state actors are not involved requires the participation of all stakeholders in the design, objective setting and implementation of policies to ensure policy coherence and shared benefits.

### ***Recognise prior learning of informal workers***

Many informal workers acquire skills in the informal economy itself. Informal sources of knowledge and skills acquisition, such as family, the workplace, informal apprenticeships, the community, co-operatives or learning by doing are commonly observed in the informal economy. Informal apprenticeships constitute a major source of training, especially for school dropouts and low-skilled young people. Yet, many of the skills obtained through these other ways of learning are not properly understood, and neither are they officially recognised. This impedes informal workers' access to other formal training opportunities, as well as formal jobs.

Recognition of prior learning (RPL) is a significant part of the skills development process of informal workers. It helps to identify skills and knowledge acquired outside of formal education systems; it can provide informal workers with incentives to invest in skills; it offers pathways to further education and training; and it facilitates access to formal employment opportunities (Palmer, 2020<sup>[45]</sup>).

In many developing and emerging economies, skills recognition programmes remain undeveloped. In Morocco, for example, the legal texts enacting the development of such programmes have been in the

production stage since 2007 but had not been adopted at the time of writing this report. In their current draft form, they cover only a limited number of sectors (OECD, 2023<sup>[39]</sup>; Chatagnon, 2023<sup>[46]</sup>).

In light of this, governments should develop systems that offer certification of both formal and informal skills acquired through prior experience and learning, on a competency basis. The current value of skills should be readily recognised by employers, and their potential value should be appreciated by all workers, including informal workers. This should encompass not only technical skills but also core business skills for own-account workers, including negotiation, communication and digital skills.

For informal workers, there is often an opportunity cost in getting their skills recognised. In some instances, they may be fearful of having their skills assessed because it may damage their reputation. It is important to effectively communicate the benefits of skills assessment, which may be linked to securing better access to formal jobs, obtaining further access to public markets, receiving a licence to perform a specific activity, receiving a subsidy for undergoing further training, or acquiring a certificate with a recognised value in the market.

It is also important to involve informal workers' associations in the development of joint assessments and certifications with employers' associations, unions, public agencies and associations, including those representing informal workers. Governments can either directly finance the related costs, such as assessment fees and certificates, or they can provide funds to other actors.

In some instances, training and skills recognition should not only focus on individuals but also on sectors of activity and contexts in which the activity takes place. For example, in the case of waste pickers, their skills and knowledge may be quite different if they work for a community as opposed to a private enterprise. Sector- and community-centred skills recognition of informal workers is more likely to pave the way for formalisation, because the meaning of formalisation can be constructed together with informal workers during the process of skills recognition.

### ***Anticipate change in skills demand, and prepare the workforce accordingly***

As this chapter has shown, one reason why employers cannot fill formal jobs is that demand for skills is changing very rapidly in line with a wide range of factors, such as structural transformation; technological changes, including digital transformation; the need to adapt to climate change; and the sophistication, diversification and disruption of global and regional value chains. Together, these are resulting in changes in consumer demand and in enterprise organisation and practices. While these factors will cause some current jobs to disappear, they will also stimulate the emergence of new jobs and tasks, or trigger the modification of existing work tasks within traditional jobs (OECD, 2016<sup>[18]</sup>; OECD, 2017<sup>[20]</sup>). Yet, many future and current workers, especially those in the informal sector, are not aware of these changes and the possibilities they offer. Where such workers are aware, they may not have either the relevant skills or the opportunities to upgrade their skills.

Here, the role of government is twofold. On the one hand, it needs to anticipate skills demand and skills requirements (skill change); on the other hand, it also needs to provide better information and career guidance to workers, regardless of their formal or informal status. Efficient skills anticipation, especially with a view to improving skills matching of informal workers, is possible when governments join forces with social partners (OECD, 2019<sup>[47]</sup>; OECD, 2019<sup>[48]</sup>) and also with informal workers' associations.

### ***Strengthen opportunities for more creative learning***

Because informal workers upgrade their skills through forms of learning that are different from how formal workers upgrade their skills, governments, social partners and informal workers' associations should also work towards better supporting other learning opportunities.

For example, informal training may be available through farmers' associations or co-operatives. To improve the quality and relevance of informal training, governments should engage with informal providers and help

them find opportunities to develop their capacity (including pedagogical skills), support them financially to acquire modern equipment, and promote community involvement in order to reduce the administrative and organisational burden of delivering training (OECD, 2018<sup>[49]</sup>).

The COVID-19 crisis had a double effect on various learning opportunities. On the one hand, the decline in economic activity and a reduction in post-employment training was associated with a decline in skills acquisition. On the other hand, lockdowns also “liberated” the time for learning, especially for distance and digital learning, albeit in a very uneven way.

For governments, it is necessary to create enabling environments for dynamic, active learning over the life cycle (ILO, 2018<sup>[50]</sup>). Together with social partners and wider community engagement they can help to reach out to more disadvantaged groups, such as informal workers, through dedicated lifelong learning centres (a practice that has proved successful in Iceland), comprehensive one-stop shops for guidance on lifelong learning (as in Portugal), family skills training programmes, community-based approaches (as in Argentina (OECD, 2019<sup>[11]</sup>)), and municipal digital hubs and libraries that enable access to digital technologies in areas with poor connectivity. Providing a legislative framework for paid educational and training leave, as well as financial support for various forms of training, is equally important. These efforts should be complemented by measures that would increase the take-up rate of “second chances” programmes, including among those who missed out on opportunities during the COVID-19 pandemic.

## Notes

<sup>1</sup> These workers would have extremely low levels of skills. According to (OECD, 2019<sup>[10]</sup>), adults with low skills are those “whose highest qualification is at lower secondary level (ISCED 0-2), which means they have not completed high-school or equivalent; and adults with low cognitive skill levels, namely those who score at proficiency level 1 or below in the literacy and/or numeracy dimension of the OECD Programme for the International Assessment of Adult Competencies (PIAAC). These are adults who can at most complete very simple reading tasks, such as read brief texts on familiar topics, and mathematical tasks, such as one-step or simple processes involving counting, sorting, basic arithmetic operations and understanding simple percentages”.

<sup>2</sup> Evidence for Peru, based on the PIAAC survey. Informal status is proxied by the absence of a written work contract for an employee.

<sup>3</sup> The survey was not representative.

<sup>4</sup> Some of this result is obtained by construction: adults with low levels of education are more likely to be undereducated, compared with adults with higher education.

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# **5** Investing in the children of informal workers

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This chapter shows that the vulnerability challenge faced by informal workers is being passed on to their children. Four ways in which this is happening are identified: growing up in households with informally working parents; lower school attendance from primary levels onwards as compared to children of formally working parents; fewer financial resources and parental time devoted to their education; and longer, more uncertain school-to-work transitions. This chapter discusses policy options to help break the vicious intergenerational cycle of informal employment.

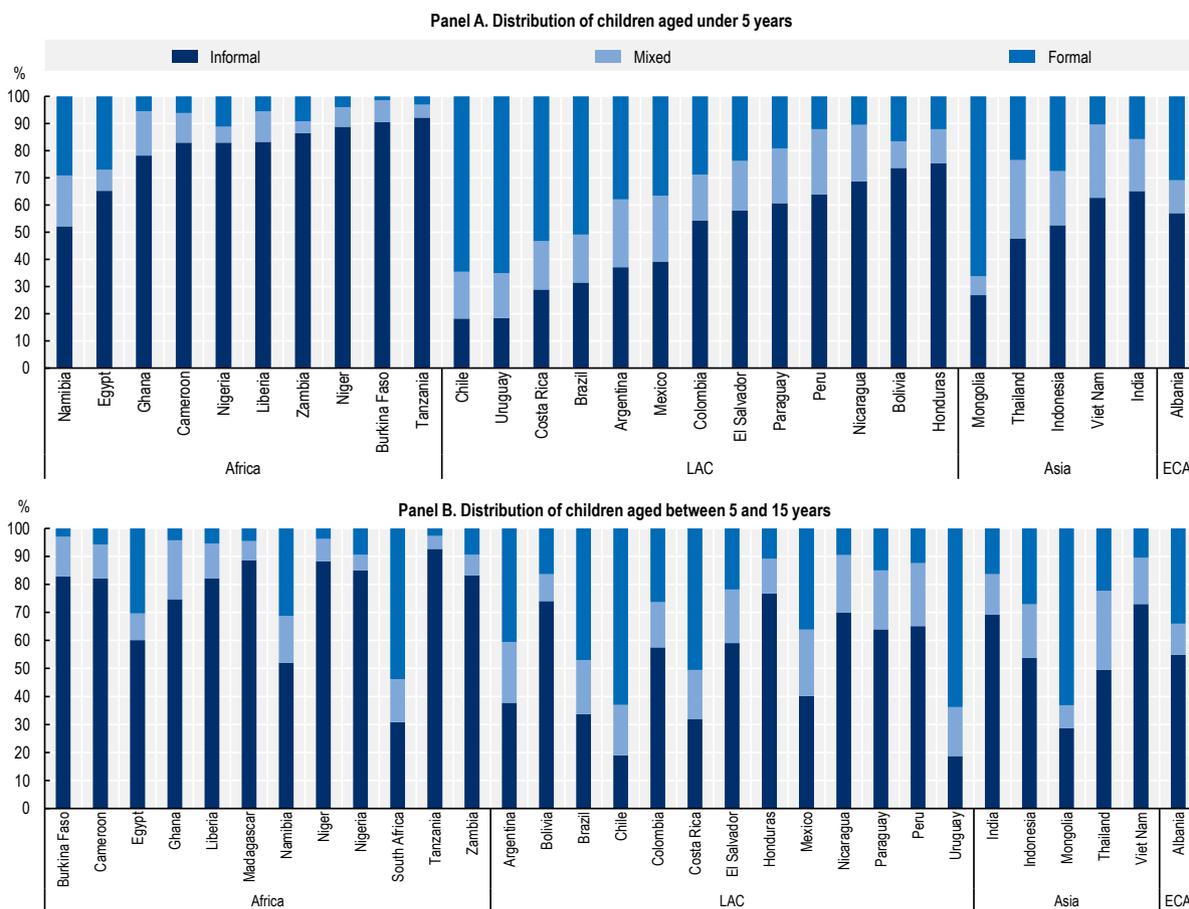
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Of major concern is the fact that the vulnerability challenge faced by informal workers is being passed on to their children. This chapter identifies four ways in which this happens.

## In many countries, more children live in fully informal households than in mixed or fully formal households

A large majority of children are directly exposed to informal employment, and this is one of the ways in which the vulnerability challenge of informal workers is being passed on to their children. On average, around 60% of all children aged under 15 years in developing and emerging economies live in completely informal households (i.e. in households where all family members are working informally, as opposed to households where at least one, or all, family members are working formally). The figure is 80% or higher in some African countries (Figure 5.1). As shown in Chapter 4, informal employment often goes hand in hand with a low level of education, and with poorer networks and connections to the world of formal work. Because an individual's probability of being employed in a formal job is positively and significantly affected not only by the individual's own level of education but also by their parents' education and their parents' employment (de Mel, Elder and Vansteenkiste, 2013<sup>[1]</sup>; Erin and Nilsson, 2014<sup>[2]</sup>), children from fully informal households are more likely, simply by virtue of being raised in an informal household, to also work informally when they grow up.

Figure 5.1. Distribution of children across different types of households



Note: This figure includes all sampled households with at least one working adult. Mixed households have at least two workers, at least one of whom is working formally and one of whom is working informally. LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Estimates based on (OECD, 2021<sup>[3]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIbIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIbIH.htm>.

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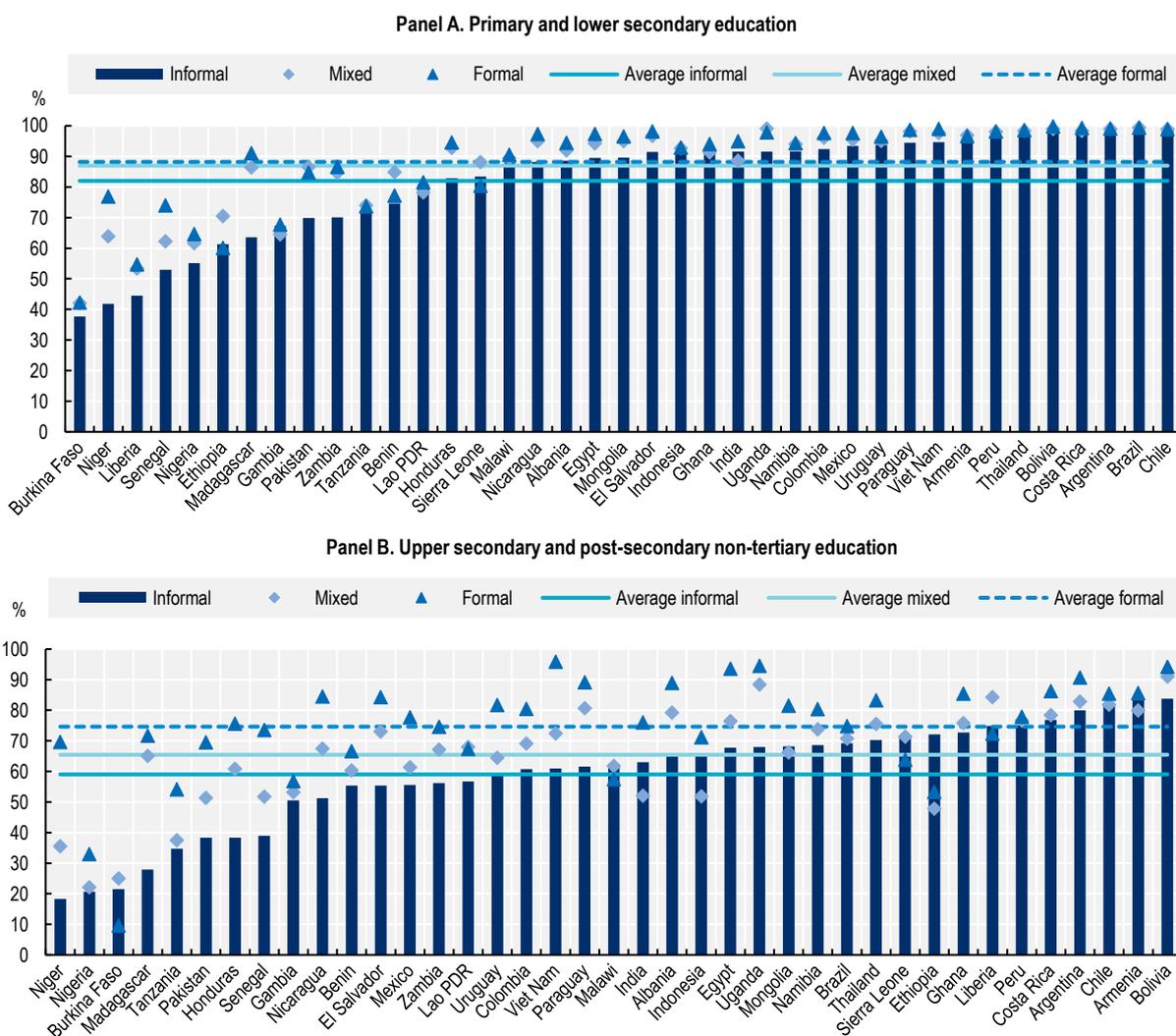
## School attendance is substantially lower among children from fully informal households compared with those from mixed or fully formal households

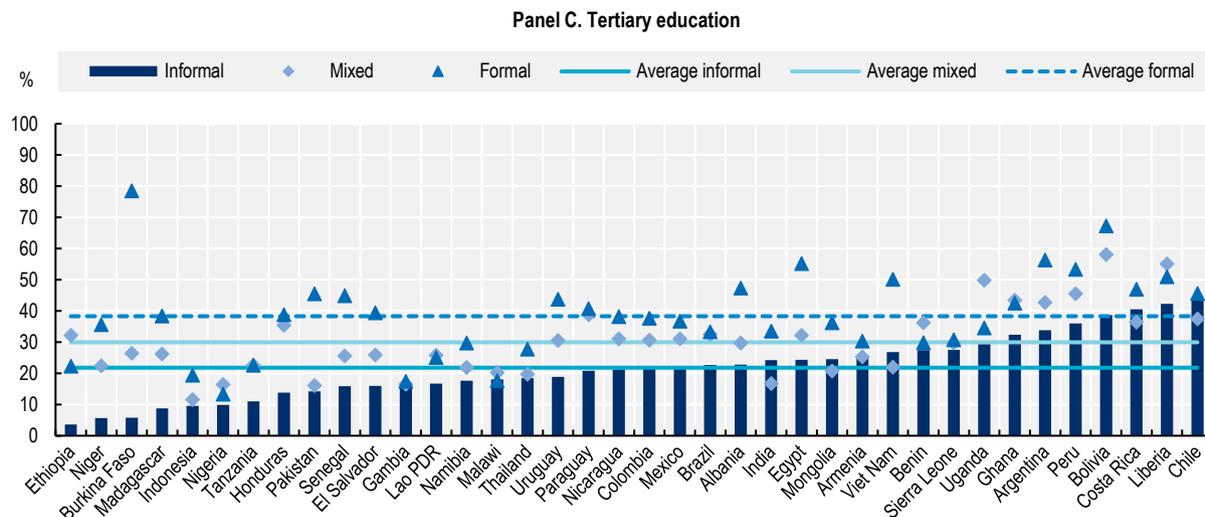
Informal workers are disproportionately poor and living in rural areas. These factors have compound effects on the choice to put and to keep children in school, which are related to school access; the possibility of providing children with sufficient school materials, books, clothing and food; the quality of schools; and the choice that parents make between children’s work and schooling. Yet, school attendance is an important factor that affects the skills of future workers, and with them, their chances of working informally.

Figure 5.2 shows school attendance in primary and lower secondary education (Panel A), in upper secondary and post-secondary non-tertiary education (Panel B), and in tertiary education (Panel C) for children from three types of households: with all informally working household members (informal), with at least one formally working household member (mixed) or with all formally working household members (formal). The figure does not consider pre-primary education, because it features a particularly low enrolment in developing and emerging economies, often linked to the lack of supply of facilities rather than demand, especially in rural areas (UNESCO, 2022<sup>[4]</sup>).

**Figure 5.2. School attendance is higher for children living in formal households**

School attendance rate, by level of education and household type





Note: Data refer to young people aged 6-24 years. Panel A: ISCED levels 1 and 2; Panel B: ISCED levels 3 and 4; Panel C: ISCED levels 5, 6 and 7. Lao PDR – Lao People's Democratic Republic.

Source: (OECD, 2021<sup>[3]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>.

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### ***There are few differences in primary and lower secondary school attendance for children of formal and informal workers***

Primary and lower secondary education are the most homogenous and best-defined components of education systems compared with subsequent levels of education. In primary education, curricula are relatively standardised, aiming to build basic reading, comprehension and mathematics skills. Panel A of Figure 5.2 shows that, in the majority of developing and emerging economies with available data, there is little or no difference in primary and lower secondary school attendance for children from different types of households. This confirms the progress towards universal schooling in many countries since the mid 1990s. However, on average, across countries, the gap in school attendance in primary and lower secondary education is six percentage points between children from formal and informal households, and one percentage point between children from formal and mixed households. Children from formal households are always at an advantage in terms of attendance rates. In a handful of countries where differences exist, they can be quite striking: for example, in countries such as Madagascar and Niger, there is about a 30-percentage-point difference in attendance rates between children from fully informal and fully formal households.

### ***The attendance gap between children of formal and informal workers widens at the level of upper secondary and post-secondary non-tertiary education***

The situation is quite different for children in upper secondary and post-secondary non-tertiary education. Three observations can be made from Panel B of Figure 5.2. First, education enrolment is substantially lower among children at this level of schooling compared with attendance in primary and lower secondary school regardless of children's family background. This confirms data from other sources, suggesting that before the COVID-19 crisis, 132 million children globally were missing from upper secondary education (UNESCO, 2022<sup>[4]</sup>). Second, there are substantially more countries – in fact, almost all countries with available data – where there is a significant difference in school attendance between children from formal,

mixed and informal households, to the advantage of children from formal households. Children from informal households account for a larger share of those missing from school. Third, the average attendance gap for children from informal, mixed and formal households is wider in upper secondary and post-secondary non-tertiary education than it is in primary and lower secondary education. The gap is 15.7 percentage points between children from fully formal and fully informal households, and 9.0 percentage points between children from fully formal and mixed households.

