

NOTES ON FORMALIZATION

Evolution of informal employment in the Dominican Republic

According to official estimates, between 2005 and 2010, informal employment fell from 58,6% to 47,9% as a proportion of total non-agricultural employment, in particular, as a result of reforms in the social security system expanding health care coverage. Maintaining high growth rates, in addition to reducing production heterogeneity to favour increased creation of formal employment, and continuing with institutional reforms undertaken would ensure future consolidation and expansion of these achievements.

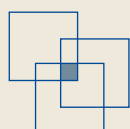


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Foreword

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.

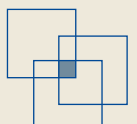
The persistence of high levels of informality is a major challenge requiring the implementation of measures that produce sustainable results.

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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1. The economic context

The Dominican economy has exhibited high growth rates in the last two decades. Over the 1992-2001 period, GDP grew at an average annual rate of 6,2%, while in the last decade (2003-2012), the average growth rate was of 5,5% despite the negative growth in 2003 resulting from the financial crisis that affected the country.

This growth went hand in hand with relatively low inflation rates. The average for the period was 12,1%, and if the financial crisis years are excluded, it would have been 6,2%, in keeping with the goals of the monetary authorities of maintaining macroeconomic stability.

In the 1990s, the most dynamic sectors were tourism and export free zones¹, which grew an average of 20,4% and 14,5% respectively. These sectors benefitted from certain incentive policies, including preferential access to U.S. markets, tax exemptions, electricity subsidies, lower labour costs than those established for larger businesses –workers receive a lower minimum wage and do not have a share in company profits–, as well as liberalization of foreign trade and foreign exchange markets, all of which favoured devaluation of the local currency and shaped a new economic model more targeted to the external market.

On the other hand, economic expansion in the last decade was boosted by high growth levels in the communications, financial intermediation, mining and wholesale and retail trade sectors. In particular, the growth of the communications sector is remarkable, with an annual average of 13,4%, thanks to important foreign investments in telecommunications. The mining industry was a key player in the 2011 and 2012 growth, as a result of a strong foreign investment in a gold mine. In these two years, the sector grew 79,7% and 42% respectively.

Another feature of the Dominican economy is the important role in the generation of foreign exchange played by remittances sent by Dominican emigrants, mostly from the United States. In fact, during the last decade, remittances grew at an average of 6% annually, and in 2011 they accounted for 6% of the GDP. They represent an important contribution towards relieving the country's trade deficit and offsetting the balance of payments

With respect to the fiscal situation, in recent years the State was managed with important deficit levels, the financing of which increased the level of public debt, both domestic and external, despite the several tax reforms aimed at increasing fiscal revenues. Over the past few years, the public sector debt, as a share of the GDP, increased from 17,2% in 2000 to 39,6% in 2011. On the other hand, and taking interest into consideration, payment of debt in 2011 was four times higher than the 2000 amount, representing 37,2% of tax revenues.

In any case, despite the high economic growth rate mentioned, the levels of poverty and inequality have remained high. In fact, according to official data, monetary poverty in 2011 afflicted 40,9% of the total population, which is largely explained by a weak employment growth, both in quantity and quality.

¹ Act 8-90 on the promotion of export free zones deals with export free zone businesses in general and distinguishes three types: industrial export free zones, export services free zones and special free zones.

2. The labour market and informal employment

The working-age population (WAP) in the country has grown at a rate of 2,3% annually over the last decade. Twenty five percent of this population is under the age of 20, while 12% is over 60 years old. The schooling level of nearly two thirds of the WAP is lower than high school.

In turn, the economically active population (EAP) grew at an annual rate of 2,4% during the last decade, with women accounting for 38% of the EAP. Additionally, it is a predominantly young population, with nearly half of it between the ages of 20 and 39 and 33% between 40 and 59. In educational terms, around 40% has only reached primary schooling level; near 32% has reached secondary schooling, while some 20,8% has attained higher education level.

The global participation rate remained stable during the 2003-2012 period, going from 54,3% to 56,2%. When sex differentiation is applied, we can see that men went from 67,7% to 68,1% while women grew from 41,4% to 45%, which shows a trend towards a greater participation of women in the labour market; nevertheless, they still lag significantly behind men.

