

Informal Employment: Beyond the Regulatory Debate

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Overview of Presentation

- Evidence for developed countries:
“Lawyer’s case empiricism”
- Evidence for developing countries:
Re-reading the WB’s *Informality: Exit and Exclusion*
- Conclusion: Moving beyond the regulatory debate requires a change of mindset: fair-minded judges rather than adversarial trial lawyers

Evidence for developed countries

- “Labour Market Institutions without Binders: The Debate over Flexibility and Labour Market Performance” – Richard Freeman (2005)
- “Unemployment and Labor Market Institutions: Why reforms pay off” – IMF (2003)
 - ❑ Contrary evidence for cross-country versus within-country (over time) variation
 - ❑ IMF study emphasizes with cross-country evidence: stronger regulations associated with higher unemployment

Evidence for developed countries

- Freeman refers to “blindness,” “prior-driven analysis” and “lawyer’s case empiricism”
- His proposed solution? Different research methods
- Less reliance on cross-country analysis, more on micro-analysis of workers and firms and on experimental methods

Evidence for developing countries

Informality: Exit and Exclusion – World Bank (2007)

- **“A substantial body of literature sees the size of the informal sector to be determined substantially by regulatory distortions or corruption.... Documenting the impact of legislation on formal sector demand in Latin America has been the subject of several major efforts in the region. Of particular importance, the National Bureau of Economic Research volume edited by Heckman and Pages (2004) collected some of the most serious attempts made to that date to quantify the impacts of various regulatory changes.... For the region and several countries, a credible case can be built that labor legislation had a substantial impact on the size of the formal sector”** (p. 121).

Consider the empirical results of several studies that address impacts of labour regulations...

Evidence for developing countries

Law and Employment: Lessons from Latin America and the Caribbean – J. Heckman and C. Pagés (2004)

Description: Seven country studies use micro datasets to estimate the effects of “job security costs” on formal employment in Argentina, Barbados, Brazil, Chile, Jamaica, Peru and Trinidad and Tobago

Results:

Statistically significant results only for Argentina and Peru, with lower job security costs associated with higher formal employment

But what are the implications of job security costs for *informal* employment?...

Evidence for developing countries

...consider the case of Peru

“Labor Market Reforms and Their Impact over Formal Labor Demand and Job Market Turnover: The Case of Peru” - J. Saavedra and M. Torero (2004)

- Job security costs fell while formal employment increased in Peru in the 1990s.
- However, informal employment increased even more rapidly, with the result that falling job security costs occurred alongside a *rising* share of informal employment.

Results for Peru are typical for the region...

Evidence for developing countries

“The Cost of Job Security Regulation: Evidence from Latin American Labor Markets” – J. Heckman and C. Pagés-Serra (2000)

Description: Cross-country panel data analysis of OECD and LAC countries, 1990-1999

Model of: Share of self-employment

Key explanatory variable: Job security index

Results:

	OLS	Fixed effects
OECD plus LAC	1.37 (5%)	-8.43 (1%)
LAC	1.09 (10%)	-8.34 (1%)

Evidence for developing countries

“The Determinants of Rising Informality in Brazil: Evidence from Gross Worker Flows” – M. Bosch, E. Goni and W. Maloney (2007)

Description: Cross-industry panel data analysis, 1983-2002

Models of: share of formal employment, formal job creation and destruction

Key explanatory variables: % of unionized workers, labour costs

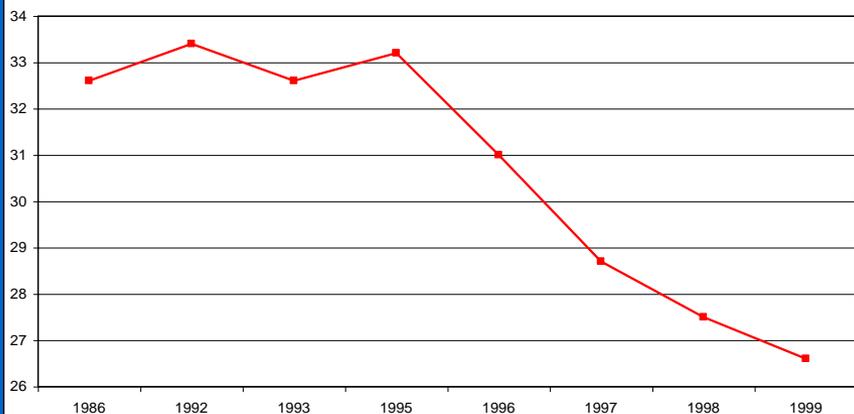
Results:

- Greater unionization is associated with higher shares of formal employment
- Estimated positive and negative effects on formal job creation and destruction cancel each other over time

