

► The youth transition to formality

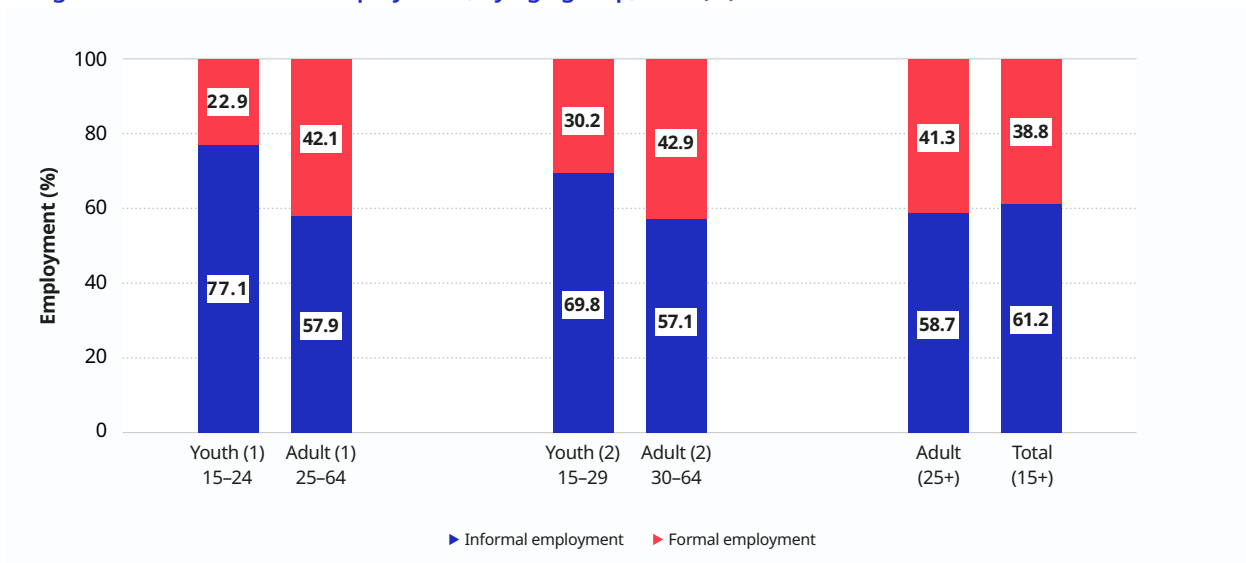
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Formality initiatives thus may be most effective if designed with a lifetime approach in mind.

Statistics indicate that working young people are more likely to be in informal employment than working adults in other age groups.¹²⁶ Recent International Labour Organization (ILO) analysis echoes that assessment with an estimate of 77 per cent for the share of informal employment among young people aged 15–24, which is higher than the global average of about 61 per cent (ILO 2018).¹²⁷

There are approximately 363 million young people engaged in informal employment globally, with more than half of them located in sub-Saharan Africa and Southern Asia (ILO 2018). Around 37 per cent of this total are young women, who are particularly over-represented in informal employment statistics in low-income countries (figure 1).

► Figure 1. Global informal employment, by age group, 2016 (%)



Source: ILO 2018, based on national labour force and household surveys from 110 countries.

125 The authors extend special thanks to Miso Lee for her valuable research assistance and to the participants in the internal ILO webinars entitled The Youth Transition to Formality, for their useful comments.

126 Unless noted otherwise, the discussion here uses the United Nations definition of youth: persons aged 15–24.

127 These figures are ILO estimates based on household survey micro data sets from 110 countries representing more than 85 per cent of the working population globally. To allow for comparisons and the calculation of global and regional estimates, a harmonized definition of employment in the informal sector and of informal employment was applied systematically (ILO 2018). In line with the ILO resolution concerning statistics of employment in the informal sector, adopted by the Fifteenth International Conference of Labour Statisticians in 1993, the operational definition to identify workers employed in the informal sector is based on the institutional sector, the final destination of production, the absence of registration or of a complete set of accounts. Alternatively, the size of enterprises combined with the place of work and, for employees, the absence of social security contributions by the employer, were used as proxy criteria. As per the ILO Guidelines Concerning a Statistical Definition of Informal Employment, adopted by the Seventeenth International Conference of Labour Statisticians in 2003, an operational definition of informal employment includes the following components: (i) among own-account workers and employers, the formal or informal nature of employment depends on the formal or informal nature of the economic unit; (ii) among employees, informal employment is defined by the absence of social security gained through employment (via employer and employee contributions) or, in case of missing information, by the absence of entitlement and benefits related to annual paid leave and paid sick leave; and (iii) all contributing family members are involved in informal employment.

A large volume of literature exists on informality and its nature, causes and consequences. Less attention, unfortunately, has been given to the processes surrounding the transition to formality, although such research has proven particularly useful in policy creation.¹²⁸ These elements in the context of young people merge with ILO-generated data in the following discussion on a winding path towards responding to certain policy-relevant questions: Why are informality rates higher among young people? Do we need specific policies targeting the transition of young people to formality?

The age formality profile

Based on data from national labour force and household surveys, the relationship between formality and age reflects a concave or inverted-U shape. In 2016, formality rates (at 23 per cent) were low in the beginning of an individual's working life. Although the rates increased with age, reaching a maximum of 44 per cent among workers aged 35–54, they began to drop off for older workers. Formal employment rates for people older than 64 then became as low as those for young people.¹²⁹ This phenomenon is considered an empirical regularity and is observed worldwide (figure 2, panels A–D).

Although the overall extent of formal employment and its age-related variations indicate significant differences depending on the income groups of a country, the U shape remains. In low-income countries, the formal employment rates were low in all age groups, mostly at less than 10 per cent. This was especially evident when agricultural work was included in the 2016 statistics. Less than 5 per cent of persons aged 15–24 and less than 10 per cent of persons aged 25–29 were employed formally in 2016. Formal employment barely reached 10 per cent among persons aged 30–54 and declined in the older age groups (ILO 2018).

Formal employment rates were generally higher in middle-income countries, at an average of 33 per cent; the rates ranged from 17 per cent for youth employment to more than 35 per cent for adults aged 35–54 years. In middle-income countries, the link between access to formal employment

and older age, as well as an increase in experience and assets, was more pronounced than in low-income countries. In high-income countries, formal employment was the norm: approximately 82 per cent of total employment, regardless of age, was formal, with a sex breakdown in formal employment of 81.1 per cent for men and 82.4 per cent for women. In high-income countries, the rate of formal employment for young people (aged 15–24) was 81 per cent, with the majority of them starting as employees.

The empirical regularity in the age formality profile has many implications. Chief among them: young people are not alone in labour markets, rather, they work alongside other generations; and their formality rates may be influenced by and also have influence on the formality rates of other generations. Formality thus can be seen as part of the overall labour trajectory of an individual person and may be a decisive factor in their working-life success. From a policy perspective, formality initiatives thus may be most effective if designed with a lifetime approach in mind.

The age-to-earnings profile demonstrates a similar statistical trajectory, although earnings do not fall as drastically as formal employment does after reaching retirement age.¹³⁰ It is not surprising that the formal employment trend increases up to a certain age, after which both formality and earnings begin to decrease. Formality is a product of the labour market, similar to outcomes regarding employment levels and earnings; formality is also closely associated with the quality or level of functionality within the labour market.

