

NOTES ON FORMALIZATION

Reduction of informal employment in Uruguay: policies and outcomes

Since 2005, informal employment in Uruguay has declined as a result of a number of public policies implemented in a context of strong economic growth. This decline can be explained by the reactivation of collective bargaining; tax reforms and investment promotion favouring investments with job creation; and reforms in the social security system, which have increased significantly the benefits of formality.

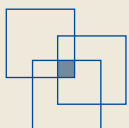


TABLE OF CONTENTS

Foreword	3
1. Economic growth with reduction of informal employment	4
2. Policies for the generation of more and better jobs	6
2.1 Collective bargaining	6
2.2 Tax reform	6
2.3 Promotion of productive investment	7
2.4 Fiscal policy	8
2.5 Alignment of social security programs	8
3. Conclusions	9

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.

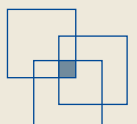
The persistence of high levels of informality is a major challenge requiring the implementation of measures that produce sustainable results.

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.

Elizabeth Tinoco
ADG

Regional Director of the ILO
for Latin America and the Caribbean

Regional Office
for Latin America
and the Caribbean

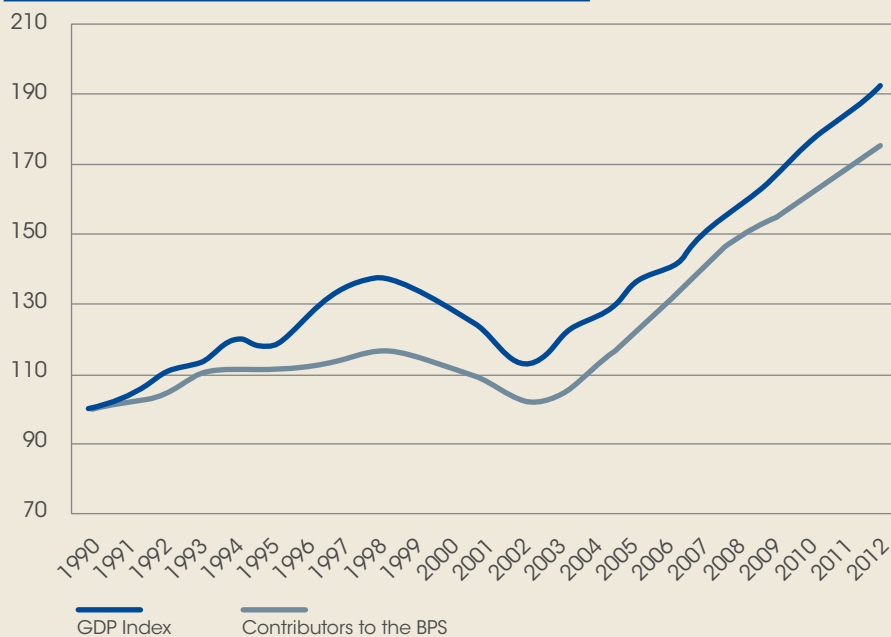


1. Economic growth with reduction of informal employment

Since 2003, Uruguay has exhibited a period of economic growth with significant improvements in all the labour market indicators. As illustrated in Chart 1, the evolution of GDP shows two distinct stages in the growth rate: one starting in the 1990s, with an average increase of the GDP of 4,1%; and another one of sustained high growth –annual average of 5,5%– starting in 2003 and continuing until today.

In turn, considering as indicator the increase in the number of contributors to the Banco de Previsión Social (BPS), the social security institute, the evolution of formal employment has also been positive, particularly in the second stage. In fact, in the 1990s, the amount of contributors grew at an annual average of 1,9%, while in the most recent stage, the increase was remarkably higher: an annual average of 6,0%. This results in a coefficient of variation of contributors to the BPS –with respect to variation of the GDP– of 1,09. This figure compares positively to the 0,46 obtained in the 1990s.

Chart 1: Evolution of the GDP and of contributors to the Banco de Previsión Social (In index numbers: 1990= 100. 1990-2012 period)



Source: Prepared using data from the BCU and the BPS.

