

Trends in informal employment in Ecuador: 2009 - 2012

Several studies have confirmed that informal employment in Ecuador has declined in recent years, particularly in the formal sector. The implementation of institutional and political changes designed to promote increased compliance with labour law has favoured public and private wage workers as well as domestic workers. The main challenge for the future is to reduce informal employment in the informal sector.

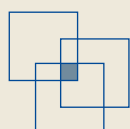


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Foreword

Informal employment is a persistent problem in Latin America and the Caribbean. Following a decade of economic growth and decline in unemployment rates, there are still 130 million workers holding informal jobs, deprived of social protection and labour rights.

This does not mean, however, that there has not been any progress made on the issue of formalization.

Formal employment, wage labour and social protection coverage have increased in Latin America and the Caribbean. Now, it is important to speed up this process to confront the long-time growth and consolidation of informality in the region.

We cannot forget that the reduction of informality is a key component of the efforts to reduce inequality and social exclusion.

The experience of the last few years confirms that economic growth is essential for the generation of more and better jobs, but it is not enough. To reduce informality, it is necessary to implement deliberate and integrated economic, social and labour policies and actions that complement economic growth, in the framework of sustainable development.

In fact, the policies implemented in several countries were key components of the progress achieved on the subject of formalization. This formalization process has not been uniform. In some countries, processes were faster and took a relatively short time. In others, progress has been slower.

In 2013, the ILO Regional Office for Latin America and the Caribbean launched the **Programme for the Promotion of Formalization in Latin America and the Caribbean, FORLAC**. The programme has three components: a) generation and dissemination of knowledge on formalization policies, b) technical assistance to specific countries, and c) capacity-building of workers' and employers' organizations in formalization issues.

The ILO FORLAC Notes presented here are part of the first component. We analyze public policy experiences trying to identify the most remarkable ones according to the academic or political discussion.

Formalization strategies require a favourable economic context, as well as articulated policies that allow us to address a multidimensional and highly heterogeneous phenomenon.

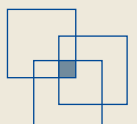
The persistence of high levels of informality is a major challenge requiring the implementation of measures that produce sustainable results.

The ILO expects that the dissemination of these experiences will help promote broader discussion on the strategies that countries may use to facilitate the transition to formality in the region.

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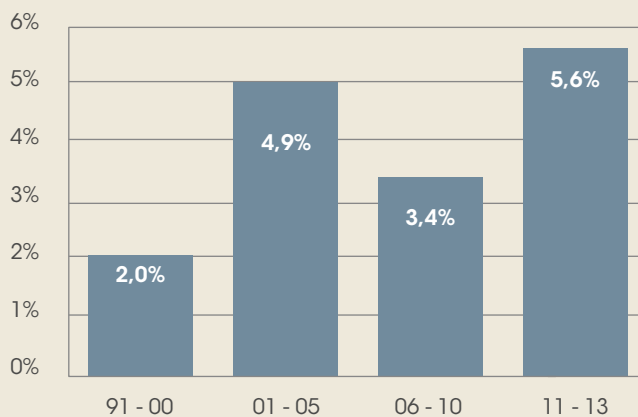
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1. Economic and labour market trends

Between 2001 and 2012, the Ecuadorian economy grew at an annual average rate of 4.5%, equivalent to a per capita increase of 2.7%. The 2008-2009 crisis moderately affected growth: in 2009, a growth rate of 0.6% was recorded, followed by a rapid recovery of 3.5% in 2010, and 7.8% in 2011. Despite the impact of the crisis, the economy grew at an annual average rate of 4.2% in the period 2007-2012. The non-oil sector led economic growth.

Figure 1. Ecuador: Economic growth, 1991-2013
(% average annual change for each sub-period)



Source: ILO, based on IMF (2013)¹.

From a macroeconomic perspective, monetary policy kept interest rates low and expanded liquidity by requiring banks to maintain at least 45% of their reserves in Ecuador.² From the fiscal side, an existing plan to increase spending in education was accelerated, doubling the share of education in GDP between 2006 and 2010. At the same time, aid programmes were implemented to enable low-income families to access housing, doubling the participation of this component of GDP between 2006 and 2010. The government also expanded its main conditional cash transfer programme – the Human Development Bonus – increasing the budget from US\$ 190 million to US\$ 760 million between 2004 and 2011. Unregistered eligible families were incorporated into the programme and coverage of the aid pension to citizens over age 65 and disabled individuals was expanded.³ Between 2006 and 2010, public social spending increased significantly as a share of GDP, from 4.76% to 9.84%.

