Informality and the achievement of SDGs

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Sustainable Development Outlook 2021

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Introduction

The 2030 Agenda for Sustainable Development and its 17 Sustainable Development Goals (SDGs) had set an ambitious aspiration for current and future generations, and require decided action and political will from all stakeholders to achieve significant advance. When the world was on the track of such a difficult path, the irruption of COVID-19 has meant and is still meaning an unprecedented disruption. Its effects on the world's most vulnerable people and the high risks of a further exacerbation of existing inequalities and deterioration of living conditions, call for detailed consideration and analysis of social inclusion dimensions.

This consideration faces a relevant challenge: the lack of basic socio-economic data to assess country-level progress around the world, a problem which may even be jeopardized by the pandemic and the difficulties it carries for national office statistics' work. In this context, the simple exercise of monitoring progress, identifying trends, and learning from successful experiences becomes more complicated, and a complete picture cannot be provided. The uncertainties that emerge from the future evolution of the pandemic and the still unmeasured impacts on human development around the world add more complexities to the proposed analysis.

With these caveats in mind, this document provides an updated vision of the conceptual aspects included in specific targets of SDGs 8 and 10 and an in-depth analysis of specific country experiences of progress in terms of achieving these SDGs. The selection of specific targets within SDG 8 and SDG 10 was guided by their importance for social inclusion. A brief discussion of the situation of the world relating to the dimensions involved in these targets and an analysis of the interrelation between them are presented in section 1. This discussion highlights the importance of decent work conditions and especially, the relevance of formal employment to achieve sustainable social inclusion. The relationship between informality and economic growth on one side, and inequality on the other, is discussed in section 2, whereas a more detailed consideration about the concept and measurement of formal employment is presented in section 3. This section also presents updated available data about changes in informal work, as this data guides the selection of certain countries which witnessed interesting achievement in terms of labor formalization. A general picture of learnings derived from the experiences of three countries selected from this pool (Bosnia and Herzegovina, Uruguay and Vietnam) are presented in section 4, whereas the analysis of each of these country experiences is presented in the Appendix.

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1. Social inclusion in the SDGs: the role of labor markets and inequality

The attainment of inclusive economic growth and more egalitarian societies are central pillars of the achievement of sustainable development. Within the 2030 Agenda for Sustainable Development, this is reflected on two specific Sustainable Development Goals (SDGs): SDG8 related to decent work and economic growth, and SDG10 concerning the reduction of inequalities. Both goals include specific targets -addressed in this document- which are closely related to social inclusion and decent work, as shown in figure 1. For these targets, indicators have been defined, although updated data for them at the international level is not always available.

Among other relevant aspects, selected targets consider the promotion of productive activities and decent job creation, the achievement of full and productive employment and decent work, with special consideration of disadvantaged groups like women and youth, and the reduction of youth not in employment, education, and training. With regards to reducing inequality, aspects like income growth for most disadvantaged populations, social, economic, and political inclusion of all, and the adoption of progressive policies, are promoted.

Figure 1. SDGs 8 and 10. Selected targets related to social inclusion and decent work, and indicators

		TARGETS	INDICATORS
GOAL 8	Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all	Target 8.3: Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services Target 8.5: By 2030, achieve full and productive employment and decent work for all women and men, including for young people and persons with disabilities, and equal pay for work of equal value Target 8.6: By 2020, substantially reduce the proportion of youth not in employment, education or training	Indicator 8.3.1: Proportion of informal employment in total employment, by sector and sex Indicator 8.5.1: Average hourly earnings of employees, by sex, age, occupation and persons with disabilities Indicator 8.5.2: Unemployment rate, by sex, age and persons with disabilities Indicator 8.6.1: Proportion of youth (aged 15-24 years) not in education, employment or training
GOAL 10	Reduce inequality within and among countries	Target 10.1: By 2030, progressively achieve and sustain income growth of the bottom 40 per cent of the population at a rate higher than the national average Target 10.2: By 2030, empower and promote the social, economic and political inclusion of all, irrespective of age, sex, disability, race, ethnicity, origin, religion or economic or other status Target 10.4: Adopt policies, especially fiscal, wage and social protection policies, and progressively achieve greater equality	Indicator 10.1.1: Growth rates of household expenditure or income per capita among the bottom 40 per cent of the population and the total population Indicator: 10.2.1 Proportion of people living below 50 per cent of median income, by sex, age and persons with disabilities Indicator 10.4.1: Labour share of GDP Indicator 10.4.2: Gini index of prefiscal per capita (or equivalized) income less the Gini index of postfiscal per capita (or equivalized) income

Five years after the adoption of the SDGs by the United Nations Member States in 2015, the irruption of COVID-19 has meant a severe disruption in terms of output, employment, and income, with negative consequences on the possibilities of progressing in terms of SDG8. The threat over the promotion of sustained, inclusive, and sustainable economic growth, full and productive employment, and decent work for all, is undoubtful.

The global growth contraction was estimated at -3.5% for 2020, and it has had adverse impacts on the poor, the informal workers, women, youth, and workers in contact-intensive sectors. In 2021, the global economy is projected to grow 5.5%, although the levels of uncertainty are extremely high. The projection for 2022 is 4.2% (IMF, 2021). The projected recoveries vary across countries and regions (see table A.1), depending among other things on the severity of the health crisis, the magnitude of the activity crisis, and the effectiveness of policy support.

The Sustainable Development Goal Progress Chart 2020 allows to visualize global and regional progress in some goals and targets by the end of 2019, presenting a trend assessment and a level of development assessment (see table A.2). Within SDG8, only target 8.5 related to full employment and decent work is analyzed. On that target, the world presents limited or no progress, and the situation is relatively worse in Sub-Saharan Africa and Latin America and the Caribbean, where deterioration is reported. Only in East and South-Eastern Asia, a trend of fair progress is detected. In terms of the current levels of achievement, Northern and Western Asia are the regions more compromised, with a level of development far from the target. The abrupt fall in economic activity during 2020, still not included in this track of SDGs, has had a significant adverse impact on labor markets around the world, affecting especially more vulnerable workers.

The negative impact of COVID-19 in the labor market has translated mainly into rising inactivity rather than unemployment, with a reduction in the global labor force participation rate by 2.2 percentage points and an increase in the unemployment rate by 1.1 percentage points (ILO, 2021). Even in an optimistic scenario, ILO is not expecting a recuperation of the hours of work in 2021 concerning 2019. The message about labor markets in 2021 is clear: modest recovery with high uncertainty.

The main impact of the COVID-19 disruption was an 8.8% decline in global working hours, with high variation between regions. Working hour losses were particularly large in Latin America and the Caribbean, Southern Europe, and Southern Asia. In contrast, Eastern Asia and Africa experienced relatively smaller working-hour losses, reflecting less stringent lockdown measures in these countries (ILO, 2021). These working-hours losses have led to large reductions in labor income, which were attenuated by income support measures, although the variation in the implementation of these measures was significant around the world. These global declines in working hours have implied both employment losses and reduced working hours for those who remain employed. Both inactivity and shorter hours have turned out to be major drivers of global working-hour losses.

Employment losses – and consequently income losses- were higher for women than for men, and for young workers than for older workers. Additionally, job destruction has disproportionally affected low-paid and low-skilled jobs (ILO, 2021). These factors imply that the existing gaps in access to decent work will probably rise, increasing the already persistent labor market inequalities and undermining social inclusion. Moreover, disruptions to schooling will have long-term effects on labor markets (and of course people´s lives). Recent global projections suggest that almost 0.6 years of schooling adjusted for quality will be lost due to the covid19-linked closures (Azevedo et al., 2020), and this loss will be unequally distributed, and imply significant impacts on their long-term development outcomes and productivity. For Latin America, Neidhöfer et al (2020) estimate that the likelihood of children from low educated families attaining a secondary schooling degree could fall substantially as a consequence of lockdowns due to COVID-19, despite mitigation policies.

Additionally, the COVID-19 crisis is having a disproportionate impact on the self-employed and in general, on informal workers. These workers were not reached by traditional social protection programs such as unemployment insurance, and in many countries, they were also not covered by other income support policies. Moreover, in most developing countries, health care and social protection are not universal but mainly employment driven, so the effects of the pandemic are magnified by the high incidence of informality. The service sectors, whose demand was heavily affected by the lockdowns in many countries, are dominated by informality. Many informal workers are involved in the provision of face-to-face services, with the higher risks of contagion and impossibility to work. Distance working or digital alternatives are not an option for these workers. Limited or inexistent savings and constrained access to credit make the situation worse for them. In sum, the COVID-19 has come to remember the world about the importance of improving the structural problem of informality in the labor markets.

Turing into **SDG 10,** whose focus is on the reduction of inequality within and among countries, the situation is also worrisome. Economic inequality is a widespread phenomenon, and even if the ideal level of inequality may be a matter of public deliberation, there are strong philosophical and practical reasons to be concerned about high levels of inequality. High inequality may have implications in terms of unacceptable living conditions for part of the society, and this is not compatible with basic notions of justice and fairness. On the practical side, high levels of inequality may lead to important political, economic, and social problems. The fact that in recent decades, income inequality has increased in nearly all countries, but at different speeds, suggests the importance of institutions and policies to shape inequality (Alvaredo et al, 2018). In recent years, inequality has increased in most developed countries and some middle-income countries, and the World Social Report 2020 identifies four powerful global forces behinds this trend: technological innovation, climate change, urbanization, and international migration. Latin American countries have been, up to 2015, the exception in terms of this increasing trend in inequality. Income inequality, as measured by the Gini coefficients from household surveys, declined significantly between 2002 and 2014 in the 15 Latin American countries analyzed in ECLAC (2021), at a rate of 1.1% per year. While that trend continued between 2014 and 2019, the rate of decline in inequality slowed considerably, to 0.5% per year. These results imply that, even without considering the expected reversal in the context of the pandemic, Latin America was not making significant progress in reducing inequality in income distribution in the very recent years. But it is important to highlight that, in spite of the generalized increasing trends, there is room for the creation of a fairer world through the actions of governments and international organizations.

Consistently with this increasing trend in income inequality, ILO (2021) reports that the labor income share declined at the global level from 54% in 2004 to 51% in 2017, and this decline has been more pronounced in Europe, Central Asia, and the Americas. [2] This decline is consistent with a scenario in which new forms

[2] The labor share is the share of gross domestic product (GDP) that is paid as compensation in the form of wages, salaries and other benefits, and it is informative about the distribution of income between labor and capital. As reflected in table 1, it is one of the indicators selected to monitor SDG10. Multiple studies document the significant association between lower labor shares and higher household income inequality.

of work are eroding the earning power of the self-employed. This declining trend in the labor income share in most developed and developing countries has been taking place since the 1980s and especially the early 1990s, suggesting that lower labor share is associated with higher income inequality.

Inequality between regions, also included in SDG10, is sometimes depicted through global inequality indicators.[3] These indicators have shown an improvement in the last 25 years, as average incomes in developing countries have increased at a faster rate, mainly because of the performance of China and other emerging economies in Asia. Despite this convergence between countries, inequality between countries still accounts for two-thirds of global inequality, implying that where someone is born is substantially more important in determining their income than their effort (see Lakner and Milanovic, 2016)

At present, there is great concern that the COVID-19 crisis may make inequality worse, by hitting the most vulnerable people hardest, but concrete evidence is still scarce. In the case of Europe, diverse studies, based on ex-ante microsimulations methodologies, have found similar results: in the absence of policy response, the Gini coefficient would have risen significantly due to the effects of COVID-19, but policy responses reversed that trend (see Almeida et al, 2020; O'Donoghe et al; 2020, among others). Other evidence for Europe is provided by Clark et al (2021) based on unique longitudinal high-frequency information on household disposable income in five European countries (France, Germany, Italy, Spain, and Sweden). The analysis of this data, which covers household income pre and post COVID indicates that the overall picture of the distribution of income in Europe during the pandemic can be split into two periods. In the first period, the irruption of COVID-19 increased income inequality, but in the second period, the evolution of the pandemic and the effects of the various policy interventions more than reversed the initial widening of inequality.

Unfortunately, evidence about the evolution of income inequality in developing countries during the COVID-19 is still scarce. In the case of Latin America, microsimulations based on predicted labor income trends indicate that total per capita income inequality would increase in 2020, resulting in an average Gini index 5.6% higher than that recorded in 2019 (ECLAC, 2021). However, the inclusion of transfers made by Governments to mitigate the loss of labor income, whose distribution tends to be concentrated in low- and middle-income groups, would result in a smaller increase in the Gini index for the region (around 2.9%). Specific studies for the cases of Argentina and Uruguay find similar results: a predicted increase in income inequality which would be only partially attenuated by government interventions (see Bonavida and Gasparini, 2020; Brum and De Rosa, 2021). In their study for Argentina, Brazil, Colombia, and Mexico, Lustig et al (2020) find that income losses in Latin American countries tend to be higher for the middle deciles rather than the poorest, something also reported in ECLAC (2021). The latter reflects the fact that poorer households have a cushion given by the existing social assistance programs. The expanded social assistance governments have introduced in response to the crisis have a large offsetting effect in Brazil and Argentina, much less in Colombia and nil in Mexico (Lustig et al, 2020).