Despite the country's high rates of economic growth, unemployment has not been substantially reduced. During the 1990s, the annual rate of job creation was 3,9%, while during the last decade (2000-2010), it was 2,4%, which reveals lower employment elasticity with respect to GDP growth. Therefore, the average of broader unemployment (includes discouraged workers who have given up looking for a job) over the last 10 years, was 15,7% of the EAP, while the level of open unemployment was relatively low and remained at an average of 5,8% of the EAP. This shows that part of the population is excluded from the labour market and has given up looking for work.

The low quality of jobs created in the country is also reflected in salary levels. Real earned income has maintained a downward trend since the end of the 1990s which has continued during the last decade, resulting in a reduction of about 27% during those years.

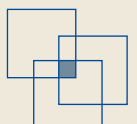
Statistics on the Dominican labour market are obtained primarily from the National Labour Force Survey (LFS), conducted twice a year since 1991 by the Central Bank.

Available data on the agricultural, communications, wholesale and retail trade and manufacturing sectors –the ones contributing the most to the GDP– reveal relative inadequacies in job creation.

In 2012, these economic sectors accounted for 51% of the GDP, but their share of total employment in the Dominican economy declined or remained the same. For example, the manufacturing sector accounted for 20,6% of the GDP, while its share in job creation fell from 17% to 11% over the 2000-2012 period.

For its part, the communications sector was the one that increased the most its share in the national value added, rising from 4,6% to 16,2% of the GDP, while its contribution to total employment barely grew from 6% to 8%. On the other hand, the 'other services' sector contributes barely 5,6% to the value added but 25% to total employment. This sector includes informal as well as low-productivity and low-quality jobs, such as domestic workers and the majority of self-employed workers.

In particular, it should be noted that the classification by occupational category of the 2012 Labour Force Survey revealed that self-employed workers accounted for 43% of the total working population. In 2006, the survey included a special section on informality which helped obtain more details about its characteristics.



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Available estimates on informal employment take into account recent international recommendations regarding employment and the informal sector. For the latter, the LFS allows the use as criterion of whether the production unit has an operating license or permit; for informal employment, whether the job provides the worker with access to social security.

The results obtained with this methodology show that informal employment, in the 2005-2010 period, and as a share of non-agricultural employment, fell from 58,6% to 47,9%, as seen in Table 1. These results match the estimates provided by the ILO's Labour Analysis and Information System for Latin America and the Caribbean (SIALC) for 2009 and 2010. They also show that the non-agricultural informal employment rate grew in the following years, from 50% in 2011 to 51,5% in 2012.

On the other hand, the data also highlights the fact that informal workers face more precarious working conditions than formal workers. Thus, more than half of them work in businesses with fewer than five employees, and 40% of them earn an income below the minimum wage; therefore, the poverty level is significantly higher in households where the male or female head of the family is an informal worker. The economic activities accounting for the largest share of urban informal employment are construction, retail trade and transport. There are no significant gender differences in the informality levels.

Table 1 shows that the highest drop in informal employment occurred in 2007 when it fell from 58,6% in 2005 to 49,6% of the total non-agricultural working population.

Table 1: Informal employment, GDP growth and coverage by the Contributory Social Security Scheme

Item	2005	2006	2007	2008	2009	2010
GDP (% of growth)	9,3	10,7	8,5	5,3	3,5	7,8
SS coverage/Working population (%)	19,0	23,3	44,8	47,2	58,1	64,2
Total informal employment/Non-agr. working pop.	58,6	56,0	49,6	51,6	48,5	47,9
- Informal employment in informal sector	34,2	33,4	30,2	31,7	29,4	30,6
- Informal employment outside the informal sector	24,8	23,0	19,8	20,2	19,4	17,8
- Informal employment: Men	58,5	55,7	47,9	49,4	46,7	45,9
- Informal employment: Women	58,9	56,5	52,4	54,8	51,4	50,9

Source: Prepared using data provided by the Central Bank and records of workers enrolled in the Contributory Scheme of the Social Security National Council.

This drop coincides with the coming into force of the health insurance contributive scheme of the new social security system. In fact, in that year the effective coverage of the contributive scheme almost doubled when the working population grew from 23,3% to 44,8%. After 2007, social security coverage continued to grow but at a slower rate, and did not have a major impact on informal employment levels. It thus follows that the primary cause of the drop in urban informal employment is the growth of the social security health coverage.