In the labour market, employment among public and private wage workers rose from 54.3% in 2000 to 56.3% in 2012. The percentage of own-account workers also increased, from 30% to 31% as a share of total employment. Especially noteworthy was the decreased participation of contributing family workers and domestic workers, categories where the incidence of informal employment tends to be higher. Similarly, there was a reduction in the category of employers.

¹ IMF (2013). World Economic Outlook Database. October 2013.

² Ecuador is a dollarized economy, with the implications that this situation implies with respect to the use of monetary policy instruments.

³ The Human Development Bonus is a conditional cash transfer programme for low-income households. In addition to guaranteeing a minimal level of consumption, its objectives include contributing to reducing chronic malnutrition and preventable diseases in children under age five years, as well as promoting school attendance and re-enrollment.

Table 1. Ecuador: Employment by status in employment, 2000-2012 (% of national urban employment)

	2000	2011	2012
Wage workers	54,3	55,7	56,3
Own-account workers	29,9	32,3	31,0
Employers	4,5	3,6	4,1
Domestic workers	4,7	2,7	2,8
Contributing family workers	6,0	5,6	5,6
Others	0,5	0,0	0,0

Source: ILO (2013). Labour Overview of Latin America and the Caribbean.

2. Trends in informality

Informal employment is an important concept when analyzing informality in the labour market. Using data from the National Survey on Employment, Unemployment and Underemployment of the National Statistics and Census Institute (INEC), it is estimated that non-agricultural informal employment was 60.9% in 2009 and declined to 50.1% in 2012, which is a significant change.

Although the reduction in this indicator occurred in all occupational categories, the largest decline in informal employment took place among formal sector enterprises. In this group, informality fell from 20% in 2009 to 14.4% in 2012. Also noteworthy was the decline in domestic work.⁴

Table 2. Ecuador: Components of non-agricultural informal employment, 2009-2012 (% of total non-agricultural employment)

	2009	2010	2011	2012
Non-agricultural informal employment	60,9	56,4	52,2	50,1
In informal sector	36,9	34,6	35,6	33,3
In formal sector	20,0	18,6	14,4	14,4
In domestic service	4,1	3,2	2,2	2,4

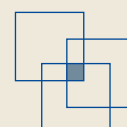
Source: SIALC ILO, based on the Survey on Employment, Unemployment and Underemployment (ENEMDU).

This is consistent with the report of the National Government of Ecuador (2013), which states that the percentage of informal sector workers did not change significantly between 2007 and 2012. According to León (2014), formalization was highest among wage workers –public and private– and among domestic workers.⁵

An analysis of informal employment by status in employment reveals that –while declining– own-account workers, domestic workers and contributing family workers have the highest rates of informal employment. These three categories account for 60% of non-agricultural informal employment in the country.

4 See *Gobierno Nacional de la República de Ecuador (2013). Políticas de formalización e indicadores de seguimiento a la economía formal*. Presentation at the LIX Meeting of the Permanent Technical Group of the Andean Community, Lima, 21 and 22 March. http://www.comunidadandina.org/economia/GTP_marzo2013ecu.pdf

5 León, Mauricio (2014). "Políticas públicas para la reducción del empleo informal del Ecuador." Paper prepared for the ILO.



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Table 3. Ecuador: Non-agricultural informal employment by status in employment, 2012
(% of total non-agricultural employment and % in each category)

	% of informal employment	Informality rate
Status in employment	100%	50,1%
Wage workers	39,8%	33,4%
Enterprises with 1 to 10 workers	31,1%	64,5%
Enterprises with more than 10 workers	8,7%	12,2%
Own-account workers	44,3%	70,0%
Domestic workers	4,9%	72,2%
Contributing family workers	11,0%	100,0%

Source: SIALC ILO, based on the Survey on Employment, Unemployment and Underemployment (ENEMDU).

