INFORMALITY MATTERS

GLOBAL FAIRNESS INITIATIVE

The **Global Fairness Initiative** promotes a more equitable, sustainable approach to economic development for the world's working poor by advancing fair wages, equal access to markets, and balanced public policy to generate opportunity and end the cycle of poverty. GFI's approach consists of:

- Engaging multiple stakeholders—workers, employers, private enterprise, and government—to find economic solutions and create opportunities.
- Partnering with locally established organizations to have the greatest impact and leave behind lasting results and institutions.
- Leveraging international networks of respected experts, political and social luminaries, trade and finance stakeholders, and business leaders to maximize the inputs and impacts of organizational initiatives.

CONTENTS:

A CALL TO ACTION

It has been 40 years since the International Labour Organization first used the term "informal sector" to identify the now billions of unprotected workers engaged in legal but unregistered enterprises outside formal economic structures. Since then, the world's economies, large and small, have undergone extreme booms and busts; and the most vulnerable have been those with the largest rates of informality. **Today we face the challenge and opportunity to promote inclusive growth across interconnected and interdependent economies.**

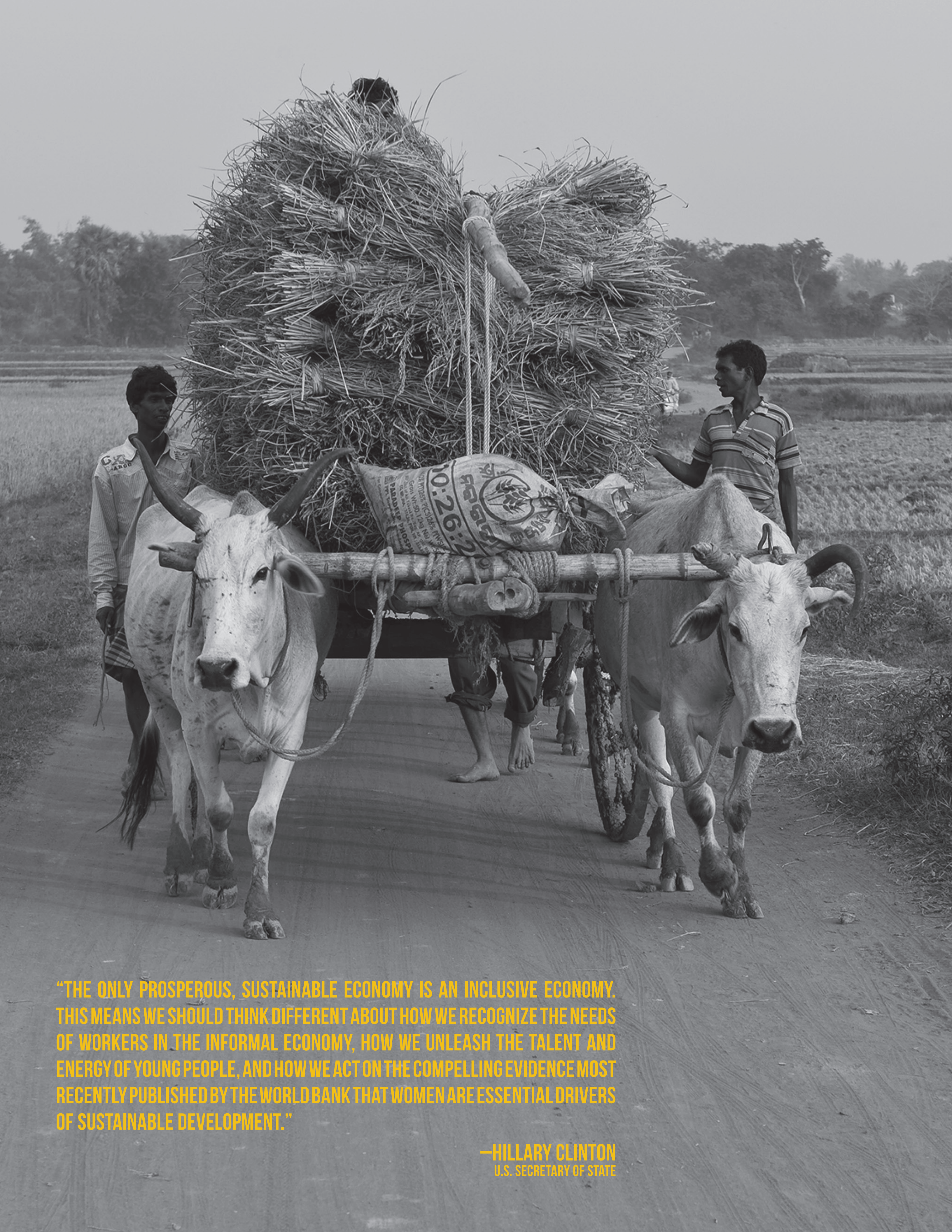
Informal workers WORK – often incredibly long hours under harsh conditions and for little pay. A large informal sector can improve a country's overall economy by boosting innovation, production, and income levels—but only for the short term. Leaving these workers on the periphery means that as much as two-thirds of the world's working population remains undeveloped and that we lose a potentially thriving addition to the mainstream economy. **A sustainable global economy requires the integration of all workers.**

With four decades of successes and failures in integrating informal workers into mainstream markets, **we have the knowledge to implement real and lasting change.** Bringing together all stakeholders—workers, business, and governments—will move us beyond short-term, immediate (and, ultimately, ineffective) fixes to a concerted approach for inclusive economic growth.

We would like to thank the many people and organizations who continue to promote the rights and interests of the poorest workers around the world. Together we can ensure that everyone can realize the promise of a global economy.

Karen Tramontano
President and Founder

Caleb Shreve
Executive Director



"THE ONLY PROSPEROUS, SUSTAINABLE ECONOMY IS AN INCLUSIVE ECONOMY. THIS MEANS WE SHOULD THINK DIFFERENT ABOUT HOW WE RECOGNIZE THE NEEDS OF WORKERS IN THE INFORMAL ECONOMY, HOW WE UNLEASH THE TALENT AND ENERGY OF YOUNG PEOPLE, AND HOW WE ACT ON THE COMPELLING EVIDENCE MOST RECENTLY PUBLISHED BY THE WORLD BANK THAT WOMEN ARE ESSENTIAL DRIVERS OF SUSTAINABLE DEVELOPMENT."