Table 1 presents a more complete view of the evolution of the labour market, characterized by positive and persistent trends during the last decade. The indicators selected show an increase of the aggregate participation and employment rates; a decrease of the open unemployment rate; an increase of the real average wage; and a marked reduction of informal employment –measured as the working population not covered by social security– with respect to total employment, which fell from a maximum of 40,7% in 2004, to 25,6% in 2012¹.

¹ It is important to keep in mind that in 2006 changes were made to the Continuous Household Survey, and therefore, the results as of that year are not comparable to those of previous years. In any case, informal employment estimates by the ILO'S Labour Analysis and Information System for Latin America and the Caribbean (SIALC) also report a similar trend, from 39,8% of non-agricultural employment to 34,1% in 2012.

Thus, the period was characterized by an increase in the availability of work, measured by the participation rate, which rose from 58,1% in 2003 to 64% in 2012. The explanation for the rise in the participation rate is the significant increase of the female activity rate, which reached 56,2% in 2012 –well above the average of the last 25 years–, in a context in which male participation remained relatively stable (around 73%)².

This supply pressure has been more than compensated for by the dynamic demand for labour, given that the aggregate employment rate exhibited a significant increase of 11,3 percentage points between 2005 and 2012. As with the economically active population (EAP), growing female participation in employment is noticeable. In fact, the female employment rate grew to 51,5% in 2012, an increase of 26,5% over the 2004 rate. In turn, the male employment rate reached 69,1% in 2012, or 10% above the 2004 value.

Consequently, the open unemployment rate fell from a maximum of 17% in 2002, to 6,7% in 2012, reaching a historical low, with a trend towards narrowing the unemployment gender gap.

Table 1: Uruguay. Labour market indicators: 2001-2012

Indicator	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Annual real GDP growth	-3,9	-9,1	8,6	3,4	8,5	2,2	7,7	6,1	4,0	7,1	3,8	4,8
Participation rate (WAP %)*	60,6	59,1	58,1	58,5	58,5	60,9	62,7	62,6	63,3	63,5	65,0	64,0
Employment rate (WAP %)	51,4	49,1	48,3	50,8	50,8	53,9	56,7	57,6	58,4	58,8	60,7	59,6
Unemployment rate (Workforce %)	15,3	17,0	16,9	13,1	13,1	11,4	9,6	8,0	7,7	7,5	6,6	6,7
Average real wage (Annual var %)	0,0	-19,5	-3,4	2,9	2,9	3,7	4,1	4,3	5,6	3,4	4,0	5,2
Informal employment (Total employment %)	36,0	37,2	39,5	40,7	38,7	34,9	34,4	32,9	31,6	30,6	27,1	25,6

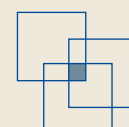
Source: Prepared using data provided by the National Statistics Bureau (INE) and the Central Bank of Uruguay.

*WAP = Working-age population

Finally, the greater dynamism in the generation of employment seen in the 2004-2012 period was accompanied by the significant decline in informal employment of 15,1 percentage points of its proportion of total employment, without any changes in its distribution by sex (Perazzo, 2012, op cit).

Table 2 shows that there is a remarkable decrease of informal wage employment in the private sector, which dropped its share in the total of wage workers to less than half of the 2004 share.

This downward trend was also observed in the rest of the categories, among them, the relatively important category of own-account workers, which showed a decrease of 8,1 percentage points in its share of the total of independent work.



² Perazzo, I. (2012). "El mercado laboral uruguayo en la última década". Serie Documentos de Trabajo, DT 1/12. Instituto de Economía de la FCCEE.

NOTES ON FORMALIZATION

Table 2: Uruguay. Informal employment according to occupational categories: 2004-2012 (In % of totals of each category)

Category	2004	2005	2006	2007	2008	2009	2010	2011	2012
Private sector wage worker	36,4	33,8	28,1	27	25,2	23,7	22,6	19,2	17,1
Public sector wage worker	1,4	1,4	1,5	1,3	1,5	0	0	0	0
Cooperative member	35,4	50,1	13,8	18,8	13	26,5	29,4	17,2	22,6
Employer	21	15,7	15,4	15,9	17,9	15,8	17,2	15,2	12,9
Own-account worker	78,6	78,1	76,9	76,4	75,1	74,2	74,1	71,4	70,5
Total	40,7	38,7	34,9	34,4	32,9	31,6	30,6	27,1	25,6

Source: Perazzo (2012) according to the Continuous Household Survey of the INE.