Attrition from the school system, or school dropout, has many causes. These causes include difficult access to schools, especially in remote rural areas; unappealing quality of schooling and low relevance of education; grade repetition (UNICEF, 2019<sup>[5]</sup>); and child marriage and pregnancy (which can be both a cause and a consequence of early school dropout). They also include the need for family income that incentivises households to withdraw their children from school and encourages child labour – which is usually informal, especially for children who have not reached the authorised working age. Access to school, the rate of school dropouts, and the reasons for dropout also remain unequal for boys and girls. Out-of-school girls are at a higher risk of child marriage, while boys are at a higher risk of child labour (UNICEF, 2015<sup>[6]</sup>). In some parts of the world, persistently high dropout rates can be explained by ongoing security issues, lack of appropriate programmes and facilities, and low levels of family support (EFT, 2021<sup>[7]</sup>).

The numbers in Figure 5.2, Panel B also include pupils in formal technical and vocational education and training (TVET) programmes, delivered as a dedicated track at secondary and post-secondary levels. Globally, the share of young people who participate in TVET is low. Enrolments in TVET vary significantly, with the lowest rates found in sub-Saharan Africa (around 1% among those aged 15-24 years had ever benefitted from it) and the highest rates found in Central Asia, in Central and Eastern Europe, and in East Asia and the Pacific (up to 15%) (UNESCO, 2021<sup>[8]</sup>; UNICEF, 2019<sup>[5]</sup>). In developed countries, TVET at upper secondary level is intended to ensure the transfer and acquisition of knowledge and skills needed to carry out the tasks associated with a particular occupation. It may also include vocational guidance; however, this component is not commonly found in developing and emerging economies and is generally left to parents. This omission can particularly affect students from informal households.

### ***Attendance gaps continue to widen at the level of tertiary education***

Finally, education inequalities between children from different types of household further widen in tertiary education (Figure 5.2, Panel C). First, attendance rates are substantially lower in all countries for which data were available when compared with those in the earlier stages of education. Second, the attendance gap continues to widen and stands at 17 percentage points between children from fully formal and fully informal households. The most striking difference is observed in Burkina Faso, where the gap is more than 70 percentage points. On average, the attendance gap is eight percentage points between children from fully formal and mixed households. At the same time, the change in the attendance gap between Panel A and Panel B is substantially more pronounced than the change in the attendance gap between Panel B and Panel C, suggesting that inequality in attendance between children from formal and informal households starts early on, and especially manifests itself as children proceed to upper secondary and post-secondary non-tertiary education.

### ***The COVID-19 crisis exacerbated school attendance inequalities***

While substantial progress to improve school enrolment and attendance was made in the majority of countries since the mid 1990-s, the COVID-19 crisis put these developments at risk. The effects of the crisis have mostly hit those who can least afford them; it had a compound effect on the lower enrolment rates of children and students from underprivileged backgrounds, and on school dropouts.

Social distancing measures associated with the COVID-19 pandemic led to school and university closures in 192 countries. At the peak of the pandemic, the United Nations Educational, Scientific and Cultural

Organization (UNESCO) reported that nearly 1.6 billion learners, or 94% of the world's student population, were affected by educational institution closures (UN, 2020<sup>[9]</sup>). School closures over the period 2020-21; the lack of electricity, broadband Internet and computers in rural areas; and the unequal preparedness of teachers have particularly compromised education for children from vulnerable backgrounds (including children of informal workers) and for girls (UN, 2020<sup>[9]</sup>). Globally, at least 463 million children could not be reached by digital and broadcast remote learning programmes during school closures. Seventy-five percent of these students came from rural areas and poor households (mostly informal), and were students with disabilities who were disproportionately excluded from remote learning modalities. Children and students from disadvantaged backgrounds often remained without any teaching support when their schools shut down; for many, especially for girls, temporary school closures led to permanent school dropout (De Giusti, 2020<sup>[10]</sup>). By September 2021, a total of 260 million children and young people were out of the education system – 3 million more than in 2019 (UNESCO, 2022<sup>[4]</sup>). A further 24 million learners were at risk of dropping out of education; most of these were from disadvantaged backgrounds.

Many TVET programmes have faced particular challenges due to their work-based learning component and the inability to deliver practical education when businesses were closed (OECD, 2021<sup>[11]</sup>). Education and training institutions as well as their students and trainees increasingly adopted a wide range of education technologies to mitigate the impact of the closures of learning institutions. The findings of a global interagency survey of the effects of the COVID-19 crisis on TVET provision show that the crisis triggered a rapid uptake of distance learning approaches in TVET (ILO, 2021<sup>[12]</sup>). The majority of TVET respondents in 46 out of 92 countries reported the provision of courses that were entirely based on remote learning during the crisis, whereas, prior to the COVID-19 pandemic, only 13 out of those 92 surveyed countries featured a majority of TVET respondents who provided online distance learning regularly or often (ILO, 2021<sup>[13]</sup>). Again, the availability of remote learning, and the possibility to participate in it, varied greatly across sectors of activity, occupations and place of residence (rural or urban), with the most vulnerable learners being excluded from these possibilities.

In addition to the impact on school attendance, a global study of 157 countries conducted three months after the onset of the pandemic simulated the likely effects of the crisis response on a series of education outcomes (Azevedo et al., 2020<sup>[14]</sup>). Results were reported for three scenarios (optimistic, intermediate and pessimistic) assuming three, five and seven months of school closures. Bearing in mind that before the crisis 53% of children in low- and middle-income countries were living in “learning poverty” (unable to read and understand a simple text by the age of ten years), the results of closures for five months under the intermediate scenario suggested: (i) the loss of Learning-Adjusted Years of Schooling (LAYS) could be as high as 0.6 years compared with the global average of LAYS of 7.9 years; (ii) the reduction in Programme for International Student Assessment (PISA) test scores could be 16 points below the average of 440 in 2019; (iii) the share of lower secondary school age children who are below the minimum level of proficiency could increase by as much as 25% (from 40% to 50%); and (iv) nearly 7 million students from primary up to secondary education could drop out due to the income shock of the pandemic. In the longer term, this can lead to substantial productivity losses of future workers (de la Maisonneuve, Égert and Turner, 2022<sup>[15]</sup>). The distributional effects of these losses are expected to disproportionately affect the most vulnerable learners, such as low-paid informal workers in rural areas, and more so in low-income countries.

### **Formal households also spend more on education per child compared with informal households, thus exacerbating inequalities**

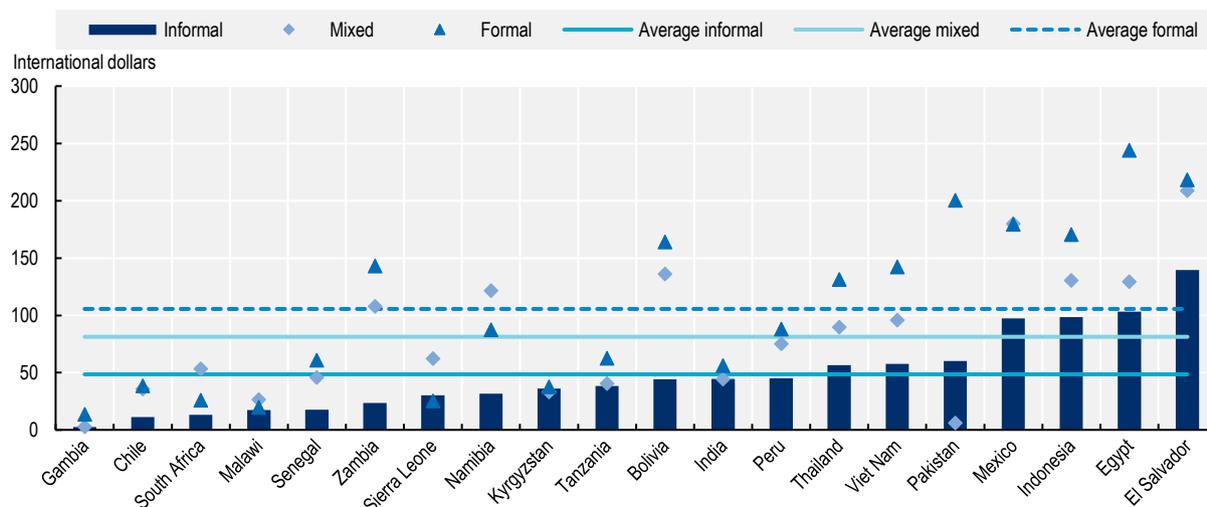
Significant underinvestment in education is another way in which the cycle of informal employment perpetuates from one generation to another.

Even if education is now meant to be free in many developing and emerging economies, going to school is not. Computations based on the KIIbIH data show that, on average, households spend between 4% and

5% of their total expenditure on education (education expenditures include, among others, registration fees, expenditures on educational materials such as books and stationery, transportation, uniforms, and food). However, the average monthly spending per child of school age varies by household type (Figure 5.3). In the vast majority of countries with available data, fully formal households spend relatively more on schooling per child in absolute terms than mixed and informal households do. This reflects the fact that working parents in formal households have higher earnings and may be able to afford to spend more. This, in turn, ensures that children stay in school longer and possibly get better-quality schooling. At the same time, this confirms that earnings inequalities across parents and household types translate into education inequalities early in their children's lives.

**Figure 5.3. Education expenditures, by household type**

Average monthly out-of-pocket expenditures per child of school age, by household type, in international dollars



Note: Education expenditures include all actual out-of-pocket expenditures of households on items such as school fees, books, other educational materials, transport costs, and meals. The availability of each item may differ from country to country, affecting cross-country data comparability. "Children of school age" refers to children aged 6-18 years. An international dollar is defined as the currency unit that has the same purchasing power over gross national product (GNP) as the US dollar in the United States.

Source: Estimates based on (OECD, 2021<sup>[3]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIbIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIbIH.htm>. Stat.

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The COVID-19 crisis further exacerbated these existing inequalities through unequal access to parental help. At the higher end of the socio-economic spectrum, during school closures, children of formally working parents with higher education benefitted from their educated parents who teleworked, had access to more resources and knowledge, and tended to be more active in child rearing. In some cases, they also benefitted from enhanced learning through private tutors. Compared with their less privileged counterparts, such children have managed to compensate, or even overcompensate, for the negative effects of school closures (Bayrakdar and Guveli, 2020<sup>[16]</sup>; Andrew et al., 2020<sup>[17]</sup>).

It is too premature to say how future public spending on education and training in particular will be affected by the diversion of funds to health services and social protection following the COVID-19 crisis and, more recently, the economic effects of geopolitical uncertainties and disruptions. The looming inflation and the fiscal austerity efforts to contain it have already reduced the rate of economic growth and will increase unemployment (and reduce household incomes) before they have an opportunity to recover to their pre-

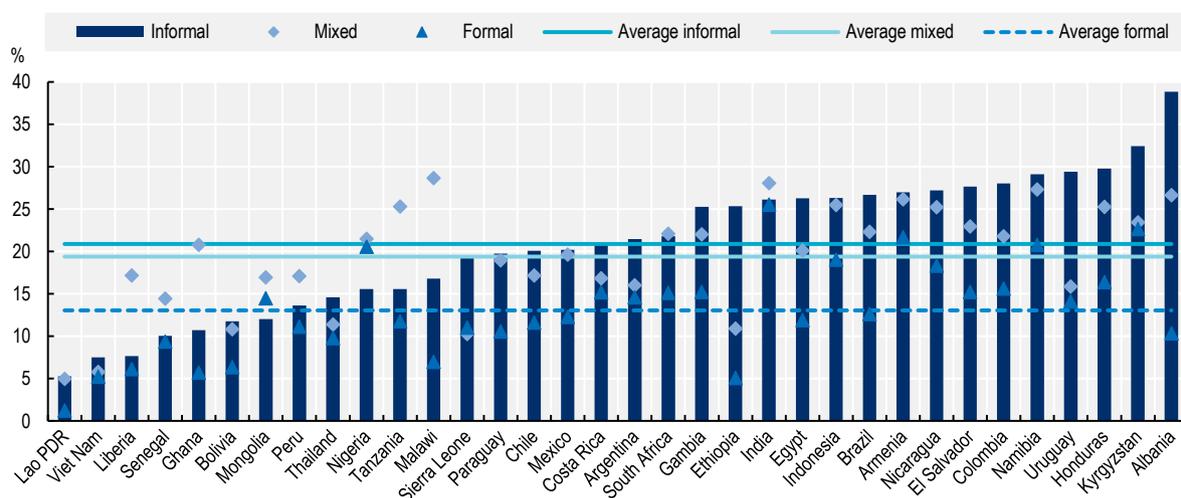
pandemic levels. This reduces households' ability to finance investments in the human capital of their members, particularly in developing and emerging economies and in the poorest families.

## Young people from informal households are more likely to be NEET and face longer and more uncertain school-to-work transitions

Later on in the life cycle, the educational disadvantage of children from informal households translates into a clear disadvantage for young people. Among young people, the share of NEET (not in education, employment or training) is higher for those from informal households than for those from mixed and fully formal households (Figure 5.4). Across developing and emerging economies with available data, there is a 7.9-percentage-point gap in the NEET rate between young people from fully informal and fully formal households. On average, young people from mixed households are similar to young people from formal households in this regard. This may be related to the underlying characteristics of young people in informal households (less schooling), as well as to the fact that informally working parents may have more limited networks to help their children find work.

**Figure 5.4. NEET rates are higher for young people living in informal households**

Young people aged 15-24 years neither in employment nor in education and training, as a percentage of young people aged 15-24 years living in each household type



Note: Includes all sampled households with at least one worker; mixed households have at least two workers. Household type averages are unweighted averages across sample countries. Lao PDR – Lao People's Democratic Republic.

Source: Estimates based on (OECD, 2021<sup>[3]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIbIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIbIH.htm>.

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One of the pathways towards a working life could be through internships and apprenticeships. These two forms of skills acquisition are still less common in low-income countries compared with richer countries. According to the International Labour Organization (ILO) School-to-Work Transition Surveys in 33 developing and emerging economies, only one in five respondents below the age of 35 years had participated in at least one internship or apprenticeship. And where self-reported estimates exist, the incidence of internships or apprenticeships was found to be higher among well-off households than among poor households. Those with secondary education were twice as likely to be offered apprenticeships than

those with primary education only, and the percentage of such beneficiaries is much higher for those working in the formal economy (Bonomelli Carrasco, 2021<sup>[18]</sup>). A critical factor underlying these differences is that apprentices from better-off households are in a much better position to get ahead of their peers through social networking, often through their educated and formally working parents (de Mel, Elder and Vansteenkiste, 2013<sup>[1]</sup>; Erin and Nilsson, 2014<sup>[2]</sup>).

Given the high level of informal employment in developing and emerging economies, most apprenticeships and internships also tend to be informal. Informal arrangements are most prevalent in sub-Saharan Africa (UNICEF, 2019<sup>[5]</sup>). They usually take the form of skills acquisition for trade or crafts in a micro or small enterprise or workshop, learning and working side by side with an experienced practitioner. Often, however, such apprenticeships are not effective in providing the necessary skills (Werquin, 2021<sup>[19]</sup>), and when they are, these skills are not formally recognised, as discussed in Chapter 4.

Finally, evidence from other studies, such as the ILO School-to-Work Transition Surveys, also shows that when young people in developing and emerging economies transition to work, more than three-quarters of their first jobs are informal (Erin and Nilsson, 2014<sup>[2]</sup>). Young workers have the greatest chances of working formally in Europe and Central Asia and, to a certain degree, LAC (with the exception of El Salvador and Peru). In contrast, in sub-Saharan African countries, up to 95% of young workers are in informal employment. The probability of working informally decreases with age and with the level of education. In 20 countries where ILO School-to-Work Transition Surveys were conducted, young people with tertiary education have at least a 51% chance of finding formal employment, compared with 14% for young people with less than primary education.

## Policy discussion

Taken together, the analysis of this chapter confirms that informal employment continues to be “past dependent” (Erin and Nilsson, 2014<sup>[2]</sup>). Early childhood education inequalities, coupled with those of the previous generation, as well as early-life work experience of informal employment, strongly determine informal employment in adulthood. Given this, investing in children and young people from informal households, especially the poorest ones, and investing in quality education early on is a critical way to break the cycle of informal employment.

Chapter 4 already provided several policy recommendations to continue raising the general level (in terms of quality and quantity) of schooling in order to strengthen foundational skills as a basis for the future learning of all workers. To complement them, several additional actions should be considered.

### ***Investing in accessible quality education, in order to equip future workers with solid foundational skills***

As this chapter showed, inequality of opportunities starts very early in children’s lives and widens at subsequent levels of education. Inequality in school attendance between children from formal and informal households is already visible at the level of upper secondary and post-secondary non-tertiary education, and in some countries even at the primary education level. Having poor or inadequate foundational skills will preclude children from the most disadvantaged backgrounds from developing higher-order technical and soft skills through any type of further learning.

Poor performance of education systems will continue to be a major push factor leading to informal employment for labour market entrants. Closing rural-urban gaps in education quality, rendering education more relevant to labour market needs, improving physical access to educational establishments through better transportation, providing better teacher training, and emphasising the development of soft skills valued by employers – such as communication, problem-solving and teamwork – alongside technical skills are all important ways to keep children in the education system.

The impact of the COVID-19 crisis calls for urgent measures to recover the loss in school-based learning for future labour market entrants, and especially for children from disadvantaged backgrounds, including informal households. The short-term emphasis should be on addressing the widening gaps in education created by school closures; to restore the amount of lost learning; to prevent students from dropping out of school; and to ensure that the historically increasing trend in enrolment continues.

In this light, it is important to immediately prioritise public spending on education in order to keep education enrolment rates at pre-COVID-19 pandemic levels. The worsening macroeconomic conditions, aggravated by uneven post-crisis recovery and the global impacts of multiple ongoing wars and military conflicts, will undoubtedly limit the range of possible policy responses in the education field. Already in 2020, forecasts assumed that the global share of public budgets allocated to education would decrease by at least 10% (World Bank, 2020<sup>[20]</sup>). In addition, declining household incomes may result in enrolment transitions from private to public schools, which will exacerbate the pressure on government budgets dedicated to education. Yet, the cost of inaction will be much higher. It is estimated that failure to achieve the Sustainable Development Goal (SDG) on education would result in a discounted loss in global gross domestic product (GDP) during the rest of the 21st century equivalent to an annual loss in current global GDP of 11%, with most of the losses incurring in developing and emerging economies (Hanushek and Woessmann, 2022<sup>[21]</sup>).

### ***Devoting sufficient resources to education and providing equitable education opportunities***

This chapter has also shown that formal and informal households provide unequal resources to support their children's schooling. In this light, the role of governments should be to better support children from all backgrounds, and especially from poorer informal households. In the longer term, supporting universal education for all will remain relevant. Continuous efforts should also be dedicated to traditional approaches to reducing the direct and indirect costs of schooling, especially for children from vulnerable households, including informal households. The role of cash transfer programmes, fee waivers, scholarships, school meals and the free provision of educational materials remains incontestable. These tools have proven to be potent interventions for increasing access to education, reducing the dropout rate of poor students and promoting equitable development.

To support enrolment in tertiary education, it is also necessary to consider providing scholarships, grants or low-interest loans to students in order to reduce financial barriers to acquiring necessary skills.

The COVID-19 crisis also revealed the importance of closing the digital gap in learning between children from informal (often rural and poor) households. This will require long-term efforts to reduce the costs of participating in the digital world; increasing access to mobile Internet technology and adequate infrastructure; supporting the uptake of digital learning; investing in physical and digital infrastructure, particularly in rural areas; and investing in digital skills development (ILO, 2021<sup>[12]</sup>).

### ***Preventing school dropouts***

Poor quality of compulsory schooling and high dropout rates both disproportionately affect those students who are already disadvantaged – typically those living in rural areas, from poor and informal households, and with few options for employment outside of (often informal) family businesses. By leaving school early, children lose skills and competencies that could later allow them to enter more advanced training and more skill demanding, higher-paying jobs. As a result, these future workers often become trapped in the intergenerational cycle of informal work that is low-skill and low-productive (OECD/CAF/ECLAC, 2016<sup>[22]</sup>). Both phenomena also contribute to skills shortages and become major barriers to public and private sector strategies for industrialisation, adoption of new technologies and boosting productivity (OECD, 2023<sup>[23]</sup>).