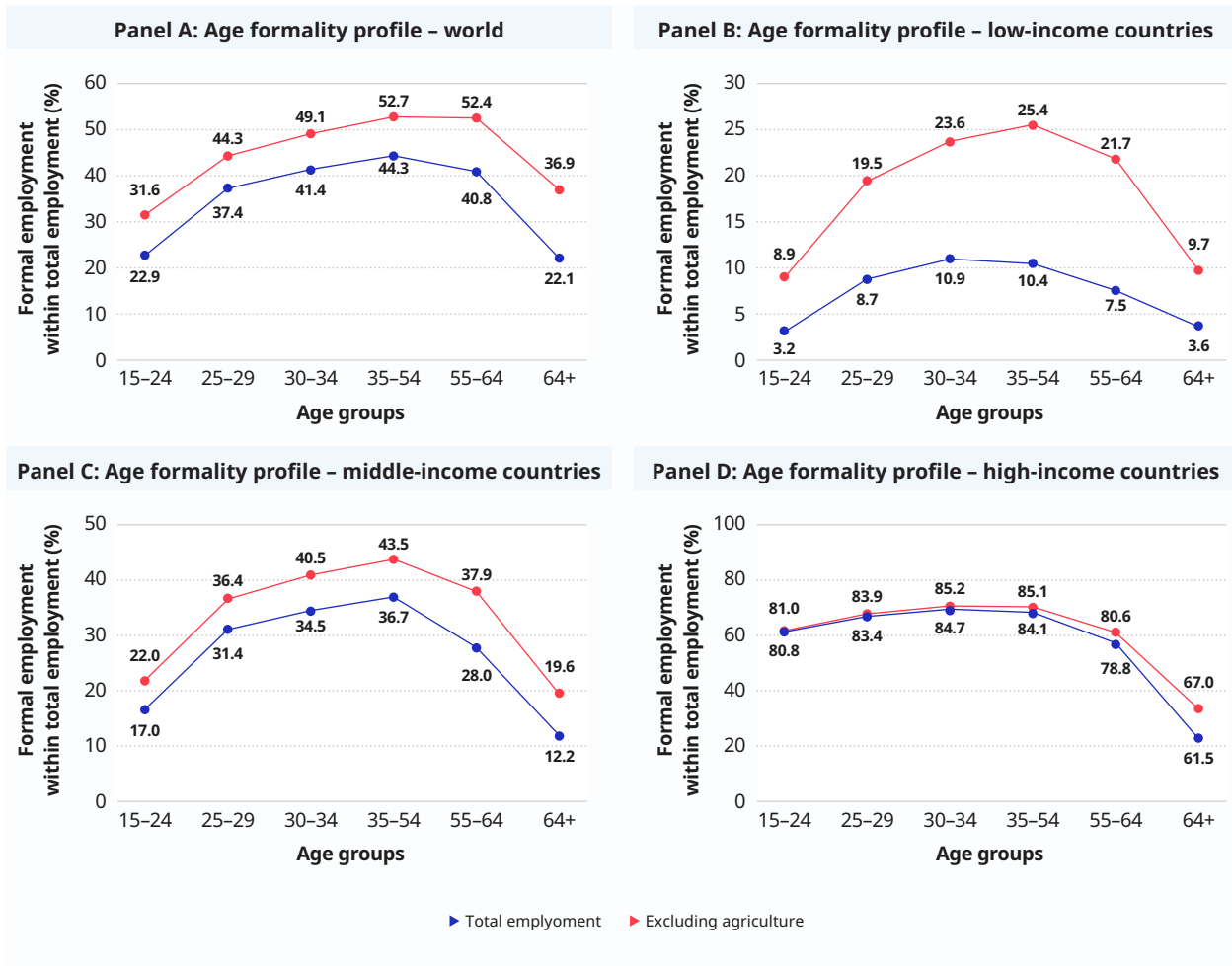
The overall rates of formal employment and the accompanying patterns that occur over the course of an individual's working life are largely determined by the structure of the labour market and an individual's employment status (figure 3 panel A). In other words, the respective proportions of workers in employment statuses who are more likely to be employed informally, including contributing family workers and own-account workers, shape the overall share of informal employment. The variations in the inverted-U shape, based on individual employment status, are noteworthy: Globally, formal employment rates increased rapidly with

128 The ILO adopted Recommendation No. 204 concerning the Transition from the Informal to the Formal Economy in 2015.

129 Low formality rates among adults aged 65 and older could be related to working after retirement, either in combination with or as a substitute for a retirement pension, but it is a topic beyond the scope of this chapter.

130 The age-to-earnings profile is generally used to assess the effects of experience, or age, on earnings. See Murphy and Welch 1990; Mincer 1974.

► **Figure 2. Age formality profile for overall and non-agricultural employment, globally and by country income groups, 2016 (%)**



Source: ILO 2018, based on national labour force and household surveys.

age and reached their highest rates for employees and, to some extent, employers¹³¹ but remained flat and below 20 per cent across all age groups for own-account workers. All categories decreased as workers aged.

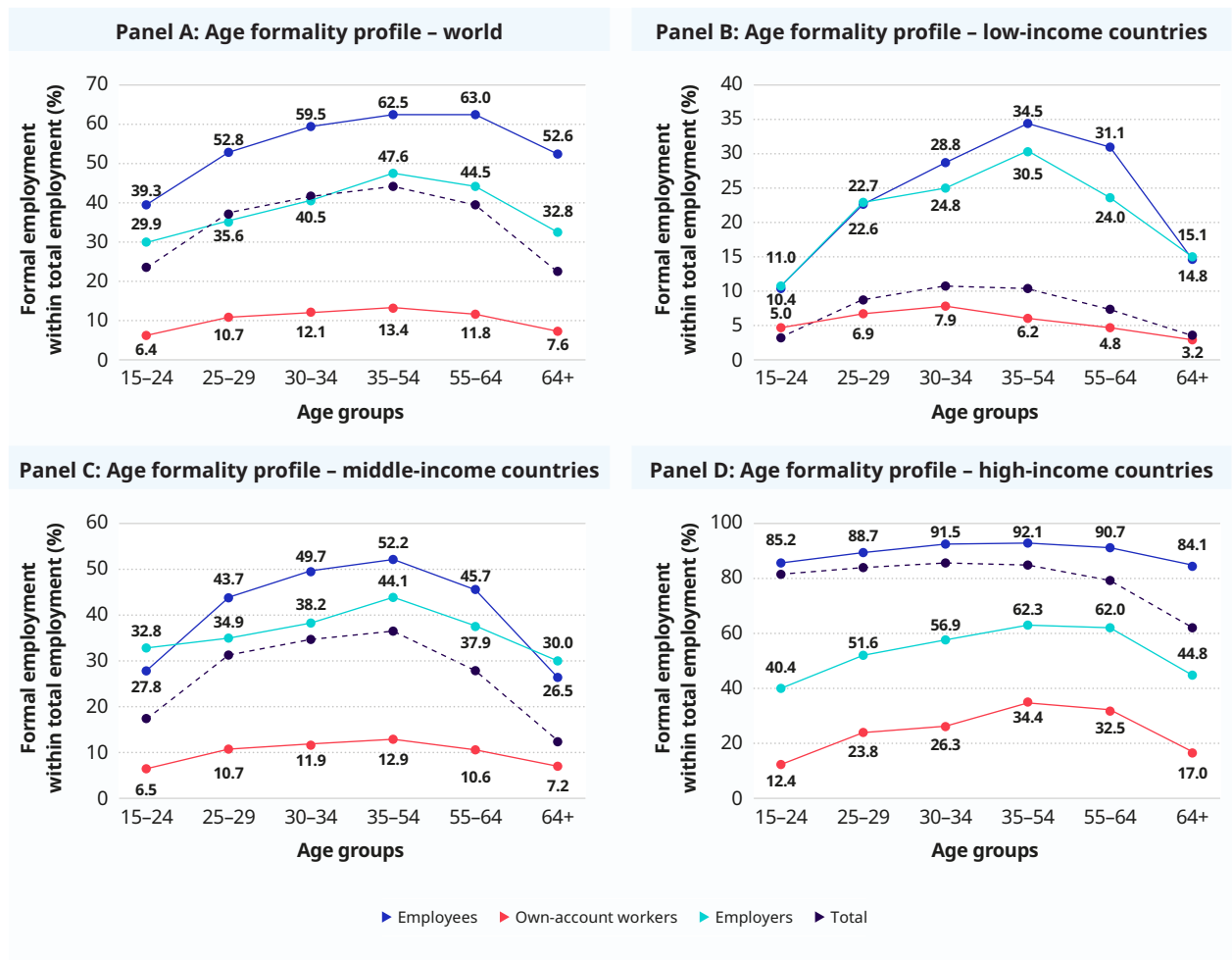
In low-income countries, the overall data on both young people and other age groups were driven by the situation of own-account workers, which represented the majority of those employed in the labour market. The main difference in formal employment rates between young and prime-age adults occurred in the categories of employees and employers, where there appears to be some opportunities to move from informal to formal

employment. Among employees in middle-income countries, there were viable opportunities for transitioning to formal employment in the higher age brackets that influenced the formal employment rates overall. However, as was the case in low-income countries, in the absence of dedicated interventions or changes to the macroeconomic context, own-account workers in middle-income countries had lower levels of formality at all ages and limited prospects for formalization during the course of their working lives.