With respect to the effect of the economic cycle on the reduction of informal employment, there is no significant association between annual average growth of the main non-oil economic sectors and rates of annual average change in the incidence of informal employment in those sectors, at least during the period of reference. In other words, there is no evidence that the fastest-growing sectors had greater relative reductions in informal employment during the period.

In this regard, a recent study indicated that the net effect of the economic cycle on informality depends on the prevailing flows of labour transition.⁶ Thus, the decline in informality between the first quarter of 2007 and the fourth quarter of 2010 appeared to be associated with a balanced effect between fewer relative entries into informality (53%) and increased relative exits from informality (47%). Likewise, an increase in relative entries into informality and a decline in relative exits from informality drove the formalization process among wage workers.

The main factors that most likely influenced those flows are analyzed below, considering both the institutional changes identified and the application of a set of public policies during the period.

3. Institutional changes and public policies

Since 2007, the Government of Ecuador has promoted a set of labour policies designed to improve employment conditions.⁷

In 2008, the National Constituent Assembly eliminated several forms of precarious employment. Specifically, it eradicated labour subcontracting and hiring by the hour, with a view to eliminating sources of non-compliance with labour rights. These changes are designed to guarantee part-time employment with stability, integral protection, proportional remuneration and the right to all benefits stipulated by law, including social security coverage. These measures should be evaluated in the future, with an emphasis on identifying the adjustment measures used by enterprises in response to these changes.

⁶ Goñi (2013). "Andemic Informality. Assessing Labor Informality, Employment and Income Risk in the Andes." Inter-American Development Bank. Cited by León (2014).

⁷ This section is based on León, Mauricio (2014). "Políticas públicas para la reducción del empleo informal en Ecuador." Paper prepared for the ILO.

Additionally, an active minimum wage policy was applied with a view to achieving the so-called “dignified wage.”⁸ This framework also includes policies designed to ensure that employers fulfill their obligation to affiliate their workers to social security. Failure to do so will result in a penalty as per Article 327 of the country’s new Constitution.

3.1 Expansion of social security coverage

Policies of the 2009-2013 National Good Living Plan included the promotion of social security and its expanded coverage, development of dignified working conditions and respect for labour rights. It established a 2013 target rate for social security coverage at 40% of the population. The Ministry of Labour also aligned its institutional policies with the plan, whose 2013-2017 version has an objective –the ninth, “guarantee dignified employment in all of its forms” – which establishes the target of increasing contributory social security coverage among the labour force aged 15 and over from 41.4% in 2012 to 60% in 2017, and from 32.7% to 50% at the rural level.

Additionally, the 2001 Social Security Law mandates that public institutions must obtain certifications of contributions paid to the Ecuadorian Social Security Institute (IESS) by construction firms. This regulation may have contributed to the formalization of construction workers in a context of a major increase in public investment in infrastructure, which rose from 4.1% of GDP in 2007 to 12.1% of GDP in 2012.

Despite the delay in defining non-affiliation to social security as a criminal offense, the expectations for the penalization of this offense could have served in practice to pressure enterprises to formalize employment relationships since the drafting of the new 2008 Constitution. This was strengthened by the public consultation of 2011.

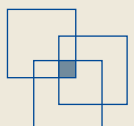
On 7 May 2011, a referendum and a public consultation took place, convened by the President of the Republic. The referendum had five questions, as did the public consultation. The 10th question –fifth on the public consultation– was: “Are you in agreement that the National Assembly should define the lack of affiliation of dependent workers to the Ecuadorian Social Security Institute as a criminal offense, without delay and within the period established by the Organic Law of Legislative Function, beginning on the date of the publication of the results of the plebiscite?” A total of 55.02% of the valid votes was in favour, while 44.97% were against it.

On 10 February 2014, the National Assembly issued the Comprehensive Criminal Code, which defines in three articles the criminal offense for not providing IESS coverage. Article 242 refers to the illegal retention of social security payments, punishable by a prison sentence of one to three years; in the case a corporation is found to have criminal responsibility, the penalty is the closure of the establishment until workers’ payments are made in full.