[3] The most used indicator of global inequality refers to inequality in disposable income amongst all the individuals in the world (see Milanovic, 2005).

As an additional point, it is important to remember the interrelation between inequality and poverty. Increases in income inequality not only narrow the possibility of meeting SDG 10 but also diminishes the feasibility of reducing poverty and extreme poverty, a goal that is still relevant for Latin America.

The evidence reviewed above about Europe and Latin America illustrate that the interventions of Governments to ameliorate the negative consequences of the pandemic, through a wide portfolio of policies (including income support, employment protection programs through payroll subsidies, contributory and non-contributory social protection, combined with progressive tax policies) have been of varied scope.[4] The final result of relevant socioeconomic dimensions during the pandemic are clear examples about the power of spending and taxes to determine the difference between the market income and personal disposable income, and so to affect the wellbeing of individuals.[5]

With regards to global inequality during COVID-19, a recent paper by Deaton (2021) provides a detailed analysis based on the available data on GDP, and not incorporating within-country inequality. He concludes that even if the argument of increasing global inequality due to pandemic is compelling, it is not backed up by the available data on international GDP per capita. The result obeys the fact that poorer countries suffered fewer COVID deaths per capita in 2020 than richer ones, and each country's loss in per capita national income was strongly related to the per capita COVID death account. This means that, on average, per capita incomes have fallen more in countries with higher per capita GDP, and this may result in a narrowing of global income inequality. But the result is fragile and It is still too soon to make predictions on this topic.

The interlinked nature of the SDGs has been widely discussed and is evident in the case of the two goals discussed previously. Unequal access to productive employment and decent work are in the basis of inequalities in labor market incomes, which in turn explain the major part of inequalities at the national levels. Among the crucial features of decent work is the formal condition, which implies access to better working conditions during the active life, and to social security benefits at older ages. Better working conditions imply, among other things, access to social protection (including health coverage) and adequate earnings. The earnings penalization to informal work has been documented (see for example Gindling et al, 2016) and this also potentially explains income inequality. During the COVID-19, working from home has implied higher probabilities of keeping the job, and it has been easier for male, older, better educated, and higher-paid workers, and this can lead to increasing labor income inequality (see Palomino et al, 2020; Bonacini et al, 2021). All these aspects justify a closer look into informality and an analysis of the role of policies in their reduction.

2. Informality and the relationship with growth and with inequality

Two competing theories can be identified with respect to the nature of the informal sector and its links with the rest of the economy. The traditional view is based on the idea that labour markets are segmented, and workers queue for their preferred formal jobs while subsist in an informal sector with worse working

[4] The policy tracker of the IMF presents key economic responses of governments around the world (https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19).

[5] Country case studies that illustrate about the scope of governments' redistributive policies can be found at Commitment to Equity (CEQ) Institute, www.commitmentoequity.org.

conditions (the origins of this view can be traced to Harris and Todaro, 1970). In a modern version, informality is the consequence of firms' efforts to face international competition through lower labor costs, by subcontracting production to unprotected workers (Portes et al, 1989). Under this vision, the availability of jobs in the formal sectors in periods of economic growth, determines a flow of workers from the informal to the formal sector, and so informality in employment is counter- cyclical, decreasing during economic booms and operating as a buffer during economic downturns, to absorb excluded workers.

The competing theory conceives formal and informal sectors as parts of an integrated labor market and visualizes informal sector as dynamic, arguing for the voluntary nature of the entry into informality through self-employment. On this line, the influential work of De Soto (1989) has underlined that the numerous, complicated and costly entry regulations prohibit small firms from becoming formal. These small businesses are led by individuals who see the informal sector as a place of growth opportunities, and opt out of formal institutions as they do not value the quality of state´s provision. Under this vision of voluntary choice of informality, the informal labor market and the formal one are integrated, informal firms provide services to the formal sector, and the informal sector is not necessarily negatively correlated with the business cycle. Moreover, the formal and informal sector can move in the same way, expanding in recovery phases.

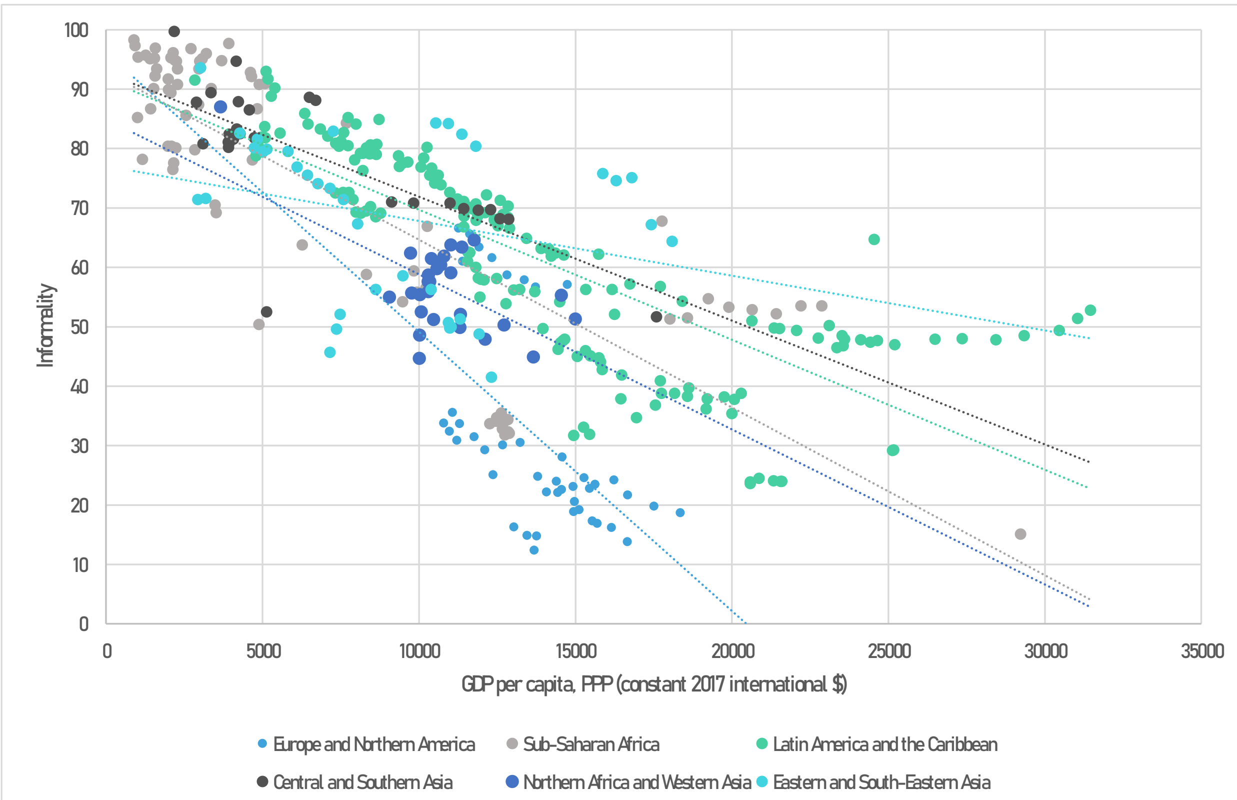
The empirical evidence suggests that the patterns are more complex, and probably a mix of both views is reasonable, as proposed by Fields (1990), who sees the informal sector as heterogeneous and two-tier, with some involuntary informal workers waiting for their opportunity in the formal labor market, and some voluntary workers looking for flexible hours and being one's own boss, while undervaluing social security benefits. In general terms the evidence about the counter-cyclicality of informality tends to dominate in the literature (Loayza and Rigolini, 2011; Fiess et al, 2010; among others).[6] In their detailed review, La Porta and Shleifer (2014) present evidence that is broadly consistent with the dual vision of informality, supporting the idea that informality declines, at a slow path, with economic growth and development. Despite the predominance in favor of this view, there is also evidence in favor of the pro-cyclical hypothesis, reminding about the importance of country characteristics (institutional factors, wage rigidities) and the nature of economic shocks (sector of origin, international context) to understand the behavior of the informal sector along the business cycle.

While it is not necessarily the case that economic growth leads to a decrease in informality, it is important to recognize that economic growth and stability provide very favorable conditions for its reduction. In a context of economic stability, the risks of layoffs –and their associated costs in the case of formal workers– are lower, which can give employers an incentive to favor formality. Also, lower unemployment rates can increase workers' bargaining power and their chances of being formalized. Finally, the increase in demand for goods and services in periods of economic growth benefits the self-employed and may increase earnings, which can contribute to covering the costs of formalization. All of these factors may have played a role in the recent evolution of informality in Uruguay, confirming the existing evidence on the pro-cyclical behavior of formal employment.

[6] This counter-cyclical behavior between the share of informal employment and the economic cycle is consistent with informal employment acting 'acyclically' in absolute terms during output fluctuations (see Ohnsorge and Yu, 2021).

Taking a more medium or long run perspective, the relationship between informality and development is even more complicated. The association between the level of development (as measured by the GDP per capita) and informality is widely documented (see figure 2), but is informality a consequence of underdevelopment, or does informality cause underdevelopment? The direction of causality is an open question in the literature, although the strength of the correlation between informality and several indicators of underdevelopment is widely documented.

Figure 2. Informality and GDP per capita.



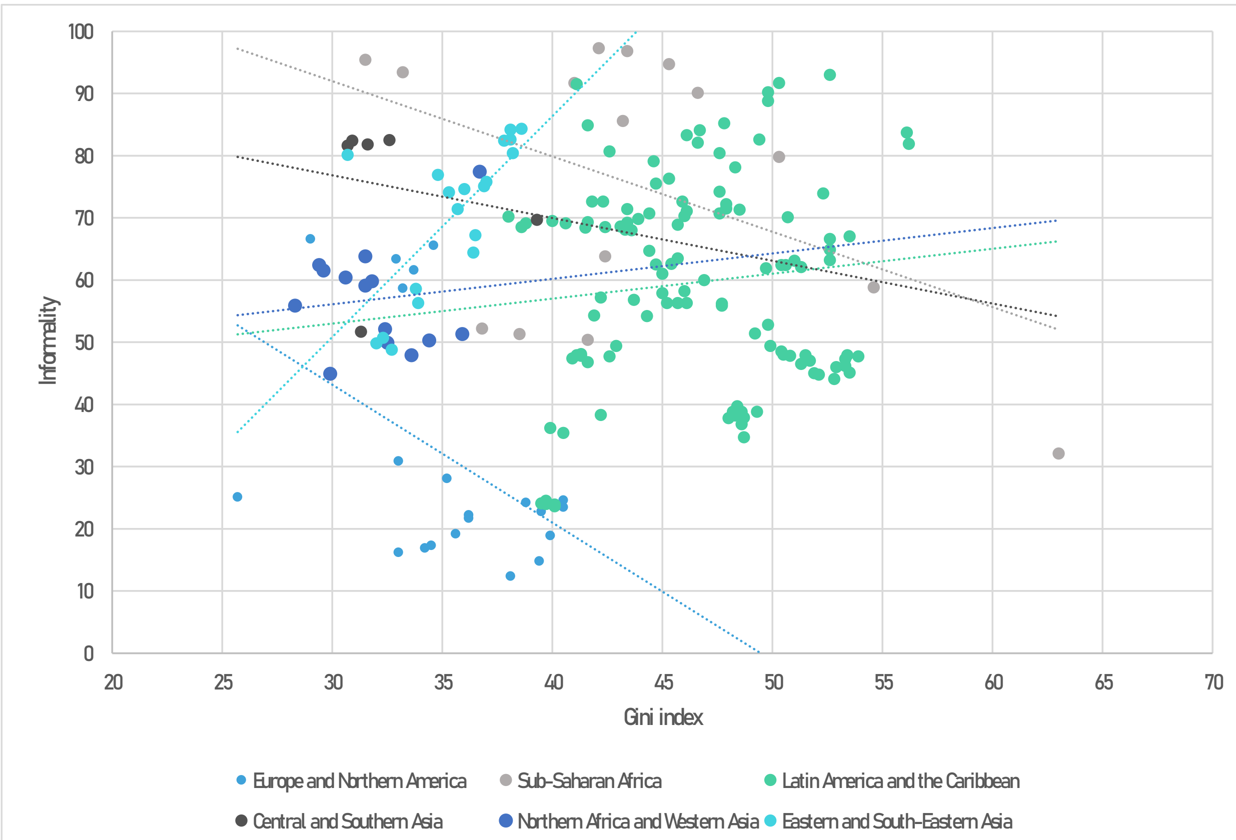
Source: SDG global database & World Bank Indicators

High levels of informality imply lower tax revenues for governments, limiting the state's capacity to provide social protection and implement increasing productivity policies. Weaker social protection and lower public services' quality may discourage formalization (see Loayza, 2019). In fact, higher levels of informality coexist with weak enforcement of rules, besides implying lower tax revenue to finance public services. These aspects may dampen growth in the medium and long run. In spite of this, informality may be tolerated by governments because there is a trade-off between pursuing greater enforcement and reducing informality, with the consequent increase in productivity, but also increasing unemployment and reducing social welfare (Boeri and Garibaldi, 2005; Ulyssea, 2010).