In high-income countries, the situation was significantly different, particularly among employers and own-account workers, with a clear trend towards a

¹³¹ For employers, older age tends to increase access to critical factors, including assets, finances, networks and experience. Formality rates increased from approximately 30 per cent for the 15-24 age group to nearly 48 per cent for the 35-54 age group.

► Figure 3. Age formality profile, by employment status globally and by country income groups, 2016 (%)



Source: ILO 2018, based on national labour force and household surveys.

transition to formality as the age and experience of workers increased (at least until reaching retirement age). In the high-income countries, formality among employees was high overall, with formality rates of 85 per cent for young people. The predominance of employees within the total employment numbers largely explains the high rates observed in the total employment data.

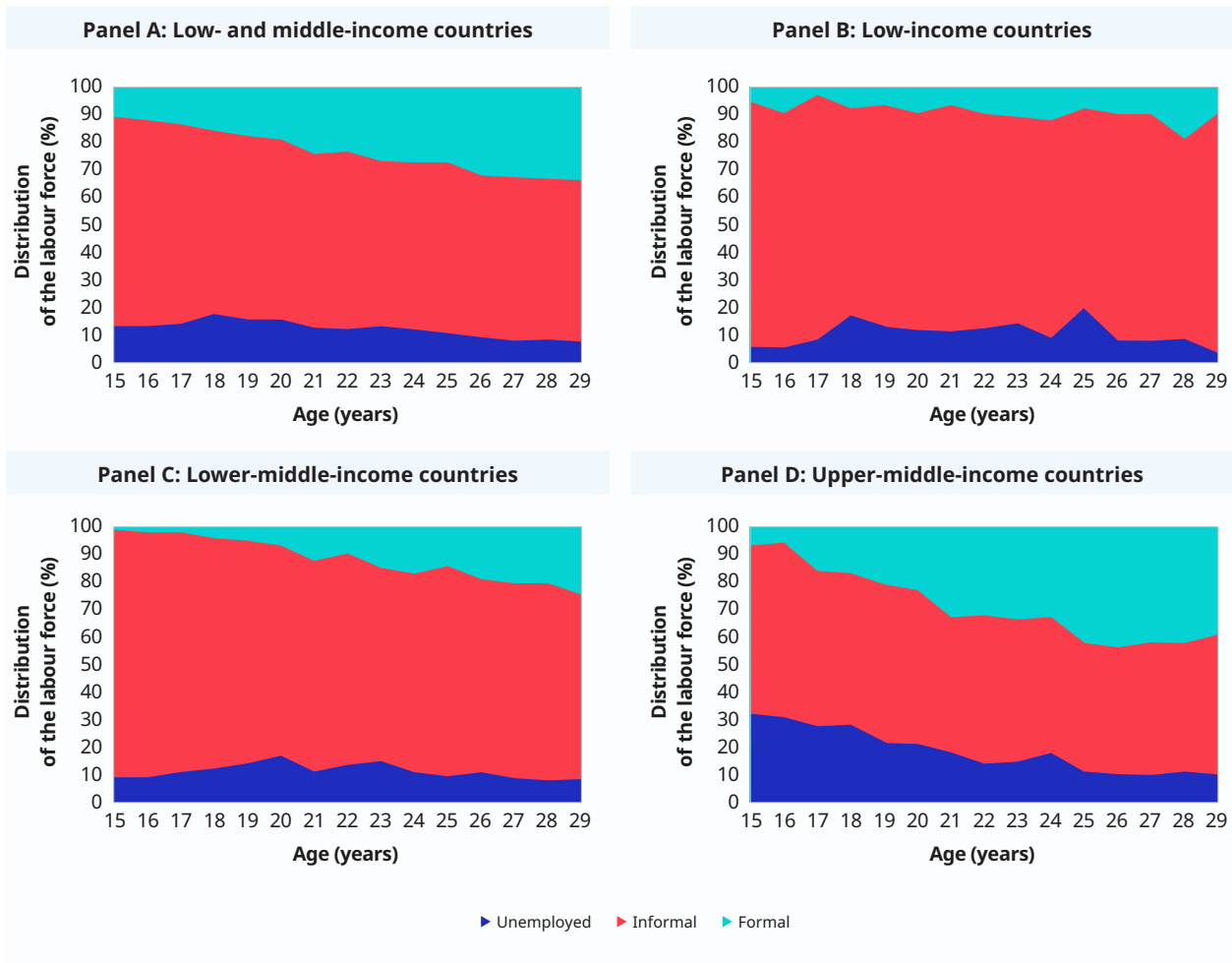
The situation of high formality rates for employees and low rates for own-account workers has been extensively studied, although not from the perspective of the trajectory of work over a lifetime. The data demonstrate that the reasons why many individuals have informal jobs vary greatly, and therefore, there can be no one solution for facilitating transitions to formality. As the 2015 ILO Recommendation No. 204 concerning the Transition from the Informal to

the Formal Economy (ILO 2015b) suggests, an integrated approach to policy development is needed, and this involves simultaneous intervention and coordination combined with an assessment of needs, as elaborated further on.

Causes and consequences: Evidence from the school-to-work transition surveys

Although there has been much research and discussion on the causes and consequences of informality in general, there have been far fewer conversations regarding young people and the same issue. Yet, the low formality rates for youth employment merit an explanation. Why does the trend occur?

► **Figure 4. Share of unemployed and employed populations aged 15–29 in 34 low- and middle-income countries, by age (%)**



Note: The data that did not include information on formality were not included in the calculations. The graph shows formal employment, informal employment and unemployment as a percentage of the economically active population.

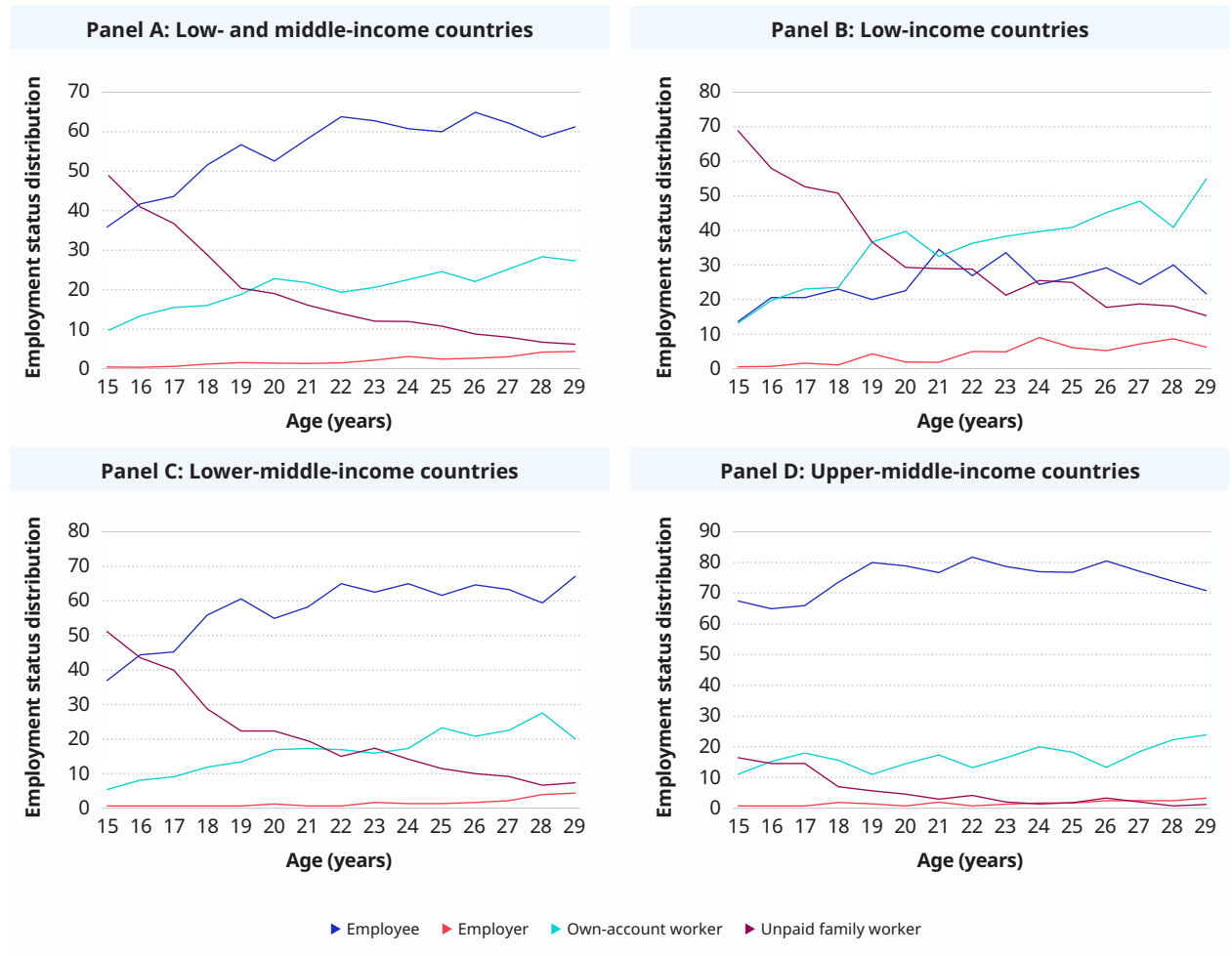
Source: The calculations are based on the ILO school-to-work transition survey data. In the case of a country with two rounds of surveys, the most recent data were used.