2. Policies for the generation of more and better jobs

During the period under review, a group of economic and social protection policies were implemented. Their main characteristics, as well as their impact on the reduction of informal employment, are discussed below.

2.1 Collective bargaining

The Government that took office in 2005 reactivated collective bargaining and called upon workers and employers to take part in this endeavour. Thus, in 2009, through amendments to Act 18.566 on Collective Bargaining³, an institutional structure was set up comprising a Higher Tripartite Council, wage councils for each branch of economic activity, and bipartite bargaining⁴.

The role of the Higher Tripartite Council, composed of delegates of the Executive and of the most representative worker and employer organizations, is to issue an opinion prior to the fixing, enforcement and adjustment of the minimum wage; and to carry out the classification of tripartite bargaining groups by branch of activity or production chain, designating, as appropriate, negotiating organizations in each area.

Wage councils, in turn, set the minimum amount of wages by labour category and update wages of private sector workers, among other responsibilities. In this framework, bipartite bargaining cannot reduce minimum amounts agreed upon at higher-level collective bargaining.

Thus, given the growing level of formality exhibited by the labour market, the above collective bargaining processes have increasingly involved the majority of workers.

2.2 Tax reform

In 2007, a tax reform was approved with three objectives: a) to provide a sense of fairness to the tax system, b) to improve the system's administrative and economic efficiency, and c) to promote

³ It should be noted that the ILO observed essential aspects of the Collective Bargaining Act (Case 2699) through its Committee on Freedom of Association, the Committee of Experts and the Committee on the Application of Standards of the ILO. They suggested to the Government the introduction of legislative amendments to ensure the practical application of the fundamental principles and rights at work. The case is still open until substantial progress on the recommendations of the ILO's supervisory bodies can be verified.

⁴ Amarante and Buchelli (2007). "Negociación salarial colectiva: revisión de la literatura y de la experiencia en Uruguay 2005-2006". Mimeo.

investment and employment incentives. The approved legislation provided for direct and indirect incentives to job creation, through the promotion of productive investments.

One of the relevant measures was the alignment of employers' pension contributions to social security, reducing those of the trade and service sectors and increasing those of the manufacturing industry, with a neutral impact on tax revenues. Given that the first two sectors have more workers than the third one, this measure had a positive impact on the total of protected employment.

Additionally, several measures were adopted with respect to the Business Income Tax (IRAE). On one hand, authorization was granted to deduct from the IRAE, as additional expense, 50% of the average monthly salary increase in one financial year over the previous year, as an incentive to the hiring of labour. At the same time, a higher deduction was incorporated –corresponding to one and a half times the real expense– for expenses related to the training of workers in priority areas.

These provisions were supplemented by incentives to the reinvestment of company profits and investments in fixed assets, in addition to tax exemptions for investments in research and development.

A further development in this period, directly targeted at the formalization of employment, was the expansion of the single tax to include own-account workers and their assisting spouses. This possibility to have access to social security was launched in 2001 and included a series of activities carried out in the streets or other public spaces.

The 2007 modification intended to expand the activities included in this simplified lower-cost tax, by including activities carried out in small public or private facilities and premises.

In December 2012, the number of active businesses affiliated with the BPS under the single tax modality reached 26.900, which is 7,4 times the number existing in June 2007, before the tax reform.

2.3 Promotion of productive investment

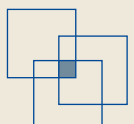
Another instrument used in relation to the goal of creating more and better jobs, was the upgrading of legislation to promote productive investment, through exemption from the business income tax up to specified investment amounts.

In 2007, when considering the creation of new related jobs, the possibilities to declare an investment promoted were expanded⁵. In 2012, the concept of quality of the jobs created was added, granting a weighting factor that increases according to the salary level of jobs created. This weight further increases if women, young people under the age of 25, workers older than 50 and agricultural workers are hired.