In many countries, decisions to keep children and adolescents in school are often made within the family, based on the calculated probability that staying in school will actually lead to a job relative to the need to have

children participate in providing income for the family. Thus, again, improving school quality and aligning school programmes with labour market needs is necessary in order to prevent dropouts (OECD, 2023<sup>[23]</sup>).

To be effective, such policies also need to be complemented with social policies. One such policy is eradicating child labour. This policy can have many components that would tackle child labour from both the demand and the supply side (Thévenon and Edmonds, 2019<sup>[24]</sup>). With regard to the findings of this report specifically, this would include making school an affordable alternative to child labour, as well as expanding social protection floors so as to protect families from fluctuations in their economic situation that can increase recourse to child labour (*ibid.*).

Other social policies would include the prevention of early dropouts because of arranged marriage and early pregnancy. This would encompass, among other policies, promoting gender equality in education and the workforce and the reduction of stereotypes around the roles of men and women in society (OECD, 2023<sup>[25]</sup>).

### ***Smoothing school-to-work transitions for young people, especially from informal households***

Young people from informal households have a particularly difficult time transitioning to their first job, and especially to a formal job. One of the pathways is through apprenticeships, but these are often informal. In addition, in developing and emerging economies, the first job is also frequently informal, taking place in an informal family business.

In this regard, several policy options are possible, with a view to helping transitions to the labour market, and especially to formal jobs.

- Leverage formal vocational education and training (VET) programmes

In many developing and emerging economies, formal TVET systems are not explored to their maximum potential. Often, they lack resources, deliver low-quality training that is poorly adapted to labour market needs and offer insufficient choice as to fields of study. In turn, they are characterised by high dropout rates and suffer from low status and poor reputations, which may penalise graduates (OECD, 2015<sup>[26]</sup>; OECD, 2023<sup>[23]</sup>). Improving TVET and leveraging its potential with a view to improving labour market transitions to formal jobs should be on the policy agenda. This means establishing new vocational schools dedicated to specific fields, providing more laboratories for practical work and collaborating with local industries to design VET curricula that align with current labour market needs.

- Develop formal apprenticeship programmes

Similarly, countries should strive to promote formal apprenticeship programmes that allow students to gain hands-on experience while learning on the job. To help the transition to formal jobs, governments should provide incentives for employers to hire apprentices.

- Recognise the role of informal apprenticeship programmes and of skills acquired through them

Informal apprenticeships continue to play an important role in smoothing labour market transitions, and this role should be recognised. Yet, there is a need to inject more quality skills into these systems. There is also a need to establish mechanisms of skills recognition, and ensure that employers recognise certifications delivered outside of standard education systems.

- Strengthen career guidance, counselling and networking

Children of informal workers are often penalised because they do not have sufficient networking opportunities to apply for, or even learn about, formal jobs. Establishing career guidance and counselling services in schools and in communities, that are available to all children, can help students make informed decisions about their education and career paths. Such services should also be leveraged to promote networking and simply ensure that potential formal employers and would-be workers meet.

- Create or reinforce existing employment programmes for young people

Just like their parents, young informal workers can have very heterogeneous backgrounds and situations. To help them move to formal jobs, targeted programmes and incentives that offer training, subsidies or job placement services can be established, especially if these young people are not eligible for standard support measures because of their own informal status or the informal work status of their parents. For informal enterprises, access to such programmes may be conceived in a way that encourages enterprise formalisation, and is part of the overall formalisation strategy. The effective implementation and co-ordination of these policies requires collaboration between government agencies, educational institutions, employers and civil society organisations. It is crucial to adapt these policies to the specific context and needs of each country so as to ensure successful school-to-work transitions for young people.

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# **6** Extending social protection to informal workers

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Using the OECD Key Indicators of Informality based on Individuals and their Household (KIIBIH) database, the OECD Global Revenue Statistics Database, and new evidence from Women in Informal Employment: Globalizing and Organizing (WIEGO) and the International Labour Organization (ILO) on global experiences in extending social insurance to informal workers, this chapter reviews the current de facto social protection coverage for informal workers across developing and emerging economies. It explores individual and household characteristics of informal workers to identify policy options for extending social protection to informal workers; and discusses possible methods of, and constraints to, financing the extension of social protection.

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## Overview of current coverage of social protection schemes

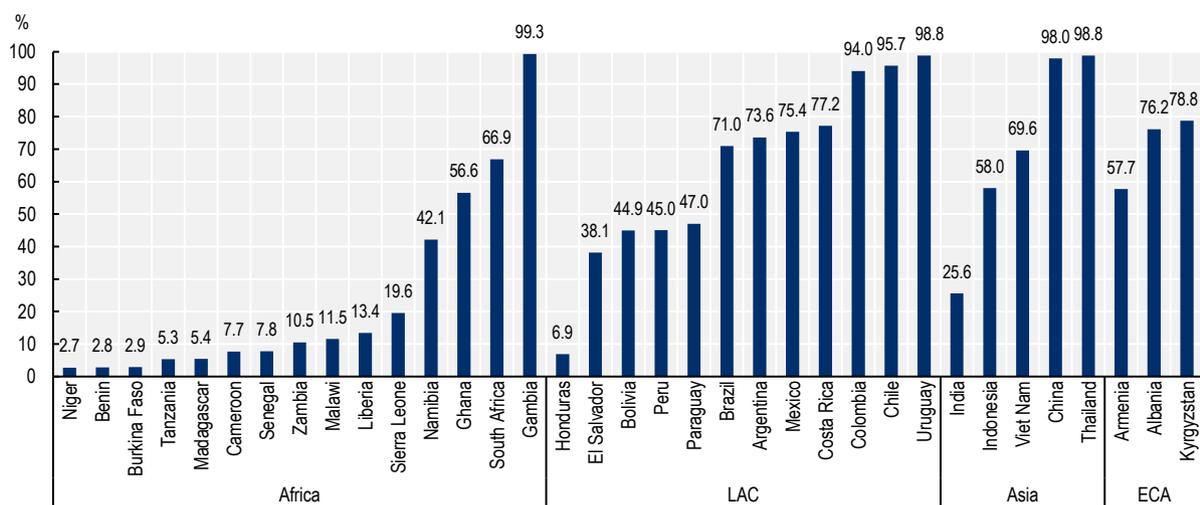
Universal social protection constitutes an essential component of the global agenda for sustainable development and is one of the key policy priorities in several regional and national commitments. Yet, the road to universal social protection remains difficult in many countries. One common challenge in most developing and emerging economies with a large informal economy is to remove the many legal, economic and institutional constraints that informal workers face in accessing social protection and to install funding mechanisms that are appropriate, fair, efficient and sustainable.

### ***Throughout the world, social protection coverage for workers is often inconsistent and sparse***

Evidence from KILBIH data indicates that social protection coverage for workers is limited in most developing and emerging economies, although significant differences can be found across countries. The percentage of workers who benefit from social protection, either directly or indirectly through a household member, is lowest in countries in Africa and relatively higher in countries in Latin America and the Caribbean (LAC), Europe and Central Asia (ECA) and Asia (Figure 6.1).

**Figure 6.1. Social protection of workers lags in some parts of the world**

Percentage of workers receiving at least one form of social protection



Note: Social protection programmes include contributory pensions, employment-based health insurance, unemployment insurance, programmes providing universal health coverage and/or unconditional/conditional cash transfers (including non-contributory pensions). Coverage rates are calculated for direct and indirect beneficiaries of social protection programmes and contributors to social insurance programmes. Surveys for some countries do not include specific questions on all of these programmes, and this can affect cross-country comparisons. It is important to note that coverage rates provided here for any particular country are only estimated to the best extent possible given data quality and are not necessarily indicative of adequate targeting or adequate benefit levels. In many of the countries discussed here, social protection coverage refers to whether an individual is a direct beneficiary or a contributor to or indirect beneficiary of at least one social protection programme within the past month or past year. LAC – Latin America and the Caribbean. ECA – Europe and Central Asia. Bolivia refers to the Plurinational State of Bolivia (hereafter: Bolivia); China refers to People's Republic of China (hereafter: China).

Source: Estimates based on (OECD, 2021<sup>[1]</sup>), *Key Indicators of Informality based on Individuals and their Household (KILBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KILBIH.htm>.

African countries have relatively fewer resources to sustain social protection systems, and programme coverage is therefore lowest on this continent. In the ECA sample of countries included in the KIIbIH database, some form of social protection, such as mandatory privately funded pensions, is found in all countries. In many parts of Asia, social protection coverage is low, but countries provide a large mix of programmes, which results in high coverage estimates (see note below Figure 6.1). In LAC, social protection systems are generally well funded with a variety of programmes, ranging from insurance and cash transfers to other forms of protection.

### Box 6.1. Social protection coverage in the KIIbIH database

The KIIbIH database is a new OECD database that provides information on informal workers and their households in developing and emerging economies (OECD, 2021<sup>[11]</sup>). Building on household surveys, the KIIbIH database provides comparable indicators and harmonised data on informal employment, and the well-being of informal workers and their dependents. It currently covers 42 countries across North and sub-Saharan Africa, ECA, Asia and LAC. However, the sub-set of KIIbIH countries included in this chapter covers only 15 African countries, 12 LAC countries, 5 Asian countries, and 3 ECA countries for which sufficient information on social protection is available.

The definition of informal employment used by the KIIbIH database is the same definition currently used by the ILO, following standards agreed at the 15th and 17th International Conference of Labour Statisticians (ICLS): employees are informal when they are not affiliated with social security (such as a pension fund, unemployment benefit or health insurance), and do not benefit from some type of pension, paid leave or paid sick leave from their job; and employers and own-account workers are informal when they belong to the informal sector, which is defined as a group of production units composed of unincorporated enterprises owned by households, including informal own-account enterprises and enterprises of informal employers (typically small and non-registered enterprises). Contributing family workers are always considered informal.

Based on the information available and the nature of the underlying data, the definition of social protection coverage in this chapter includes contributory pensions, employment-based health insurance, programmes providing universal health coverage, unemployment insurance and/or unconditional/conditional cash transfers. Coverage is based on reported direct beneficiaries of social protection programmes or contributors to contributory schemes and indirect beneficiaries.

Social protection is then further divided into two sub-categories:

- Contributory social protection constitutes voluntary or mandatory contributory (usually employment-based) pensions, employment-based health insurance and unemployment insurance.
- Non-contributory social protection constitutes unconditional and conditional cash transfers, including non-contributory pensions.

Source: Authors' compilation.

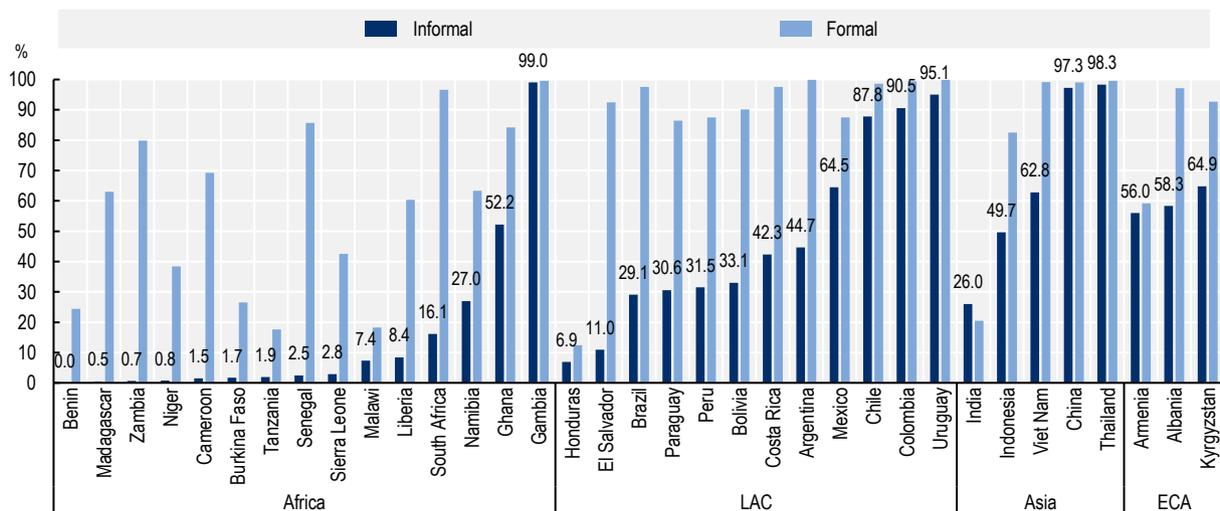
### ***In most countries, informal workers experience a social protection gap***

Formal workers are better covered by social protection than informal workers are in most countries, according to KIIbIH estimates. More than 70% of formal workers across the surveyed countries benefit from or contribute to at least one of the following programmes: contributory pension, employment-based health insurance, programmes providing universal health coverage, unemployment insurance or unconditional/conditional cash transfers (hereafter, collectively constituting social protection coverage)

(Figure 6.2). In comparison, only about 37% of informal workers benefit from one of these programmes. There are also large disparities across regions and countries. The coverage gap of informal workers is particularly significant among the sample of African countries, and is less pronounced in the sample of LAC, Asian, and ECA countries.

**Figure 6.2. Informal workers are half as likely as formal workers to be covered by social protection**

Percentage of workers contributing to and/or benefitting from at least one form of social protection



Note: Social protection programmes include contributory pensions, employment-based health insurance, unemployment insurance, programmes providing universal health coverage and/or unconditional/conditional cash transfers (including non-contributory pensions). Coverage rates are calculated for direct and indirect beneficiaries of social protection programmes and contributors to social insurance programmes. Surveys for some countries do not include specific questions on all of these programmes, and this can affect cross-country comparisons. LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Estimates based on (OECD, 2021<sup>[1]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>.

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### **The large social protection gap between formal and informal workers is largely due to a gap in contributory schemes**

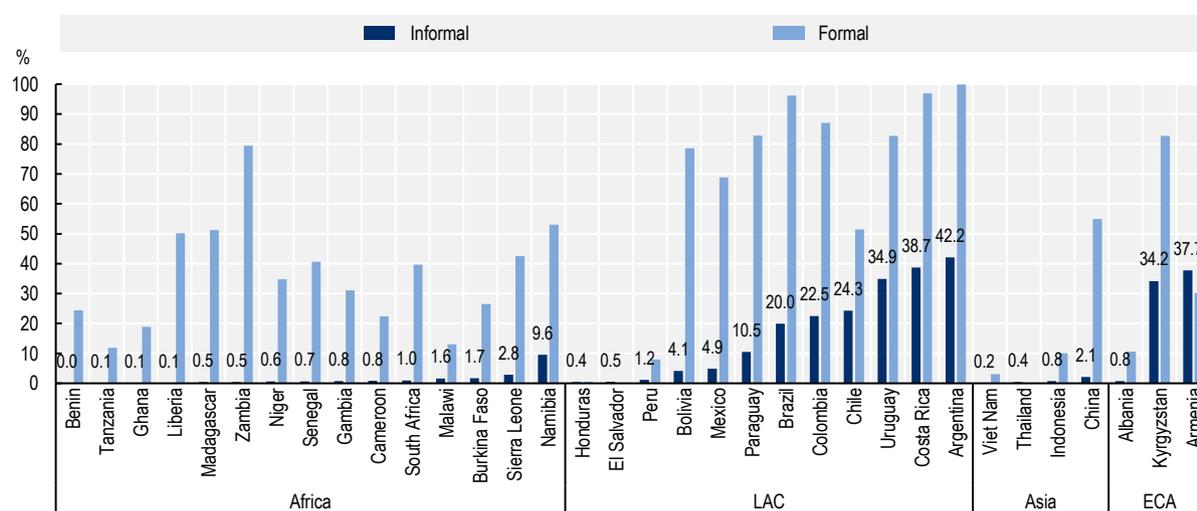
The large social protection gap between formal and informal workers mirrors, to a large extent, the coverage gap of informal workers with regard to contributory schemes. Formal workers benefit more often from contributory programmes (43.7%) than informal workers do (8.9%) (Figure 6.3). Most contributory schemes are traditionally employment based, and informal workers are usually unable to access them either because they are excluded from the scope of social security or because they are excluded from it in practice, due to the non-payment of contributions and lack of capacity to contribute to them, among other things. Yet, informal workers can (and, as evidenced, do) benefit from some contributory schemes, often on a voluntary basis, thanks to certain programmes<sup>1</sup> that have eased barriers to participation for specific categories of informal workers, such as those who are self-employed.

In contrast, the coverage of non-contributory programmes across workers does not seem to be linked to their formal/informal status. This may reflect the fact that informal workers are more likely to receive lower pay or to live in poorer households, which would make them or their household eligible for means-tested social assistance programmes and are therefore more likely than formal workers to rely on government

assistance (non-contributory programmes) to meet basic needs. Yet, the coverage non-contributory programme coverage varies depending on the country. In the sample of African countries, an average of 29.4% of formal workers and 17.2% of informal workers benefitted from non-contributory programmes; in the sample of Asian countries, an average of 62% of formal workers and 66% of informal workers benefitted from non-contributory programmes (Figure 6.4). The sample of countries from LAC is a notable exception, with the average non-contributory programme coverage for informal workers (33.1%) far outstripping the average coverage for formal workers (24.7%), probably reflecting the extension of cash transfers to poor households, which are more likely to be in the informal economy.

**Figure 6.3. Formal workers are more likely than informal workers to benefit from contributory schemes**

Percentage of informal workers and formal workers contributing to and/or benefitting from contributory social protection



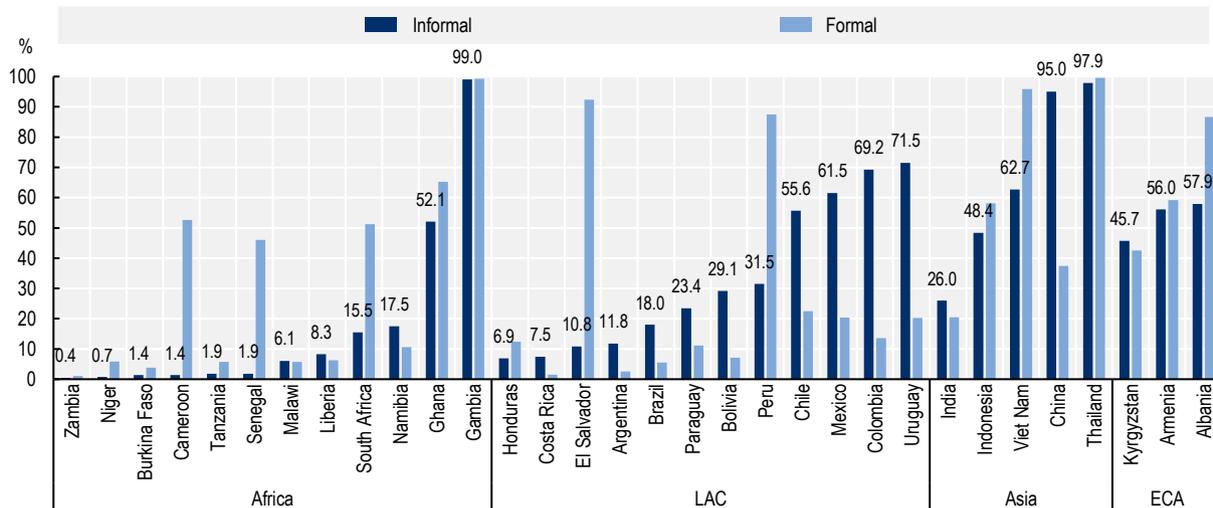
Note: Contributory social protection programmes include contributory pensions, employment-based health insurance and unemployment insurance. Coverage rates are calculated for direct and indirect beneficiaries of social protection programmes and contributors to social insurance programmes. Surveys for some countries do not include specific questions on all of these programmes, and this can affect cross-country comparisons. LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Estimates based on (OECD, 2021<sup>[1]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIbIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIbIH.htm>.

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**Figure 6.4. Non-contributory programme coverage of workers does not seem to be linked to their formal/informal status**

Percentage of informal workers and formal workers covered by non-contributory social protection



Note: Non-contributory social protection programmes include programmes providing universal health coverage and/or unconditional/conditional cash transfers (including non-contributory pensions). Coverage rates are calculated for direct and indirect beneficiaries of social protection programmes and contributors to social insurance programmes. Surveys for some countries do not include specific questions on all of these programmes, and this can affect cross-country comparisons. LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Estimates based on (OECD, 2021<sup>[1]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIbIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIbIH.htm>.