The association between higher informality and higher income inequality, as depicted in figure 3, is more complex in nature. In some regions a higher inequality and higher informality take place simultaneously

(Latin America, Northern Africa and Western Asia, and Eastern and South Eastern Asia), but this correlation is not necessarily true in all regions. National studies for Latin America tend to corroborate a significant correlation (see Attanasio and Binelli, 2010; Binelli, 2016; Amarante et al, 2016; among others), whereas for transition economies the evidence is mixed (for a review, see Dell'Anno, 2021). But beyond these statistical associations, the link entails similar complexities than the ones discussed when considering the relationship between informality and development.

Figure 3. Informality and income inequality.



Source: SDG global database & World Bank Indicators

In effect, the issue may be addressed considering that income inequality is a determinant of informality, or argue in favor of the opposite causation, claiming that informality is the origin of inequality. Within the first perspective, higher income inequality has been associated to lower benefits of formalization or higher demand for informal goods, fostering higher informality (see Chong and Grastein, 2007; Mishra and Ray, 2010). Underlying the direction from informality to growth, other authors have emphasized that high informality implies lower tax revenue which in turn can affect State capacity to redistribute, both directly and indirectly through education, and thus have a direct impact on inequality (Loayza, 1996; Johnson, et al, 1998; Schneider and Enste, 2000; Rosser et al, 2003).

Beyond causality, the direction and magnitude of the changes in inequality related to changes in formalization are not easily predictable. The potential effects on labour income inequality of an increase in the size of the formal sector will depend on the labour income differential between the formal and informal sectors and also on the within levels of inequality in both sectors. An analysis of multiple experiences in Latin America- Argentina, Brazil, Ecuador, and Uruguay- compiled by Amarante and Arim (2015) indicates that the recent decline in informality in these countries has been related to the decline in labour income inequality. Also considering multiple Latin American countries, Messina and Silva (2018) argue that declines in informality played a role in the remarkable drop in inequality that occurred in many Latin American countries between 2000 and 2012.

3. The importance of informality in the developing world

A defining feature of labor markets in developing countries is the high proportion of workers in the informal sector. Reflecting the debate in development economics at that time, the International Labor Office Organization adopted the term the informal economy -previously coined by Hart (1971)- during the 70s. For more than fifty years, the discussion about the conceptualization and measurement of the informal sector has been profuse and long, and two conceptual approaches can be distinguished. The productive approach sees informal employment as that related to small productive units whereas the legalist vision associates informal employment with the evasion of labor regulations.[7] In terms of measurement, the debate has been equally profuse, leading to the distinction between the informal sector and informal employment (see ILO, 2013). For measurement purposes, ILO proposes that informal employment comprises all informal jobs carried out in formal or informal sector enterprises or households.[8]

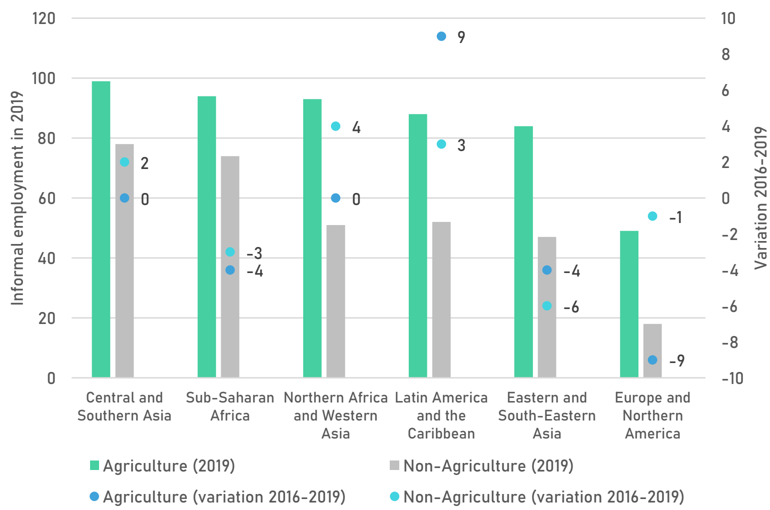
There is little consensus on whether informal workers are in those sectors because they are excluded from formal sector employment or because they choose to be in those sectors due to monetary or non-monetary benefits (see Perry et al, 2007). In any case, the importance of informal employment in developing countries is high, especially in the agriculture sector. But also in the non-agricultural sector, more than half of workers are informal in Central and Southern Asia, Sub-Saharan Africa, Latin America, and the Caribbean and Northern Africa, and Western Asia (figure 4). According to ILO (2020), around 2 billion workers worldwide are informally employed, accounting for 61% of the global workforce. These workers are therefore significantly less likely to have rights at work or to enjoy the benefits of social

[7] On empirical grounds, the overlapping between the two approaches of informality is very high, and on broad terms the policy actions involved are similar, comprising the need of accumulation of skills and assets to enhance productivity. But it may be argued that the productivist definition of ILO leads to a focus on policies related to structural transformation and the shift of resources from traditional to modern sectors, whereas the legalist approach emphasizes policy actions towards labor market regulation, taxes and contributions.

[8] The following types of jobs are included: (i) own-account workers employed in their own informal sector enterprises; (ii) employers employed in their own informal sector enterprises; (iii) contributing family workers, irrespective of whether they work in formal or informal sector enterprises; (iv) members of informal producers' cooperatives; (v) employees holding informal jobs (not subject to national labor legislation) in formal sector enterprises, informal sector enterprises, or as paid domestic workers employed by households; (vi) own-account workers engaged in the production of goods exclusively for own final use by their household.

protection systems. Informality also implies a lack of legal recognition, fall to comply with fiscal obligations, and difficulties to enter into commercial contracts.

Figure 4. The proportion of informal employment by sector (percentage)

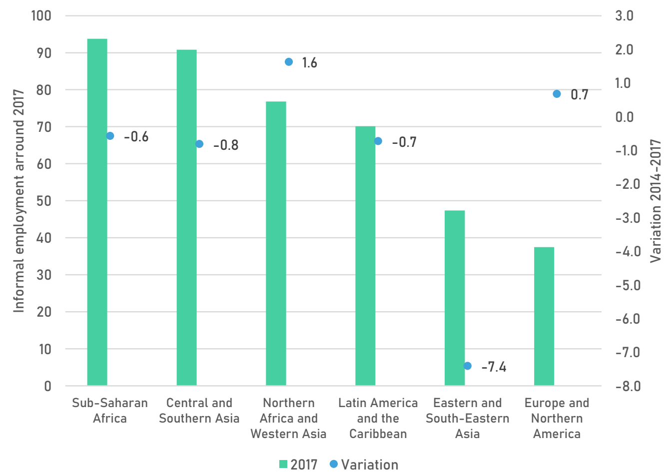


Source: SDG Global database & SDG Global Report 2020

If the legalist approach is considered, through the indicator of active contributors to pension schemes in the working-age population (15-64), the levels of informality are higher and changes between 2014 and 2017 are especially relevant in Eastern and South Asia (figure 5). In some regions (Sub-Saharan Africa and Central and Southern Asia) informal employment is the norm in the labor market. It is interesting to note that the correlation between both measures at the country level is around 0,76 (see figure 6).

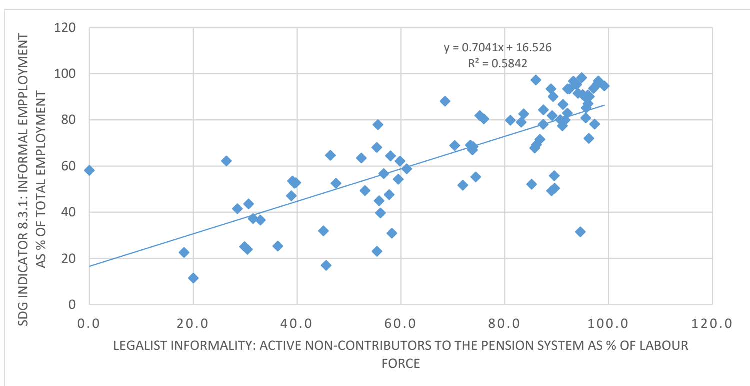
A recent report about Latin American labor markets (ILO, 2021) shows that the coronavirus crisis has implied destruction of both formal and informal employment, but contrary to what happened during other economic crises in the region, the informality rate has decreased. Throughout the previous Latin American economic crisis, formal salaried employment was destroyed and workers ended up in the informal sector as a surviving strategy. This counter-cyclical behavior of informality seems to be broken in the coronavirus crisis, as the informal sector has not acted as a cushion, but instead, it has also expelled workers. This resulted in the paradox of a declining informality rate in Latin American labor markets during the COVID.

Figure 5. The proportion of informal employment by sector (legalist definition)



Source: World social protection report 2014/2015 & 2017/2019 (ILO)

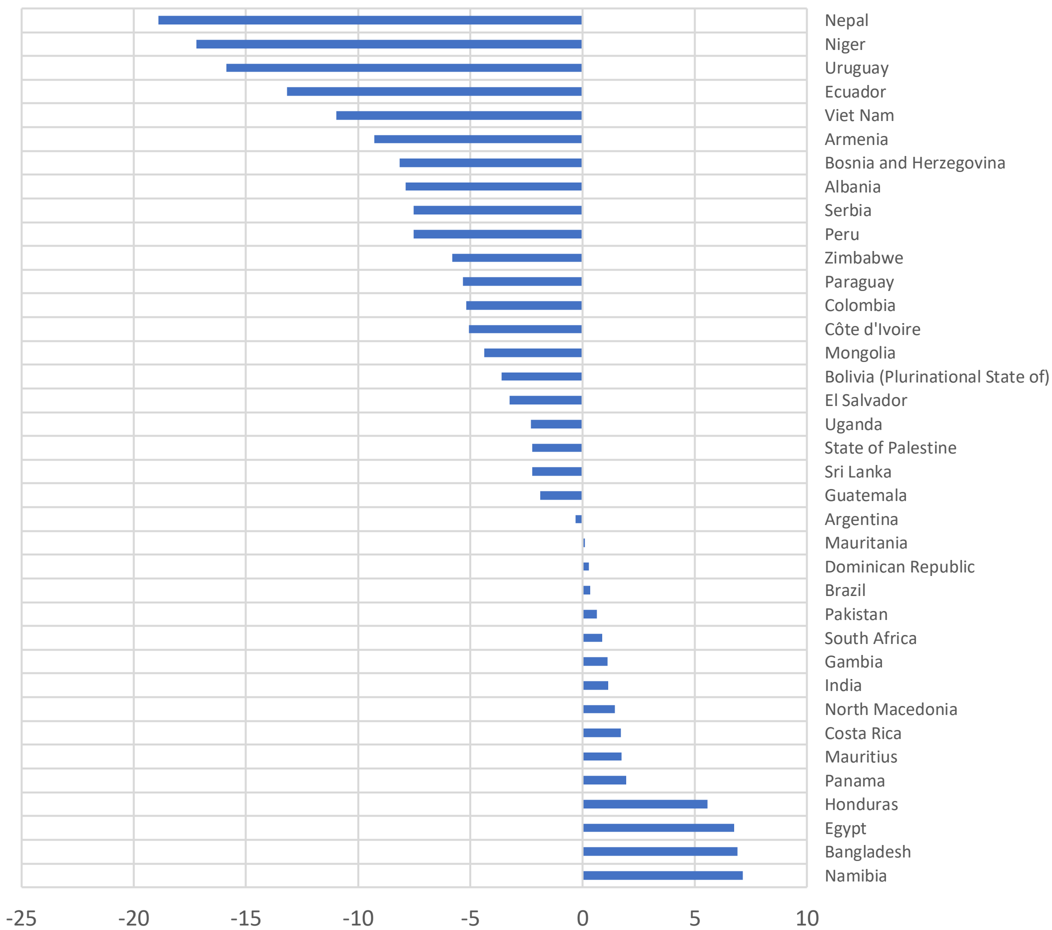
Figure 6. Informal employment and non-contribution to the pension system



Source: SDG Global Database & World social protection report 2017/2019 (ILO)

The selection of our case study countries was based on the pool of countries with available data from 2000 onwards about the rate of informality, as defined by SDG 8.3.1. The serious data limitations discussed before leave us with fewer cases, but whose information is much more robust and reliable than when shorter periods of time are considered. We are aware that our selection of countries is biased since countries with no data could have had an excellent performance in the informality indicator, and they are not detected nor analysed. Other countries, which experienced decreases in informality but in shorter periods of time (for example Chile and Ghana between 2015 and 2019) were also discarded. Figure 7 shows the change in informality between circa 2010 and circa 2018 among countries with data for the whole period. The top 10 performers in terms of informality reduction are: Nepal, Niger, Uruguay, Ecuador, Viet Nam, Armenia, Bosnia and Herzegovina, Albania, Serbia and Peru.