—HILLARY CLINTON
U.S. SECRETARY OF STATE

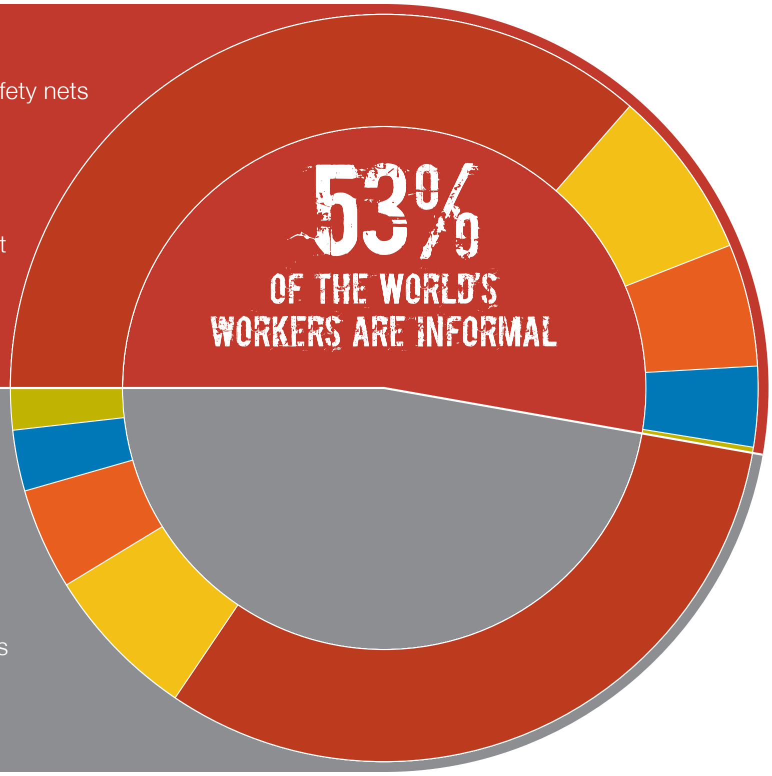
INFORMALITY MATTERS

The December 2010 uprising in Tunisia, set off by the self-immolation of Tarek al-Tayeb Mohamed Bouazizi, brought to international attention the powerlessness felt by billions of informal workers around the world. Excluded from the mainstream economy by the barriers of corruption, ineffective regulations, prohibitive costs and administrative processes, and lack of training or representation, the world's informal sector continues to grow.

INFORMALITY AT A GLANCE:

4 BILLION WORKERS LACK:

- Social security or other safety nets
- Labor rights protections
- Access to training and education
- Access to finance or credit
- Childcare at work

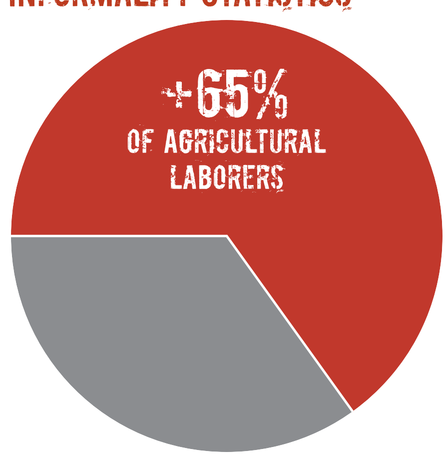


THE FORMAL SECTOR:

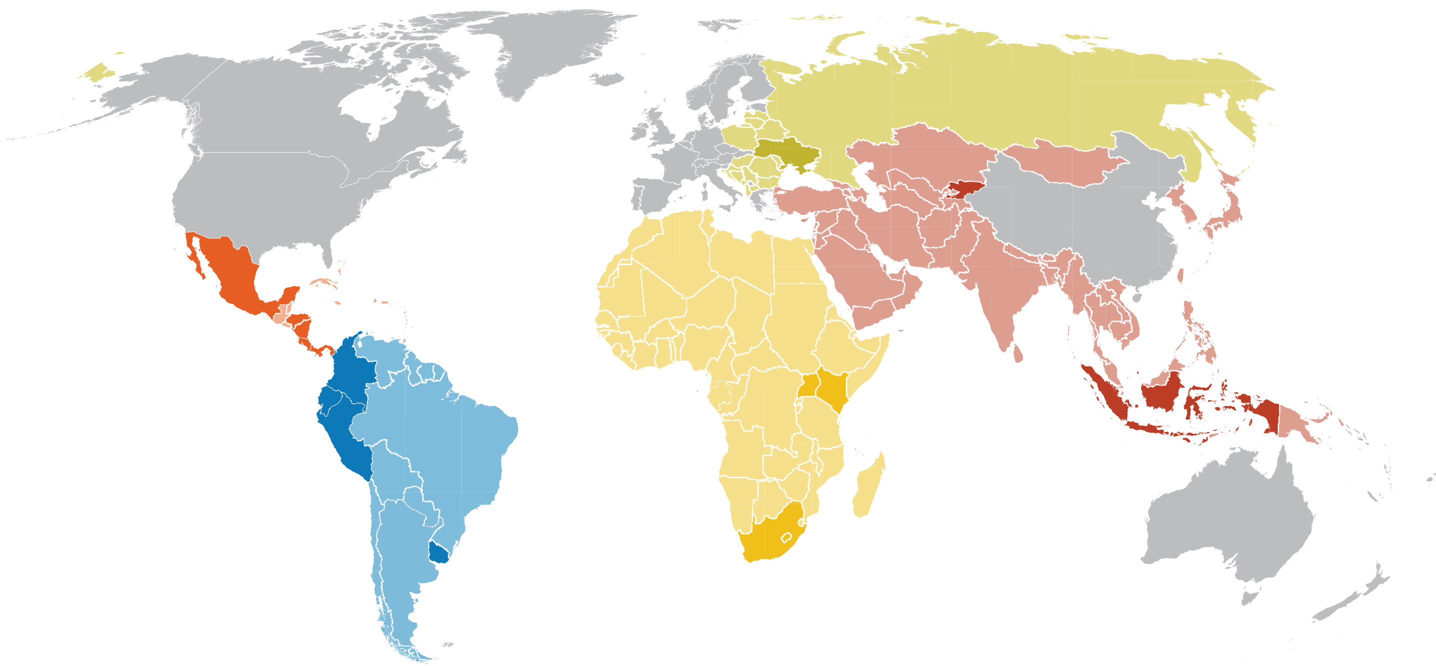
- Cannot protect intellectual/property rights
- Suffers from unfair competition and obscure supply chains
- Has limited export markets
- Has difficulty attracting foreign investment