Evidence for developing countries

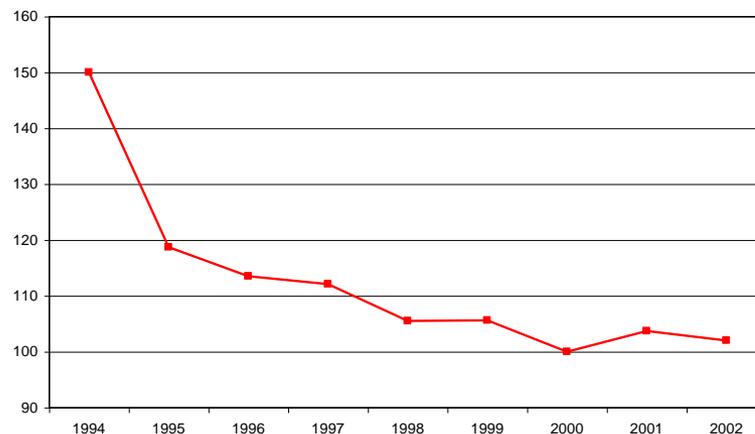
The authors conclude that the increase in informal employment in Brazil in the 1990s resulted from *“increases in union power”* and *“rising labor costs”*

Fig. 4: Union Enrollment Rate, Brazil, 1986-1999



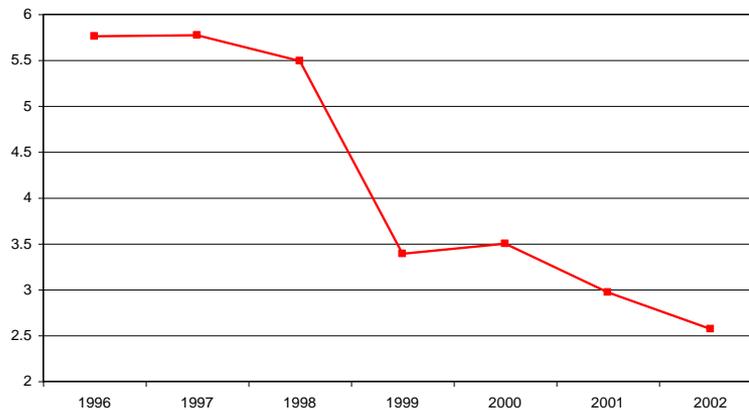
Source: Bosch, Goni, and Maloney (2007)

Fig. 5: Real Manufacturing Wage Index, Brazil, 1994-2002 (2000 = 100)



Source: ILO, Key Indicators of the Labour Market, 5th Ed., 2007

Fig. 6: Hourly Compensation Costs in Manufacturing (wage plus non-wage), US dollars, Brazil, 1996-2002



Source: ILO, Key Indicators of the Labour Market, 5th Ed., 2007

Evidence for developed & developing

“Dodging the Grabbing Hand” – J. Friedman *et al.* (2000)

Description: Cross-country analysis of 69 developed and developing countries

Model of: “Unofficial” activity as a share of GDP

Key explanatory variables: Tax rates and index of corruption

Results: Higher taxes and less corruption are associated with less “unofficial” activity

Contrary to WB, stronger regulations may be associated with a smaller informal economy insofar as associated costs of LM regulations are paid for from taxes.

Evidence for developed & developing

“The Regulation of Entry” – Djankov *et al.* (2002).

Description: Cross-country analysis of 85 developed and developing countries

Model of: “Unofficial” activity as a share of GDP and share of labour force

Key explanatory variable: Number of procedures required to start a company, including for labour and social security-related procedures

Results: Greater number of procedures are associated with more “unofficial” activity

The results are more about how a state regulates labour than strength of de jure or de facto labour regulations. E.g., China requires 5 labour and social security-related procedures whereas Canada requires 0

E.g., evidence for careful policy design rather than de-regulation

Conclusions

- Given what is at stake for workers in developing countries, those arguing that labour regulations exclude informal workers from formal employment ought to hold themselves to a high standard regarding the strength of empirical evidence. This standard has not been met.
- Some of the statistically strongest results show a positive association between shares of formal employment and the strength of labour regulations.
- Other studies could be cited to show a positive association between shares of formal employment and the strength of labour regulations and labour standards (e.g., R. Galli and D. Kucera (2004)).
- In short, recent empirical evidence does not support the view that weakening labour regulations is an effective policy to reduce informal employment.

Conclusions

- Re Freeman, micro-analysis is surely helpful, but micro results can be just as readily mis-represented as macro results
- Researchers need to act as fair-minded judges rather than adversarial trial lawyers
- Particularly important that policy-makers can trust literature surveys as well as authors' conclusions of their own work, as policy-makers may not have time or expertise to scrutinize these studies
- Acting as fair-minded judges facilitates moving beyond the regulatory debate to a discussion of optimal design and implementation of labour regulations in country- and time-specific contexts