Figure 7. Change in the share of total employment under informality between around 2010 and around 2018.



Source: based on Global SDG database

It is interesting to analyze the performance of these countries in terms of other SDG indicators for Goal 8 and also for Goal 10 (related to inequality) (see table 1). No clear pattern about the relationship between informality and inequality emerges from these experiences, corroborating the discussion in the previous section. An improvement in informality levels does not necessarily lead to a reduction in inequality. In Latin American countries both dimensions (informality and inequality) improved, consistent with the evidence previously discussed, but the other countries present different patterns.

Table 1. Performance of the top 10 countries with greater informality drops in other indicators corresponding to goals 8 and 10.

Does the country improve in other indicators other than informality?		Goal 8				Goal 10	
Country	Region	8.3.1	8.5.1	8.5.2	8.6.1	10.2.1	10.4.1
Albania	Europe and Northern America	yes	no data	yes	yes	no	no
Armenia	Northern Africa and Western Asia	yes	no data	no	yes	no	no
Bosnia and Herzegovina	Europe and Northern America	yes	yes	yes	yes	no data	no
Ecuador	Latin America and the Caribbean	yes	no data	no data	no	yes	yes
Nepal	Central and Southern Asia	yes	no data	no	no	no data	no
Niger	Sub-Saharan Africa	yes	no data	no	no data	no data	no
Peru	Latin America and the Caribbean	yes	yes	no data	no	yes	yes
Serbia	Europe and Northern America	yes	no data	yes	yes	no	no
Uruguay	Latin America and the Caribbean	yes	yes	no	yes	yes	yes
Viet Nam	Eastern and South-Eastern Asia	yes	yes	no	no	no	no

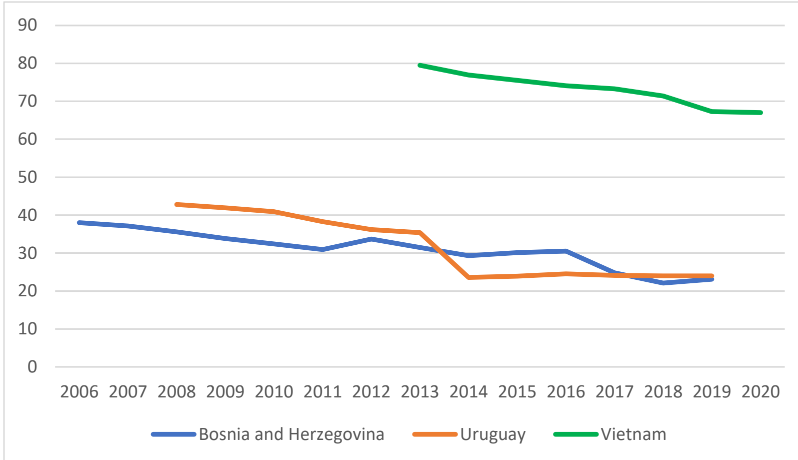
Source: Own elaboration based on Global SDG database

4. Informality revisited: some country experiences

We considered the recent experience in terms of informality reduction of three countries: Bosnia and Herzegovina, Uruguay and Vietnam. These three countries belong to different regions (Western Europe, Latin America and Asia) and although they all can be classified as developing economies, they present important differences. According to the World´s Bank income criteria, Vietnam is a lower-middle income economy, whereas Bosnia and Herzegovina is an upper-middle income economy and Uruguay is a high income economy. In effect, Vietnam´s per capita GDP in 2019 was 8.041 USD (PPP), whereas for Bosnia and Herzegovina the figure is 14.922 USD (PPP) and for Uruguay it is 21.561 USD (PPP).

Their historical contexts are also very different, given that both Bosnia and Herzegovina and Vietnam can be considered as economies in transition from centralized regimes to market economies. Another distinctive category is the share of agriculture in employment: for the most recent data, it corresponds to 18% in Bosnia and Herzegovina, 8% for Uruguay and 25% for Vietnam. Accordingly, the three countries have differential incidence of informality: Bosnia and Herzegovina and Uruguay present similar levels by the end of the period we are considering, whereas Vietnam presents a significantly higher incidence. The three countries have in common the fact that they have witnessed an important process of reduction in informality (figure 8).

Figure 8. Evolution of productive informality in selected countries



Source: ILOSTAT

The appendix to this document discusses in depth each one of these experiences. A common factor among them is that, in all cases, declines in informality took place in periods of economic growth, although in the case of Bosnia and Herzegovina this growth is moderate. It is also interesting to note that whereas in Uruguay the decline in informality took place simultaneously with an important decline in income inequality, in the other two experiences this does not seem to be the case.

It is methodologically difficult to identify the main drivers in these processes of informality decline, and studies are scarce, especially in the case of Bosnia and Herzegovina. In Uruguay, the important changes in labor market regulations as well as the health reform and the specific regulation of the domestic service, seem to have helped the process of formalization. In Vietnam, part of the process seems to be driven by the transition from an agricultural to an industrialized economy, and also specific reforms to the social insurance policy may have played a virtual role.

5. Concluding remarks

The irruption of COVID-19 has implied a step back for many countries in terms of the achievement of SDGs. The specific target analyzed in this document, full and productive employment for all (SDG8) and reducing inequality (SDG10) are among the ones reported as regressing or with no progress, as labor markets and living conditions have been strongly hit by this crisis. Given the interconnectedness of the SDGs, the overall progress of the 2030 Agenda is at risk.

Even if it is still too soon to quantify the impacts of the COVID-19 pandemic on these dimensions, it is clear that job destruction seems to have disproportionally affected low-paid and low-skilled jobs. It has implied destruction of both formal and informal employment, and so in specific regions where data is available, the relative importance of informal work has not increased. With regards to inequality, it is clear that in the absence of policy response it would have increased significantly, but the magnitude of policy responses was able to reverse this trend in the case of many European countries, or attenuate it in some Latin American ones. The wide portfolio of policies that were activated at different parts of the world are illustration of the power of social interventions to affect the well being of individuals.

Given the importance of informality as a constitutive feature of labor markets in developing countries, and its central role for achieving SDG8, this document reviewed three recent experiences of informality reduction, selected on the basis of the available information. The three cases illustrate that economic growth and stability provide very favorable conditions for informality reduction. In a context of economic stability, the risks of layoffs –and their associated costs in the case of formal workers– are lower, which can give employers an incentive to favor formality. Also, lower unemployment rates can increase workers' bargaining power and their chances of being formalized. Finally, the increase in demand for goods and services in periods of economic growth benefits the self-employed and may increase earnings, which can contribute to covering the costs of formalization.

In two of the countries, the process of formalization seems to be led by the structural transformations of the economy: in the case of Vietnam implying the transition from an agricultural to an industrialized economy and in the case of Bosnia & Herzegovina linked to the other the advanced stages in the transition process towards a market economy.

The decline in informality in Bosnia & Herzegovina, as the process in other Balkan economies, remains an under-researched issue. What we do know from previous studies is that the levels of regulations and taxation of the formal economy are high, and coexist with a weak approach to the rule of law and enforcement. The tax wedge and its discouraging effects for low wage earners to formalize seem to be operating. Even if some recent policy changes have taken place recently, it is not possible to link them to the decline of informality, which began earlier.

In Vietnam, social protection is a relatively new concept, as the institution was created in 1995 and reformed in 2008 to overcome wide exclusion. The 2008 reform consisted in the inception of a voluntary insurance regime, and some years later, in 2014, the state was entitled to subsidize participation in this voluntary scheme. Some other recent changes in the labor market (recognition of the activity of subletting) as well as information campaigns and expansion of inspections may also be associated to the formalization process.

Finally, Uruguay is a rich example given that a wide array of policies, including the reinstatement of collective bargaining, increases in the minimum wage, regulation of domestic work, modification of the single tax, tax incentives and health reform seem to have favored labor market formalization. Additionally, only in one of the countries (Uruguay) it is clear that informality decline took place simultaneously with a decline in income inequality.

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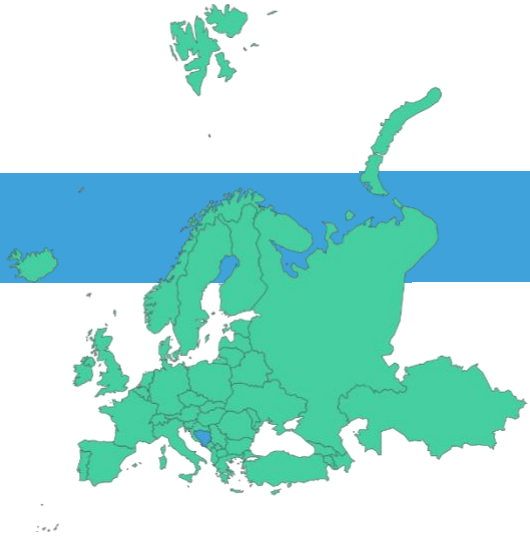
Appendix: COUNTRY STUDIES.

BOSNIA AND HERZEGOVINA, URUGUAY AND VIETNAM

BOSNIA AND HERZEGOVINA



Introduction

More than 25 years after the peace agreement (Dayton Accords) of 1995, the Bosnian (B&H) economy -comprising the Federation of Bosnia and Herzegovina, FB&H, and the Republic of Srpska, RS- is still struggling in its transition process. This transformation process has been difficult, and despite the progress made to date, major challenges still exist in all fields, including social and economic development. Undoubtedly, one of the major challenges for the labor market in Bosnia and Herzegovina is the low level of job creation in the formal economy. Informal sector comprises a significant portion of total employment. A decreasing trend in informality is detected in the past years in the country, the following paragraphs try to illustrate this experience, whose main drivers are still unclear to researchers and analysts.

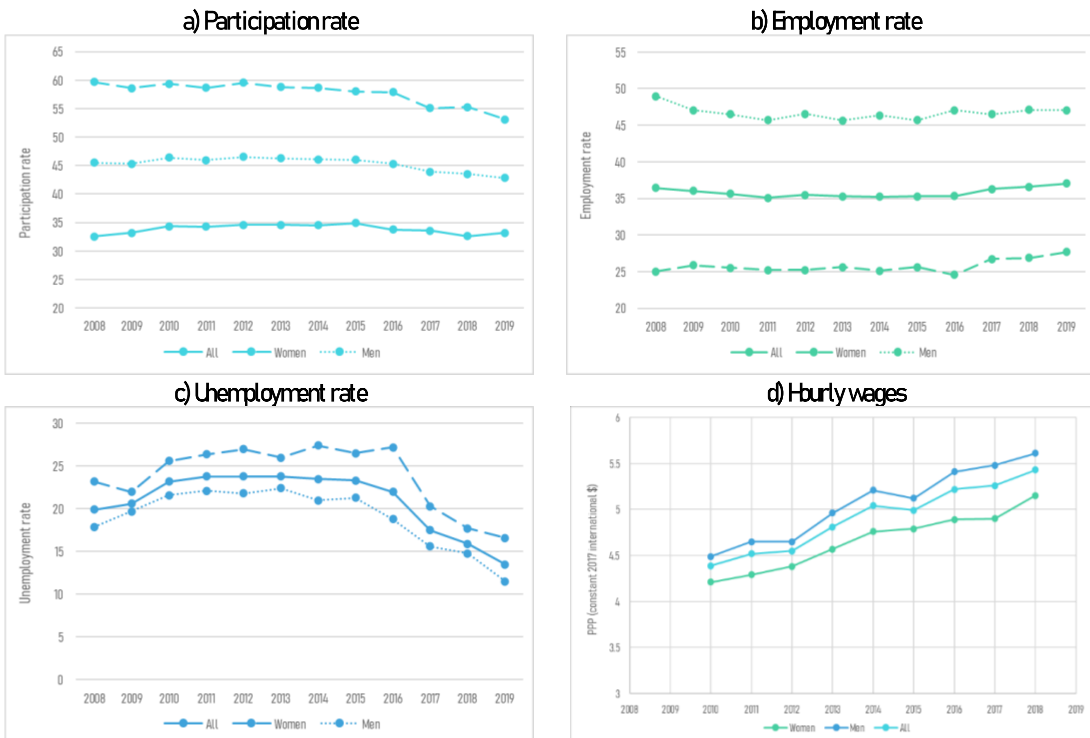
A glance at the labor market in the last decade: structural problems and some good news

The share of informal employment among total employment declined steadily between 2010 and 2018. A first look into labor market indicators suggests that this decline took place in the context of relatively stability of the labor market, with improvements in the last years (figure 1). Female participation rate presents an increasing trend until 2015, from then on, both female and especially male participation rates have shown less dynamism, and at the same time employment rates were increasing for both sexes. As a consequence of these movements, the unemployment rate presents a very significant decrease for all workers between 2015 and 2019, although it still stands at very significant levels. According to World Bank and Wiiw (2020), apart from new job creation, emigration was key to the reduction in unemployment. The report establishes that the rise in employment and activity rates was the result of a significant decline in the working aged population, due to population aging and also of continued outmigration.