Article 243 establishes that an enterprise can be intervened and fined in the amount of three to five basic unified salaries of the worker, in general, for each worker without coverage.⁹ Finally, Article 244 establishes sentences for employers who fail to provide social security coverage to their workers. Jail sentences range from three to seven days. The sentences and fines of articles

8 Between 2007 and 2012, the minimum wage in dollars increased annually by an average of 10.6% whereas inflation rose 4.8%. Average labour productivity increased by an average of 4.1%. Wage policy established that the minimum wage would be increased to the equivalent of the sum of inflation plus an equity factor to close the gap with the dignified wage. The dignified wage was defined as the cost of a basic family basket divided by the number of household members. Components included the salary or monthly salary and the proportional part of the 13th and 14th salaries, profit-sharing and reserve funds.

9 The basic unified salary general coincides with the minimum wage, which in 2013 was US\$ 318 monthly.



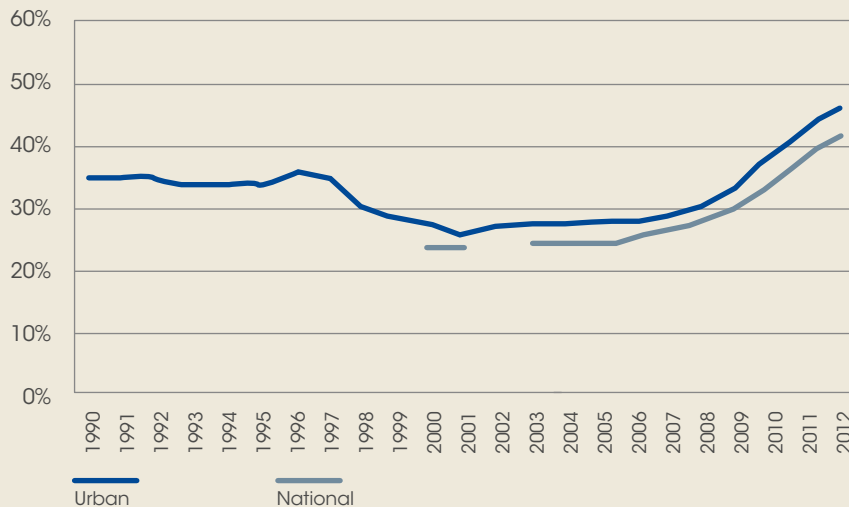
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243 and 244 are applied if the employer does not pay the amount due within a period of 48 hours after receiving notification.

With respect to the probable effect that this measure has had on informality, a 2012 World Bank study¹⁰ found that the costs of informality had risen and that “while it would be difficult to attribute the entire increase [in the index of social security affiliation of workers¹¹] to a legislative change that has not yet gone into effect, the signal sent by authorities regarding the seriousness of the situation has probably played a role in stimulating the uptick in affiliations.”¹²

In addition, the benefits of formality were made more attractive, which explains the increase in coverage, as illustrated in Figure 2, particularly, that of health insurance for children under age 18 and spouses of affiliated members; the reduction of the waiting period to claim health insurance benefits from six to three months¹³; changes in management models (health benefits through contracting of clinical services, hospitals and private medical centres); reactivation of pledge, unsecured and mortgage loans for affiliated members¹⁴; and improvement of services, infrastructure and equipment.¹⁵ At the same time, the IESS facilitated affiliation and social security payments of workers through online procedures.¹⁶

Figure 2. Ecuador: Population with social security coverage (% of the labour force)



Source: INEC, Surveys of employment, unemployment and underemployment.

According to IESS administrative records, expansion of legal coverage of health insurance to children under 18 years of age and spouses in 2010 more than doubled the potentially insured population, from 20% of the total population in 2007 to 52% in 2013.

¹⁰ World Bank (2012). Ecuador, the Faces of Informality. Cited by León (2014).

¹¹ The text in brackets was added in this note.

¹² Goñi (2013) says that the “In Ecuador, a new constitution in 2008 with clear mandates on worker protection, along with invigorated labor regulation enforcement mechanisms, most likely predisposed labor markets to observe formal arrangements.”

¹³ The Reform Law of the Social Security Law establishes that “affiliated contributing members shall be able to enjoy the medical benefits beginning on the first day of their affiliation in the case of accident or emergency; and after the third month of contributions shall enjoy the healthcare benefits the system offers.”