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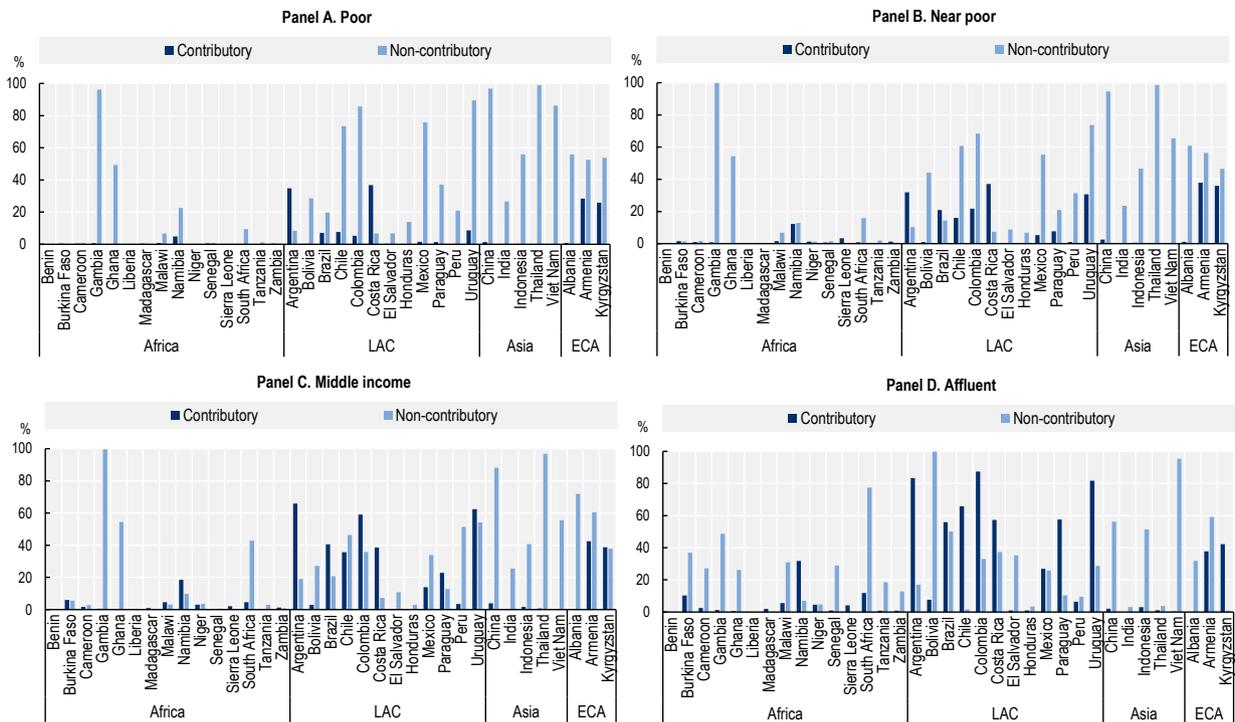
### **Contributory schemes tend to benefit relatively better-off informal workers, while non-contributory schemes typically benefit poorer informal workers**

Social protection coverage tends to vary among the household income classes of informal workers,<sup>2</sup> leaving a large segment of workers belonging to the near poor and middle-income categories largely uncovered. Contributory schemes tend to benefit relatively richer informal workers more than poorer ones, while non-contributory schemes typically benefit poorer informal workers rather than richer ones (Figure 6.5). Overall, in the sample of countries for which data are available, an average of only 5% of poor informal workers are covered by some type of contributory scheme compared with about 20% of more affluent informal workers. Likewise, about 39% of poor informal workers are covered by a non-contributory programme compared with nearly 31% of higher-earning informal workers.

Coverage levels also differ across countries. In the sample of countries from LAC and Asia, non-contributory programmes are targeted at the most vulnerable informal workers, whereas in the sample of African countries, affluent informal workers are more likely to be covered by both contributory and non-contributory schemes.

**Figure 6.5. Contributory schemes tend to benefit relatively better-off informal workers, while non-contributory schemes are relatively pro-poor**

Percentage of informal workers contributing to and/or benefitting from social protection, by economic class category



Note: Contributory social protection programmes include contributory pensions, employment-based health insurance and unemployment insurance. Non-contributory social protection programmes include programmes providing universal health coverage and/or unconditional/conditional cash transfers (including non-contributory pensions). Coverage rates are calculated for direct and indirect beneficiaries of social protection programmes and contributors to social insurance programmes. Surveys for some countries do not include specific questions on all of these programmes, and this can affect cross-country comparisons. Economic classes are based on four absolute per capita per day welfare thresholds, which differ by per capita household income level. Low-income countries (LICs): poor: international dollar (int'l dollar) 2.15/day or less; near poor: int'l dollar 2.15-4/day; middle: int'l dollar 4-8/day; affluent: int'l dollar 8/day or more. Low- and middle-income countries (LMICs): poor: int'l dollar 3.65/day or less; near poor: 3.65-7/day; middle: int'l dollar 7-20/day; affluent: int'l dollar 20/day or more. Upper middle-income countries (UMICs) and high-income countries (HICs): poor: int'l dollar 6.85/day or less; near poor: int'l dollar 6.85-15/day; middle: int'l dollar 15-70/day; affluent: int'l dollar 70/day or more.

Source: Estimates based on (OECD, 2021<sup>[1]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>.

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***In the majority of the sample countries, urban informal workers have better access to contributory programmes, but rural informal workers are better covered by non-contributory programmes***

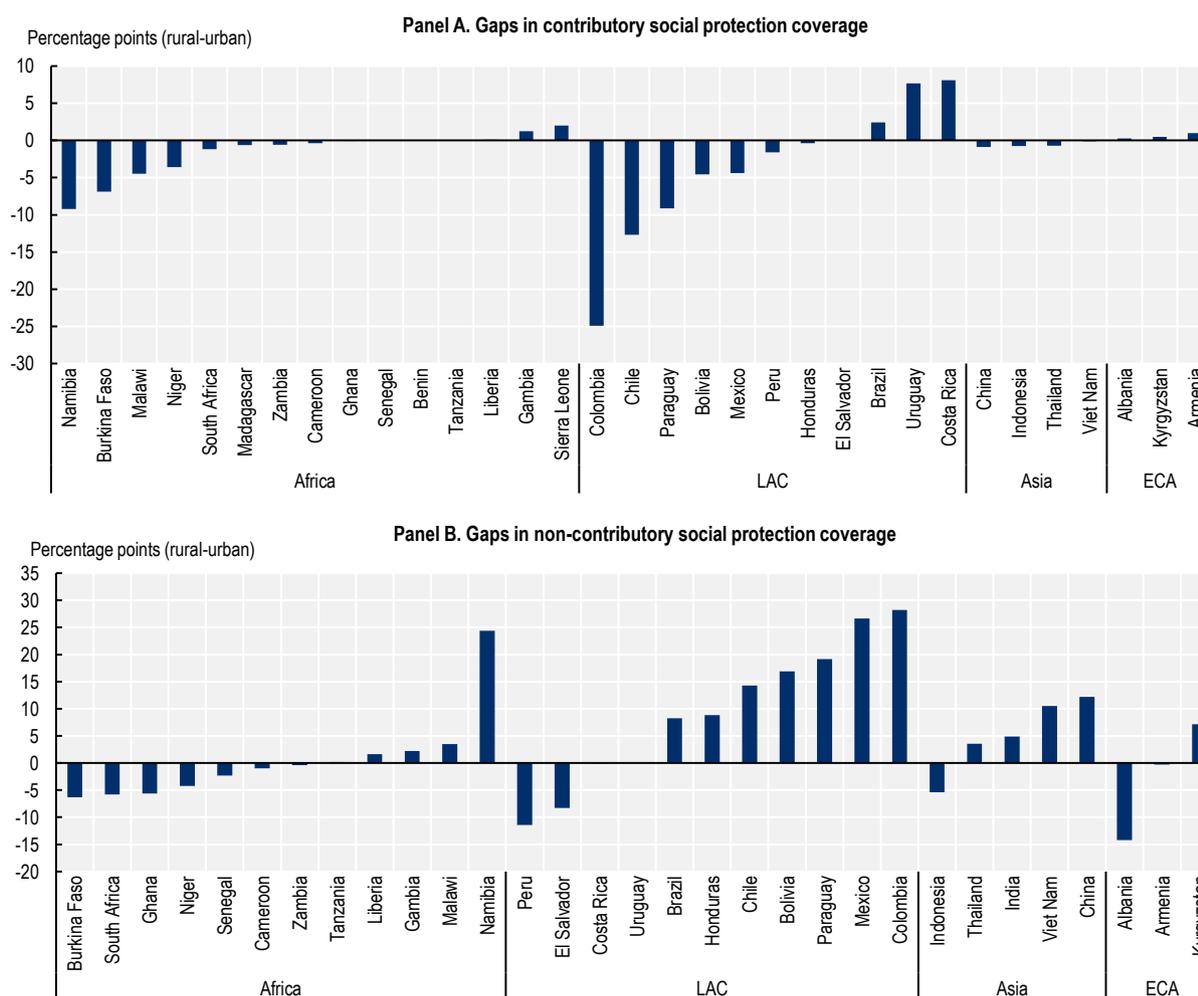
Informal workers also appear to benefit from different types of social protection when they live in rural rather than urban areas. Urban informal workers have better access to contributory programmes, but rural informal workers are better covered by non-contributory programmes (Figure 6.6). In two-thirds of the countries for which information is available, urban informal workers were more likely than rural informal workers to benefit from contributory programmes (Figure 6.6, Panel A).

In most countries (with the noticeable exception of the sample of African countries), rural informal workers reported better coverage by non-contributory schemes than urban informal workers did (Figure 6.6,

Panel B). This is likely due to the long-standing disadvantage of rural areas with regard to access to services, infrastructure and information, and much of the rural labour force is precariously employed in agriculture. Not only is it harder to distribute and manage contributory schemes in rural areas but informing eligible participants about schemes can also be more difficult in rural areas than in urban areas. Cash or in-kind transfers are usually provided in rural areas to help households meet basic needs. This rural-urban difference in the type of social protection coverage may also reflect the higher prevalence of employees in urban areas and self-employed individuals in rural areas.

**Figure 6.6. Informal workers benefit from different types of schemes in rural and urban areas**

Difference in contributory and non-contributory social protection coverage between informal workers in rural and urban areas



Note: Contributory social protection programmes include contributory pensions, employment-based health insurance and unemployment insurance. Non-contributory social protection programmes include programmes providing universal health coverage and/or unconditional/conditional cash transfers (including non-contributory pensions). Coverage rates are calculated for direct and indirect beneficiaries of social protection programmes and contributors to social insurance programmes. Surveys for some countries do not include specific questions on all of these programmes, and this can affect cross-country comparisons. The difference in coverage rates (measured in percentage points) is determined by subtracting the coverage for urban informal workers from the coverage for rural informal workers. LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Estimates based on (OECD, 2021<sup>[1]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIbIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIbIH.htm>.

Access to social protection may also be influenced by whether informal workers hold citizenship in the country where they work. Using KIIbIH data, we find a relative disadvantage in accessing social protection between foreign-born informal workers and native-born informal workers. Compared with native-born informal workers, foreign-born informal workers are less likely to benefit from social protection. Such a gap does not seem to reflect a disadvantage in terms of contributory schemes, however. Since few informal workers have access to contributory schemes, the differences in contributory coverage between foreign-born informal and native-born informal workers tend to be small. Rather, the relative overall social protection disadvantage of foreign-born informal workers mirrors a gap in non-contributory schemes, which is particularly visible in countries where access to non-contributory schemes is more important. For instance, in China and Chile, foreign-born informal workers were about half as likely as native-born to benefit from non-contributory programmes.

## Extending non-contributory schemes to informal workers

The previous section documented the extensive gaps in social protection for informal workers. Social protection for informal workers will need to be based on a combination of contributory and non-contributory schemes. Country experiences show that very few countries have achieved both universal social protection coverage and adequate benefit levels by offering only one of these types of social protection. Universal social protection will most likely be achieved over time through progressive expansion, even if some countries have been successful in expanding their non-contributory schemes quickly, such as universal pensions or universal health coverage (ILO, 2018<sup>[2]</sup>).

Non-contributory schemes do not require contributions from individuals who benefit from social protection and are mostly financed directly from a government's general budget – that is, from general taxation, non-tax revenue, or external grants or loans. There are many types of non-contributory programmes, such as universal schemes that benefit all individuals (e.g. a national health service), categorical schemes covering certain broad groups of the population (e.g. social pension or universal child benefit schemes) or social assistance schemes that provide benefits for groups of the population living in poverty (usually based on a means test, a proxy means test or other targeting mechanism).

Non-contributory schemes play a key role in ensuring a basic level of protection within the social protection system for poor and vulnerable groups who do not have access to contributory social protection. Non-contributory schemes are an essential component of any nationally defined social protection floor.

### ***The extension of non-contributory programmes for the poor would cover a large share of informal workers***

In many countries, reaching a consensus for using non-contributory, tax-financed programmes to reduce the social protection gap for the poor is often possible. It is therefore useful to assess the proportion of informal workers that could be covered through non-contributory programmes targeting the poor.

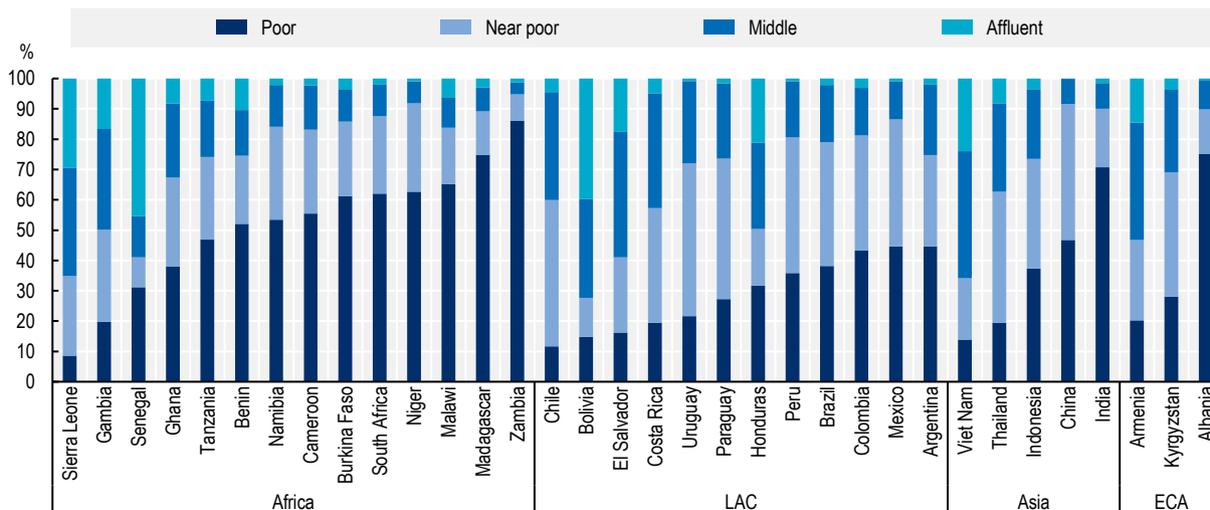
The extension of anti-poverty programmes would cover a large share of informal workers in many countries. According to KIIbIH data, and using international poverty lines for comparison purposes, around 86% of the informal workers in Zambia would be covered if anti-poverty programmes were successful in covering all informal workers who are poor (with a maximum daily income of int'l dollar 2.15/day), with similarly large proportions for Madagascar (75%) and India (71%) (Figure 6.7).

Yet, while a consensus for using non-contributory, tax-financed programmes to reduce the social protection gap for the poor may exist, in some countries this is not necessarily the case for informal workers who are not considered poor. In designing an approach to increase coverage for non-poor informal workers, countries face a host of difficult decisions, including whether to offer universal entitlements or use other coverage mechanisms, such as voluntary or mandatory public social insurance; how to develop processes

for identification and enrolment of the non-poor; and how to create attractive social insurance schemes to collect voluntary contributions, and whether to subsidise contributory schemes.

**Figure 6.7. Informal workers are predominantly poor, but some belong to the upper quartiles of income distribution**

Percentage of informal workers by income class



Note: Economic classes are based on four absolute per capita per day welfare thresholds, which differ by income level. LICs: poor: int'l dollar 2.15/day or less; near poor: int'l dollar 2.15-4/day; middle: int'l dollar 4-8/day; affluent: int'l dollar 8/day or more. LMICs: poor: int'l dollar 3.65/day or less; near poor: 3.65-7/day; middle: int'l dollar 7-20/day; affluent: int'l dollar 20/day or more. UMICs and HICs: poor: int'l dollar 6.85/day or less; near poor: int'l dollar 6.85-15/day; middle: int'l dollar 15-70/day; affluent: int'l dollar 70/day or more. LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Estimates based on (OECD, 2021<sup>[11]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>.

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### **Child benefits and social pensions can play an important role in lifting informal sector workers and their families out of poverty**

According to KIIBIH data, more than one-half of children (60%) and older dependents (57%) live in households where all workers are informal (see also Chapter 5). This points to the key role that child benefits and social pensions could play as a supplementary mechanism to extend social protection to informal workers. If properly designed, these benefits could contribute to reducing the vulnerabilities that households with informal workers face.

Non-contributory social protection aimed at workers in the informal economy can play an important role. Emergency income support measures implemented during the COVID-19 pandemic showed that non-contributory social protection aimed at workers in the informal economy can play an important role in mitigating income risks. Brazil's emergency income support programme, the Auxílio Emergencial (AE), showed the positive economic impact of incorporating informal workers into non-contributory income support programmes. The scheme was implemented in April 2020, with the benefit level set at BRL 600 (Brazilian reals) (int'l dollar 120) per worker initially, which later decreased in subsequent iterations. Importantly, the income threshold for access to the programme was raised to three times the minimum wage per household. As a result, millions of informal workers who lost their income because of restrictive measures adopted during the COVID-19 crisis gained access to the programme. Subsequent research

has shown that this initial phase of the AE lifted 13 million Brazilians out of poverty and reduced inequality by offsetting poverty among Afro-descendant and indigenous people in the country (Lusting and Trasberg, 2021<sup>[3]</sup>).

South Africa's COVID-19 Social Relief of Distress (SRD) Grant also initially incorporated informal workers. The South African government introduced the grant in April 2020. The eligibility criteria excluded those in formal employment, those aged under 18 years and over 59 years, those in receipt of any other grants or Unemployment Insurance Fund (UIF) benefits, and those in receipt of a stipend from the National Student Financial Aid Scheme (NSFAS). In this way, the SRD Grant partially addressed a large gap in the social security system by including those of working age in the informal economy. This iteration of the SRD Grant came to an end in April 2021 and was re-introduced subsequently with income threshold eligibility criteria which generally exclude informal workers. Research indicates that the initial design of the SRD Grant had positive economic impacts, including: (i) an increase in customer demand for the goods and services provided by informal traders, (ii) support for informal businesses, enabling them to survive in an environment of extreme economic stress and even to build businesses, and (iii) support for the circulation of people, goods and money, thus stimulating higher transaction intensity in different sectors and across value chains (Plagerson et al., 2023<sup>[4]</sup>). At ZAR 350 (South African rand) (int'l dollar 20 per month ) the SRD Grant was too small to reverse many of the negative impacts of the COVID-19 economic crisis, but it was assessed to have acted as an effective shock absorber, indicating the potential for such interventions to support informal workers and local economies over the longer term (Plagerson et al., 2023<sup>[4]</sup>).

## Extending contributory schemes to informal workers

Contributory social protection schemes constitute a key element of the extension of social protection to informal workers. Contributory schemes are based on the payment of contributions by workers and, in the case of employees, by their employers, which gives rise to acquired rights. As such, these schemes play an important role in the financing of social protection systems and can reduce the fiscal pressure on a government budget by offering a reliable and stable financing mechanism. Moreover, the level of protection offered by contributory schemes is usually higher than for many non-contributory schemes.

In most developing and emerging economies, contributory scheme coverage remains, by definition, limited to formal employees assuming a defined employment relationship based on a written contract and remunerated through regular wages, and with contributions typically shared between workers and employers. However, several contributory schemes also include other categories of workers, such as employers and own-account workers (ILO, 2021<sup>[5]</sup>).