It is important to notice that participation rates in this transition economy remain much lower than in the EU and other countries in the region. In other words, low labor force participations and high structural unemployment still remain as structural problems, even if there were some good news in very recent years. Moreover, B&H presents the highest youth unemployment rate among European countries, even if the last three years it declined significantly, accompanying the trend of the global rate.

The gender gaps are smaller at the end of the period when compared to a decade before, but they are still very sizeable. The period has also been characterized by an increase in hourly earnings, which grew around 24% between 2010 and 2019, with similar changes for men and women. Until 2015, increases in earnings (and in wages) were in parallel to increases in unemployment, Kovtun et al (2014) attribute this behavior to the high levels of employment protection and inflexible structures of wage bargaining.

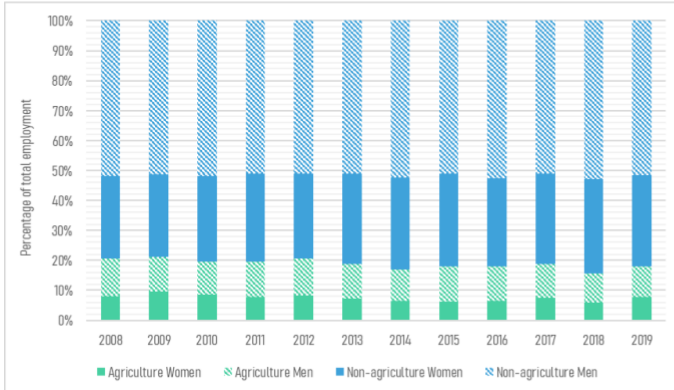
Figure 1. Main labor market indicators by sex. 2008-2019



Source: SDG Global Database & ILOSTAT

Like other transition economies, the informal sector has become relevant in Bosnia and Herzegovina during the post-war period. Individuals who have lost their jobs and/or cannot find employment in the formal economy, end up in subsistence agriculture, petty trade or low-value-added production activities. This has configured a labor market where agricultural sector is important, and no relevant structural changes in the labor market are detected in this period (figure 2), although the importance of the agricultural sector presents a slight decline. In terms of GDP in this economy, around 60% is accounted by services.

Figure 2. The structure of employment .2008-2019



Source: ILOSTAT

Another characteristic of the B&H labor market is the strong segmentation between the public and private sector. The public sector has outsized its role as a direct employer, with better working conditions and opaque recruitment process, creating distortions in the labor market (World Bank, 2019). On the private side, jobs are created by large companies or small and micro enterprises, while medium-sized enterprises contribute a relatively low share of jobs.

Informality: importance, evolution and determinants

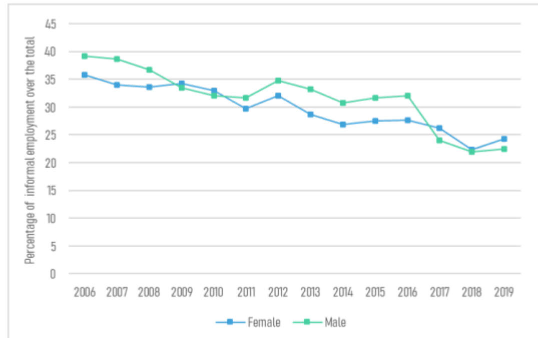
Between 2006 and 2019 the average growth rate of the Bosnian economy was 3.4%. In this context of moderate economic growth (with the exception of the decline in 2009), the importance of informal employment in total employment, under the productive definition, decreased from 38 to 23 % (see figure 3). An important reduction is detected from 2016 on, simultaneously with the fall in the unemployment rate mentioned before. The evolution is similar for men and women. Different studies measuring the informal sector through indirect methodologies find a similar decrease in the period, with the informal sector going from 36 % of GDP in 2006 to 30% in 2019 (Pasovic and Efendic, 2018; Medina and Schneider, 2018). In other Balkan economies like Serbia, Albania and North Macedonia, the employment in the informal sector has also declined since 2014 (World Bank and Wiiw, 2020).

As expected, empirical research based on survey data report that individuals who are young, less educated, low skilled, from rural areas and from economically weak families have higher probabilities of participating in the informal economy in B&H (Efendic and Williams, 2018). According to ILO (2019), the prevalent form of informality is given by independent workers (67% of informal workers), followed by employees (13,5%), both in the informal sector. The sectors more represented in the informal economy are agriculture (54%), followed by information, finances, and manufacturing (around 8% each). In terms of the exposure to informality, it is higher among domestic workers, agriculture, other services and information.

Figure 3. Informality in employment. 2006-2019

a) Informality and GDP

b) Informality by sex



Source: SDG Global Database & World Bank

Measures of inequality in B&H are difficult to find. In a regional comparison, Jusic (2018) states that the Gini coefficient on per capita household consumption was estimated in 0.44 in 2011, indicating that it is the region's most unequal country. The high inequality of disposable income in the region has been explained partly as a consequence of an apparent failure by labor taxation systems to reduce market income inequality (Arandarenko et al., 2017; Jusic, 2018).

The reasons behind the sizeable informal employment in B&H are complex. In the early stages of the transition process, informal activities helped people to survive, and attitudes towards informality remain ambivalent also because the social safety net is weak. The lack of dynamism in formal employment determines that individuals need to engage in subsistence activities. It has also been highlighted that the levels or regulations and taxation on the formal economy are high, and this coexists with a weak approach to the rule of law and enforcement (ETF, 2006). Numanovic et al (2020) also highlight that B&H is characterized by relatively rigid and inefficient regulations for doing business, according to international country classifications, and this is related to expensive and complex dismissal procedures.

Although the average contribution rates on labor are not high by European standards, studies suggest that they discourage low wage earners from entering the formal labor market. Most of the wedge on labor corresponds to social security contributions, whereas the personal income tax is set at a flat rate for all workers. Tax-free family allowances imply very small amounts, and so the high tax wedge applies to all workers, regardless of their income or family situation. The system ends up in the tax burden being progressive for those earnings incomes below the 50% of the average gross wages, whereas the effective tax burden falls as incomes increase (see Atoyan and

Rahman, 2017, Obradovic and Jusic, 2019).[9] In words of Arandarenko (2019), the low progressivity of the labor taxation in B&H negatively affects low-wage earners who do not earn much in terms of the net take-home pay but are still relatively costly to firms, which are also less motivated to hire low-wage workers. In sum, different studies coincide about the fact that the tax wedge probably has more influence on labor market performance, and on the informal economy in B&H, than minimum wages or employment protection legislation, and it is a crucial factor to understand informality in B&H.

In their exploration about the drivers for engaging in the informal economy (based on a survey specially designed), Numanovic et al (2020) find that the main perceived drivers in B&H are: employers insist on paying undeclared wages (40% of surveyed people selected this option, options were not mutually exclusive), people receive higher wages from undeclared labor because labor taxes are high (36%), and people do not want to lose social benefits (18%). Even if the tax burden is explicitly considered in the second driver, the first driver also could reflect employer's strategy of reducing production costs as a consequence of high labor taxes.

The puzzle about the recent decline

Unfortunately, not much light can be shed about the reasons behind the recent decline in B&H in informality, as it remains an under-researched issue. In fact, a similar process is detected in other Balkan economies, also facing periods of macroeconomic stability. In a relatively favorable economic context, the quality of employment seems on the rise, with most new jobs created in the Western Balkans being formal, waged jobs, while informal employment, especially self-employment, is on decline (World Bank and Wiiw, 2020). But the reasons behind this decline are still not clear: the identified policy changes, described below, are relatively recent and of partial coverage.

Specific studies about the declining trend in informality in B&H are still missing. Among the exceptions, Pavonic and Efendic (2018) suggest that the downward trend over the last years could be related to the decrease in the value added tax, after the inception of a tax reform in 2006.

In terms of other tax policy changes, there have been some recent movements in the RS, but no changes in the FB&H (Numanovic et al, 2020). Personal tax-free allowance was increased form EUR 102 to EUR 256 in 2018, lowering tax wedge and increasing nominal wages. It can be estimated that the tax wedge in RS was reduced by this recent policy change in around 3.6 pp when compared to 2015. The labor taxation system in FB&H remained almost unchanged over the

[9] It is interesting to note that the origin of this structure of labor taxes dates back to the socialist past of the country, when pre-tax income inequality was relatively low, so progressive taxes were not perceived to be required to redistribute income, as in market economies. At the same time, relatively high social contributions financed diverse social benefits (pensions, health, unemployment, housing) (World Bank and Wiiw, 2019).

past decade. In any case, these changes in RS are too recent to have any impacts yet, although they were motivated in the need of fostering formality.

Also in RS, amendments to the Law on Contributions were adopted in this entity in 2019, with a lower contribution rate for unemployment insurance. Finally, in an attempt to increase tax compliance and raise awareness about the negative consequences of informality, RS has implemented the so-called receipt lottery, which should stimulate consumers to ask for a receipt, changing their behavior on an interest-driven basis. This receipt lottery was introduced in RS in 2019, after other countries in the region implemented similar tools.

B&H also introduced a reform in the labor legislation to enhance more flexibility, in 2016. The reform was based on the diagnosis of a segmented labor market between the private and public sector, with a large footprint of the state as an employer, and an unfavorable business environment, all aspects that impede private sector growth. One of the specific objectives was to support the private sector to create more and better jobs.

According to Numanovic (2020), changes were predominately cosmetic and failed to ensure a coherent policy to support flexicurity. Measures of the changes in employment protection that this reform could have driven are still not available. Existing studies indicate that rigidities associated to collective bargaining and collective agreements were tackled, although measures that could encourage better occupational labor mobility were neglected.

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Uruguay

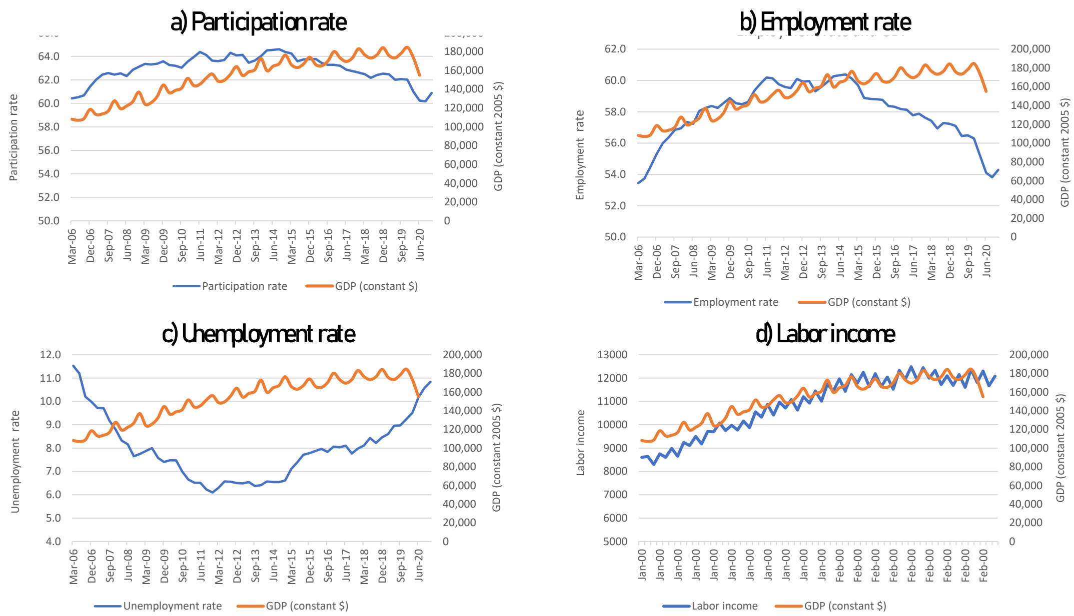
Introduction

Some years after the severe economic crisis of 2002 in Uruguay, and in a new context of economic recovery, the labor market started to present a very good performance in the country. In an environment of macroeconomic stability and rapid economic growth fostered by an increase in the international demand for commodities, all indicators related to the labor market started to show significant improvements. Among other things, informality experienced a big reduction. It was also the time when a centre-left coalition took government for the first time in the country, and many policy changes were implemented. Probably multiple factors are behind this relevant reduction in informality in Uruguay, as discussed below. The combination of a sustained economic growth process, jointly with the introduction of several macroeconomic and redistributive reforms, seem to be related to the success in reducing informality in the labor market.