One possible explanation could be the nature of the demand side and/or the structure of labour markets. In some countries, informality seems to be the major point of entry for young people into the labour market, according to data from the ILO school-to-work transition survey findings, which included interviews with individuals aged 15–29. (The school-to-work transition survey database covers 34 low- and middle-income countries that conducted at least one round of the survey between 2012 and 2015.) In those cases, unemployment is not an option, and these young people must enter the labour market even if the work is not formal employment. This scenario is especially true for persons who leave the education

system prematurely because of a financial need to work.

Again in those cases, the next relevant question becomes: What jobs are available to young people? The ILO school-to-work transition survey findings show that the majority of young people, especially those younger than 18, began their working lives as unpaid workers in businesses run by their families, which were generally small businesses or microenterprises and mostly informal (figure 5). The labour market share of employees greatly increased with the age of workers and was always larger than the share of own-account workers in the overall labour market for all income groups, except for low-income countries.

► Figure 5. Employed population aged 15–29 in 34 countries, by status and age



Note: Less frequently occurring employment statuses, including members of a cooperative or similar designation, are not represented in the graphs.

Source: The calculations are based on the ILO school-to-work transition survey data. In the case of a country with two rounds of surveys, the most recent data were used.

Contributing family workers are informal by definition, and as already noted, informality among own-account workers is high. Based on the school-to-work transition survey findings, the most frequent response recorded for own-account workers was a desire for independence, especially among young men (table 1). This response was the most likely rationale given when a family business was involved. For both family workers and own-account workers, lack of finding a salaried job was the second-most cited reason. In addition, in all scenarios, women were more often influenced by family obligations than men.

Another possible explanation for the preponderance of informal work among young people could

be the characteristics of employed youth (the supply side). Young people are at a stage of life in which they are still accumulating certain assets, including skills and funds, and those will be useful for their working lives in the future. Accumulation of education is a good example of assets. Young people are still learning skills needed in the labour market, both at school and at work. As expected, a positive correlation is observed between the education level of the labour force and formality rates in work among the findings of the school-to-work transition survey. Literature on this transition discusses the heterogeneity of young people in this regard even though circumstances may vary, with some young people not having started the transition to work,

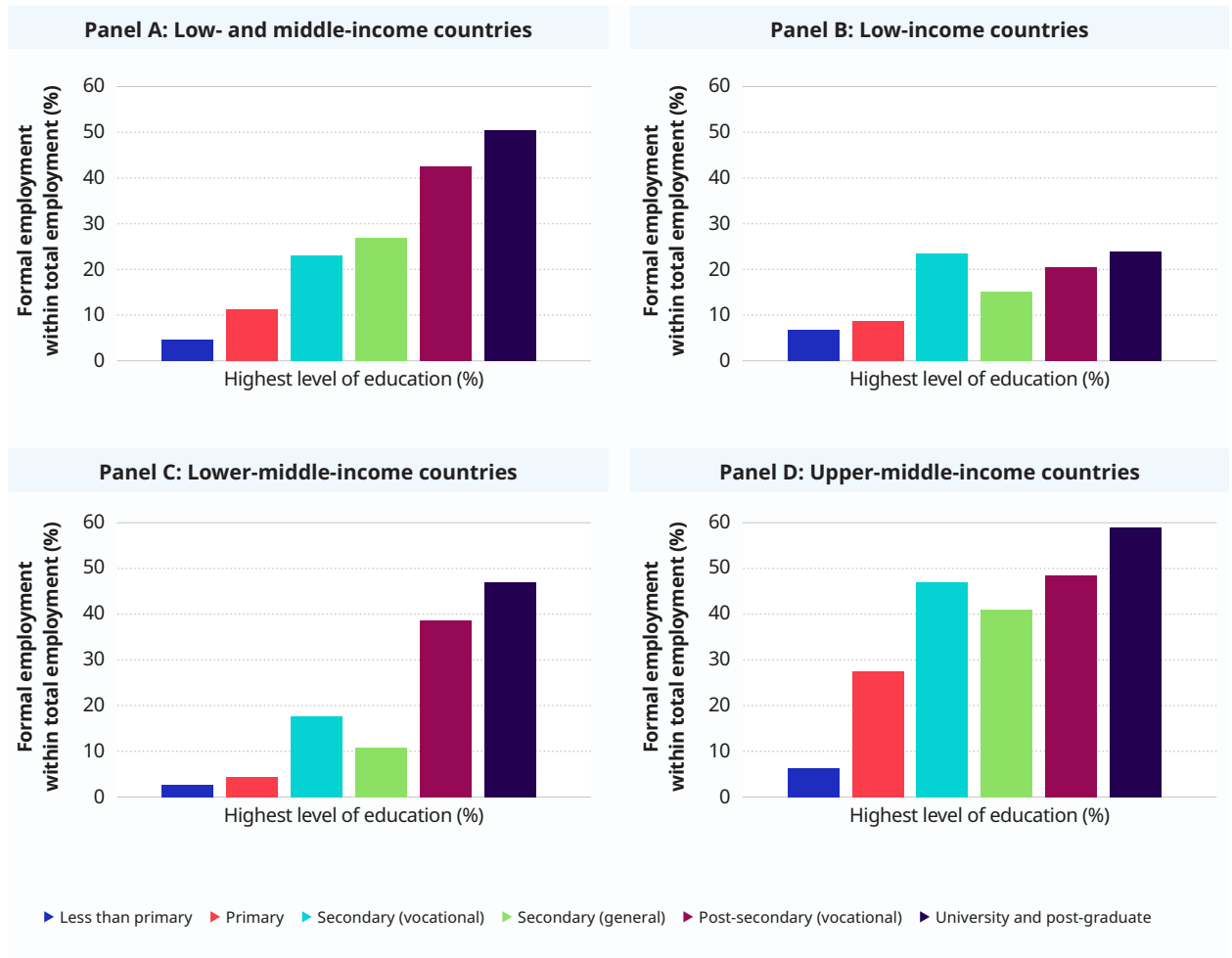
► **Table 1. Reasons why young people (aged 15–29) were own-account workers, by sex (%)**

	Male	Female	Total
Why are you in own-account work? (low- and middle-income countries)	100	100	100
Could not find wage work	29	31	30
Greater independence	42	27	36
More flexible working hours	7	12	9
Higher income level	13	10	12
Required by family	7	14	10
Other	3	5	4
Why are you in own-account work? (low-income countries)			
Could not find wage work	33	36	35
Greater independence	36	26	31
More flexible working hours	7	9	8
Higher income level	12	9	10
Required by family	9	17	13
Other	3	3	3
Why are you in own-account work? (lower-middle-income countries)			
Could not find wage work	23	18	22
Greater independence	53	39	49
More flexible working hours	5	8	6
Higher income level	12	12	12
Required by family	7	18	10
Other	0	4	1
Why are you in own-account work? (upper-middle-income countries)			
Could not find wage work	33	31	32
Greater independence	31	20	26
More flexible working hours	10	22	15
Higher income level	16	11	14
Required by family	4	7	5
Other	6	10	8

Note: Missing values were not included in the calculations, which were based on 34 low- and middle-income countries.