EXCLUSION OF AGRICULTURAL WORKERS FROM INFORMALITY STATISTICS

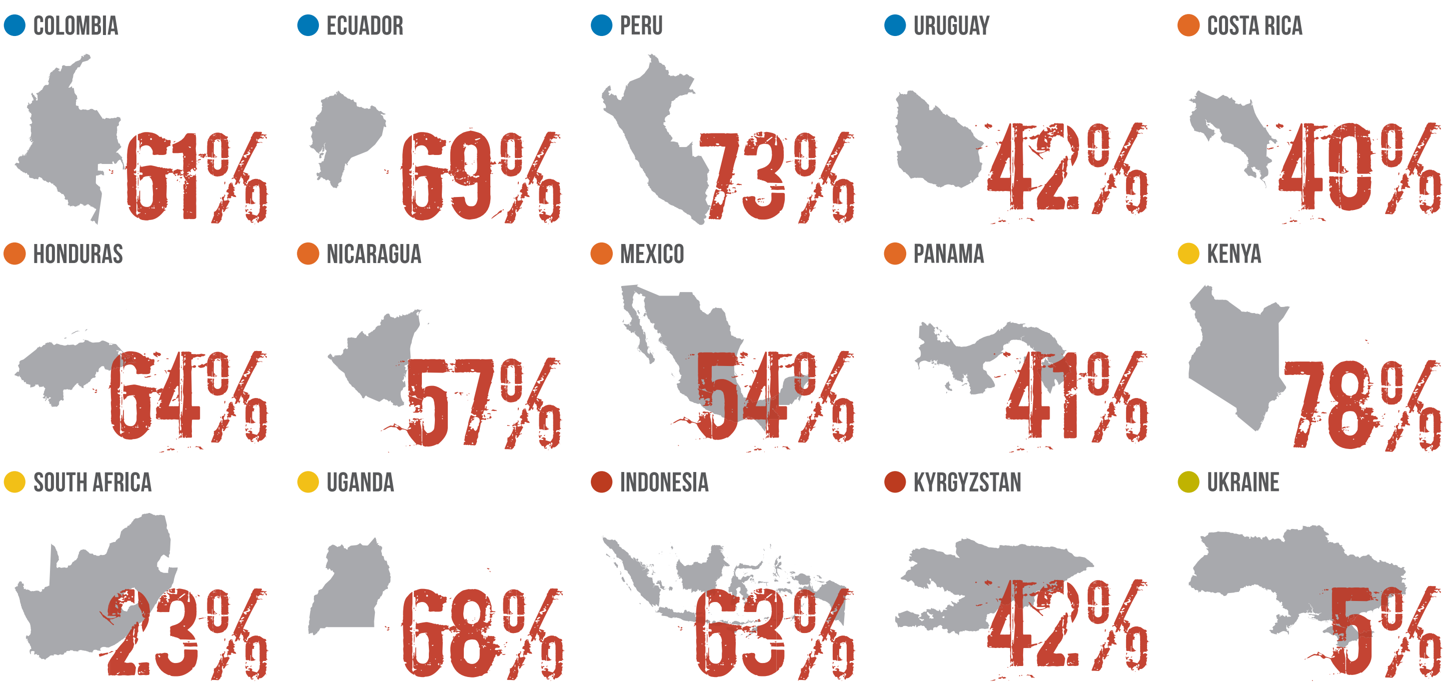
Because informal workers operate without registration, determining their exact numbers is difficult. In the case of agricultural workers—often temporary, migrant, or working in remote areas—quantifying informal participation is even more of a challenge. Current estimates put informal agricultural employment at more than 65% of total wage employment, with rates as high as 80% in regions that rely heavily on agriculture.



AREAS OF STUDY:



INFOMALITY RATES AMONG SAMPLE COUNTRIES



INFORMAL ECONOMIES:
SEPARATE BUT NOT EQUAL

Informality encompasses the economic activities that workers engage in outside a nation's mainstream economy. It doesn't include illegal workers or activities but is, put simply, undocumented work by unregistered individuals or enterprises. The informal sector exists as a parallel economy, its participants segregated—whether by choice or not—from the formal labor market.

With more than 50% of non-agricultural workers and 65% of agricultural workers operating informally in developing countries, a majority of the population lives and works in a separate track, excluded from the structures and opportunities that bring workers, governments, and the private sector together for vibrant and transparent economic growth.