According to the Committee on the Application of the Investment Act (COMAP), responsible for the monitoring and follow-up of compliance of promoted investments, the outcome has been positive. Between January 2008 and December 2012, projects promoted through this mechanism increased by 948% with respect to the 2002-2007 period, while investment amounts grew by 380%, involving the creation of 31.613 jobs, 51% of which are concentrated in small and medium size businesses⁶.

⁵ Other factors taken into account are: geographical decentralization, contribution to the growth of exports, use of clean technologies, investment in development and innovation, and contribution of the investment to GDP growth.

⁶ Ministerio de Economía y Finanzas (2013). "Evaluación del funcionamiento del régimen de promoción de inversiones entre los años 2008-2012". Unidad de Apoyo al Sector Privado. See: http://www.mef.gub.uy/unasep_documentos_trabajo.php



NOTES ON FORMALIZATION

These developments occurred in a context where productive investment during the period rose to 19,6% of the GDP, well above the historic average. Additionally, it was sectorally diversified, with a pronounced bias towards the generation of exportable supply.

Similar observations can be made about foreign direct investment which, distributed in competitive areas of the economy, accounted for 5,9% of the GDP, in contrast to the 0,8% reported between 1980 and 2004, and was focused on non-tradable, financial and trading sectors.

2.4 Fiscal policy

Economic growth and improved efficiency of the country's two main revenue collection bodies: the Dirección General Impositiva (DGI) –the national tax administration– and the Banco de Previsión Social (BPS) –the social security institute– created a fiscal space that enabled the execution of direct job creation plans and sectoral reforms, particularly in the social security field, which will be dealt with below.

The fiscal policy was also conducted with counter-cyclical purposes when the global crisis hit in the second half of 2008. While in 2009, total gross fixed capital formation fell by 6,3%, the decrease was not more pronounced due to the fact that public sector investment grew 13,9% in real terms in that same year. At the same time, government consumption grew 3,9% resulting in increased public expenditure. Uruguay weathered the 2009 global economic crisis with a 4,0% real GDP growth, which made it possible to sustain activity and employment growth.

2.5 Alignment of social security programs

In 2005, the need to build a new social protection matrix was raised, with two fundamental cornerstones: the incorporation of a component for the transfer of income to the most disadvantaged sectors of society and the flexibilization of conditions for access to the benefits of traditional social security programs.

The first objective was achieved, primarily, through modifications to the family allowance program, substantially increasing the benefit amount and expanding its coverage regardless of whether the head of the beneficiary household worked in the formal labour market. The second objective was implemented on the basis of reforms to the retirement and pension, health and unemployment systems.

From the perspective of its contribution to the employment formalization process observed, it is possible to highlight, in the first place, the health insurance reform. As of 2008, along with the gradual integration of retirees and pensioners, workers' spouses and dependent minors, and other groups were also incorporated. This incorporation is funded with a contribution by the worker concerned, who instead of contributing 4,5% of its salary for his own coverage, contributes 6,0% if he has at least one dependent minor.

This measure resulted in a very significant net benefit (difference between the value of the healthcare benefit and the contribution as a percentage of the wage) for the majority of workers; the lower the worker's wage level and the more dependent minors, the higher the net benefit. It is therefore a strong microeconomic incentive for the formalization of employment, particularly among lower wage workers, who are the ones exhibiting higher levels of informality. Thus, while in 2007 there were 672.000 private sector workers entitled to health insurance, in 2012 their number grew to 955.000.

In 2008, the unemployment insurance was also modified with the purpose of promoting the permanence of the relationship between a worker and his employer in the event of an unfavourable situation. Therefore, the duration of this benefit was extended –in the event of economic recession– from six to eight months, and the possibility of continuing to receive the unemployment benefit was accepted under the condition of keeping a secondary job.

Furthermore, the Executive was empowered to establish a special unemployment allowance scheme –which can be total or partial– for certain economic activities or labour categories, for a one year period, renewable for an additional year should the conditions under which the benefit was awarded persist. This benefit can be used when a business is affected and the situation is considered to be temporary or likely to be reversed. This scheme was used during one year, starting in July 2009, with low coverage, given that the economy recovered quickly following a quarter of declining economic activity⁷.