A crucial step in the extension of contributory social insurance to informal workers has been the extension of social and labour rights to domestic workers through a combination of legal reforms and enforcement and simplification measures; the inclusion of self-employed workers in social insurance schemes through adapted mechanisms and simplified registration, tax and contribution payment mechanisms; the adaptation of contribution calculation and payment modalities to the capacities of workers and employers; and the use of digital and mobile technology to facilitate access to social protection.

As countries look at ways to extend contributory schemes to informal workers, they need to address several questions. One question is whether the extension of contributory schemes can be linked to an identifiable employment relationship between an employer and a dependent worker so that co-payments from the side of both employers and employees could presumably be an option. Another question is whether potential contributors may have the contributory capacity to enrol in contributory schemes. There is also the question about the extent to which the extension of contributory schemes can be best achieved through voluntary or mandatory enrolment.

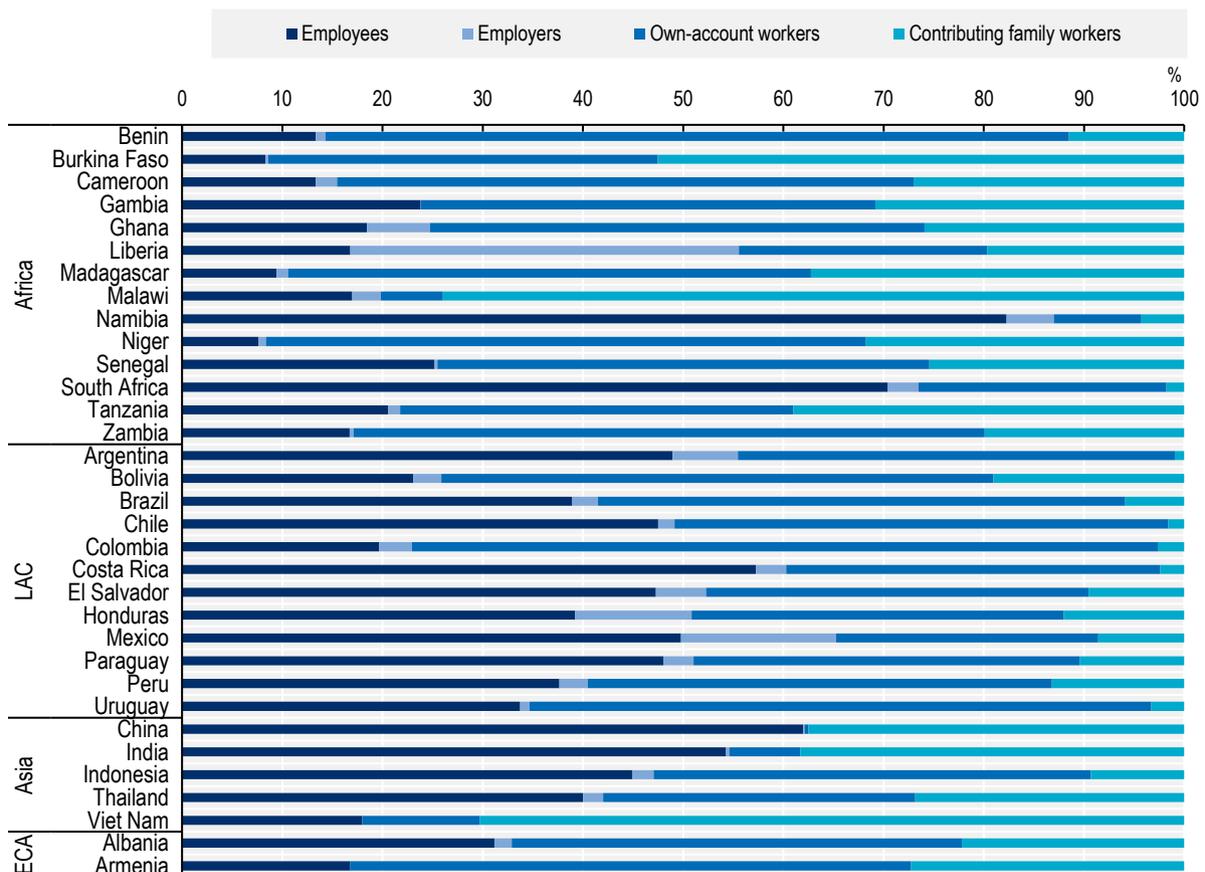
Finally, in contexts where a significant number of informal workers live with formal workers and where transitions into and out of informal employment may take place, the extension of social insurance to informal workers through other household members who are formally employed and the portability of contributory schemes throughout the life cycle of workers need particular attention.

**While a large share of informal workers do not have co-payment possibilities, the scope exists for employer or employee contributions for certain types of informal workers**

Status in employment is an instructive indicator for examining which actors should have responsibility for paying for the extension of social insurance to informal workers. As shown in Figure 6.8, a large share of informal workers in KIIbIH countries are own-account workers (39.0%) with no co-payment possibilities.<sup>3</sup> However, another significant share of the informal worker population is composed of employees (32.5%) for whom co-payments from the side of both employers and employees could theoretically be a possible option.

**Figure 6.8. Most informal workers are employees and own-account workers**

Distribution of workers by status in employment



Note: In Viet Nam, there is no way to distinguish between employers and own-account workers. LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Estimates based on (OECD, 2021<sup>[1]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIIbIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIbIH.htm>.

### ***The contributory capacity of informal workers appears limited overall, yet some informal workers have a contributory capacity at the individual or household level***

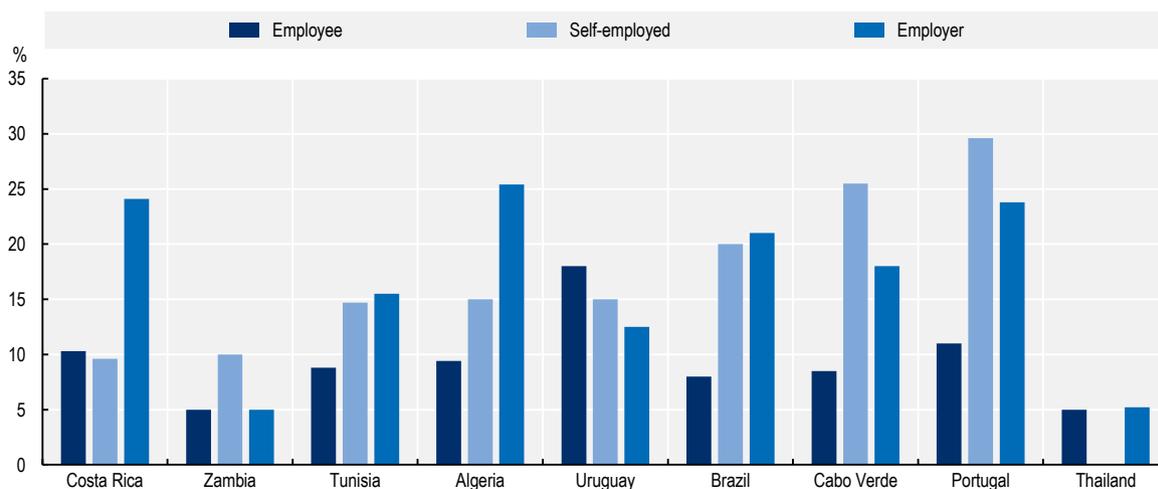
Recent experiences with the development of social insurance schemes for informal workers show that affordability issues need specific attention in the design of such schemes. Therefore, looking at the individual contributory capacity of informal workers as well as that of their household is critical. As shown in Chapter 2, information on the level of earnings of informal workers within the country sample indicates that a large number of informal workers have low earnings. These workers may lack the contributory capacity to pay for social protection, and contributory schemes would either have to be subsidised by the government and/or complemented with employer contributions when possible. However, a significant proportion of informal workers – between 18% and 90%, depending on the country – have medium or high earnings. As a result, these informal workers may have some individual capacity to contribute to social insurance schemes.

### ***The affordability of schemes is particularly challenging for self-employed workers***

The affordability of schemes for informal workers will also vary depending on their status in employment. A key issue for self-employed workers is the affordability of contributions. The fact that they do not have an employer who can share the cost means that self-employed workers are often required to contribute a higher share of their earnings to finance social insurance benefits. High contribution levels are particularly concerning, as many self-employed workers have low and often fluctuating incomes.

As a result, even when self-employed workers are legally entitled to access social insurance through voluntary or mandatory schemes, many of them are unable to afford contributions, which tend to be much higher – often twice as high – for self-employed workers than for employees (OECD, 2019<sup>[6]</sup>; OECD/ILO, 2019<sup>[7]</sup>). As Figure 6.9 shows, contributions from self-employed workers can often be higher than those paid by employees.

**Figure 6.9. Statutory contribution rates for formal workers, by status in employment, in selected countries**



Note: Rates are for statutory schemes covering workers in the private sector. Rates reported may not be comparable or fully representative, as rates may vary according to income level and degree of risk and may be assessed on different reference earnings. Flat-rate contributions are not included in the totals. When a range of rates is reported, the lowest value is included.

Source: Analysis in (WIEGO/ILO, Forthcoming<sup>[8]</sup>), based on International Social Security Association (ISSA) country profiles (2018-19).

### ***Various options exist to improve the affordability of contributions for self-employed workers***

To improve the affordability of contributions for self-employed workers, governments have pursued a range of strategies, including enabling a gradual scaling up of contributions, providing matching subsidies, adjusting contributions to income levels and facilitating the settlement of arrears. In Algeria and Uruguay, the government allows new self-employed contributors to begin contributing at a lower rate and then gradually increasing to the standard tax rates that apply (ILO/FAO, 2021<sup>[9]</sup>; Aguiar et al., 2023<sup>[10]</sup>).

In several cases, governments have provided matching subsidies. For example, in Mongolia, the government matches contributions of herders and other informal and self-employed workers at 13.5% of their declared earnings. In Costa Rica, the government implements a proportional matching subsidy, with rates that vary with the income of the contributor and an inversely proportional schedule of subsidies. Mandatory health insurance for self-employed workers requires contributions of 11,00%, and mandatory pension insurance for self-employed workers requires contributions of 7.75%. However, only those with earnings of more than ten times the minimum wage pay the full amount. Those earning around half the minimum wage only pay 3.75% for health insurance and 4.25% towards their pension. Between those two categories, there are five earnings categories, set as multiples of the minimum wage. As incomes grow, workers pay higher contribution rates and government subsidies decrease, while the totals always remain at 11,00% and 7.75%.

Members of Thailand's voluntary social security scheme for informal and self-employed workers (Social Security Fund Article 40) receive a contribution from the government, paid into their social security account. The government's contribution increases with workers' contributions. In the case of the most basic benefit package, workers pay a monthly contribution of THB 70 (Thai baht), complemented by THB 30 from the government. Those who opt into higher benefit packages pay THB 100 (with the government contributing THB 50) or THB 300 (with the government contributing THB 100) per month.

In Costa Rica and Mongolia, programmes to help self-employed workers settle social security arrears are likely to have helped bring back former contributors who had accumulated debt from periods when they had not made contributions. For example, in Costa Rica, the government has periodically implemented payment plans, moratoria and interest/fine cancellation, including following the COVID-19 crisis, when employers and self-employed workers were given 12 months to apply for cancellation of surcharges, interest and fines, which is expected to restore the rights of some 140 000 workers. In Mongolia, the Law on Repayment of Pension Insurance Premiums of Herders and Self-employed, implemented in 2020, enabled participants to settle arrears on favourable terms (including making back payments at a rate of 10% of the minimum wage). In Uruguay's social Monotax, accounts are frozen if registrants miss two months of contributions, but no late-payment interest is charged. The registration can be reactivated by paying the delayed contributions.

However, reducing contributions to address affordability challenges can have negative implications in terms of their adequacy, especially if not paired with subsidies that raise contributions to a sufficiently high level. In the case of Uruguay's Monotax, subsidised contribution rates enable low-income informal workers to access benefits that are limited when compared with those offered by the standard social security system. In particular, Monotax registrants note the low value of retirement benefits and occupational injury benefit. Members of Thailand's Article 40 scheme for self-employed workers also perceived the value of their benefits to be inadequate, especially regarding the scheme's sickness benefit and compared with the scope and quality of benefits offered to formal sector workers.

Low levels of adequacy appear to be a particular issue in stand-alone schemes for informal or self-employed workers when compared with countries where such workers can access the general social security system with rights and entitlements comparable to those of formal employees. ILO supervisory bodies have generally observed that schemes based on the capitalisation of individual savings fall short of

International Labour Standards on Social Security, in particular the principles of solidarity, risk sharing and collective financing, as well as the predictability of benefit levels (ILO/WIEGO, 2023<sup>[11]</sup>).

The low and often fluctuating earnings of most informal workers mean that the integration of informal workers in schemes not based on the principles of solidarity, risk sharing and collective financing will likely result in inadequate benefits. A recent evaluation of Rwanda's Ejo Heza long-term savings scheme highlights the challenges of achieving adequate pension levels for informal workers through voluntary savings schemes alone. The authors calculate that annual savings rates would have to increase by a factor of four to five – and be paid consistently for at least 25 years – in order to provide pensions equivalent to the poverty line for 240 months (Guyen and Jain, 2023<sup>[12]</sup>). The capacity of general social insurance schemes to generate adequate and predictable benefits through solidarity, risk sharing and collective financing heightens the importance of reforms seeking to ensure their inclusiveness for informal workers.

***For certain contributory programmes, the affordability of schemes can also be influenced by the level of household income***

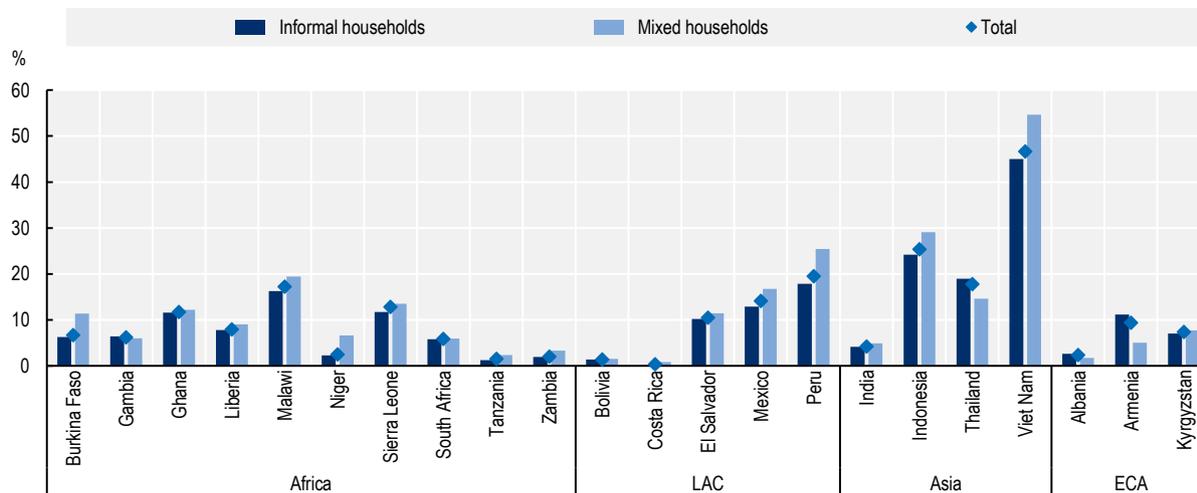
The contributory capacity to enrol in contributory schemes may also depend on household income, at least for some specific schemes such as health insurance. Examining the income category of informal workers is therefore essential. Evidence from KIIbIH data suggests that some informal workers live in non-poor households. Of these “non-poor” informal workers, between 27.7% (Zambia) and 94.8% (Sierra Leone) are in the middle or affluent class and could potentially be enrolled in non-subsidised contributory schemes if such schemes were available and/or enrolment compliance improved (Figure 6.7). Yet, between 8.8% (Zambia) and 50.4% (Uruguay) of informal workers are in the “near-poor” category and would most likely need to be supported through subsidised contributory schemes, as their contributory capacity to pay contributions on a regular basis may not be sufficient.

Remittances may also influence the contributory capacity of informal workers at the household level. They enable households to finance voluntary contributory schemes (Kolev and La, 2021<sup>[13]</sup>) and act as an informal insurance (Beuermann, Ruprah and Sierra, 2016<sup>[14]</sup>; Geng et al., 2018<sup>[15]</sup>). Relatively well-off recipient households may use the funds to participate in formal contributory schemes. In the case of Colombia, for instance, recent evidence shows that remittances are an important source of income that increases enrolment in contributory social insurance schemes among informal workers (Cuadros-Meñaca, 2020<sup>[16]</sup>). Moreover, remittance receipts can provide useful information to governments on the capacity of households to contribute to social insurance schemes such as health insurance.

An important question, therefore, is to what extent and under which conditions informal workers who receive remittances and who do not qualify for social assistance may be willing and able to channel some of their resources towards enrolling in formal social insurance schemes. According to KIIbIH data, 10.5% of informal workers live in a household that receives remittances and that is food secure (Figure 6.10). This suggests that the development of social insurance schemes targeting middle-class informal workers who receive remittances may be worthwhile.

**Figure 6.10. Informal workers who receive remittances have some capacity to pay for social protection around 2018**

Percentage of informal workers living in households that receive remittances and which are food secure



Note: Capacity to pay is estimated based on household food security (share of household consumption or expenses on food are less than 50%) and non-poor status (based on national poverty lines). Informal workers living in mixed households are those living with at least one other household member who is working in formal employment. LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Estimates based on (OECD, 2021<sup>[1]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIbIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIbIH.htm>.

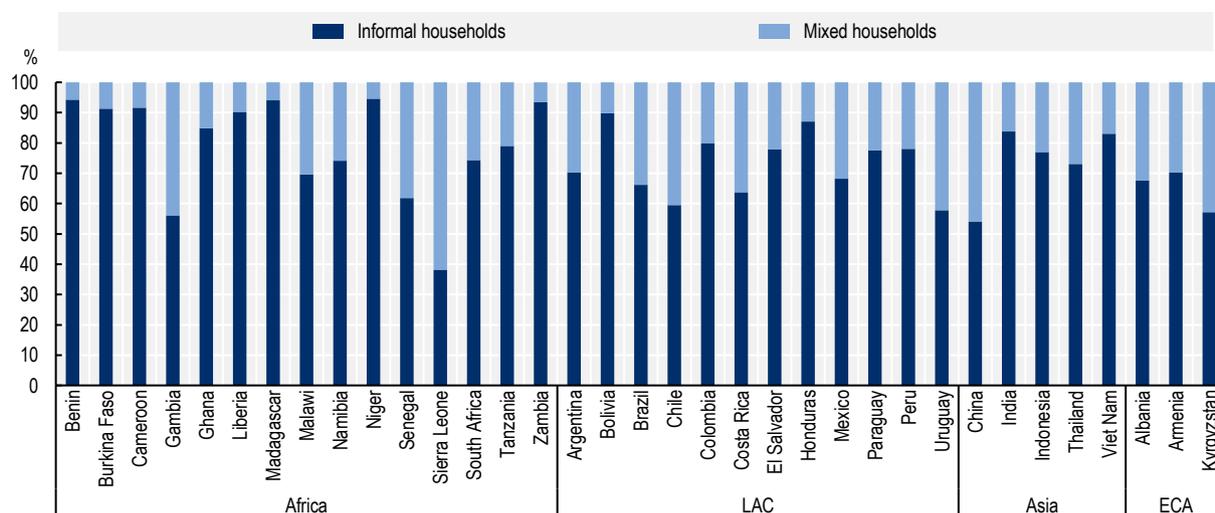
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### ***A small share of informal workers could be covered through formally employed household members***

Looking at the presence of formally employed workers in informal workers' households can also yield useful information for the extension of social protection to informal workers. In principle, a small share of informal workers could benefit indirectly from the social protection coverage provided by formally working household members. One-quarter of informal workers live in households with other formal workers (so-called "mixed households"; 24.9%, Figure 6.11) and could presumably be covered indirectly by certain social protection schemes that they would not otherwise have access to (such as health insurance and old-age pensions). In LAC, for example, certain programmes like survivor pensions are paid for through contributions from the formal worker's salary but can benefit any informal workers who were part of the household unit when the formal worker passed away.