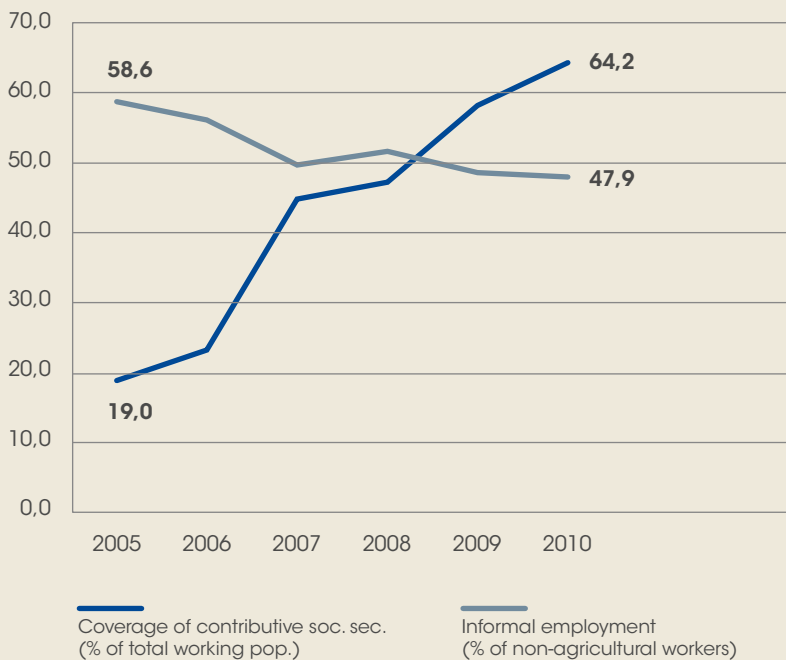
This view is supported by the fact that the largest drop in informal employment took place in the formal sector, falling from 24,8% to 19,8% -a reduction of 5,0 percentage points according to Table

1-, while the decline of informal employment in the informal sector was of 3,9 percentage points.

It is important to underscore that the development of the contributory social security scheme also contributes to the formalization of businesses, since the affiliation of their workers puts pressure on businesses to become formal.

Furthermore, as illustrated in Chart 1, the levels of informal employment and the expansion of contributory social security coverage moved in opposite directions, most notably in 2007.

Chart 1: Social security coverage and urban informal employment. Dominican Republic: 2005 - 2010



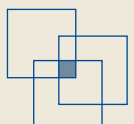
Source: Table 1.

3. Key characteristics and developments in the Dominican social security system

The approval of Act 87-01 that created the Dominican Social Security System in 2001 was the result of a long discussion process leading to agreements between the several social, economic and political actors, and of changes later introduced during its public information process and approval by the National Congress. The objective of this legislation piece was to find an answer to the low level of insurance affiliation in the country.

At the time, the health insurance coverage provided by the Dominican Social Security Institute (IDSS) barely reached 7% of the population. This, in addition to the health care delivered through private health insurance companies, provided coverage, in total, to only 24% of the population.

The system created is characterized by a complex architecture and a combination of different social security visions and systems. A clear example is the fact that in the occupational safety and



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health field, the PAYG model was chosen, while on the subject of pensions, the system adopted was that of individual capitalization.

Thus, taking mainly into consideration the relationship between people and employment, the following three schemes were established:

- Contributive scheme, covering wage earners –public and private- and employers. It is funded by workers (30%) and employers (70%), including the State in its capacity as employer.
- Subsidized scheme, protecting self-employed workers with unstable income below the national minimum wage, as well as the unemployed and indigent. It is funded by the Dominican State.
- Subsidized contributive scheme, targeting independent professionals and technicians, as well as self-employed workers with an average income, equal to or above the national minimum wage. It is funded by contributions from the workers and a State subsidy to compensate for the lack of employer.

The system comprises old-age, disability and survivorship, family health and occupational hazard insurance plans.

Considering the complexity of interests, the system contemplates new institutions to ensure its implementation. This, together with the struggles between conflicting interests and the lack of experience of stakeholders in these matters, hampered the implementation of the law.