Source: The calculations are based on the ILO school-to-work transition survey data. In the case of a country with two rounds of surveys, the most recent data were used.

► **Figure 6. Share of informal employment among persons aged 15–29 in 34 low- and middle-income countries, by education level**



Note: Missing values were not included in the calculations.

Source: The calculations are based on the ILO school-to-work transition survey data. In the case of a country with two rounds of surveys, the most recent data were used.

some being in transition and others having fully completed the transition into the labour market and decent work.

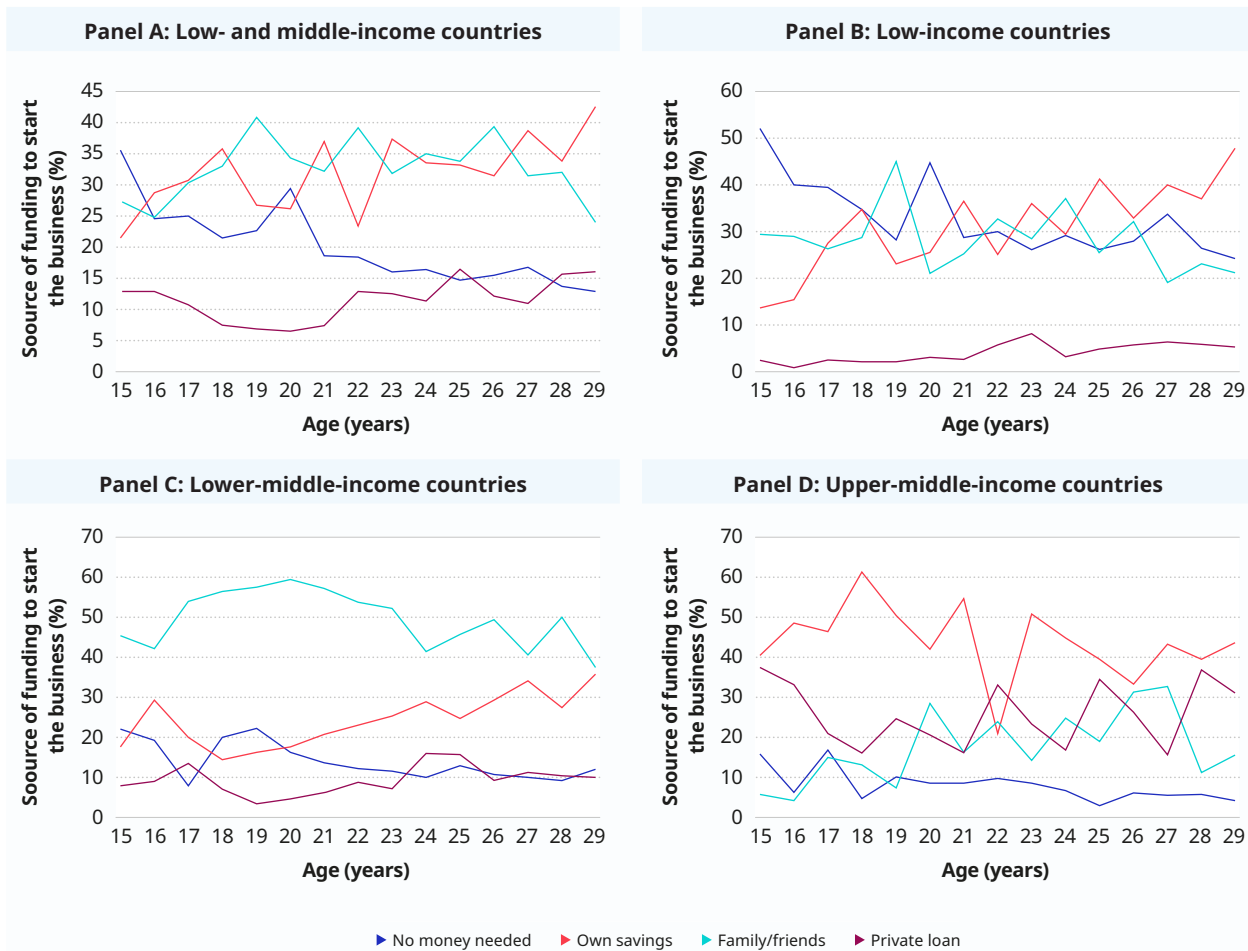
In the case of workers who made the transition to owning a business or self-employment, other assets became relevant in their set of work skills. Entrepreneurial training was fundamental, but funding to start the business was typically also crucial. Although no data were collected from persons aiming to start a business, the school-to-work transition survey asked employers and own-account workers how they had acquired funding for their entrepreneurial activities.

The most common answer to that question by the youngest workers was “no money needed”

(figure 7). This response indicates that these individuals started a business or their own-account work without significant capital. The response of “own savings” increased with age, as did “private loans”, while help from family and friends remained relatively flat for all ages, at around 30 per cent. This indicates that the young entrepreneurs and own-account workers lacked financial assets in their early years but began to accumulate them in later years.

In terms of asset accumulation, young people are generally at a disadvantage. The most notable exception to this phenomenon, and this is characteristic of the current generation of young people, is access to and the ability to learn and use new technologies. Several studies have found that even

▶ Figure 7. How did young people (aged 15–29) acquire funding to start their business?



Note: Based on 34 low- and middle-income countries.

Source: The calculations are based on the ILO school-to-work transition survey data. In the case of a country with two rounds of surveys, only the most recent data were used.

though technologies have developed rapidly over the past few decades, people born more recently are more used to them (World Bank 2016). The first question for this analysis thus becomes: What is the relationship between new technologies and formality? Certain recent studies demonstrated that new technologies have the potential to generate new forms of informality, while others pointed out that they also have the potential to facilitate the transition to formality (ILO 2016).¹³² When developing youth-centred policies, this dimension should be explored in great detail.

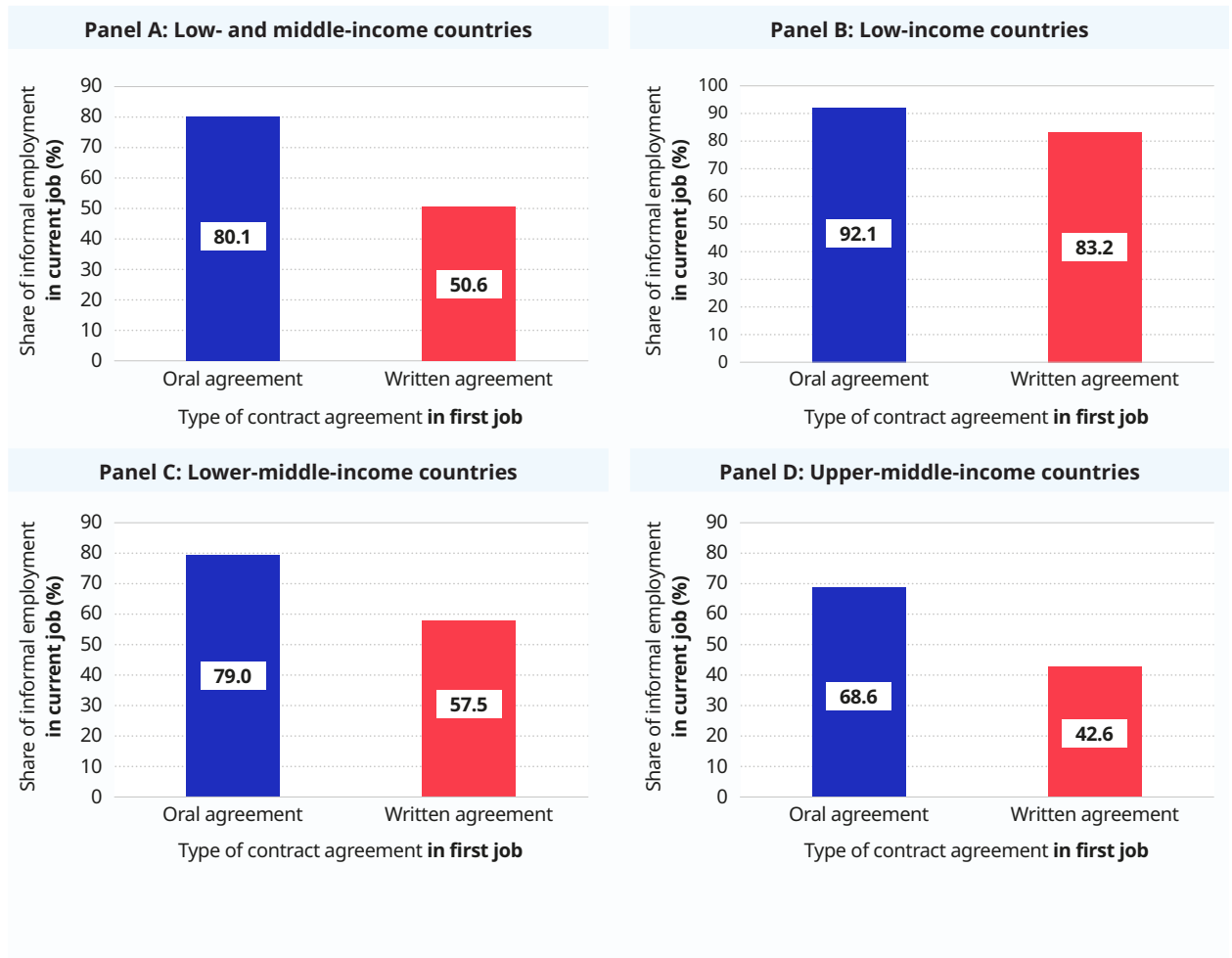
A second question then becomes: What are the consequences of low formality rates among