**Figure 6.11. Informal workers are more likely to live with others who work in the informal economy, rather than with formal workers**

Distribution of informal workers by degree of household informality



Note: LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

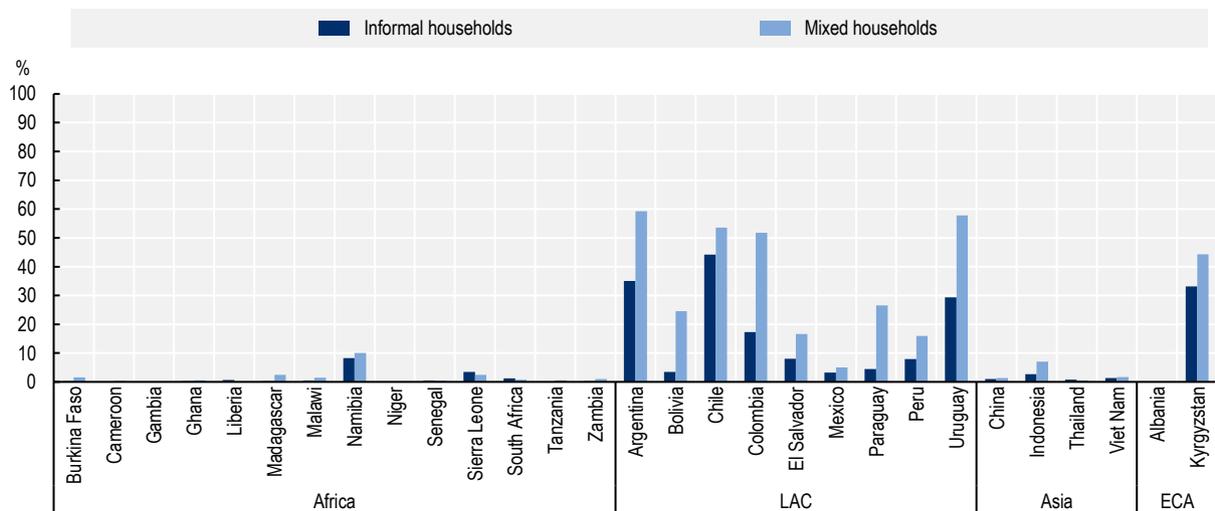
Source: Estimates based on (OECD, 2021<sup>[11]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>.

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Indirect access to social insurance through other formally working household members can be seen in, for example, health insurance coverage for informal workers. In a few countries, employment-based health insurance enables formal workers to add household members to their insurance plans, effectively covering them where they might not be entitled to any other insurance (Figure 6.12). According to KIIBIH data, health insurance coverage for informal workers in mixed households is higher than coverage for informal workers in informal households across many countries: for example, in Argentina, 59.2% of informal workers in mixed households benefitted from some form of employment-based health insurance coverage compared with 35.0% of informal workers in informal households. The findings are similar for Indonesia (7.0% in mixed and 2.6% in informal), Kyrgyzstan (44.3% in mixed and 33.2% in informal) and Namibia (10.1% in mixed households and 8.2% in informal households).

**Figure 6.12. Social protection for formal workers can benefit informal workers in mixed households**

Percentage of informal workers covered by employment-based health insurance



LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: Estimates based on (OECD, 2021<sup>[1]</sup>), *Key Indicators of Informality based on Individuals and their Household (KIbIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIbIH.htm>.StatLink  <https://stat.link/zt3xg0>

However, a social protection strategy based solely on the potential for informal workers to benefit from the coverage of formal workers may also come with some adverse incentives for formalisation and may not take into account the fact that informal workers tend to live only with other informal workers. Moreover, not all social protection programmes benefitting formal workers (contributory programmes) can be opened to other household members.

### ***Although limited, employment transitions into and out of informal employment call for the portability of social insurance benefits***

While this does not describe most of the workforce, some individuals tend to transition between status in employment and into and out of informal employment and the workforce (Chapter 3). As a result, provisions that allow workers to carry benefit entitlements across formal and informal forms of employment can reduce the likelihood that workers will lose their entitlement to social protection after transitioning to another job opportunity. Moreover, contributory social protection should be designed in such a way that it is able to manage workers' fractional contribution histories and additional payments at one point in time, so that workers are able to obtain access to benefits that have been paid for through both contributory and non-contributory schemes.

Overall, these results confirm that countries do have opportunities to develop strategies to extend contributory social protection to informal sector workers, and that these strategies need to take specific challenges and constraints at the individual or household level into account. Aside from the barrier of affordability and co-payment possibilities, some informal workers may be living in a household that comprises only informal workers, whereas others may be living in a household where at least one of the members has a contract in the formal economy. Other challenges include the fact that some informal workers may face difficulties in meeting administrative requirements; other categories of informal workers may simply not be covered by the applicable legislation; or the social insurance schemes may not be adapted to the specific needs of informal workers in different work and household environments. Finally,

when specific contributory schemes are made available to informal workers, the level of benefits may be considered too low to make the schemes attractive.

### ***Important lessons can be drawn from country experiences in extending social protection to self-employed informal workers***

Despite these challenges, efforts by governments to expand contributory schemes to informal workers are gaining traction around the world. Lessons about what works to extend contributory social protection to informal workers can be learned from such attempts across a range of criteria, including affordability, attractiveness, access, awareness and association (ILO/WIEGO, 2023<sup>[11]</sup>). Table 6.1 provides a summary of ten short case studies collected by WIEGO and the ILO showcasing innovations in social insurance to better cover self-employed informal workers.

**Table 6.1. Innovations in social insurance for self-employed informal workers in ten countries**

Country	Scheme	Description and innovation
Algeria	Caisse nationale de sécurité sociale des non-salariés (CASNOS), or National Social Security Fund for Non-Wage Earners	In Algeria, CASNOS demonstrates the effectiveness of a long-established mandatory scheme for self-employed workers – supplemented by other government policies to encourage formalisation – in continuing to improve access through an online portal, which allows members to check their account and status, declare their activities and contribution base, consult their career statements, make payments online, and request documents. To improve affordability, new affiliates with the scheme can gradually increase their contribution levels and formalise their professional situation over a period of three years, allowing them time to adapt to the welfare impact of a contribution, thereby smoothing the transition from informal to formal employment.
Brazil	Previdência Rural (Rural Pension) scheme and Simples Nacional monotax regime	The expansion of the rural pension in Brazil has ensured that many rural workers will now benefit from affordable and accessible social insurance. Meanwhile, the introduction of the Simples Nacional monotax regime – which has facilitated a simplified system for tax calculations, declarations, and collection – and its accompanying attractive benefits has led to the improved access and affordability of social insurance. In 2017, 4.9 million micro and small enterprises (MSEs) were reported to have applied to the Simples Nacional regime, and between 2009 and 2015, the percentage of individual micro-entrepreneurs registered increased from 33.0% to 41.7%. However, there continue to be challenges with this approach, including the low levels of contributions requiring significant subsidisation by the government, the challenge of ensuring that incentives for enterprise growth re preserved, and the continued existence of high tax evasion.
Cabo Verde	Compulsory social insurance under Instituto Nacional de Previdência Social (INPS) and proactive outreach activities	In Cabo Verde, more than one-half of economically active people aged 15 years and over are contributing to social insurance. Social security coverage expanded from 39.8% to 55.3% between 2016 and 2020. Compulsory social insurance is complemented by affordable options for low-income workers. Attractive benefits have encouraged formalisation and the uptake of social insurance, and the reduction of administrative barriers has improved access. Efforts to expand coverage have been complemented by advocacy and association measures and broad approaches to awareness raising. These innovative strategies are accompanied by proactive efforts by the government to increase awareness of social insurance across the wider population. For this, TV programmes, radio shows, newspaper articles, workshops, and building alliances with self-employed workers' organisations are utilised.
Costa Rica	Mandatory insurance for the self-employed under the Caja Costarricense de Seguro Social (CCSS), or Costa Rican Social Security Fund, and collective insurance agreements	Between 2005 and 2009, registration for health insurance by the self-employed in Costa Rica increased from 30.5% to 59.9%, and registration for pensions increased from 15.9% to 44.8%. This case demonstrates the effectiveness of mechanisms to ensure the affordability of social insurance for workers, particularly the use of government subsidies for those with low contributory capacity. The establishment of collective insurance agreements which consider the productive activity of the worker to determine contributions and facilitate access by enabling co-operatives to collect and transfer the contributions of their members is an innovative strategy to expand coverage of social insurance schemes to self-employed workers, particularly for rural workers. These efforts are supported by the imposition of mandatory health and pension insurance as well as investments in human resources which further promote enforcement.
Mongolia	One-stop shop and subsidies for informal self-employed workers	Mongolia is a good example for governments committing to expanding access for informal, self-employed workers in a context that is characterised by geospatial and logistical challenges. The innovative consolidation and simplification of social security services

		through one-stop shops has facilitated access to social insurance for Mongolia's widely dispersed population. The introduction of mobile technologies and non-cash-based contribution payment methods provide innovative examples for expansion. Specific efforts have been made to ensure that social insurance is affordable. Such efforts have been complemented by advocacy and association efforts, in particular engaging with herders' co-operatives.
Portugal	New benefits for the self-employed and clarifying "economic dependence"	The case of Portugal demonstrates how the creation of a new scheme with attractive benefits and amendments to eligibility requirements can increase coverage of social insurance schemes. This case also exemplifies how the recognition of a sub-category of the self-employed can provide affordable social insurance through a rebalance of social insurance contributions between a self-employed worker and a contractor in a fairer way. The classification of "economically dependent self-employed" workers as a sub-category of the self-employed is used as an innovative strategy to effectively facilitate the co-contribution to social insurance by workers and contractors.
Thailand	Voluntary access to Social Security Fund (Article 40)	Thailand's Article 40 scheme allows self-employed workers to voluntarily join the country's Social Security Fund. Workers can choose between different contribution and benefit packages, starting with sickness, disability and survivors' benefits and including a lump sum old-age benefit and a child allowance for those contributing more. Affordability and level of benefits is improved by a subsidy provided by the government that increases with workers' contributions. Few documentation requirements and multiple access points, including convenience stores, ensure accessibility. Despite being in existence since 1990, coverage under Article 40 remains low and challenges with maintaining regular contributions persist, likely due in part to the scheme's voluntary nature.
Tunisia	Ahmini ("Protect Me") scheme	Tunisia is a rare example of an attempt at incorporating gender-responsive elements into social insurance extension mechanisms by making social security contributions accessible for informal and self-employed women workers. The Ahmini scheme demonstrates innovative uses of mobile technology to facilitate the inclusion of informal workers with high illiteracy rates, and further utilises ambassadors and volunteers to reduce administrative barriers and to raise awareness. The scheme was recently interrupted, and participants were transferred to an existing scheme for low-income workers. However, the scheme nonetheless provides instructive insights into the challenges and potential solutions for rural workers, particularly women, on irregular incomes.
Uruguay	Simplified tax and contribution regimes – <i>Monotributo</i> and <i>Monotributo Social</i>	Uruguay's level of informal employment is the lowest in Latin America, with significant reductions in informality over the last decades. A key factor in this is the emergence of the <i>Monotributo</i> regime. <i>Monotributo</i> , established in 2001 and expanded in 2006, is a simplified regime that combines social security contributions and income tax in a single payment. Self-employed workers can register as personal enterprises with no more than one employee, partnerships with up to two partners or family businesses with up to three partners and no employees. Monotax registrants cannot operate from more than one small business location, must be providing their services or products exclusively to end consumers, and have an annual income of up to USD 20 000. Since 2011, the <i>Monotributo Social</i> targets low-income self-employed workers. Under both the <i>Monotributo</i> and the <i>Monotributo Social</i> , contributions are calculated based on a presumptive monthly income. Benefits include access to retirement pensions, sickness pay, occupational accident insurance, maternity/paternity leave and child benefits.
Zambia	SPIREWORK and Extension of Coverage to the Informal Sector (ECIS) pilot schemes under the National Pension Scheme Authority (NAPSA)	Zambia is a potential good practice example of the inclusion of informal – including self-employed – workers in a low-income context, through increased affordability and awareness. The introduction of pilot schemes implemented by NAPSA demonstrates the use of innovative strategies, including a mix of short-term and long-term benefits; an e-registration platform; easily accessible payment and balance information; the alignment of contributions to seasonal income flows; advertisement and awareness raising through pamphlets and roadshows; and a proactive engagement with organisations of informal workers. The roll-out of the new informal sector schemes has been delayed due to the COVID-19 pandemic and publicly available data on coverage rates and impacts are scarce. The Government of Zambia has expressed a clear commitment to enabling informal (including self-employed) workers to exercise their right to social security.

Source: (WIEGO/ILO, Forthcoming<sup>[8]</sup>), *Inclusive social insurance – exploring real solutions to reach the self-employed*.

The affordability of schemes has been addressed by governments through several strategies, including a gradual increase in contributions for newly contributing workers; a reduction in contributions either by lowering the rates or removing a contribution and possibly by making contributions income dependent; providing matching subsidies; providing top-ups for care credits; and facilitating the settlement of arrears.

However, lowering contributions as a single strategy may result in inadequate benefits so that the attractiveness of the scheme to workers is compromised.

Matching subsidies from the government can play an important role in ensuring the adequacy of benefits while maintaining affordability. Costa Rica's Social Security Scheme 'CCSS) provides progressive matching subsidies according to income levels in order to ensure greater inclusion of low-paid workers in the informal economy. Another less well-explored strategy is to derive co-contributions from economic actors other than employers within the value chains in which informal workers are embedded. For example, waste pickers in Argentina are exploring ways in which to leverage extended producer responsibility legislation in order to generate finance designed to improve working conditions and social protection coverage (Cappa et al., 2023<sup>[17]</sup>). In India, the same sector has been successful in making claims for social protection benefits from various actors in recycling value chains, including municipalities, citizens and businesses (Chikarmane and Narayanan, 2023<sup>[18]</sup>). Such co-responsibility for financing has also been observed in Portugal for "economically dependent" self-employed workers, which are workers who receive more than 50% of their income from one contracting entity, such as certain gig and platform workers.

Contributions and benefit levels across schemes should be designed to ensure that incentives towards underdeclaration of income, disguised employment and illicit registration are minimised. In Brazil, steep increases in contributions between the individual micro-entrepreneur regime, the monotax regime and the general tax regime, while social protection benefits remained similar across all three, meant that there was little incentive in place for businesses to increase contributions as they grew (ILO, 2019<sup>[19]</sup>). In 2018, the country implemented a new, progressive tax schedule to address this issue.

While the affordability of contributory schemes is an important consideration for low-income workers, this is not the sole barrier to uptake. The attractiveness of benefits is an important area for consideration in the design of contributory social protection. In Thailand, an ILO (2022<sup>[20]</sup>) study noted that contributions to the voluntary Article 40 Social Security Fund fell well within the average savings capacity of more than two-thirds of the working age population. Nonetheless, membership in the scheme remains much lower than the proportion of the population who should have sufficient savings capacity to participate. Qualitative investigation into perceptions of the Article 40 Social Security Fund among informal workers found that key reasons for the lack of uptake included the benefits not being considered sufficiently attractive, concerns about administrative barriers and a lack of knowledge about the scheme.

One common strategy is to combine long-term benefits (such as pensions) with short-term benefits in order to provide benefits that are immediately relevant. This combination was the case for all of the countries listed in Table 6.1, with old-age benefits most commonly combined with disability and survivors' benefits. Maternity benefits and health insurance were also common short-term benefits, and in the case of Zambia, a weather index insurance was included in order to enhance the attractiveness of the benefits for small farmers.

Countries have also experimented with the inclusion of incentives aimed at MSEs in addition to a mix of social security benefits. In Cabo Verde, the Regime Especial das Micro e Pequenas Empresas (REMPE), or Special Regime for Micro and Small Companies, provides a favourable tax regime to MSEs, with a 30% reduction in taxes for the first year of membership and a 20% reduction during the second year. Subsidies for personal income tax (PIT), value added tax (VAT), fire tax and social security contributions (SSCs) for employees are also available.

Simplified registration and benefit claim procedures can be found in many countries as a strategy to improve access to contributory social protection. Brazil and Uruguay have implemented monotax schemes for specific groups of workers, where a single payment covers both tax and SSCs. See Box 6.2 for a more detailed discussion of business-related incentives in Uruguay. Brazil has also reduced the documentation requirements for registration and benefit claim procedures. Mongolia uses one-stop shops where workers can access a range of social security services, including mobile services for workers unable to travel and herders unable to leave their livestock.

Tunisia's Ahmini ("Protect Me") scheme – affiliated to the Caisse Nationale de Sécurité Sociale (CNSS), or National Social Security Fund – provides insights into how to effectively use innovative technology to improve access to contributory social protection and facilitate contribution collection. The scheme specifically targeted low-income women working in agriculture, drawing on partnerships with telecommunications enterprises to provide an online application and payment service to members. In order to enable greater accessibility in a context of low literacy, the application could also operate through voice activation. In addition, community volunteers and "ambassadors" supported the collection of documents and the distribution of social security cards to those unable to use the mobile technology. This highlights the importance of offering flexibility and choice, with both manual and online options in place for registration and benefit claims.

Self-employed workers are not necessarily well informed about their social protection rights and obligations, and they are often underrepresented in processes that determine social protection rights and entitlements. The two challenges, and the solutions to address them, are mutually reinforcing: raising awareness about social security often requires the active engagement of community members, and vice versa. Several case studies, notably Cabo Verde, facilitated awareness raising through carefully designed and targeted communications campaigns. Government actors in Mongolia, Tunisia and Zambia have engaged with workers' organisations, and in Costa Rica, the use of collective insurance agreements stands out among the case studies as perhaps one of the most distinctive approaches to engaging self-employed workers and their representatives in the management of their schemes. For nearly 40 years, the CCSS in Costa Rica has enabled workers' co-operatives to collect and transfer contributions on behalf of workers.

The design of extension strategies often hinges on two key issues: first, whether to make schemes mandatory or voluntary, and second, whether to integrate schemes for self-employed informal workers into mainstream social protection schemes or to develop them separately. On the first issue, the case studies presented here point towards mandatory coverage being more effective (Brazil, Cabo Verde, Costa Rica and Uruguay). Voluntary schemes in Mongolia and Thailand were less successful in expanding coverage. However, the case studies also offered some evidence that mediating factors – such as the type and quality of benefits on offer, the degree and type of enforcement, and the existence of incentives – also had an impact on whether schemes were successful or not. Moreover, in the most successful case studies, extension was integrated into a wider whole-of-government approach to reducing informal employment. Where participation is mandatory, it must be accompanied by adequate investment in enforcement, as well as affordability and accessibility.

On the second issue, the case studies presented here tended towards the incorporation of self-employed workers into mainstream schemes, rather than creating separate schemes. However, there was wide variety and nuance in these two approaches. In several countries (Algeria, Cabo Verde, Costa Rica, Mongolia and Portugal) where self-employed workers were incorporated into the general scheme, specific mechanisms were put in place to encourage access for the self-employed. Conversely, in Brazil, Thailand, Uruguay and Zambia, separate schemes were established with specific adaptations for the self-employed, but within the institutional framework of the general system. This suggests that the reality is more nuanced than simply choosing between integrating self-employed workers into mainstream or specific schemes.

### Box 6.2. Uruguay's Monotributo and Monotributo Social regimes: An informal worker perspective

Uruguay's Monotributo and Monotributo Social schemes represent the best-known examples of expansion of social protection to self-employed workers, who make up 26-29% of the country's total workforce (Abramo, 2022<sup>[21]</sup>). The Monotributo is a simplified regime that combines SSCs and income tax in a single payment. The regime covers MSEs with no more than one employee, up to two partners, or family businesses under limited conditions. The more recently implemented social Monotax scheme covers households below the poverty line or those in a situation of socio-economic vulnerability as defined by the Social Security Institution and who do not employ others within their business (i.e. they are own-account workers).

Several studies have described the institutional arrangements of the Monotributo regimes, but few studies (if any) have focused on the motivations and experiences of self-employed informal workers, a situation corrected by recent research from Aguiar et al. (2023<sup>[10]</sup>). Such studies are important because although the Monotributo regimes are in many ways success stories, coverage is still limited to between 14% and 23% of the target population. Better understanding the perspective of informal workers may help to develop further innovations to increase access. The findings of the research cut across the dimensions of affordability, attractiveness, access, awareness, and association.

**Affordability:** Efforts have been made to keep the minimum contribution for both regimes relatively affordable, and under the Monotributo Social scheme, participants can begin at a reduced rate, gradually increasing contributions over a four-year period. While some interviewees stated that in general the payments were not considered too high, several also mentioned that it was sometimes difficult to pay in months with low earnings. Monotributo Social registrants further emphasised that payments could become onerous on reaching the full payment amount. This is related at least in part to the fact that while the Monotributo Social scheme reduces informal employment, it does not necessarily increase job security, meaning that precariousness remains pervasive.