The pension system was the first to start operating in 2003, while the contributive health insurance scheme started only in 2007, following the above mentioned complex negotiation process between the various stakeholders to reach a consensus on the health services plan of the Family Health Insurance system.

Between 2003 and 2012, effective coverage of the population under the contributive scheme expanded from 576.869 people –equivalent to 18,6% of the working population- to 2.747.735 (68,7%). This means that during those years, 2.170.866 workers joined the system, and that coverage of the contributive scheme grew by 376,3%.

The fact that the subsidized contributive scheme has not been implemented limits in a large measure the expansion of coverage by the system. This scheme considers a mixed funding system in which the worker covers part of the affiliation cost and the State covers the rest with funds from the national general budget.

The law provides for the undertaking of studies to determine the share corresponding to the State and to the various sub-sectors of self-employed workers. The population targeted by this scheme exceeds 40% of the working population, meaning that a substantial State subsidy would be required. This is the main reason for the delay in its implementation.

Another significant stumbling block for the expansion of social security coverage has been the lack of incorporation of municipal workers from all over the country, since a large part of them are paid salaries below the minimum wage established for joining the social security system.

Additionally, there are still many businesses that operate in the informal sector, which is why the system does not cover all wage earners that could be potentially enrolled in the contributive

scheme. On the other hand, there are no mechanisms in place to facilitate the inclusion of other important social sectors, such as domestic female and male workers, migrant workers and workers with temporary or occasional jobs.

The case of migrant workers is particularly complex, since Act 87-01 is based on the principle of universality as it protects Dominicans and legal residents. However, since the General Migration Act No. 285-04 does not grant resident status to temporary or seasonal workers, they are excluded from social security coverage; i.e., most immigrants are excluded because the salaried migrant population works in these types of activities (agriculture and construction).

Nevertheless, invoking the principle of territoriality, the Labour Code acknowledges their labour rights regardless of their legal status. According to the National Immigrant Survey (ENI-2012), 524.632 immigrants live in the country, accounting for 5,4% of the total population.

In addition to the intrinsic difficulties of the system, the characteristics of the country's labour market present significant obstacles to its universalization, due to the high unemployment rates and the profile of a large part of the country's businesses. Furthermore, the fiscal structure and the tax burden level make it difficult to have access to sufficient public resources to fund the large subsidized component of both health care and pensions.

4. Conclusions

Although in the last few decades, the Dominican economy has experienced economic growth rates above the Latin American average, informal employment levels remain high. This affects the possibilities of workers to improve their living conditions and social cohesion; thus, the main social partners in the country agree on the relevance of bringing about changes aimed at increasing the quantity and quality of jobs generated by the economy.

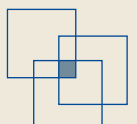
Measured under the criteria of business characteristics (size and others) and labour categories of the working population, informal employment has remained high and relatively constant over the last 10 years.

If, on the contrary, the concept of formality is used linked to the levels of social security coverage of workers, it is evident that there have been important advances in the levels of formalization of occupations.

Nonetheless, informality is structural in the Dominican economy and the level of informal employment is high, all of which limit the impact of the country's economic growth on income levels and living conditions of workers.

Progress made in the reduction of informal employment is still limited and basically responds to the implementation of the contributive scheme of the new social security system. This system has been the product of extensive discussions and social dialogue, which made it possible to overcome institutional difficulties and to have a substantial impact on the quality of employment.

However, the biggest challenge for this mechanism to move forward is the incorporation of self-employed workers through the contributive scheme –subsidized, specially designed for this population, or through any alternative way that may be established through institutional and social dialogue. It should be kept in mind that the implementation of the subsidized contributive



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scheme requires important State resources, in a framework of fiscal restrictions. This is in addition to the technical, organizational and cultural complexities involved in the formalization of self-employed workers.

Another important challenge is the incorporation of migrant workers to the social security system, given the weight of this group in the labour market.

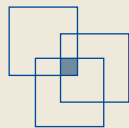
Finally, it is necessary to promote other strategies aimed at increasing the benefits for businesses and workers of operating in the formal markets, such as guaranteeing the exercise of labour rights and forging agreements to increase the productivity of both labour and the production system. This further involves sustaining economic policies that promote a high and stable economic growth, and reducing production heterogeneity thus increasing the capacity to generate productive and protected employment.



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