younger people? Because formality rates have a pattern that follows an entire working life, interventions for improving the transition to formality aimed at younger people could impact an individual later in life.

This hypothesis was demonstrated by a recent study in Latin America that compared the characteristics of current jobs and first jobs (Dema, Chacaltana and Diaz 2015; ILO 2015a) among a group of individuals. The study found that in four of the countries covered, people who had had a good start with certain formal arrangements in their working life had a greater chance of obtaining a formal job later. The analysis assumed that a written agreement was

¹³² See also Chacaltana, Lee and Leung 2018; Chen 2016.

► **Figure 8. Share of workers with informal employment in current job in 34 low- and middle-income countries, according to type of agreement in first job, by income group**



Source: Authors' extrapolation based on the ILO school-to-work transition survey findings.

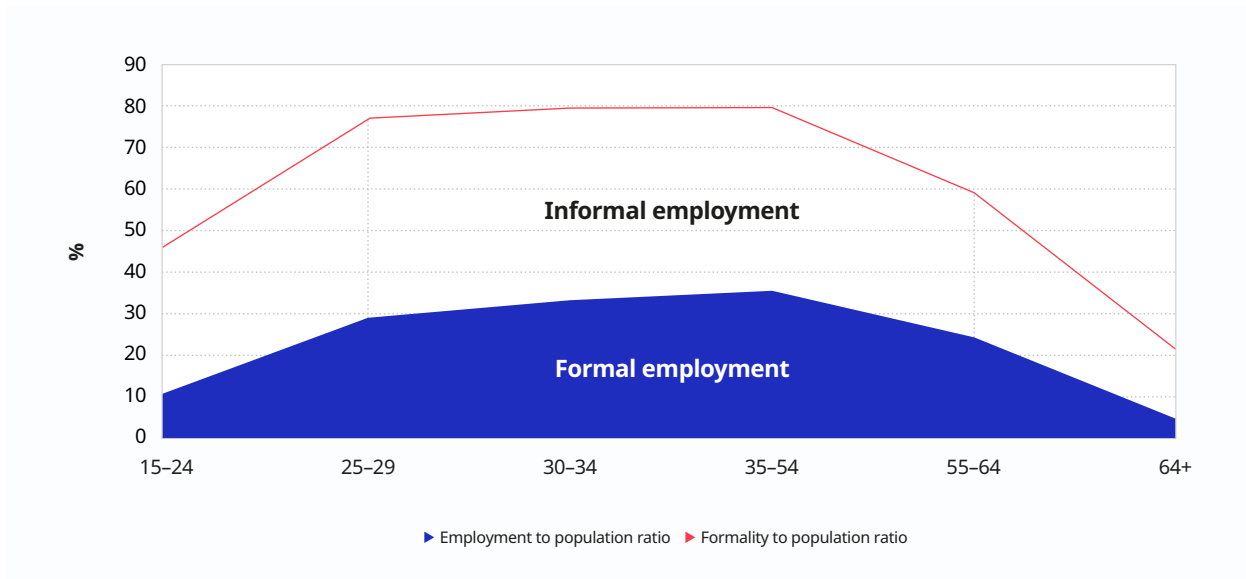
more formal and binding than an oral agreement. Overall, 50 per cent of persons working informally in their current job (at the time of the study) had had a written agreement in their first job, whereas 80 per cent of those with only an oral agreement in their first job were working informally in their current job. The similar differences also existed in the low-income countries in the school-to-work findings (figure 8).¹³³

Policies need to be age sensitive

ILO Recommendation No. 204 provides a comprehensive policy framework for the transition from the informal to the formal economy. An empirical age earnings profile could have different policy implications for different age groups. Formality in work increases with age and then, at a certain point, it decreases, but the employment-to-population ratio remains the same (figure 9). The difference between the employment-to-population ratio and the formality rate is the informality gap, and this

¹³³ These differences were not controlled for in the data. Interestingly, another case study on Peru indicated that these differences persisted at rates of around 17 per cent even when controlled for as characteristics. See Cavero and Ruiz 2016.

► Figure 9. Informality gap



Source: Authors' calculations based on ILO 2018.

must be countered with specific policies. It is clear that while some transversal policies are applicable to all age groups, certain aspects could be emphasized for specific groups. For example, policies applicable to young people are not necessarily relevant for older adults.

Young people require comprehensive measures that will facilitate their school-to-work transition. These measures could include youth guarantee schemes that provide access to training and ongoing productive employment. Policies aimed at providing childcare and access to productive assets would benefit women and younger women in particular. Policies intended to improve legislation and regulatory frameworks to mitigate the exclusion of certain individuals, including domestic and agricultural workers, for example, would be needed to bring them under the scope of formal work arrangements.

Policies for managing the traversal drivers of informality include pro-employment macroeconomic policies that support aggregate demand, productive investment and structural transformation for formal job creation and measures to improve the efficiency of social security systems and services.

What are the most common approaches for supporting the transition of young workers to formality? The ILO Youth Employment Policies and Legislation, or YouthPOL, database, which encompasses 485 policy documents concerning young people in 65 countries around the world dating from 1947 to 2015, is a good source of ideas. The database classifies various policy types, including from training to macroeconomic measures.¹³⁴

The most common approaches to promote youth employment relate to incentives for labour demand, mainly for work as employees, and to enterprise development for entrepreneurs. These types of policies are generally known as “first-job” and/or “first-business” initiatives. However, initiatives for both business and employment formalization are not common: Of the 485 policy documents in the YouthPOL database, only 11 of them concentrate on registration and compliance of enterprises in the informal economy and only ten documents provide incentives to promote the transition of informal young workers to the formal economy (table 2).

Regarding first-job measures aimed at promoting salaried jobs, the most common approach is to provide incentives, in particular, by providing wage

¹³⁴ See www.ilo.org/employment/areas/youth-employment/youth-pol/lang-en/index.htm.