A glance at the labor market in the last decade: strong dynamism and then deceleration

Two clear sub-periods in terms of economic activity and labor market performance can be distinguished between 2006 and 2020. Until 2015, the dynamic growth process is reflected in the increase in GDP. Simultaneously, the moderate increase in participation rates and the strong increase in employment rates determined a significant fall in unemployment, that reached its lowest values since statistics are available in the country. Real labor income also increased following the path of GDP. From 2015 on, a different scenario emerges. Participation rates begin to descend, and employment rate decreases even more, leading to higher unemployment rates. Real labor incomes remain, in the best of cases, stable. It is important to notice that the abrupt decline in participation rates and especially in employment by the end of the period reflects the impact of COVID-19 on the Uruguayan labor market.

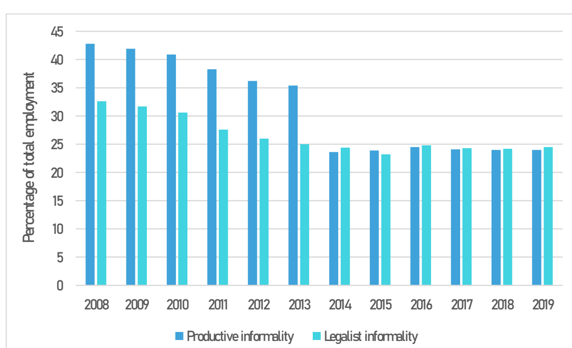
Figure 1. Main labor market indicators by sex. 2006-2020



Source: based on Uruguayan household surveys and Banco Central del Uruguay (GDP)

As in many economies in Latin America, informal employment represents a relevant portion of total employment. Whether we consider the productivist definition proposed by ILO or the legalist one, informal employment has declined in the last years (figure 2). It is important to notice that this decline is not private of Uruguay, other countries in the region also display a formalization process in the labor market on the first decade of the XXth century (ECLAC, 2014).

Figure 2. Informality in Uruguay. Productivist and legalist approach. 2008-2020



Source: SDG Database

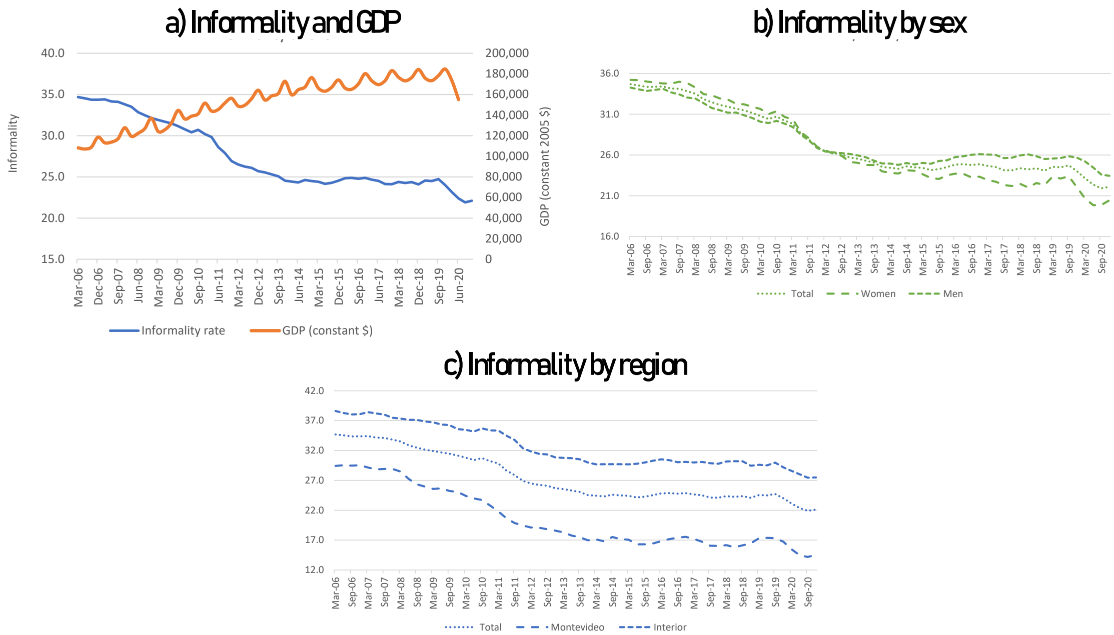
In the case of Uruguay, previous studies indicate that the overlapping between both definitions of informality (productivist and legalist) is more than 70%, and that the legalist approach is a better approximation to the problems of the labor market in the country (Amarante and Espino, 2009). In light of these facts (similar evolution, high overlapping and higher adequacy of the legalist concept to the Uruguayan case), in the following sections we discuss the evolution of informality based on data reflecting the legalist approach.

Informality: importance, evolution and determinants

Between 2006 and 2020 the importance of informal employment in total employment, under the legalist definition, decreased from 35 to 21 % (see figure 3). As in the case of the other indicators of the labor market, the decline in informality took place mainly until 2015. From then on, relative stability is detected, until the last year of the period. Informality fell in a period of sustained economic growth, with decreases in unemployment and increases in real wages and also in the minimum wage. In terms of gender differences, the incidence of informality was similar for men and women around 2012. From then on, informality among males remains stable whereas informality among women presents a small decline.

In terms of gender differences, a recent study for four Latin American countries (including Uruguay), based on event study approach, shows that women´s and men´s trajectories evolve similarly before the first child is born, but diverge dramatically after parenthood. In particular, the share of working women who are not registered workers increases after the first child is born, while fathers’ trajectories remain basically unaffected (Berniell et al, 2021). Consistently with this fact, the incidence of informality is higher among women than men at central ages, even in years when the global incidence for all ages is similar. Informality is lower in Montevideo, the capital of the country, and the evolution in the two regions follows similar path, with a stronger decline in Montevideo, especially in the last COVID year.

Figure 3. Informality in employment. 2006-2019



Source: based on household surveys

The evolution of informality during the last year of the period deserves a special note. The disruption that COVID -19 has implied for labor markets around the world has no historical precedent. In Latin America, many workers moved out of the labor force, with the main consequences of a relevant decline in participation rate and an increase in the unemployment rate that was not as high as it would have been under full participation. Latin American countries, Uruguay included, registered a strong decline in registered work, but this has not meant an increase in informality. On the contrary, the informality rate declined during COVID-19 in the region, because of the strong contraction of informal employment (including self-employment) (see ILO, 2021). This is a change in the historical dynamic of the informal sector in Latin America: in all previous crisis, informality increased during economic contractions, as the informal sector acted as a buffer and received displaced workers from the formal sector (ILO, 2021).

The decline in informality in the Uruguayan labor market during the last years is mainly explained by the lower rate of informality among private salaried workers (table 1). Sell-employed without investment continue to be mainly informal workers, but this employment category has shrunk during economic recovery. As a consequence of these movements, the profile of Uruguayan informal workers has changed: up to date more than half informal workers are self -employed with investment (table 2).

Table 1. Informality rate by occupational category

	2001	2006	2011	2016	2019	2020
Private salaried workers	29.8%	28.1%	19.2%	14.1%	13.5%	10.1%
Public salaried workers	1.5%	1.5%	0.0%	0.1%	0.1%	0.1%
Member of cooperative	31.2%	13.8%	17.2%	5.5%	11.7%	4.4%
Employer	14.8%	15.4%	15.2%	10.7%	8.2%	7.2%
Self-employed without investment	91.7%	93.9%	96.9%	97.3%	98.0%	93.7%
Self-employed with investment	65.3%	69.6%	67.2%	64.8%	64.3%	59.0%
Other	86.3%	70.5%	71.7%	65.8%	62.0%	54.0%
All private workers	**36.0%**	**34.9%**	**27.1%**	**23.8%**	**23.6%**	**21.5%**

Source: based on household surveys

Table 2. Distribution of informal workers by occupational category

	2001	2006	2011	2016	2019	2020
Private salaried workers	45.1%	44.2%	41.5%	34.2%	32.5%	24.7%
Public salaried workers	0.7%	0.7%	0.0%	0.0%	0.1%	0.1%
Member of cooperative	0.2%	0.1%	0.1%	0.0%	0.1%	0.0%
Employer	1.6%	1.9%	2.6%	1.7%	1.2%	1.2%
Self-employed without investment	22.5%	18.2%	10.0%	10.2%	10.1%	10.1%
Self-employed with investment	26.5%	31.8%	43.1%	51.7%	54.2%	61.2%
Other	3.3%	3.1%	2.7%	2.1%	1.8%	2.7%
All private workers	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: based on household surveys

The decrease in informality was very strong in the sector or construction (a male activity) and domestic service (a female activity). Whereas in 2006 around 68% of workers in construction did not contribute to the social security system, in 2019 this figure descended to 50%. Similarly, in 2006 around 70% of domestic workers were not registered whereas in 2017 unregistered domestic workers are estimated to be around 32%.

A recent study based on micro-econometric decompositions finds that the process of formalization that took place in the Uruguayan labor market is a key factor to understand the decrease in earnings inequality over the period 2006-2014 (Amarante et al, 2016). An increase in the formality premium in the first percentiles of the income distribution is detected, and this could be related to both minimum wages and wage bargaining, although this remains an open research question. But the study concludes that the institutional characteristics that regulate the allocation of the workers between formal and informal sectors and the different rules of wage formation in both sectors cannot be ignored in order to understand the recent dynamics of inequality in the Uruguayan case.

Potential explanations for the recent decline

Uruguay was marked by sustained economic growth, with an average GDP growth of 5.7% between 2004 and 2013. Economic growth and stability provide very favorable conditions for informality reduction, although it is important to remember that during the 90s the Uruguayan economy also grew, but informality did not decline. During this recent period of sustained economic growth, the behavior of informal employment has been clearly counter-cyclical.

Another relevant aspect in the recent Uruguayan experience is the significant set of reforms and new policies that were implemented in the period. As many changes took place at different levels at almost the same time, it is not possible to disentangle the effect of each of them on informality, although existing research give us some hints.

An important change is the reinstatement of mandatory collective bargaining in 2006, after not operating since 1992. Tripartite negotiations about wage levels and changes began to be set at the sector level, with the participation of representatives of employers, workers and the government, and basically covered all formal workers in the economy. Minimum wages by sector are set within this bargaining processes. Public workers, and more importantly for formalization purposes, rural workers and domestic workers were included in collective wage bargaining. These changes affect wage formation in the formal sector, and in a context of dynamism of formal employment, could have operated as an incentive for formalization. It is important to note that in the first decade of this reinstatement, most of the agreements were consensual (85%), and the level of unfulfillment was relatively low (Cabrera et al, 2013).

On a similar token, the national minimum wage (MW) began to be binding again, after decades of being non relevant in the labor market, after November 2003. In fact, by the beginning of the 21st century the minimum wage had completely lost its role as a reference price in the labor market. This was the result of a strategy to avoid deteriorating public accounts, as various public social benefits were indexed to the minimum wage. In 2004, a law was passed to finish that indexation, and the minimum wage started to increase significantly. Between 2005 and 2015, the minimum wage more than duplicated in real terms. This increased seems not to have hurt employment at the global level, although suggestions of effects for low skilled workers are reported (UNDP, 2008).

A recent study about the impacts of the MW on domestic workers in Uruguay found that the probability of being employed in the formal domestic service for workers earning below the MW was small after the increase, whereas workers above the MW were more likely to be engaged in formal employment, and their formality rate increased substantially (Katzkowicz et al, 2021). In spite of this, for women at the lower tail of the distribution, there were undesired effects of the MW policy on employment and on formal employment. The authors argue that these effects were likely to be offset by other labor policies and by sustained economic growth, and this is reflected in the high increase in the proportion of domestic workers contributing to the social security.

It is important to notice that Law 18065, passed in 2006, represented a substantial change in the regulation of domestic work, which was one of the sectors with higher increases in formalization rates. It established that wages had to be fixed trough collective wage bargaining, it set the working hours per day, the resting time and the conditions of night work. Access to unemployment and health insurance, as well as severance pay, became mandatory. During that time there was also a very strong awareness campaign to promote the formalization of domestic workers.