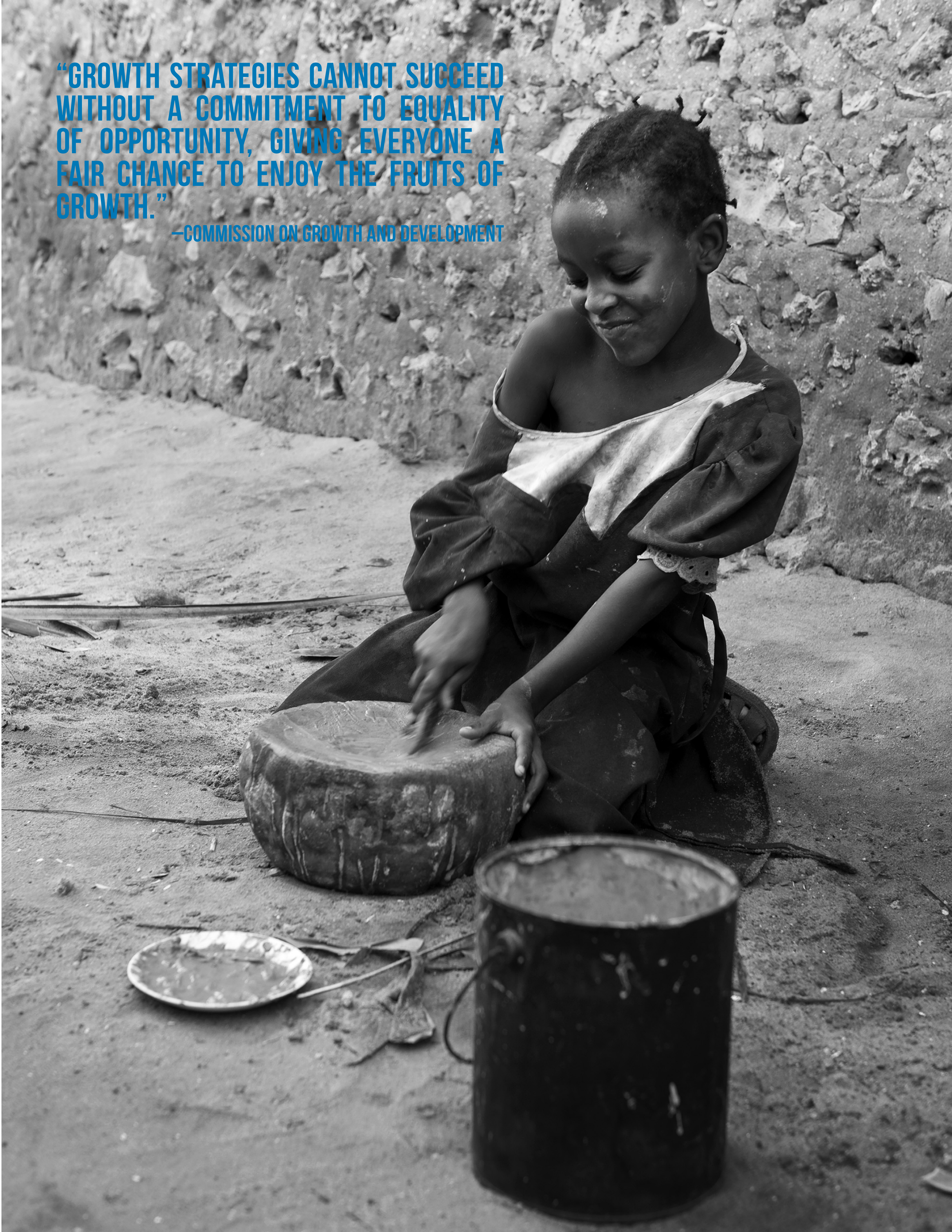
Despite some positive short-term effects—like job creation and income generation for a rapidly expanding labor force—**informality is both a cause and effect of long-term economic instability.** Chronically high informality levels point to serious institutional and regulatory problems. The factors contributing to informality—such as ineffective regulations, high registration costs, corruption, and inadequate jobs and education—limit growth and undermine economic and social development. Most troubling, however, is that **informality is self-perpetuating**. That is, it increases poverty rates and income inequality and becomes more difficult to correct the longer it goes on.

In its 2012 report, "Informality in Emerging Markets: A Cross-Country Examination," the Global Fairness Initiative examined the implications of informality in 15 developing countries. Primary findings include:

- The causes of informality vary among countries, but in all cases workers either are excluded involuntarily from the formal labor market or choose to opt out because of ineffective regulatory frameworks.
- The long-term effects of informality—such as further marginalization of already powerless groups, reduced competitiveness, and erosion of the rule of law—are associated with underdevelopment and stagnation.

"GROWTH STRATEGIES CANNOT SUCCEED WITHOUT A COMMITMENT TO EQUALITY OF OPPORTUNITY, GIVING EVERYONE A FAIR CHANCE TO ENJOY THE FRUITS OF GROWTH."

—COMMISSION ON GROWTH AND DEVELOPMENT



RECOGNIZING THE IMPACT OF INFORMALITY

ON WORKERS

Exclusion from taxation and the regulatory framework of the formal economy leads to the legal and economic disempowerment of the informal work force. Unregistered and undocumented informal workers—trash-pickers, street vendors, domestic workers, smallholder farmers, artisan fishermen—often endure low pay and significant occupational risks, including unhealthy and unsafe working conditions.

Without the protection of labor rights regulations, informal laborers have no access to employment benefits like minimum wages and paid sick leave or to social safety nets like unemployment insurance and social security. They have no redress for employer violations and no collective bargaining power. Without legally documented and protected assets, informal workers and microenterprises have limited access to credit or financial services, as they are unable to enter into contracts or raise investment capital without proper collateral.

All of these factors related to informality increase segmentation in the labor market, further marginalizing already marginalized communities. On average, informal workers receive lower wages than formal laborers, with over 600 million informal workers earning less than $1.25 per day according to ILO estimates. The divide between formal and informal workers contributes to income inequality and poverty rates. Informal workers are much more likely to work in unskilled jobs, have little education or access to training, and work informally for a family member or friend. This lack of access and opportunity means limited mobility and little ability to influence or engage in policy dialogue. **Informal workers and their families are likely to remain informal and, thus, remain poor.**

FOCUS: AGRICULTURE

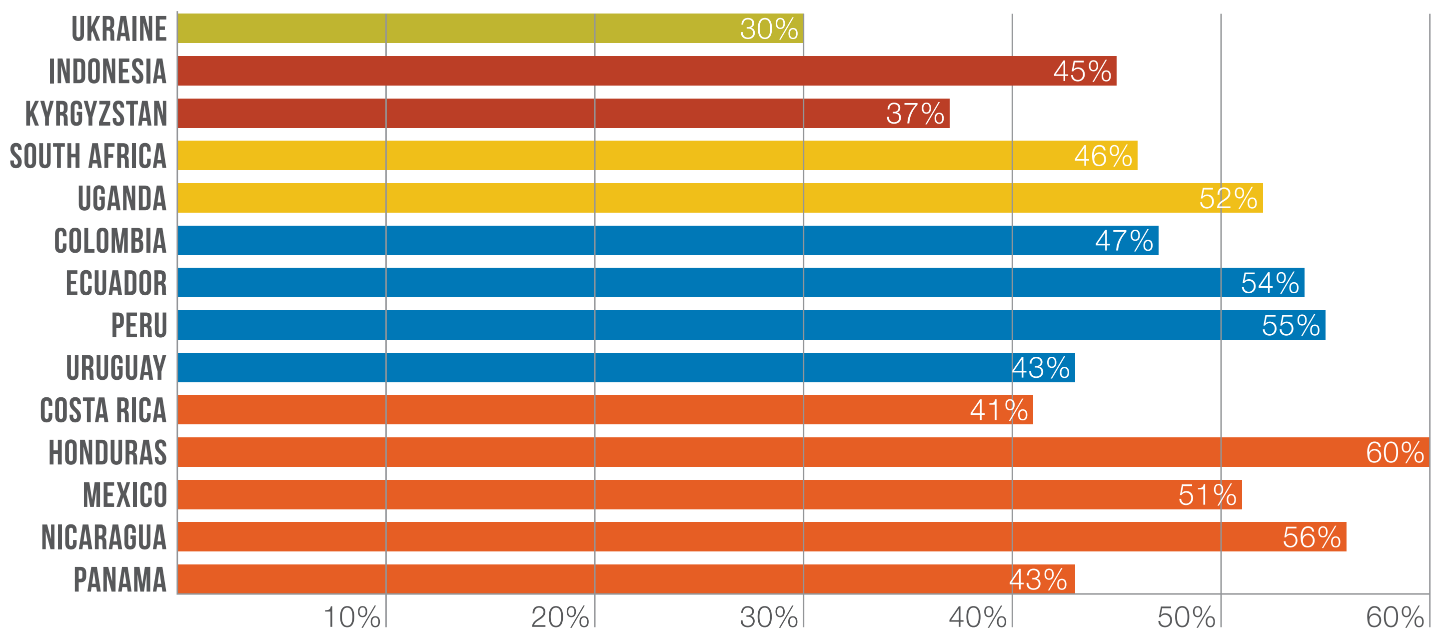
Low productivity in the agricultual sector of developing countries can have disastrous results for the rest of the world. According to the OECD-FAO Agriculture Outlook 2012-2021, world agricultural production needs to increase by 60% over the coming decades to meet the food demands of the growing world population. Developing countries must drive this growth because they have the potential to devote more land to agriculture and to improve productivity. With a limited amount of total arable land available for agriculture, however, the real change these countries will have to make is in significantly increasing their productivity. Unfortunately, low productivity and high rates of infomality go together. Food production—and the laborers who engage in it—will benefit from improved and innovative farming practices as well as a better commercial, technical, and regulatory environment with policies that support the unique needs of smallholder (generally informal) farmers.