¹⁴ The Bank of the Ecuadorian Social Security Institute (BIESS), a public bank, offers mortgage, unsecured and pledge loans to IESS affiliated members. Previously, the IESS disbursed loans directly to members, but on a smaller scale. In 2012, the BIESS disbursed loans totalling 2.1% of GDP and was the lead actor in the mortgage market, where it has replaced private banking institutions.

¹⁵ Goñi (2013) believes that offering mortgage loans under competitive terms to qualifying workers is a novel incentive to voluntarily expand coverage of social protection systems.

¹⁶ <https://www.iesg.gob.ec/empleador-web/pages/principal.jsf>

Recent changes permitting the affiliation of part-time workers, less strict requirements for accessing benefits and the possibility of using both public and private medical services have almost certainly contributed to increasing social security coverage, as well as ensuring closer monitoring of employers.

3.2 Strengthening of labour inspection offices

The Ministry of Labour launched the restructuring and strengthening of labour inspection offices in 2009. This process consisted of encouraging the resignation of long-serving inspectors, the hiring of new ones and a salary increase. The number of inspectors rose from 65 in 2006 to 245 in 2011. In addition, the management of inspection offices was changed from a passive model that simply received complaints to an active one, with a plan for inspections nationwide through seven regional directorates.

In 2010 the "Dignified Domestic Work" campaign was launched to promote and ensure compliance with labour law in the hiring of domestic workers. In 2011, in coordination with the IESS, this campaign was expanded to include all workers and was renamed "Dignified Work." The inspection programme seeks to raise awareness of workers and employers regarding their rights and responsibilities and eliminate precarious forms of employment. To achieve this, the campaign uses information, prevention, verification and control in homes and enterprises of compliance with labour provisions of the Constitution and Labour Code. Initially, communication campaigns were implemented in the leading television, radio and print media, accompanied by information brigades on main streets of cities. Non-compliance with labour obligations by employers results in the application of fines established in the Labour Code and the rectification of the situation of workers.¹⁷ Additionally, the IESS takes legal recourse to collect the amounts due.

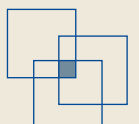
As a result of the above, the Ministry of Labour significantly increased the number of labour inspections compared with previous years and the IESS reported that the number of registered employers rose from 140,759 in 2008 to 320,823 in 2011.¹⁸ In addition, the number of people covered by mandatory general insurance, which is the main social security system, increased 81.4% between 2007 and July 2013.

The World Bank study (2012) found that 8.5% of enterprises reported having been inspected during the past year by the Ministry of Labour, and 11.1% by the IESS. It also found that "once inspected by one institution, the probability that a firm receives a visit from other inspectors increases substantially," and identified a correlation of 0.50 in inspections of the Ministry of Labour Affairs and the IESS.

The study also stated that "inspections significantly increase the probability that firms follow the rules, but do not guarantee full compliance." Additionally, it found that 50% of enterprises that were inspected over the past year comply with affiliation of their workers to social security, as compared with 20% of enterprises that were not inspected in the past year. Using a regression analysis that controls for a series of characteristics of the owner and the enterprise, the study found that the marginal impact on the percentage of workers affiliated to social security of inspections by the Ministry of Labour is 0.15, whereas those by the IESS is 0.17.

¹⁷ <http://www.elmercurio.com.ec/286441-22-empresas-sancionadas-por-incumplir-obligaciones/>

¹⁸ <http://www.iesg.gob.ec/documents/10162/83914/DIRECCION+GENERAL.pdf>



3.3 Standardization of working conditions for domestic work

For the group of domestic workers, a minimum wage increase was promoted to equal that of workers overall,¹⁹ as was their mandatory social security affiliation, right to holidays and overtime pay, reserve fund, and receipt of 14 salaries a year.

In the context of the Ministry of Labour's "Dignified Domestic Work" campaign, inspectors went door-to-door in middle- and upper-class neighbourhoods and directly interviewed domestic workers on their employers' level of compliance with labour law (social security coverage, working hours, overtime pay, holidays, payment of 14 salaries per year and the reserve fund).²⁰ After the visit, the inspectors placed a "Dignified Work" sticker at the entrance to the homes. Additionally, the Ministry of Labour offers training to domestic workers and promotes their association.