Another relevant policy change that may have impacted formalization was the creation of the National Health System in 2008. Until 2007, the social insurance administration covered the employee´s insurance to access a private healthcare provider, but the employee´s family was not covered. The reform of 2008 extended the healthcare coverage to include all registered employees' dependent children until the age of 18. There was an increase in the payroll tax contribution, but the market value of the health care was significantly higher than the increase in the tax burden for most workers with children. In their impact evaluation of this policy, Bergolo and Cruces (2014) find that the reform introduced incentives to move into benefit-eligible employment in order to take advantage of the subsidy for dependent children. For those who were not working, the benefit created an additional incentive to formalize. In sum, individuals reacted as predicted, with a substantial increase in benefit-eligible employment for parents as compared to childless individuals. Single parents, parents with several children and parents with younger children entered registered employment at a higher rate. Two years later, in December 2010, this health insurance was extended to the partners of workers in the formal sector. Parada (2016) analyzes the new policy change and finds that the policy extension reduced the share of the economically active population in the formal labor market, especially in the case of women in the formal labor market.

Uruguay also eased the rules applying to its "single tax" social security scheme for microenterprises during 2007. The system had existed for many years, but was not intensively used. It consists of a unique fee that substitute all national taxes and social security contributions. The flexibilization was in favor of the beneficiaries. Although impact evaluations of this policy were not implemented, some figures suggest that, as a result of this flexibilization, a considerable number of self-employed workers were able to join the social security (Amarante and Perazzo, 2013). The main changes refer to the inclusion of small stores, the inclusion of other activities besides retail trade, an increase in the maximum limit of sales, the possibility of having an employee (and in some special activities, more than one). In December 2012 the number of active businesses affiliated with the *Banco de Previsión Social* under the single tax modality reached almost 27 thousand workers, which is 7.4 times the number corresponding to June 2007, before the tax reform (ILO, 2014). Another similar scheme, with lower requirements, was created by the end of 2011 by the Ministry of Social Development, as a policy of inclusion of very vulnerable self-employed workers. This is a very small program in terms of coverage.

A tax reform was implemented in 2007, including the granting of tax incentives –through the reduction of corporate income taxes– for productive investment with formal job creation. An impact evaluation of these interventions revealed that the promotion of investment was associated with an increase –between 10% and 35% depending on the estimation– in formal employment (Carvajal et al., 2014). On the one hand, as part of this tax reform of 2008, a progressive tax on income was implemented, and this could have acted as a disincentive for higher income workers. This has not strictly been evaluated in Uruguay, but very recent studies explore how individual taxpayers respond to personal income taxation and find very modest elasticity of taxable income (Burdín et al, 2021), so potential adverse effects from this side seem not very plausible. Also as part of the tax reform, there was an alignment of employer´s pension contributions to social security, reducing contributions of trade and service sectors and increasing those of manufacturing, with a neutral impact on tax revenues. Given that the first two sectors have more workers than the third one, this measure may have had a positive impact on the total of protected employment (ILO, 2014).

Finally, a flexibilization in social security was incepted in 2008. It established that workers' claims for pensions would prescribe in five years, and that the activity years needed to qualify for old-age retirement would be reduced from 35 to 30 years. It also included pension credits for mothers. This reform increased significantly the number of retirees, and it has been argued that the fact that the retirement target was made more accessible may have become an incentive for formalization of labor market relationships (ILO, 2014).

Another important innovation in terms of social protection in this period in Uruguay, and similarly to the rest of Latin America, was the inception of conditional cash transfers. A temporary called *Plan de Atención Nacional a la Emergencia Social* (PANES) was launched in 2006. This program provided a cash transfer to the poorest Uruguayan households, conditional on a series of health and education controls for children in beneficiary households. An impact evaluation by Amarante et al (2011) indicates that the transfer reduced formal employment and earnings, primarily among men. This emergency program was replaced in January 2008 by a new system of family allowances, the AFAM program. It is targeted at poor households with children, and existing evaluations have found negative effects on formality. Bergolo and Cruces (2020) find that, in this case also, beneficiaries respond to the program's incentives by reducing their levels of registered employment by about 8 percentage points. The program induces a larger reduction of formal employment for individuals with a medium probability to be a registered employee. The fall in registered employment is due to an increase in unregistered employment, and to a lesser extent to a shift towards non-employment. In other study, Bergolo and Galvan (2018) confirm that the effect is mainly associated to a decline in women's movement into formal labor from unregistered jobs.

In sum, a wide array of policies was undertaken in Uruguay, at the same time that the labor market showed an unusual dynamism, in the framework of the commodity boom. Many changes implied relevant institutional modifications, like wage bargaining or the regulation of domestic work, and have probably boosted the formalization process. Other more indirect measures, like tax incentives, the single tax system or the health reform may also have helped in this process. At the same time, the expansion of conditional cash transfers has had potential disincentives to registered employment, a result that has been also found in other countries in the region and calls our attention about the coherent design of the social protection system.

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Vietnam

Introduction

Vietnam's transition from a planned to a modern economy began in mid-80s, and has been a successful process. Until that moment, in a centrally planned economy, economic activities, including employment and wages, were set and controlled by the government. This implies that the formation of the labor market, in the sense of market oriented, is relatively recent (Nguyen & Nguyen, 2006). This relatively recent developed labor market still has an important share of agriculture activities (representing nowadays around 25% of total employment, an impressive decline from the 65% figure of 1997), followed by services and industries. The proportion of workers in individual household enterprises is also very significant. These two facts (relevance of agriculture activities and individual household enterprises) are in the bulk of the importance of informality in the country.

Social protection is also a relatively new concept in in Vietnam. The Vietnam Social Security (VSS) was created in 1995, covering just a part of workers. To overcome the wide exclusion, in 2008 a regime of voluntary insurance was incepted, to include workers not covered by the compulsory social insurance.

Three important group of workers are identified among informal workers (Cling et al, 2017): a first group consists of workers in the informal sector, mainly individual household enterprises. They currently have the option to contribute to the VIS, but their incomes are usually very low. Another group is formed by informal workers employed in formal private enterprises but with short term contracts, for which enterprises are not obliged to pay social contributions. This type of contracts is very extended in formal enterprises, and represented between 25-30% of total contracts some years ago (Castel, 2012). The third group, of smaller size, consists of workers with permanent labor contracts but for whom their formal employer does not pay social contribution.

In 2012, a resolution of the Party´s Central Executive Committee set a goal of increasing social insurance coverage to 50% of the labor force by 2020. Even if some progress has been made in the last years, in a context of economic growth and policy efforts, the goal has still not been accomplished. The last available figure from 2017 indicates that only 25% of the labor force is covered by social insurance (Huong, 2019). The following paragraphs discuss the main features of social protection and informality in Vietnam, as well as the recent policies implemented to increase social insurance coverage.

A glance at the labor market in the last decade: stability in a context of growth

The transition from an agrarian, rural and informal economy to an urban, manufacturing and services-based formal economy has still not been completed in the country (Schmillen and Packard, 2016). Even if incomplete, the process has implied a shift of employment away from agriculture towards manufacturing and services, away from household enterprises towards registered and regulated businesses, and away from state owned enterprises towards private domestic and foreign owned firms (Mc Caig and Pavcnik, 2013). Since the economic and political reforms began in 1986, economic growth has been sustained and the country has transformed from one of the world's poorest nations into a lower middle-income country, although this rapid growth and industrialization process has had detrimental impacts on environmental terms (Vo and Ho, 2021).

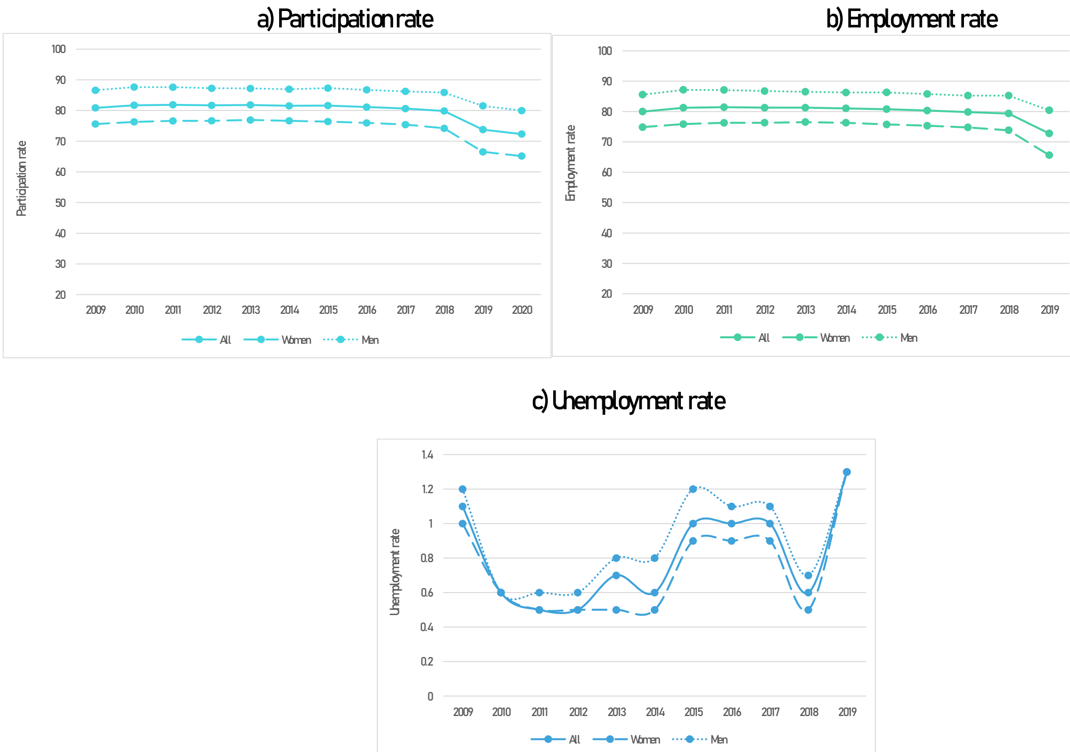
Vietnam´s transition to a market economy is considered as a successful story, its economic growth in the 1990s was one of the highest in the world, averaging 7.8% between 1990 and 2000 (World Bank, 2003), with a strong simultaneous decline in poverty incidence.

If we consider the last fifteen years (2006-2020), the average growth rate has reached 5.8%, with a peak in 2018 and still a relatively good performance during the last covid crisis (7.5% growth in 2018, 3.4% growth in 2020). During this period, the country has also shown a commitment to 'growth with equity', implementing numerous poverty reduction programs. During the 2000s, growth has been pro -poor, as lower income households benefited proportionally more from economic growth (Nguyen and Pham, 2018).

Labor force participation has been rather stable in the last decade, with a recent decline (see figure 1a). Given that the social protection system is weak, participation in the labor market is essential to survive, and this explains these high rates (Cling et al, 2017). As usual, female participation is lower, although Vietnam presents greater gender parity in terms of labor force participation than most countries (10 pp gap).[10] Employment rates show a similar trend and present high levels (figure 1b), with the resulting low levels of unemployment rates (figure 1c). It is important to notice that a low unemployment rate in a developing country like Vietnam mainly reflects the fact that, due to the lack of financial support while looking for a job, people end up working in the informal sector. Lack of social protection (unemployment benefits) imply that the unemployed cannot to stay out of a job for a long period, and accept to work in poor quality jobs. The structure and quality of employment matter even more than unemployment in a context like the Vietnamese (Pierre, 2012).

[10] The Vietnam War led to a sharp decline in the male population relative to the size of the female population, and once the economy started to grow following the reforms in 1986, the available supply of labor was predominantly female, facilitating female entrance into the labor market. This helps to understand the relatively small gender gap in participation.