WOMEN AND INFORMALITY

Women are perhaps the most vulnerable group in the informal sector, accounting for almost three quarters of the informal workforce in some developing countries. With cultural and social attitudes that relegate household and childcare duties to women, that limit their education or how far they may travel, informal work is often the only way for women to earn an income while fulfilling domestic responsibilities. Women are working—but with few protections or opportunities for advancement.

Informality traps women and their families in a cycle of poverty. Juggling work and family responsibilities, these women have little time or money to invest in training that might increase their income potential and mobility. Without access to affordable childcare, many women in the informal sector must leave children home alone or with an older sibling—or even bring them to work.

PERCENTAGE OF FEMALE INFORMAL SELF-EMPLOYMENT



FOCUS: CHILD LABOR

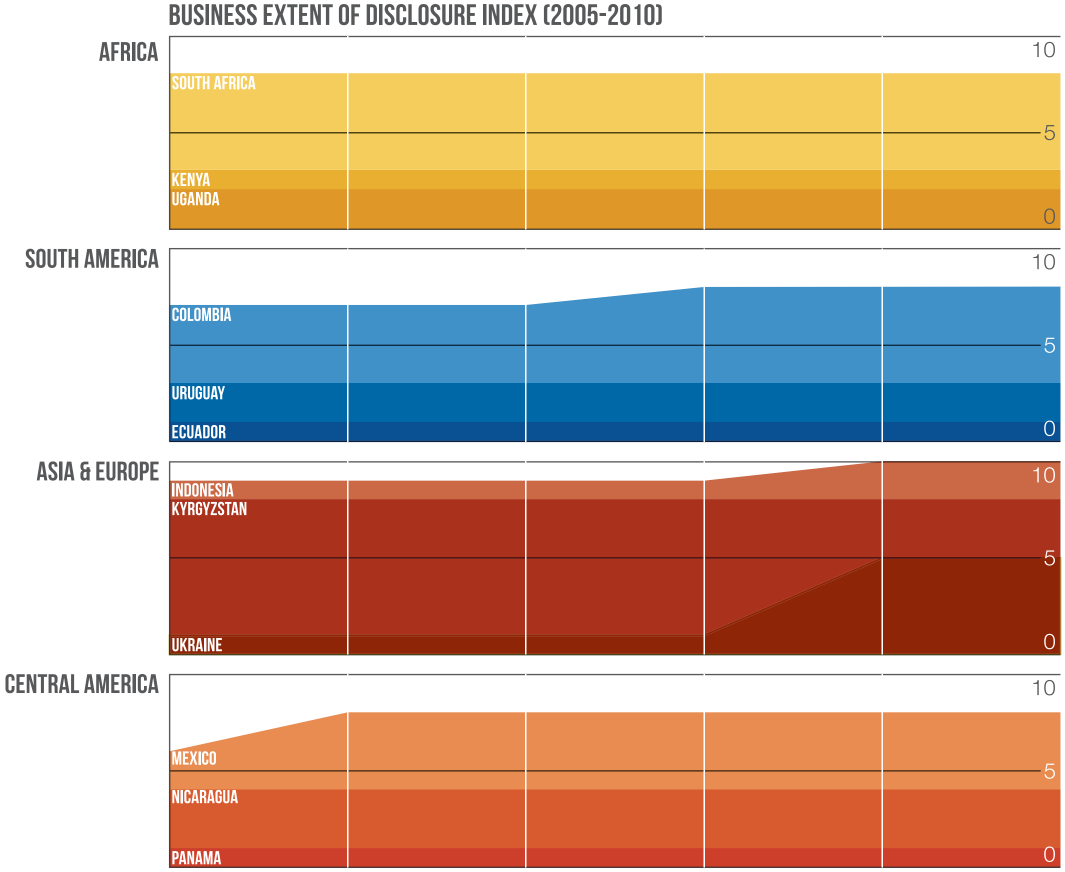
Because it cuts children off from opportunities for education and development, informality deepens the divide between children of different socio-economic strata. Countries with high rates of informality—particularly female informality—generally have high rates of child employment (over 90% of children aged seven to fourteen in some regions). Robbed of their childhoods, children who can't attend school because they must work to help their families survive are also robbed of their futures. Gathering water, farming on small subsistence crops, or shining shoes—working children will remain trapped in low-skilled and low-paying employment as adults.

ON THE PRIVATE SECTOR

Informality limits the dynamism and competitiveness of the private sector, stifling growth and development. Unable or unwilling to comply with complex or costly regulations, many firms and workers prefer participation in the informal economy. The ineffective regulatory framework that allows this "opting out" means that even formal firms operate in a system that lacks accountability and transparency and encourages corruption. Within this environment, all private sector firms have limited access to financing, including small loans or long-term foreign direct investment. Potential investors cite factors associated with informality—policy uncertainty, unfair competition, and corruption—as major concerns.