► **Table 2. Documents in the YouthPOL database concerning policy approaches to youth employment and formality**

	Total
Total policy documents in the YouthPOL database	485
Number of countries included	65
Is education and training addressed in the document?	392
Are labour market policies addressed in the document?	239
Is enterprise development addressed in the document?	173
Is there an explicit strategy for ensuring access to non-financial services?	102
Is there an explicit strategy for ensuring access to finance?	96
Is there an explicit strategy for any other measures regarding self-employment?	90
Is there an explicit strategy for enterprise start-ups for young people?	79
Is there an explicit strategy for promoting registration and compliance of existing enterprises in the informal economy?	11
Is labour law and legislation addressed in the document?	111
Is labour demand addressed in the document?	103
Is there an explicit strategy for raising incentives for employers to recruit young people?	
Yes	80
Yes, on tax rebates	13
Yes, on wage subsidies	40
Yes, on waiver for social security contributions	21
Yes, on other measures to reduce labour costs	23
No	23
Is there an explicit strategy for incentives to promote the transition of informal young workers from the informal to the formal economy?	10
Is there an explicit strategy outlined for any other measures aimed to boost the demand for youth labour?	22
Are macroeconomic and/or sectoral policies addressed in the document?	45
Have these policies been evaluated? Yes.	37

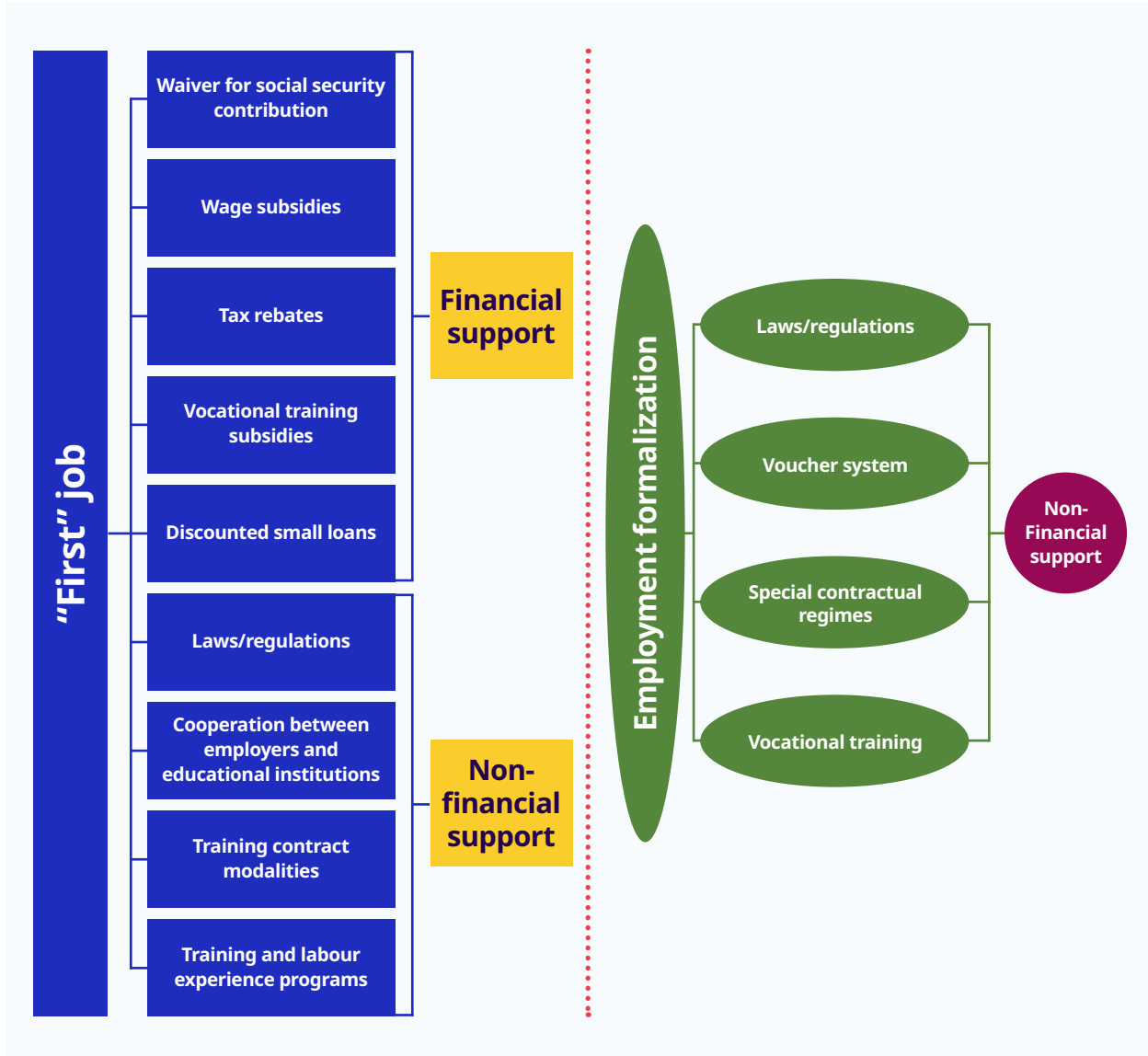
Source: ILO 2017, based on the ILO Youth Employment Policies and Legislation database.

subsidies for formal enterprises to hire young people. That measure allows authorities to monitor the hiring practices of formal entities. Other approaches include social security contribution waivers, tax rebates, vocational training subsidies and discounts on small loans, all with the aim of bringing young people into the labour market. In addition, amending laws to ensure job security, promoting cooperation between employers and educational institutions, offering special training contracts and labour experience programmes that aim to aid poor and vulnerable young people are common non-financial means of support to facilitate access for young people in obtaining their first job.

A more detailed review of the ten policy documents intended to promote the transition of young workers from the informal to the formal economy found measures to enact laws and regulations that facilitate formalization, promote a voucher system and call for special contractual regimes and vocational training programmes (figure 10).

In the case of first-business interventions, the most common policy approach is to provide general non-financial services to young people. For example, the approach could include laws and regulations to support youth entrepreneurship and solidarity economy, provide opportunities for young

► Figure 10. Type of financial and non-financial support in youth policies focused on first job and the formalization of informal employment among young people



Source: ILO 2017, based on the ILO Youth Employment Policies and Legislation database.

people to engage with enterprises, training, start-up support and follow-up guidance and mentoring and, lastly, through the building of infrastructure, including incubators and one-stop-shop access aimed at improving the business environment.

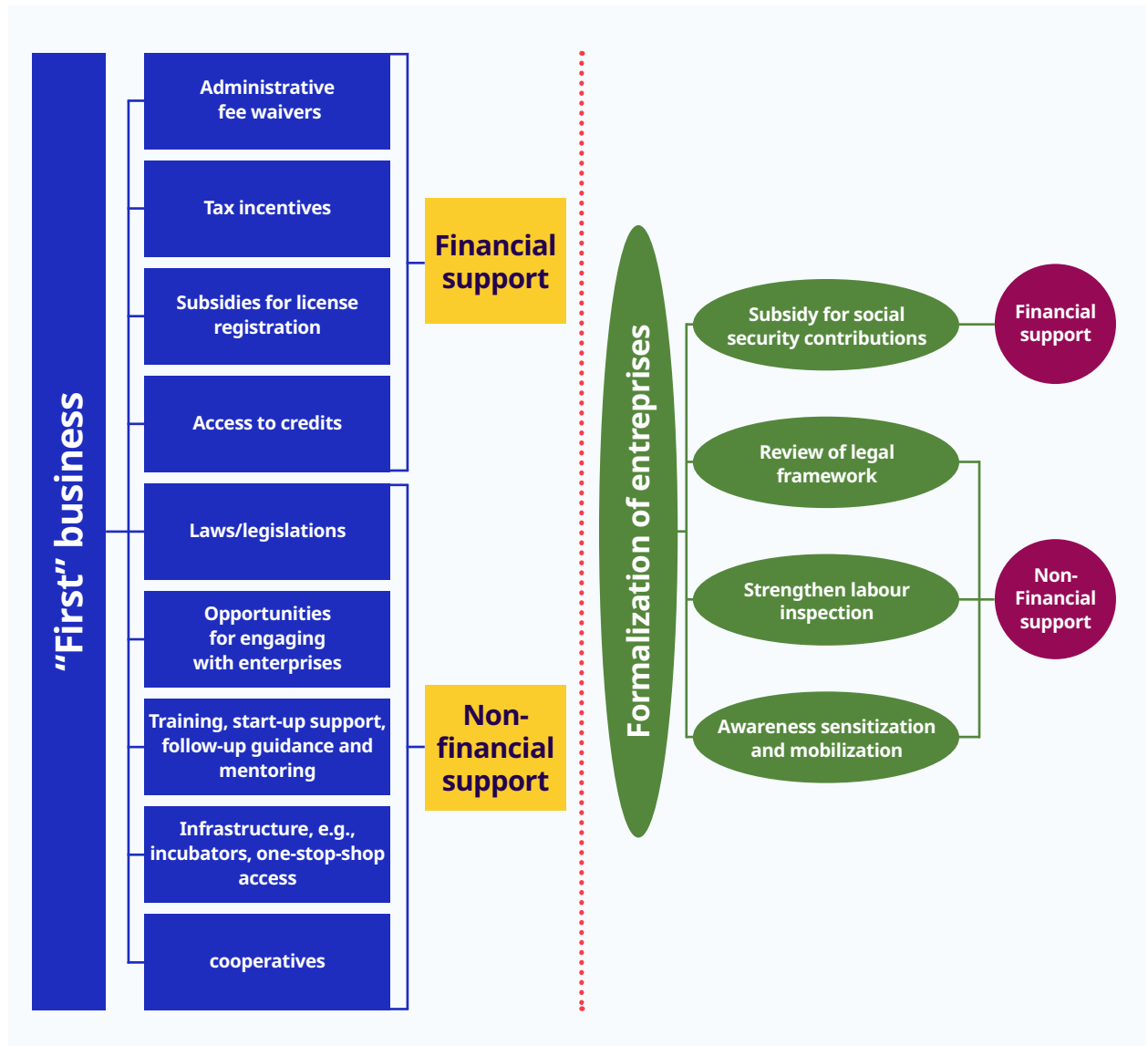
Because it is more difficult to monitor whether a start-up enterprise will be formal, there is greater need for a more targeted approach to formality. Interventions documented in the YouthPOL database related to formality concentrate on social security contribution subsidies, the strengthening