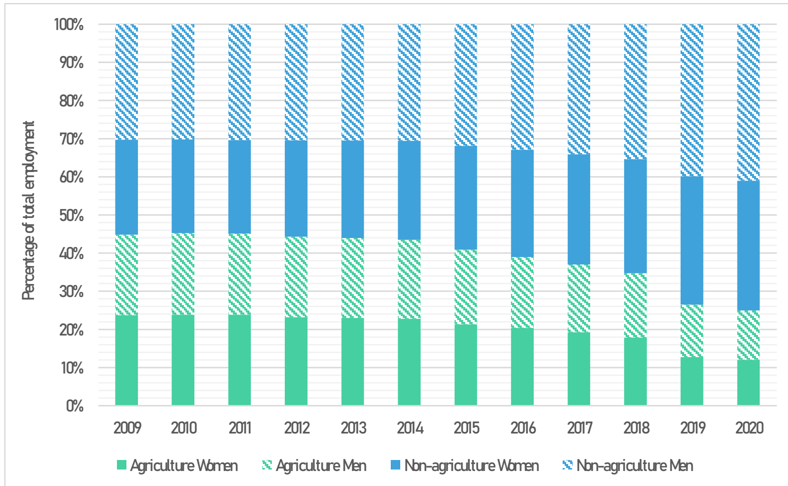
Figure 1. Main labor market indicators by sex. 2006-2020



Source: SDG Global Database & ILOSTAT

The first clue about the decline in informality is given by the fact that the importance of agricultural employment has decreased significantly during the last decade (figure 2), accounting for around 25% of employment by the end of the period. It was around 45% in 2009, and it is reported to concentrate around 65% of employment in 1997 (Cling et al, 2017). Strong economic growth fostered by foreign investment have pushed the development of the industrial sector, and the country is now a big exporter of clothing and electronics. But even with this important structural change, the share of the population in non-waged employment or working in household enterprises continues to be very high in the country, and this is directly associated to the importance of informality.

Figure 2. The structure of employment. 2009-2020



Source: ILOSTAT

Informality: importance, evolution and determinants

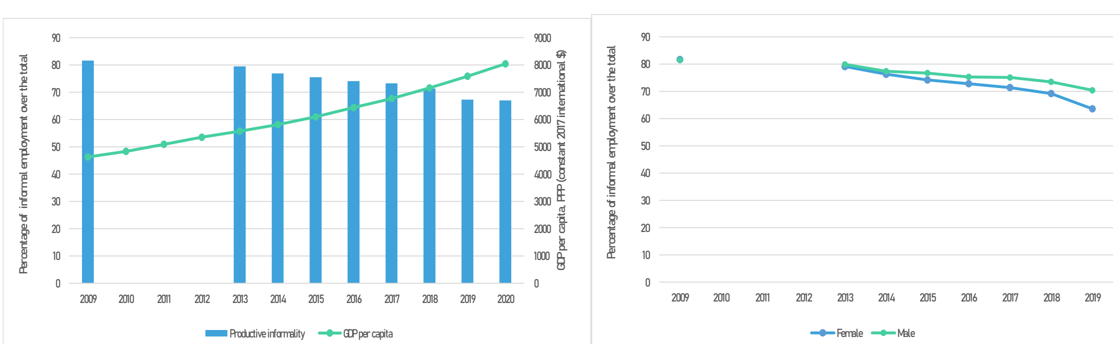
Research about the informal sector in Vietnam is recent. A report from ILO (2011) discussed the statistical difficulties to measure informality in this country, stating that, to that date, the contours of the informal sector in Vietnam were blurred.

As a first approach, the analysis of informal employment under ILO's productive definition, shows an important decrease from 82 to 67% of total employment between 2009 and 2020, in a period of economic growth and relevant structural changes, as discussed before. Informality was similar between men and women in 2009, and declined for both, but this decline was higher among women.

Figure 3. Informality (productive)

a. Informality and economic growth

b. Informality by sex



Source: ILOSTAT

The major part of Vietnamese workers are self-employed and family workers, although their relative importance is declining: they represented 63% of total workers in 2012 and five years later their share descended to 55% (table 1). These workers were basically excluded from social insurance until 2008, when they had the chance of entering the voluntary system. Wage and salaried workers, if they have a labor contract of at least three months, are subject to compulsory contribution to social insurance. But a very high share of these salaried workers are under short-term labor contracts or even do not have a labor contract, and so they are not obliged to compulsory contribution.

Table 1. Labor market in Vietnam

	2012	2013	2014	2015	2016	2017
Total (thousands)	51,442	52,208	52,745	52,840	53,303	53,403
Structure	100	100	100	100	100	100
Wage and salaried workers	35	35	36	39	41	43
Employers	3	3	2	3	3	2
Self-employed and family workers	63	63	62	58	56	55

Source: Huong (2019)

Estimations about social insurance coverage among Vietnamese workers, presented in table 2, indicate that it includes only 25% of total workers (Huong, 2019). Among those comprised in the compulsory system (wage and salaried workers) coverage was 57% in 2017, whereas among self-employed and family workers, which can contribute in the voluntary system, coverage did not reach 1% in 2017.[11] As mentioned, this is far from the aim of 50% coverage set in 2012.

[11] Consistently with this data, a report from ILO (2011) states that in 2007, around 82% of employment was informal (no social insurance) in Vietnam.

Table 2. Social insurance coverage in Vietnam.

	2010	2014	2015	2016	2017
Total labor force (thousands)	50,840	53,750	54,320	54,450	54,940
Total contribution (thousands)	9,523	11,646	12,291	13,066	13,818
Compulsory contributors	9,442	11,453	12,073	12,862	13,584
Voluntary contributors	81	193	218	204	234
Contribution to VSI (%)	**19%**	**22%**	**23%**	**24%**	**25%**
Compulsory (%)	54%	58%	54%	55%	57%
Voluntary (%)	0.24%	0.59%	0.71%	0.68%	0.80%

Source: Huong (2019)

Around 83% of informal economy workers were engaged in business production households or classified as own-account individual workers. Even if these workers have the possibility to contribute to the voluntary scheme since 2008, their incomes are very low and they do not perceive social protection as a priority (Cling et al, 2017).

Two reports developed by ILO study informality in the non-agricultural sector. They define and analyze the informal economy, contemplating workers in the informal sector as well as informal workers in the formal sector. They exclude all workers in unregistered production households in terms of agriculture, forestry and fisheries (ILO,2011; 2016). The most recent report assesses that during 2014-2016, the rate of informality among non-agricultural workers tended to decline, although in the same period the absolute number of informal workers increased (but the average growth rate of informal economy workers was lower than that of formal economy workers). Under this definition, the rate of informal workers was 59% in 2014, and descended to 57% in 2016, and in the three years, informality incidence was higher among males than females.

The report also provides a profile of informal workers in non-agricutural activites. The incidence of informality is higher among the youngest age groups (15-24 years) and in the 55 and over age group, presenting the U shaped pattern found for other countries. Another key characteristic of informal workers in Vietnam is that they hold unstable and temporary employment, work more hours, receive lower incomes. The vast majority of these informal economy workers do not have written employment contract and do not have any social insurance.[12]

Other studies have found that, on average, earnings for informal workers are equivalent to two thirds of earnings for formal workers, and mobility from the formal to the informal sector is very low (Cling et al, 2017; Nguyen et al, 2011).

[12] The majority of informal employment in formal enterprises seems to be related to short term contracts (Cling et al, 2017).

As discussed, informal workers can belong to the formal sector of the economy. A study about social security contributions in Vietnam finds that, among the enterprises that contribute to social security, the share of contribution is much lower than the contribution rate established by law: 7.6% against the legal 23% (Castel and To, 2012). This may entail two situations: enterprises do not register all their employees (contracts shorter than 3 months are not registered), or enterprises do not report all the wages that they pay to their employees. This can happen because contributions are not calculated on the total amount of wage costs that enterprises report to the tax authorities, but on the wages that are reported in employees' labor books, which are set when contracts are signed, but are not revised when wages are revised. Also, subsidies, bonuses and other allowances are not subject to social security contributions. The study investigates who benefits from the practice of avoiding registration and underreporting wages, and finds strong evidence that employees in enterprises that are not registered to social security and in enterprises that underreport wage, receive higher net wages. Evidence about enterprises' higher revenues per worker are not strong. The authors clarify that this result reflecting that in Vietnam workers are more likely to be the ones who benefit from evasion through higher wages cannot be associated, like in Latin America, with non-contributory benefits that reduce the incentives to participate in contributory schemes, as these non-contributory benefits are very low in Vietnam. In any case, the expansion of social security coverage in Vietnam is clearly not just related to law enforcement, but worker´s motivations and value of social protection need to be taken into account.

Recent policy changes

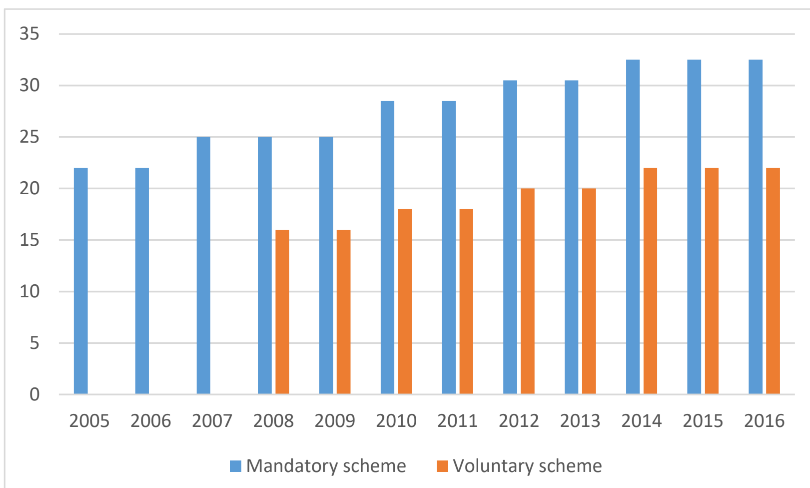
Social protection is a relatively new concept in in Vietnam. Before the country began its transition to a market economy in 1986, only public-sector employees received a retirement income. In 1995, with the creation of the Vietnam Social Security (VSS), compulsory social insurance began to include officials and civil servants, as well as wage workers with labor contracts, excluding short term contracts. The insurance covers sickness, maternity, working accidents and occupational diseases, pensions and survivor benefits. This definition of social insurance, tied to the labor contract, excluded the majority of wage workers.

During the past decade, some important reforms and policies have been developed, aiming among other things, to reduce informality. Unfortunately, systematic impact evaluations of these policies are not available (Cling et al, 2017), and so the link between policies and results can only be formulated in a hypothetical way

In 2008, as an attempt to overcome the wide exclusion of workers from social protection, a regime of voluntary insurance was incepted, to include workers not covered by the compulsory social insurance. This voluntary insurance provides benefits of pensions and survivor benefits. In other words, the voluntary contribution to VSI mainly aims to give social protection to farmers and other informal, as well as enterprises with less than 10 employees. This new voluntary scheme made social insurance more affordable by reducing the contribution when compared to the compulsory scheme (see figure 4), potentially fostering worker's willingness to participate in social insurance. This lower contribution does not cover short term social insurance (sickness, maternity, labour accidents or occupational diseases). Compulsory participation corresponds to workers with labor contracts from one month and enterprise owners in formal sectors, whereas voluntary participation applies to the rest of workers (including wage workers with labor contract less than a month, non-wage earners or working household business with no employees, and self-employed.

The level of payroll tax has been increasing in the last years (figure 4), and is considered to be high among East-Asian countries (Schmillen and Packard, 2016). The successive increases in payroll taxes and minimum wages may have slowdown the progression of social insurance coverage and employment (Huong, 2019).

Figure 4. Social contribution rates in Vietnam.



Source: OCDE (2018)

Given that temporary work represented a massive share of employment in the private sector in Vietnam, the New Labour Code of 2012 began to officially recognize the activity of subletting (labour subcontracting). According to Clinge et al (2017), this represented a significant progress which could help to extend social protection and reduce informal employment for sublet workers.

In 2014, the Social Insurance Law was revised: the state was entitled to subsidize participation in the voluntary social insurance system and some rules to strengthen compliance in the compulsory system were introduced. It has been argued that this revision of the Social Insurance Law in 2014 expanded coverage, as it reduced the obstacles for participation and implemented a number of useful actions to expand coverage (Castel and Pick, 2018).

The reform included the inception of government subsidies ranging from 10 to 30% of the minimum level of contributions was motivated by the idea of supporting the participation of very low-income workers.

Coverage was extended to contracts lasting from one to three months, which were previously exempted from contributions. Workers were allowed to combine pension rights in the mandatory and voluntary scheme, and the age ceiling was removed for participants reaching pension age in the compulsory scheme. This will allow workers to continue to participate in the voluntary social insurance system to complete the vesting period, and so it may constitute an incentive to formality.

An official grassroots organization, well embedded in rural areas, was in charge of an information campaign and mobilization for social insurance. Different agencies and actors were authorized to inspect and settle complaints on social insurance avoidance.

The reform implied an improvement of the system, in terms of information and transparency. Employees have the right to be informed, twice a year by their employers and once a year by their local social insurance agency, about the amount of social contributions transferred in their name to the VSI. Modernization of the VSI management and information systems, electronic social insurance cards, individual records and online access to personal information also contributed on that line.

Finally, higher penalities for delayed payments for social contributions were established. Enforcement was also strengthened by increasing inspections, in a coordinated effort by several institutions (Ministry of Finance, Ministry of Labour and provincial authorities in VSI).

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