The World Bank's Business Extent of Disclosure Index (BEDI) measures the extent to which business investors are protected through disclosure of ownership and financial information. Index values range from 0 to 10, with 10 indicating higher disclosure. Countries with high rates of informality typically have low BEDI values. For example, Honduras and Ecuador had BEDI values of 0 and 1, with informality rates of roughly 74% and 61%, respectively. Countries with lower levels of informal employment had correspondingly higher BEDI values—South Africa's informality rate reached 33% over the past several years, and its BEDI value has remained at 8.

BUSINESS EXTENT OF DISCLOSURE INDEX (2005-2010)

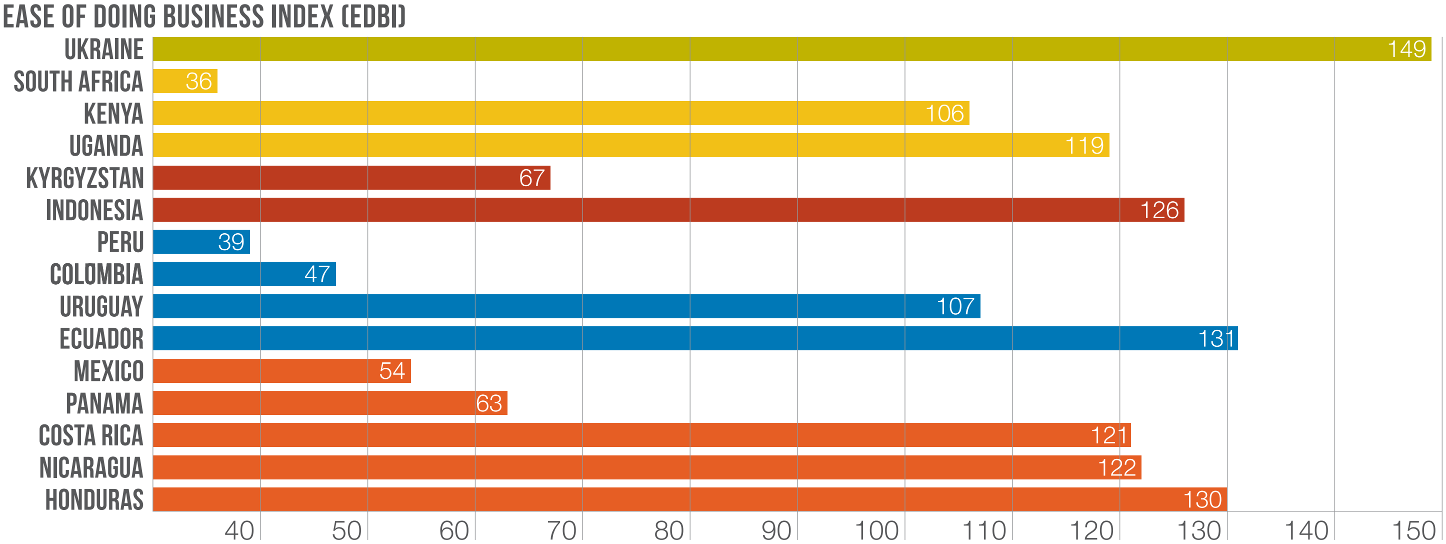


Ineffective business, tax, and labor regulations discourage entrepreneurs from registering their economic activities. In countries with high rates of informality, registering a business tends to be more difficult and cumbersome than in other countries – requiring higher average numbers of procedures and days to obtain a license or register property.

The World Bank's Ease of Doing Business (EDBI) rates regulatory environments from 1 to 183, with 1 being the most business friendly. Of the 15 countries in GFI's study, those with higher informality levels tended to rank the lowest—Indonesia, with an estimated informality rate of over 60%, has an EDBI rank of 126; Honduras (nearly 75%) ranked 130; and Ecuador (60%) ranked 131. Sample countries with lower informality generally ranked higher—South Africa (below 45%) ranked 36, and Panama (below 35%) ranked 63.

The combined effects of a poor regulatory environment and limited investment reduce levels of growth. New business densities (or new firms per 1,000 people ages 15-64 years) confirm this trend. Countries with low informality—including Costa Rica, Panama, and Uruguay—had the highest new business densities of roughly 10, 4, and 3, respectively. Except for Peru, all remaining sample countries with high informality had consistent new business densities of 1 or 0.

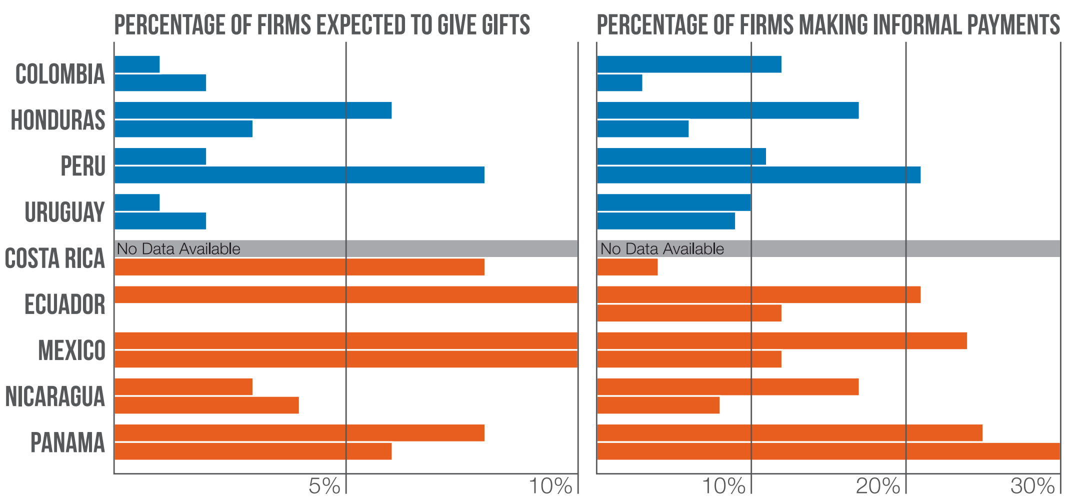
EASE OF DOING BUSINESS INDEX (EDBI)



ON GOVERNMENT

Informality weakens a government's ability to engage with and represent its constituents. Because informal workers and enterprises can't or won't comply with existing regulation, the informal economy inherently erodes the strength of a country's rule of law. Additional effects of informality on governments include decreased tax revenue, increased potential for political instability, and limited effectiveness of foreign aid.