These measures, among others, strengthened the institutional framework of protection against unemployment, thus contributing to the protection of formal jobs in adverse circumstances while avoiding the transition to unemployment and informality.

On the subject of retirement and pensions, in 2008 a parametric reform was undertaken which made the conditions for access to benefits more flexible. It established that workers' claims would prescribe in five years, and that the activity years needed to qualify for old-age retirement would be reduced from 35 to 30. Additionally, a positive discrimination in favour of women was included, acknowledging one year of presumed activity for each child or dependent minor, up to a maximum of five years.

With this reform, the number of new retirees tripled, from 11.200 in 2007 to 34.056 in 2011⁸, which proves that the disincentive for groups with a lower contribution density had been reduced. Consequently, the fact that the retirement target was made more accessible is likely to have become an incentive for the formalization of employment relationships.

Finally, in 2006 a domestic service act was enacted equating the labour rights of this sector to those of the rest of workers in the country, and in August 2008, the sector was incorporated to the collective bargaining process⁹. In April 2012, Uruguay was the first country to ratify ILO's Convention No. 189, and in 2012, the number of domestic workers enrolled reached 64.400, an all-time high considering that it was 67% higher than the 2004 figure.

3. Conclusions

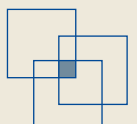
The evidence examined suggests that the decline in informal employment seen in Uruguay in recent years was the result of a series of factors that acted simultaneously boosting each other.

On one hand, following a long recession and starting in 2003, the country got back on the path of economic growth enhanced by a shift in economic and social policies that gave the State an active role with the explicit goal of job creation. Thus, in a context of high and persistent growth,

⁷ Lazo, M. (2013) "Evolución del subsidio de desempleo". *Comentarios de la seguridad social*, N° 40, BPS.

⁸ Colombo, C. (2012) "Análisis de las principales características de las altas de jubilación de los años 2002 al 2011". *Comentarios de la seguridad social*, N° 35, BPS.

⁹ Bene, N. (2012) "Trabajo doméstico: características y normativa". *Comentarios de la seguridad social*, N° 36, BPS. In 2011, at the 100th session of ILO's International Labour Conference, the Committee on Domestic Workers considered Uruguay to be an example due to its legislation covering this group and the protection of their rights to social security.



NOTES ON FORMALIZATION

open unemployment also declined –despite the pressure of an increased labour supply–, and real salaries grew.

In this context, a group of policies marked a turning point with respect to the characteristics of jobs created: tax reforms implemented over the period aimed at encouraging the hiring of labour through tax deductions; those encouraging investment in fixed capital and human resources; and the ones aimed at the promotion of investments in terms of the quantity and quality of new jobs created.

Thus, the impact of improvements to the tax administration (Banco de Previsión Social and Dirección General Impositiva) contributed to the decline of informality rates. These management improvements had a clear effect –in practice– on formalization: it is increasingly difficult to be informal.

Uruguay has taken a leap forward in terms of investment-to-GDP ratios and this, having a recursive effect, has invigorated the growth of the economy and of formal employment.

In turn, the fiscal policy also made a significant contribution to these goals, by giving stability to growth and weathering successfully the effects of a severe crisis, as well as by taking advantage of the fiscal space to fund sectoral reforms that strengthened social security institutions.

These institutions favoured the formalization of employment by providing net health benefits, particularly for lower wage workers; by making retirement requirements more accessible to those who have a lower contribution density; and also by protecting formal employment when businesses face adverse situations, thus avoiding the transition to unemployment or to informal activities.

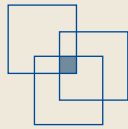
In conclusion, over the last decade, a high and steady economic growth, along with the implementation of a number of policies incorporating and promoting the objective of employment generation and adequate protection, have shaped a scenario conducive to the reduction of informal employment in Uruguay. And all this, in a context where policies encouraged social participation venues, which have multiplied in this period.



International
Labour
Organization

FORLAC

PROGRAMME FOR THE PROMOTION OF FORMALIZATION
IN LATIN AMERICA AND THE CARIBBEAN



NOTES ON FORMALIZATION

Regional Office for Latin America and the Caribbean