As a result of the policies mentioned, informal employment in domestic service declined significantly, although levels are still quite high (Table 2). While the percentage of domestic workers who were affiliated increased, the total number of domestic workers fell, which suggests that some households eliminated these services, whether because they were unable to cover the costs involved in paying the minimum wage and social security contributions or to avoid being penalized.²¹

4. Conclusions and public policy implications

Between 2007 and 2012, the reduction in informal employment in Ecuador occurred mainly in the formal sector of the economy. The evidence indicates that this was most likely due to the joint effect of institutional changes and the implementation of policies designed to promote and enforce compliance with labour obligations.

These changes included, first, constitutional and legal reforms that strengthened the rights of workers and the obligations of employers, including penalization for failing to provide social security coverage. Second, the policies to promote the increase in social security coverage, together with administrative reforms of the IESS, which made affiliation more attractive and affiliation procedures and payments easier; and, third, the reactivation of labour inspection offices to verify compliance with affiliation and labour obligations in enterprises and homes.

Nevertheless, while there is room to continue to expand social security coverage and reduce informal employment in the formal sector, there are signs that the effectiveness of these changes has been exhausted since informal employment increased in the informal sector and among own-account workers at the same time it declined among employers and domestic workers.²²

This problem is also observed when considering the relatively high incidence of underemployment in Ecuador's economy. This indicator includes "anyone who is working but willing and able to

19 Minimum wages of domestic workers, crafts makers and microenterprise collaborators were increased to equal those of private workers in general beginning in January 2010. In 2007, the monthly minimum wage of domestic workers was US\$ 120; in 2008, US\$ 170; in 2009, US\$ 200; and in 2010, US\$ 240.

20 <http://www.relacioneslaborales.gob.ec/in-septiembre-mrl-inicia-inspecciones-para-verificar-cumplimiento-laboral-a-trabajadoras-remuneradas-of-the-hogar/>

21 Bosch et al. (2013) report that with respect to this programme in Ecuador: "...while the initiative did result in a larger percentage of domestic workers receiving social security coverage, it is also true that it destroyed many jobs for individuals who do not have many options in the labour market...". Bosch, Melguizo and Pagés (2013). *Better Pensions, Better Jobs. Toward Universal Coverage in Latin America and the Caribbean*. Inter-American Development Bank (IDB). Cited by León (2014).

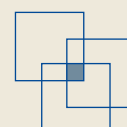
22 Goñi (2013) found that in the cities most exposed to changes in minimum wages (those with a larger percentage of workers between the old and new minimum wages), the probability of moving from unemployed to formal wage worker is reduced while the probability of remaining as an informal worker increases, as does the probability that formal workers will be displaced to the informal sector.

change their work arrangement to improve the duration or productivity of their work.”²³ Although nationwide underemployment declined from 57.2% in December 2008, it was still high at 52.49% in December 2013.²⁴

In light of the above, impact assessments of the measures mentioned should be implemented as soon as possible to identify their effects on employment and its characteristics to be able to improve on current policy instruments.

Likewise, special attention should be paid to monitoring and evaluation of the implementation of the 2010 Organic Production Code, which forms part of the 2010-2013 Agenda for Productive Change of the Production Sector Council. This Code establishes a variety of tax incentives, and calls for the creation of special economic development zones and investment contracts that lend legal stability, among others. This initiative is expected to be fully implemented this year, and therefore its effects on investments and the generation of formal, productive employment can be known.

Finally, despite the advances mentioned, the challenge of continuing to reduce informal employment remains. To this end, at least three types of initiatives should be implemented: first, one of economic growth that expands the formal sector and transitions workers from the informal sector to the formal sector; second, of a contributory social security system that generates special regimes for coverage or incentives to expand coverage among non-wage workers²⁵; and third, of an increase in labour productivity of micro-, small and medium-sized enterprises to enable them to absorb at least the costs of paying minimum wages and social security affiliation of their workers.



²³ Ray and Kozameh (2012). *Ecuador's Economy since 2007*. Washington DC: Center for Economic and Policy Research.

²⁴ See INEC in http://aplicaciones.inec.gob.ec/emp-portal_15/main.html#

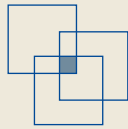
²⁵ The Ministry of Social Development Coordination is drafting a new Social Security Law.



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