Lack of accountability and transparency breeds corruption, and countries with high informality rates generally exhibit more prevalent corruption. An overwhelming majority of entrepreneurs in developing countries identified corruption as the major constraint to doing business. The percentages of firms expected to give gifts or make undocumented payments in meetings with tax officials were 84% and 77% in Kyrgyzstan and 32% and 79% in Kenya, two countries with high rates of informality. In South Africa and Uruguay—both with relatively low informality rates—the percentages of firms expected to give gifts were 3% and 2% and to make payments were 15% and 8%.



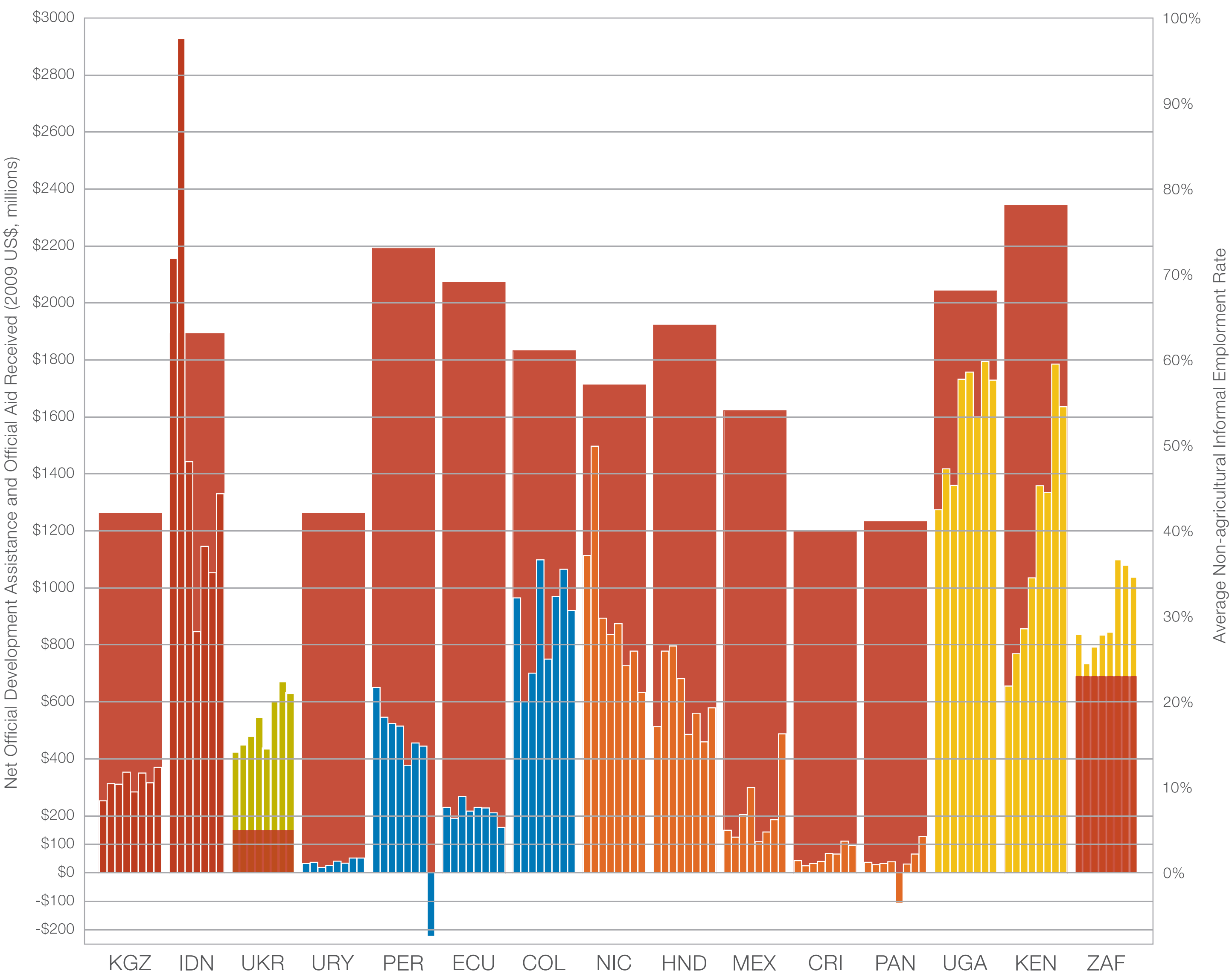
As informal economic activity isn't documented, informality reduces the overall size of the tax base and imposes a heftier tax burden on the formal sector. While the informal sector uses public infrastructure, it does so without contributing to the tax revenue necessary for maintenance. **Inadequate tax revenue resulting from a large informal sector means that governments can't provide the social safety nets that could alleviate income inequality among their citizens.**

In countries with lower rates of informality, total tax revenues generally account for a larger portion of GDP. South Africa, with a relatively low informality rate of 33%, owes 25% of its GDP to tax revenues. Indonesia, Colombia, and Uganda, on the other hand, with informality rates ranging from 60% to nearly 70%, have percentage-shares of GDP attributable to tax revenues of 11% and 12%.

ON FOREIGN AID

On a regional basis, countries with the highest levels of informality also see the largest amounts of net official development assistance (ODA) and official aid received (OAR). Uganda and Kenya—with informality rates approaching 70% and 80%—each receive over $1.5 billion. Uruguay—the country with the lowest rate of informality in South America—receives less than $50 million while Colombia, Ecuador, and Peru—where informality exceeds 60%—each receive more than $150 million.

Unfortunately, these valuable funds tend not to reach the informal sector—aid functioning within the framework of national and international laws does not typically go to those living and operating outside that framework. **The workers and enterprises with the most need—those with the lowest incomes, the least education, and no ability to afford legal mechanisms like certifications—do not benefit from the funding that could increase their economic access.** Even aid specifically targeted to the poorest of the poor either in food assistance or micro-enterprise development does not address informality, keeping the poor in their parallel economy.