of enforcement bodies, the building of legal frameworks and awareness and mobilization.

Are these policies effective? Unfortunately, few of the policies in the YouthPOL database have been evaluated, at only 8 per cent. In general, literature on the impact of formalization policies is rather new, and there is not that much available.

Jessen and Kluge (2019) conducted a systematic search and review for English- and Spanish- language documents and found approximately 30 impact studies. Among their many findings,

► Figure 11. Types of financial and non-financial support in youth policies focused on start-up businesses and the formalization of informal enterprises operated by young people

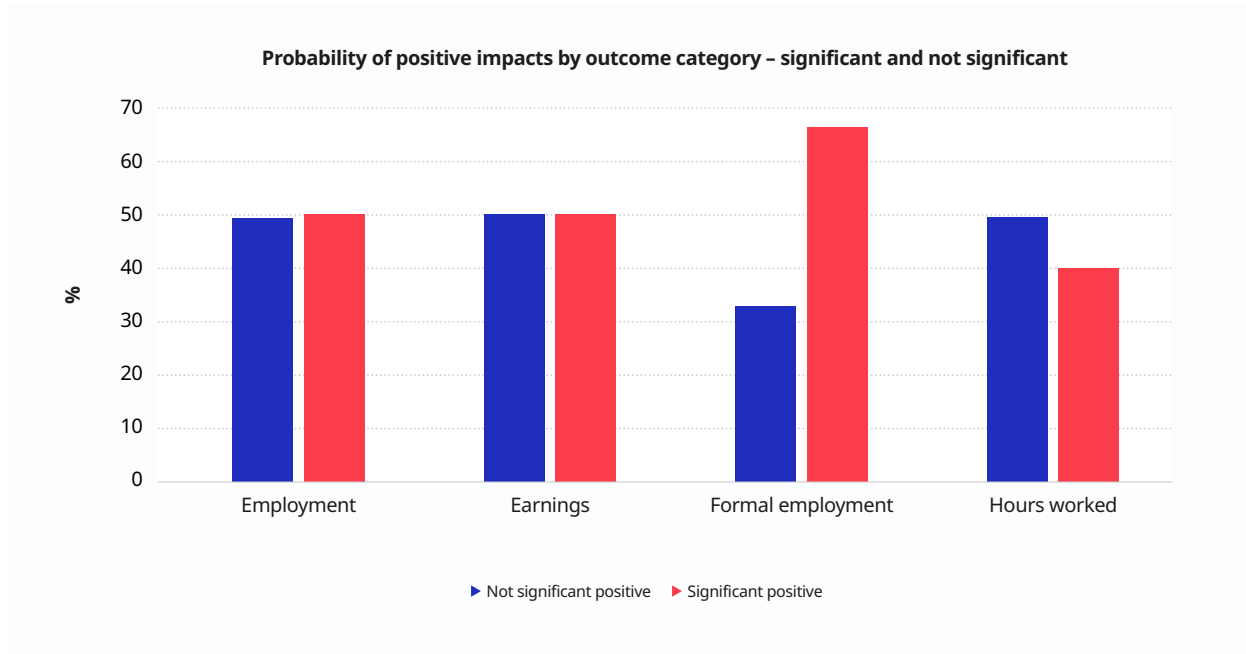


Source: ILO 2017, based on YouthPOL database.

they pointed out that the “formal jobs and labour registration” factor, also known as labour formalization, had a much higher probability of a positive and significant impact on labour market outcomes than other factors, including enterprise registration, wages, enterprise profitability, tax revenue and investment. Jessen and Kluge concluded that this was an important finding and that it may indicate that worker registration is a pivotal factor in labour market formalization. Concentrating on that issue could potentially be more promising than interventions that target other aspects of formalization.

Overall, most evaluations on youth have looked at the impact of active labour market policies (see Kluge et al. 2017). Few of these studies, however, cited formality as a targeted variable. Interestingly, while reviewing the impact of the active labour market policies in the Latin America and Caribbean region, one recent study found that (when compared to other outcomes, including employment, earnings or hours worked) formal employment was the outcome with the highest probability of having a significant positive impact on the labour market (figure 12 and Escudero et al. 2017).

► **Figure 12. Latin America and Caribbean study results: Formality as an outcome of active labour market policies**



Note: The number of total observations in the four outcome categories are: 89, 108, 59 and 37.

Source: Escudero et al. 2017.

Applying new technologies will be integral to the world of work

The most important conclusion to be drawn from the age-related formality profile and its characteristics, causes, consequences and policy implications is that policies aimed at the transition of young people to formality affect more than a young worker's current situation. They also impact the lifetime formality profile of that individual. Hence, youth employment strategies should make young people aware of the long-term implications that a good start to their working life will have on their entire career.

In many developing countries, young people begin their working careers as unpaid family workers. This phenomenon highlights the importance of finding ways to facilitate workers' transition to formality within this context, including, for example, through informal apprenticeships.

Youth formality policy approaches primarily emphasize first jobs, including through wage subsidies and

first-business strategies. Although there is a lack of information available regarding the effectiveness of these strategies in terms of formalization of the overall labour force, there is even less information on youth employment formalization and on informal enterprises operated by young people. More evaluations on policy interventions that facilitate the transition of young people to formality are needed.

More studies are also needed that examine the impact that formalization interventions have on the labour market. Particular attention should be given to youth issues, including first-job and first-business interventions, to verify to what extent these programmes actually lead to formality and for how long and to determine other policy measures that could facilitate transitioning young people from the informal to the formal economy.

Most current policy approaches to both individual employment and business generation assume that the employment created by those policies is formal. That is not necessarily the case. Therefore, more policies should be directed at the transition of young people to formality. It is not simply that

a greater number of jobs are needed but, rather, good jobs must be created to facilitate full and productive employment for individuals and to promote the Decent Work Agenda.

The reasons for higher informality rates among young people may be attributed to both the demand and supply sides. Factors contributing to the demand side include the fact that young people often work in sectors with higher rates of informality, while a lack of assets that contribute to better labour market outcomes, including education, skills and financing, affect the supply side.

Young people have ample access to a new and critical asset: new technologies. For this reason, the use of new technologies to improve formalization for young people is promising (Chacaltana, Leung and Lee 2018). Applying new technologies

has become a critical part of the world of work, and this is expected to continue. The role that technology can take in facilitating the youth transition to formality in the twenty-first century labour market deserves attention, especially regarding the use of technology in the financial inclusion of young people and in delivering public services by capitalizing on technological improvements.

Goals regarding the achievement of transitioning young people to formality should refer to the policy guidance outlined in Recommendation No. 204, including applying the threefold objectives of creating formal employment, transitioning workers and economic units from the informal to the formal economy and preventing the informalization of formal employment.

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