**Attractiveness:** In general, the workers consulted felt satisfied with being Monotributo registrants, identifying themselves with pride. The primary reason for registering under the regimes was to leave informal employment, mainly out of obligation or to gain access to new clients. In the period since the creation of the regimes, there has been a change in the general business environment in Uruguay, with a growing demand for formality. Many workers mention an improvement in the quantity and quality of customers, and other benefits such as peace of mind in the face of tax inspections, access to banking tools, and a capacity to adapt to a growing demand for formality.

Social protection benefits include access to a pension, sick pay, occupational accident insurance, maternity/paternity leave and newborn care subsidies. These benefits were a secondary reason for registering according to study participants. Both the pension and maternity benefits were assessed positively, but in general there was a sense that the benefits were too limited, and the absence of an unemployment benefit was noted. More affordable health insurance contributions, and the ability to progress to higher-level payments, were two recommendations to remedy this situation.

**Access:** Most workers interviewed considered that the various improvements and adaptations made to the regimes since 2011 when they were introduced had increased accessibility. At present, the procedures to register are generally considered simple and can be completed either online or in person.

**Awareness:** The issue of lack of awareness and information regarding the schemes' benefits was raised repeatedly during the study. Even those who were registered often did not know that they had access to a family allowance, sick pay and occupational accident insurance. Many also did not know the amount of pension they would receive. The focus group discussions repeatedly saw participants

finding out about their benefits from one another. This suggests that there is great scope for more awareness raising and information campaigns.

**Association:** There was a strong sense that the regimes could do more to ensure greater worker representation in the schemes. It was argued that the schemes emphasise entrepreneurship status over worker status, individualising (and potentially also isolating) registrants. The regimes do little to contribute to a self-perception of registrants as workers or to promoting their involvement in the collective processes of organisation and ownership of the schemes.

Source: (Aguiar et al., 2023<sup>[10]</sup>), *Monotributo y Monotributo Social en Uruguay: Apreciaciones de trabajadores y trabajadoras monotributistas*.

Overall, across the case studies, the most common enabling factor was a strong institutional and governance framework. Strong institutions were cited in Algeria, Brazil, Costa Rica, Mongolia, Tunisia, and Uruguay, and were also significant factors in Cabo Verde and Portugal. After strong institutions, the legal and policy environment was highlighted as an important enabling factor in Brazil, Cabo Verde, Costa Rica, Tunisia, and Uruguay. Several of the case studies – specifically Brazil, Costa Rica, Mongolia, Portugal, and Uruguay – indicated high administrative capacity as a key enabler of success. Less frequently, but not less importantly, additional important enabling factors in each country included relatively high levels of trust in government or expressed willingness to contribute (Algeria and Zambia); the involvement of international actors (Mongolia and Zambia); and the strength of workers’ movements and organisations (Costa Rica). No single factor is sufficient to explain or enable success on its own, but rather worked in tandem with others, the strategies employed by governments and the idiosyncrasies of the unique historical, political, economic and institutional contexts and legacies of each country. But a combination of high institutional capacity, strong legal and policy frameworks, and high administrative capacity appeared to be powerful determinants of success in countries such as Brazil, Costa Rica and Uruguay.

## Financing the extension of social protection to informal workers

Closing the global social protection coverage gap, including for informal workers, requires a step change in financing strategies. According to estimates from the ILO and the Overseas Development Institute (ODI), the funding gaps for social assistance alone, and excluding healthcare, range from USD 34 billion to USD 36 billion per year (United States dollars) for all low-income countries. As a result of the COVID-19 crisis, the ODI estimates that nearly all low-income countries and some lower-middle-income countries will not be able to afford even one-half of the required costs by 2030 (Evans et al., 2023<sup>[22]</sup>).

Designing the domestic social protection system in a way that encourages informal workers with some contributory capacity to contribute (for example, through the schemes discussed in the previous section) could be one way to mobilise revenues and finance the expansion of social protection.<sup>4</sup> Supporting the inclusion of informal workers in social insurance schemes would not only provide higher levels of protection for previously excluded workers and their dependents, but also has the potential to increase their productivity and incomes through formalisation. However, even in the best-case scenario, the number of previously informal workers who register with the social security administration will only increase gradually. In order to achieve universal social protection, most governments will have to find strategies to mobilise significant tax revenue in addition to supporting the inclusion of informal workers in social insurance schemes. Additional tax revenue may be necessary to finance universal social protection floors or to design the type of contributory schemes that are both affordable and attractive and encourage informal workers to register.

### ***Sustainably funded social protection systems are challenging to build when informal employment is high, but several options exist***

High rates of informal employment suggest that relying mostly on the revenue generated from traditional contributory social insurance is not sufficient. As discussed in the previous section, few informal workers participate in contributory social protection schemes,<sup>5</sup> which implies that these systems generate neither enough revenue nor adequate coverage for informal sector workers. Relying solely on SSCs to finance a universal healthcare system does not appear to be a recommendable strategy from efficiency and equity perspectives according to several academic studies (Yazbeck et al., 2020<sup>[23]</sup>). Countries with high rates of informal employment may opt to first establish or expand social protection floors through universal non-contributory schemes that are financed by general tax revenue, which can be supplemented with contributory social protection schemes. While this approach may result in limited protection initially due to low tax revenue it may be the only feasible option for some countries (especially low-income countries) in the short term.

Over time, countries that have chosen this path can gradually increase the generosity of their social protection floors when they are able to collect more tax revenue and/or start introducing contributory schemes that would finance social services above the minimum floors. Countries that have chosen to finance a large share of their social protection system through general tax revenue will have to ensure that all individuals pay their fair share of general taxes. A large informal sector makes it difficult to raise the general taxation revenue necessary to finance adequate universal social protection benefits for all; informal workers who do not pay SSCs will also not file a PIT return; and a large informal sector will reduce the potential revenues from VAT and other indirect taxes.

Other countries might be able to provide universal social protection floor by further redesigning the existing contributory and targeted non-contributory schemes and by expanding their coverage to those currently lacking coverage. This may be a viable strategy in, for instance, countries where SSCs are paid by employees but are not paid by self-employed entrepreneurs. The preferred strategy has to be evaluated at the country level and will depend on country-specific structural features and options for reform. The strategy will also need to be dynamic in that it can and should adjust and change over time.

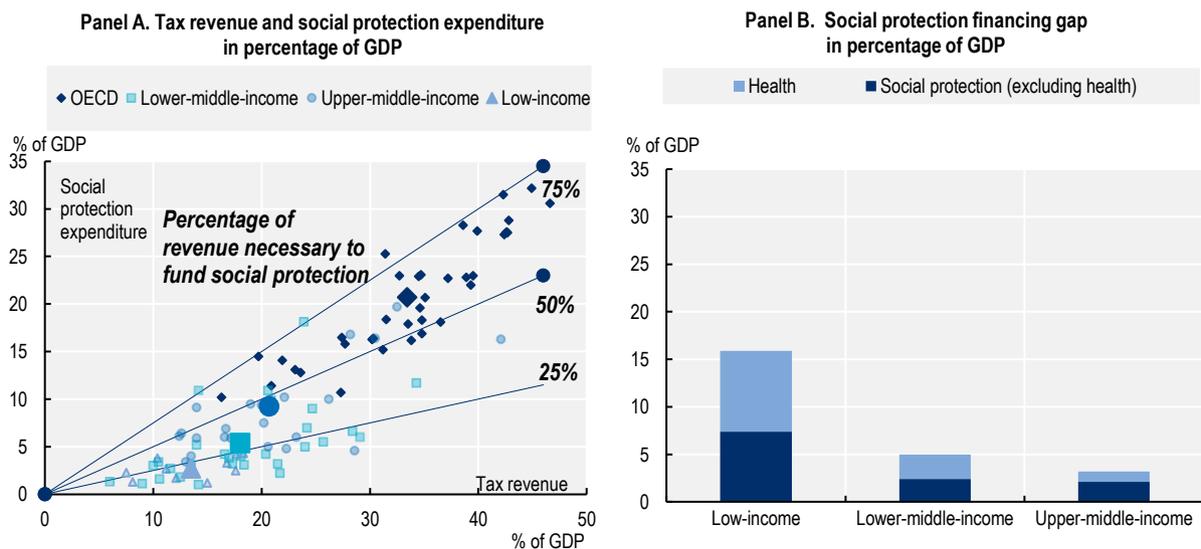
### ***Whatever the strategy chosen, developing countries will have to mobilise significant additional revenues to finance universal social protection***

Additional revenues will have to be raised primarily through the domestic tax system (including SSCs) in order to be sustainable in the long term. Indeed, only domestic government resources will provide the reliable stream of sizeable revenues that are independent from other countries' priorities and necessary to sustain and further expand social protection over the medium and longer term.

Reprioritising government expenditure and increasing spending efficiency will not be sufficient to close the substantial social protection financing gaps that can be observed in developing countries (Figure 6.13). For instance, the social protection gap is estimated to be around 15% of gross domestic product (GDP) for low-income countries and 5% for lower-middle-income countries (Figure 6.13, Panel B). To close the gap, many low-income countries would have to spend more than 75% of their tax revenues on social protection (Figure 6.13, Panel A), more than the expenditure of OECD member countries with a much larger tax revenue base.

Lower-middle-income countries would need to spend around 50% of their current tax revenue on social protection alone, which will not be possible considering other pressing spending needs. Even though spending reallocation can be part of the strategy to close the social protection financing gap, it will not be sufficient on its own.

Figure 6.13. Tax revenue, social protection expenditure and financing gaps



Note: Total tax revenues is shown as a percentage of GDP in 2019. Social protection expenditure in 2020 or for the latest available year is shown as a percentage of GDP. Includes domestic general government health expenditure obtained from the World Health Organization (WHO) (Panel A). The graph indicates the share of tax revenue that would be necessary to fund the current expenditure levels on social protection. Countries may also use other sources of funding such as debt or grants. Average financing gaps for achieving universal social protection coverage in 2020 are shown as a percentage of GDP.

Source: (ILO, 2021<sup>[24]</sup>), *World Social Protection Report 2020–22: Social Protection at the Crossroads – in Pursuit of a Better Future*; (OECD, 2022<sup>[25]</sup>), *Revenue Statistics 2022: The Impact of COVID-19 on OECD Tax Revenues*; and (Durán Valverde et al., 2020<sup>[26]</sup>), *Financing gaps in social protection*.

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Raising additional general government revenue will be a key component of most countries' strategies. The tax policy measures aimed at raising additional revenues need to be carefully chosen and accompanied by tax administration measures as well as by efforts to build a taxpayer culture. Tax measures implemented to close the social protection financing gap should ideally not harm other development goals (e.g. they should not place an additional burden on the poorest, or increase inequality) and should not come at the cost of other key development expenditure (such as on the education system).

The impact of tax measures on economic development and investment must be taken into account as well. Economic growth will be necessary to finance high-quality social protection in developing countries. In a context of low levels of GDP, mobilising a higher share of GDP in taxes to finance social protection will ultimately not be sufficient to finance high-quality social protection, especially in low-income countries. Take, for example, the average GDP per capita of a lower-middle-income country in 2021, which was around USD 2 500 per year. Even a tax-to-GDP ratio of 50% (i.e. around in monthly per capita tax revenues) would not be enough to finance high-quality healthcare, adequate pensions and other pillars of social protection in addition to other pressing spending needs (e.g. education and infrastructure) if the level of income does not change. Economic growth is therefore unavoidably part of a strategy to finance the expansion of social protection to the entire population in a developing and emerging economy. As a result, any tax and SSC reform that aims at raising funds to finance social protection should, as much as possible, avoid creating hurdles to economic growth. For instance, taxes that are generally less harmful to economic growth (such as property taxes and indirect taxes) may be preferred (IMF et al., 2016<sup>[27]</sup>).

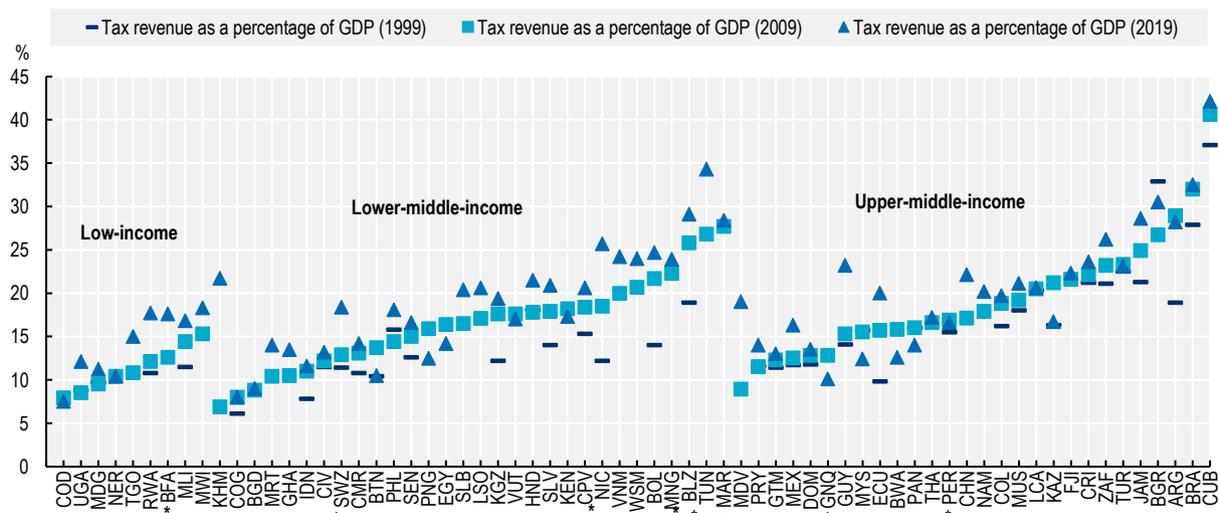
***There is significant potential to increase revenues in developing countries, but careful tax reforms are needed***

A preliminary frontier analysis (which compares current tax revenues to the estimated tax revenue frontier given a country's structural characteristics) reveals that there is significant room for increasing revenues in developing countries, even with the current level of income and informal employment. In low-income countries, the tax revenue frontier (i.e. the tax revenues attainable given a country's structural characteristics) is 5% of GDP higher than current revenue. These additional tax revenues are even larger in lower-middle-income countries, where they reach 9% of GDP on average. However, the tax revenue potential differs greatly across regions and countries.

Even if the theoretical potential for revenue growth is high, evidence shows that raising 5% of GDP – far below the actual financing gap in most low- and lower-middle-income countries – in additional tax revenue over a decade will already be challenging. Over the 1999-2019 period, fewer than ten developing countries in the OECD Revenue Statistics database managed to increase their tax-to-GDP ratio by more than five percentage points (Figure 6.14). According to the International Monetary Fund (IMF), increasing the tax-to-GDP ratio by five percentage points over a decade is an ambitious but feasible target for most developing countries (Gaspar et al., 2019<sup>[28]</sup>). Raising significant amounts of additional tax revenue over time in ways that are aligned with inclusive and sustainable economic growth objectives will require a country-specific tax reform plan that is carefully developed, implemented, and sustained over time.

Preliminary OECD analysis shows that, in countries with high informal employment, the short-term revenue potential is largest for indirect taxes such as VAT or sales taxes. Indirect taxes have the advantage of having a broad (and relatively inelastic) tax base. But increasing rates or broadening the base of indirect taxes to finance universal protection may increase the tax burden for the poorest members of society and could ultimately also have a negative impact on the size of the formal economy (by fostering the expansion of goods sold in the informal market). Recent evidence shows that, in some developing countries, poorer households mainly shop in informal markets, and thus consumption taxes are paid disproportionately by richer households, which offers an equity motive for relatively higher consumption taxes (Bachas, Gadenne and Jensen, 2020<sup>[29]</sup>). However, if the poorest members of society are not able to afford to pay the tax when they do consume (even a small fraction of their total expenditure) in the formal market, it would be an inadequate tool with which to finance universal social protection floors. Thus, the “affordability” of indirect taxes needs to be assessed with care depending on the country characteristics. One strategy to increase government revenue which limits the negative impact on the poor could be to decrease or abolish reduced VAT rates or VAT exemptions applied to non-essential goods and use the revenue to expand social protection programmes targeted at the poor. Tax expenditure reports typically show that the tax revenues forgone from reduced VAT rates and VAT exemptions are large in developing countries. Lastly, the paper trail generated by a VAT system leads to the fact that a greater enforcement of regulation upstream or downstream implies a higher probability of being formal (Ulyssea, 2020<sup>[30]</sup>).

Figure 6.14. Evolution of tax-to-GDP ratios between 1999 and 2019



Note: Stars under the countries' name indicate an increase in the tax-to-GDP ratio between 2009 and 2019 of more than five percentage points.  
Source: OECD Global Revenue Statistics Database, (OECD, 2022<sup>[25]</sup>), *Revenue Statistics 2022: The Impact of COVID-19 on OECD Tax Revenues*.

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Health taxes, environmental taxes, fossil subsidy reform and tax expenditure reform are frequently included in the list of tax measures that can contribute towards raising more revenue for social protection in developing countries. Health taxes and environmental taxes or subsidies are mentioned in the context of social protection financing because of their direct link with health and social protection. However, the link does not imply that tax revenue from these sources would automatically be earmarked for social protection expenditure (as is the case with SSCs). The advantages and disadvantages of earmarking these tax revenues would have to be discussed in their own right. Options for tax expenditure reform can be identified by analysing the forgone revenue and the effectiveness and distributional impact of the tax relief provisions in place in each country. Priority shall be given to reform tax expenditures that are ineffective at achieving their goal. For example, certain tax incentives have been shown to have a limited impact on attracting investment or fostering growth (IMF et al., 2015<sup>[31]</sup>). It is also important to consider the distributional impact of tax expenditures. Income tax expenditures are often regressive and benefit high-income households disproportionately, which may constitute a rationale for reform.

Due to high informal employment and a lack of information and enforcement in low- and middle-income countries, third-best tax policies (such as taxes on inputs and turnover, which are usually not recommended in OECD member countries) need to be considered and evaluated in low- and lower-middle-income countries (Kleven, Khan and Kaul, 2016<sup>[32]</sup>). Ideally, the tax rate for each type of tax should be set at (or just below) the revenue-maximising tax rate. This revenue-maximising tax rate can grow over time by limiting tax evasion behaviour through better tax enforcement (Bergeron, Tourek and Weigel, 2023<sup>[33]</sup>).

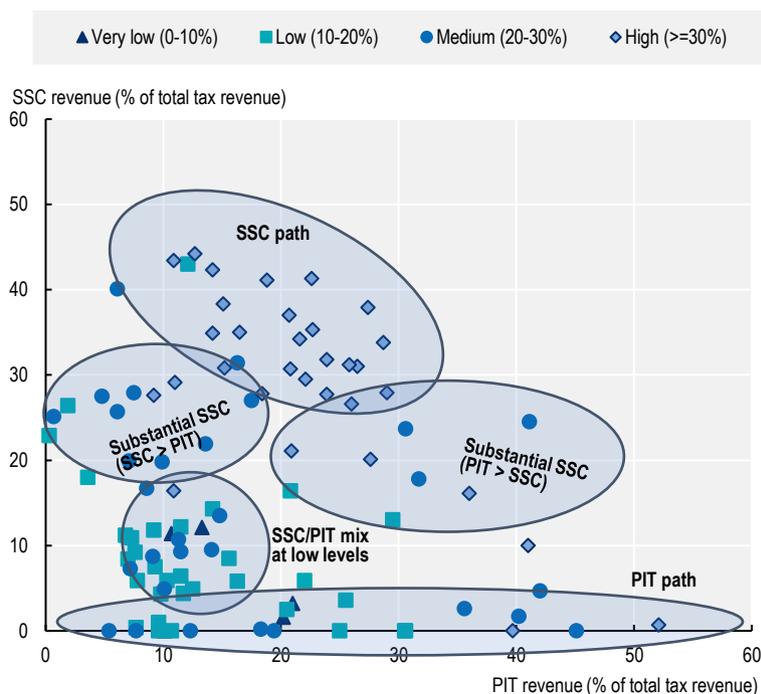
For each tax type, it is important to evaluate, at the country level, whether there is a potential to: i) increase compliance, ii) limit international leakages, iii) broaden the tax base and avoid domestic leakages, or iv) increase the rate or introduce a new tax. It is also key to evaluate the revenue potential of each tax measure. Such an analysis, at the country level, would be part of the four modules of the new Social Protection Tax Revenue framework (Box 6.4).