GLOBAL ECONOMIC CHALLENGES

The informal sector tends to be largest in developing nations. With the transition to a globalized economy in the last decade, it is imperative that strategies and policies are implemented that promote inclusive growth and transparency across interconnected and interdependent national economies. **All workers need social and economic protections, especially in times of global economic crisis.**

Reducing informality can help break the cycle of poverty that persists as long as income gaps around the world continue to widen. Making sure that everyone has access to social safety nets, like social security and health care, protects those who are most vulnerable to economic fluctuations or downturns.

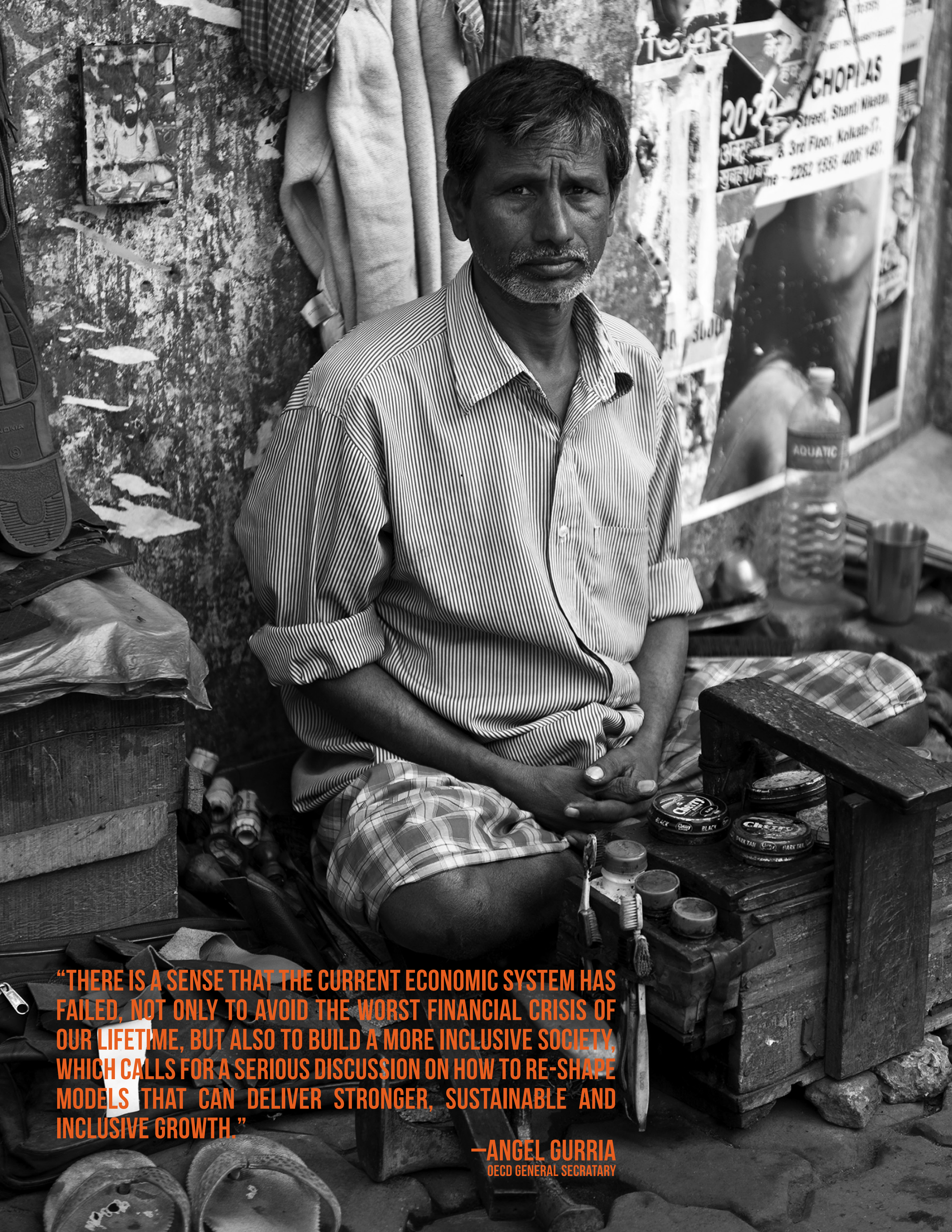
MOVING TOWARD INCLUSIVE, SUSTAINABLE ECONOMIES

Effective strategies seeking to reduce informality must focus on transitioning informal enterprises and workers to the formal sector through a multi-stakeholder engagement that includes workers, government, and the private sector. Allowed to persist, informality becomes more than an economic phenomenon. Entrenched informal practices create a cultural norm that needs to shift toward a culture of formalization and inclusion. Because the causes of informality and the reasons for its growth vary from country to country, the strategies for reducing it must adapt to each country's social and economic conditions while always emphasizing efficiency, accountability, and transparency.

Basic strategies for formalization include:

- **Sound employment statistics gathered independently by each government**
- **Direct surveying of workers to understand needs and perceptions**
- **Development of country-specific and sector-specific policies that can progressively transition workers and enterprises to the formal sector**
- **Affordable and accessible tax regimes that progressively create tax revenue**
- **Collaboration of government and the private sector to increase compliance**
- **Investment in missing middle financing to increase size of local enterprises, increase productivity, and lower informality**
- **Promotion of youth-flexible trade and entry-level placements for the integration of new workers to the formal labor market**
- **Aid to specific countries tied to improved legislation for the integration of the informal sector**

Addressing informality is about more than finding better jobs, engaging a segregated workforce, and building a country's tax base. It's about including a marginalized group into social and economic structures that allow for productive and rewarding participation in increasingly interconnected markets, ultimately enabling stable sustainable economies with decent lives and livelihoods for all.



"THERE IS A SENSE THAT THE CURRENT ECONOMIC SYSTEM HAS FAILED, NOT ONLY TO AVOID THE WORST FINANCIAL CRISIS OF OUR LIFETIME, BUT ALSO TO BUILD A MORE INCLUSIVE SOCIETY, WHICH CALLS FOR A SERIOUS DISCUSSION ON HOW TO RE-SHAPE MODELS THAT CAN DELIVER STRONGER, SUSTAINABLE AND INCLUSIVE GROWTH."

—ANGEL GURRIA
OECD GENERAL SECRATARY

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Based on data from the Global Fairness initiative's 2012 report *Informality in Emerging Markets: A Cross-Country Examination*
The full version of this report is available at info@globalfairness.org

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