## Identifying the most suitable tax revenue sources is critical

In the context of high levels of informal employment, choosing the most suitable tax revenue sources involves additional trade-offs that need to be carefully balanced, including the challenge that the tax measures should not further hamper the employability of workers. Despite the more nuanced perspectives on informal employment that proliferate (see Box 6.3), fostering formal employment and the employability of the workforce continues to be an important task for developing countries. Many countries have large informal economies where workers are trapped in low-quality jobs without opportunities to upskill and grow into more productive jobs that potentially also provide for better social protection. Informal employment makes workers and their families vulnerable to economic shocks and adverse life events. Mobilising revenues to enhance social protection and using the available resources in the most effective manner needs to go hand in hand with policies that increase the number of informal workers who enter the formal economy and, indeed, policies that stimulate sustainable economic growth and formal work.

OECD member countries with comprehensive social protection systems tend to rely mainly on direct taxes and SSCs to finance social protection (Figure 6.15). SSCs account for around one-quarter of total tax revenue, and income taxes (corporate income tax (CIT) and PIT) for more than one-third. SSCs are taxes that are earmarked to finance social protection and, in many cases, there is a link between contributions made and benefits received (e.g. unemployment benefits, pensions). In a setting where taxpayers perceive SSCs as payments to themselves, either in the future or as an insurance, they may be more willing to comply with their tax obligations. This line of reasoning offers a strong argument for keeping SSCs in the social protection financing mix (instead of relying predominantly on PIT or indirect taxes to finance social protection, for instance). Maintaining a balance between employee and employer contributions is also desirable.

**Figure 6.15. Relative role of SSC and PIT revenues by tax-to-GDP ratio (clusters of revenue paths)**



Note: Countries are grouped by their tax-to-GDP ratio in 2019 (very low, low, medium, high). Includes countries represented in the OECD Global Revenue Statistics Database.

Source: OECD Global Revenue Statistics Database, (OECD, 2022<sup>[25]</sup>), *Revenue Statistics 2022: The Impact of COVID-19 on OECD Tax Revenues*.

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Most developing countries will likely eventually have to reorient their social protection financing towards SSCs. SSCs continue to play a key role in ensuring a basic level of protection, according to the ILO. One way to gradually increase revenue generation through SSCs could be to introduce presumptive tax regimes. Under such a regime, small businesses could be allowed to pay one single tax that replaces as many taxes as possible, including SSCs. The collecting body would redistribute the funds internally among the various institutions, including tax administrations and social security funds (Mas-Montserrat et al., 2023<sup>[34]</sup>).

### ***Social security contributions play a key role in financing social protection systems***

Despite persistent informal employment, revenue raised through social insurance contributions has remained stable or even increased since the early 2000s and represent a major source of financing for social protection systems. Globally, SSCs accounted for 18.8% of total taxation or 5.7% of GDP in 2019 (for countries included in the OECD Revenue Statistics Database). In 2019, high-income countries raised on average 8.6% of GDP and 24.9% of total taxation via SSCs. Percentages were lower but still substantive for upper-middle-income countries (3.3% of GDP and 15.7% of total taxation), lower-middle-income countries (2.6% of GDP and 10.6% of total taxation) and low-income countries (1.3% of GDP and 8.1% of total taxation). From 2000 to 2019, SSCs as a share of GDP increased by 0.7 percentage points globally. Perhaps contrary to expectations, social insurance contributions as a percentage of GDP increased more in regions with higher levels of informal employment, such as LAC, Africa and Asia, albeit from a lower base (Calligaro and Cetrangolo, 2023<sup>[35]</sup>).

Replacing SSCs with PIT in developing countries that already rely partly on SSCs is therefore often not an appropriate strategy. Countries that struggle to raise revenues via SSCs face similar challenges when raising PIT given that it is a similar tax base (Figure 6.15). Abolishing employer SSCs would result in a significant reduction in tax revenue in many middle-income countries. The assumption that there will be full compensation and that wage levels will increase by the amount that employer social contributions were reduced, is also strong if the perceived link between contributions and benefits is low (Korkeamäki and Uusitalo, 2009<sup>[36]</sup>; Kugler and Kugler, 2009<sup>[37]</sup>; Bozio, Breda and Grenet, 2019<sup>[38]</sup>).

Voluntary private contributions can be complementary, but on their own (even if matched) they will fail to deliver universal and adequate social protection. Voluntary subsidised contributions have been suggested as a strategy to boost pension savings from the informal “missed middle” who are neither covered by contributory schemes nor receive universal benefits targeted at the poor (World Bank, 2019<sup>[39]</sup>). Examples of country experiences in which voluntary private schemes, on their own, managed to achieve universal and adequate social protection do not exist because social protection systems feature a redistributive component and are put in place precisely to address failures of private markets (such as adverse selection and externalities).

### ***Attention is needed to ensure that greater financing for social protection systems does not increase the cost of formalisation***

As mentioned in the previous section, the introduction of presumptive tax regimes has been one tool with which to gradually increase the coverage of non-standard workers in contributory schemes while at the same time raising some revenue and supporting formalisation. Presumptive tax regimes are often seen as a formalisation tool for enabling small businesses and self-employed workers to gradually become fully formal. However, badly designed regimes may have the unintended effect of discouraging businesses from growing in order to avoid sharp tax increases once they are subject to standard CIT or PIT, and may also encourage self-employment (Melguizo, Bosch and Pages, 2017<sup>[40]</sup>). Recent work by the OECD Centre for Tax Policy and Administration presents an analytical framework that characterises country-specific presumptive tax regimes and identifies best practices for the design and administration of such regimes (Mas-Montserrat et al., 2023<sup>[34]</sup>).

The impacts of social protection systems on labour markets with high levels of informal employment remain a concern for some policy makers at the international and national level. Existing evidence, however, does not necessarily support claims that social protection causes informal employment (Box 6.3). While the impact of social insurance contributions and payroll taxes is also a concern,<sup>6</sup> studies have found mixed results. Reviewing the existing literature on the impacts of reduced or subsidised social insurance contributions on labour markets, Calligaro and Cetrangolo (2023<sup>[35]</sup>) showed that most studies found no significant employment effect.<sup>7</sup> In his extensive review of the literature on informal employment, Ulyssea (Ulyssea, 2020<sup>[30]</sup>) reported that reducing the tax burden can induce some formalisation, although the elasticity seems to be low. The results depend on the relative level of SSCs compared with the productivity of workers in the economy and are therefore country specific. But experiences of countries cutting contribution rates – as part of structural reforms of pension or tax systems, during stabilisation programmes, and during crises, or to support the labour market participation of specific groups – have generally been disappointing in terms of generating formal employment, but have generated significant costs (Calligaro and Cetrangolo, 2023<sup>[35]</sup>).

Indeed, the fiscal cost of diminishing contribution rates might be sizeable. For instance, Egebark and Kaunitz (2013<sup>[41]</sup>) studied the payroll tax cut for young workers in Sweden in 2007-09 and estimated the cost per created job by comparing the cost of forgone payroll tax revenues due to the tax reduction with the increased tax revenues generated by the estimated employment and wage increases. The authors claim that the cost for each new job that was created was more than four times that of directly hiring workers at the average wage. More generally, any reduction in social insurance contributions creates an effective loss in government revenue in the short term. (Ulyssea, 2020<sup>[30]</sup>) concludes that reducing the costs of formality, in particular related to tax, has significant formalisation effects, but in general is not strong enough to be cost-effective, and has very limited aggregate effects.

### Box 6.3. The evolving debate around social protection and informal employment

The impacts of social protection systems on labour markets with high levels of informal employment remain a concern for some policy makers at the international and national level. For some time there has existed an idea that mixed systems of social protection – which combine employment-linked social insurance with tax-financed social assistance for low-income informal workers – increase the levels of informal employment by establishing a financial incentive for workers and enterprises to exit the formal economy or remain informal.<sup>8</sup> The claim that social protection systems can cause substantial increases in informal employment (or not), or does not allow it to be lowered in countries where the rate of informal employment is very high, presents a challenge to governments' efforts to both expand social assistance to low-income workers and make social insurance systems more affordable through subsidies or matching contributions. Following this claim's logic, introducing social assistance benefits or subsidising social insurance contributions for those not in formal employment represents a subsidy of informal employment, as informal workers and their dependents can now access benefits on a non-contributory or subsidised basis, whereas formally employed workers and enterprises are required to pay full contributions. The provision of both social assistance and subsidised social insurance to informal workers is therefore assumed to increase the difference between the costs and benefits of informal and formal employment, resulting in enterprises and workers choosing informal employment.

The core of the evidence base consists of 11 experimental or quasi-experimental studies that aimed to estimate the effects of social protection programmes – contributory, non-contributory, cash transfers and health insurance schemes – on measures of informal and formal employment. Of those, seven found increases in informal employment or decreases in formality as a result of social protection interventions. However, impacts were mainly identified for specific sub-groups of the population, such as older people, parents with young children, men working in particular sectors, or vulnerable groups,

and such impacts rarely affected the national average. Wagstaff and Manachotphong's (2012<sup>[42]</sup>) analysis of the effects of Thailand's universal health coverage (UHC) scheme found no statistically significant impacts on total formal employment, but did find a small, significant effect of 1.2 percentage points only after three years and in the manufacturing industry (Seira et al., 2023<sup>[43]</sup>). Indeed, effect sizes are generally small. For instance, Aterido et al. (2011<sup>[44]</sup>) found that Mexico's Seguro Popular programme (which provided health coverage for those outside the social security system) did not reduce formal employment, but did reduce entry into formality by a mere 0.4-0.7 percentage points. Bosch and Campos-Vazquez (2014<sup>[45]</sup>) found that Seguro Popular reduced formal employment, but the effect was only present for enterprises with fewer than 50 employees. The number of formal employers had decreased by 1.4% one year after implementation, and by 4.4% four years after implementation. The same authors estimated that, between 2000 and 2011, this translated into a cumulative reduction of 171 000 employees who would otherwise have formally registered with the country's social security system in an economy with close to 20 million formal jobs. Mexico's social protection system, and in particular Seguro Popular, remains central to the debate about social protection driving informal employment, but new evidence confirms the existing literature findings of no impacts on employment. Levy's (2008<sup>[46]</sup>) analysis of Seguro Popular placed concerns on the potential of social protection programmes to incentivise informal employment on the agendas of policy makers at the national and international level, and with it, Mexico's centrality in the research and debates on this issue (e.g. (IMF, 2021<sup>[47]</sup>; UNDP, 2021<sup>[48]</sup>)). Indeed, the majority of studies exploring potential incentives towards informal employment focused on evaluating one of Mexico's social protection programmes: mainly Seguro Popular, but also other healthcare and prescription drugs programmes (Juarez, 2008<sup>[49]</sup>) or non-contributory pensions (Galiani, Gertler and Bando, 2014<sup>[50]</sup>).

Most of the evidence finds that Seguro Popular had no effect on informal or formal jobs (Alonso-Ortiz and Leal, 2018<sup>[51]</sup>; Campos-Vazquez and Knox, 2013<sup>[52]</sup>; Azuara and Marinescu, 2013<sup>[53]</sup>; Barros, 2009<sup>[54]</sup>). However, these papers are based on surveys and suffer from not being representative at the municipality level, where the programme is implemented. An exception on both counts is Bosch and Campos-Vazquez (2014<sup>[45]</sup>), who used municipal-level social security data. They found that Seguro Popular decreased formal employment in enterprises with fewer than 50 employees. However, using more detailed data and improved econometric methods, Seira et al. (2023<sup>[43]</sup>) found that Bosch and Campos-Vazquez's (2014<sup>[45]</sup>) research findings were not robust, and were highly dependent on the municipalities selected, the regression specification used and the identification strategy implemented; changes in any of these items negates their finding that Seguro Popular reduced formal employment. In fact, Seira et al. (2023<sup>[43]</sup>) find no robust evidence of a decrease in formal employment, and also no effects on average salaries for jobs affiliated to the Instituto Mexicano del Seguro Social (IMSS), or the Mexican Social Security Institute, further suggesting that there were no strong shifts in labour supply from the formal to the informal sector. The authors conclude that "the most solid conclusion with the best available data and more robust methods is that Seguro Popular did not decrease the number of formal sector jobs in Mexico" (Seira et al., 2023<sup>[43]</sup>).

Source: Authors' compilation.

### ***Tax compliance and enforcement play an important role***

Increasing tax compliance and enforcement can also be an effective strategy to increase tax revenues for social protection. Evidence shows that taxes are often evaded by misreporting economic activities that are difficult for the government to observe. Improved information collection and information sharing combined with better enforcement can thus increase revenue collection. Increased enforcement efforts are not limited to enterprises and can be complementary to adjusting tax rates in raising tax revenues from individual taxes (Bergeron, Tourek and Weigel, 2023<sup>[33]</sup>). Several concrete strategies to increase tax compliance

have been identified in the literature. Some experiments show that in-person visits and training on formalisation induce enterprises to formalise and can increase government revenue if the interventions are sufficiently well targeted. Using third-party information reports to assist taxpayers in meeting their tax return filing obligations could also allow governments to increase tax revenues, eventually fostering formal employment (Kleven, Khan and Kaul, 2016<sup>[32]</sup>). Evidence also shows that implementing simple and objective performance-based pay incentive schemes for tax collectors could bridge wider enforcement gaps and help deliver increased tax revenues for the government. Finally, simplifying procedures, e-filing and providing reminders can help levy more revenue when tax evasion is related to a lack of knowledge about when or how to pay the taxes owed (Cohen, 2020<sup>[55]</sup>). Whether any of these strategies is applicable would have to be assessed at the country level.

Building a taxpaying culture is a crucial prerequisite for mobilising more revenue. Tax systems generally rely on the voluntary compliance of taxpayers (OECD, 2019<sup>[56]</sup>; OECD, 2022<sup>[57]</sup>). Although tax audits, fines<sup>9</sup> and third-party reporting can increase tax compliance, tax administration resources are limited, especially in developing countries. Fostering tax morale (i.e. the intrinsic motivation to pay taxes) can play a key role in achieving significant revenue mobilisation. Work by the OECD shows that higher tax morale can typically be linked to taxpayers believing the tax revenues is spent effectively. Combining tax reforms with efficient and effective government spending allows countries to initiate a virtuous cycle of better-quality social protection services and higher tax revenues.

All of these dimensions are taken into account in the OECD Social Protection Tax Revenue (SPTR) framework, a country-specific tool that provides useful guidance in developing a tax reform roadmap for any country (Box 6.4).

#### **Box 6.4. The OECD SPTR framework can help countries identify these appropriate tax measures**

The OECD has developed a novel SPTR framework that can identify concrete tax policy measures (and their tax revenue potential) that developing countries could implement in order to close their social protection financing gap.

The SPTR framework is ready for implementation and consists of four modules which are applied sequentially to arrive at a set of tangible and realistic tax policy measures. The advantage of the framework is that it provides: i) the structure, ii) the tools and iii) an initial database based on which country-specific analysis can be carried out. Applying the four modules of the framework leads to a time sequence of country-specific recommendations, whereby the selected tax measures are highlighted in terms of their associated revenue raising potential.

The SPTR framework (financing side) will be jointly implemented with the OECD Social Protection System Review (expenditure side) in order to bring together the financing and expenditure sides of social protection in the form of collaborative country projects that build on the expertise of both the OECD Centre for Tax Policy and Administration and the OECD Development Centre.

Source: Authors' compilation.

## **Key policy messages**

Overall, the evidence presented in this chapter shows that in most developing countries, social protection coverage for workers is often inconsistent and sparse. Formal workers are also better covered by social protection than informal workers, which largely mirrors a coverage gap in contributory schemes and the way informal workers are defined. Extending social protection to informal workers is possible, however. A

strategy to extend social protection to informal workers will need to be based on a combination of contributory and non-contributory schemes and incentives to formalise. It will also require a step change in financing strategies.

Non-contributory schemes play a key role in ensuring a basic level of protection within the social protection system. In nearly all developing countries, the extension of social assistance programmes for the poor would cover a large share of informal workers. Extending child benefits and social pensions could also largely benefit workers in the informal economy and their families.

Contributory social protection schemes constitute a key element of the extension of social protection to informal workers. A key challenge to the extension of contributory schemes to informal workers is that a large cohort of such workers do not have co-payment possibilities, and their contributory capacity appears limited overall. The affordability of schemes is particularly challenging for self-employed workers who cannot share the costs. Yet, the scope for employer-employee contributions can be significant for many informal workers, and some of them have contributory capacity at the individual or household level. Moreover, various options exist to improve the affordability of contributions. In addition, for certain types of contributory schemes, such as healthcare or pension schemes, a small share of informal workers could also be covered through formally employed household members.

Closing the global social protection coverage gap, including for informal workers, will require a step change in financing strategies. Reprioritising government expenditure and increasing spending efficiency will not be sufficient to close the substantial social protection financing gaps that can be observed in developing countries, and additional revenues will have to be raised primarily through the domestic tax system. Sustainably funded social protection systems are challenging to build when the level of informal employment is high, but several options exist. Although developing countries will have to mobilise significant additional revenues to finance universal social protection, significant potential exists to increase tax revenue in developing countries, including through well-designed SSCs. Careful tax reforms are needed in order to identify the most suitable tax revenue sources, and tax compliance and enforcement will have to play an important role.

## Notes

<sup>1</sup> For example, monotax schemes and others. Further discussion to follow later in the chapter.

<sup>2</sup> Depending on the country, income status used for this report is based on either household income or household consumption.

<sup>3</sup> Co-payment could actually be a possibility for some informal workers classified as own-account workers who may indeed be dependent contractors according to the new ILO definition of employment.

<sup>4</sup> The potential to increase financing of social protection systems through more inclusive social insurance systems is recognised by the *Joint Statement on the Principles for Financing Universal Social Protection* issued by the Global Partnership for Universal Social Protection to Achieve the Sustainable Development Goals (USP2030), which suggests that countries should seek to “increase revenues from social insurance contributions by expanding coverage of social insurance schemes to previously uncovered workers.”

<sup>5</sup> The few informal workers covered through contributory schemes are mostly self-employed persons who opt for voluntary contributions, or persons covered by their spouses (see the previous section).

<sup>6</sup> (Packard et al., 2019<sup>[58]</sup>) assert that social insurance contributions and payroll taxes have a negative impact on formal sector employment” (p. 207). Similarly, the World Bank expresses its concerns that contributions present a “risk of creating incentives for workers to remain in the informal sector” (World Bank, 2022<sup>[59]</sup>).

<sup>7</sup> Of the 16 empirical studies reviewed, 10 find no impact and the others observe an increase in formal employment (1 finds increases only for older women).

<sup>8</sup> This argument was most clearly outlined in Santiago Levy’s 2008 book on Mexico’s social protection system, *Good Intentions, Bad Outcomes: Social Policy, Informality, and Economic Growth in Mexico* (Levy, 2008<sup>[46]</sup>). Recently, this line of thinking featured notably in the United Nations Development Programme’s (UNDP’s) 2021 Regional Human Development Report for Latin America and the Caribbean, which declares that “social protection policies contribute to informality” because they “tax formality and subsidise informality” (UNDP, 2021<sup>[48]</sup>). In the same year, the IMF’s report titled *The Global Informal Workforce: Priorities for Inclusive Growth* dedicates significant space to making the case that “payroll taxation on formal sector workers [...] increase[s] the cost of doing business and create[s] double taxation of labour, thus encouraging informality. Further, means-tested benefits [...] generate severe disincentive effects and often create poverty traps” (IMF, 2021<sup>[47]</sup>).

<sup>9</sup> Or, on the contrary, amnesty programmes for evaders (Londoño-Vélez and Ávila-Mahecha, 2021<sup>[60]</sup>).

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# Breaking the Vicious Circles of Informal Employment and Low-Paying Work

This report adds two perspectives on informality. First, it disassembles the mechanics of the deleterious links between informal employment, low-paying work and low skills. It shows that informal employment is highly persistent, and that the vulnerability of informal workers is passed on to their children in the absence of adequate education, skills and social protection policy. Second, the report underscores the double burden of informality and low-paying work that a large share of workers in developing and emerging economies carry, and as such calls for policy solutions that go beyond the formalisation agenda and embrace the goal of social justice.



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