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## **INSTITUTIONAL MISMATCH: FORMAL INSTITUTIONS AND INFORMAL REALITIES**

### **I. LABOUR LAW**

Historically, around the world, the “employment relationship” has represented the cornerstone – the central legal concept - around which labor law and collective bargaining agreements have sought to recognize and protect the rights of workers. Whatever its precise definition in different national contexts, it has represented “a universal notion which creates a link between a person, called the employee (frequently referred to as ‘the worker’) with another person, called the employer to whom she or he provides labour or services under certain conditions in return for remuneration” (ILO 2003).

The concept of employment relationship has always excluded those workers who are self-employed. But, increasingly, some categories of dependent workers have found themselves to be, in effect, without labour protection because their employment relationship is either disguised, ambiguous, or not clearly defined. The net result is that a large and increasing share of workers worldwide are not protected under labor law or collective bargaining agreements.

#### Recent Debates on the Employment Relationship -

Since its foundation in 1919, the International Labour Organisation (ILO) has been engaged in promoting the protection of workers through the adoption of a wide range of instruments and policies. In recent years, there has been a series of debates at the International Labour Conference (the annual meeting of the ILO) on dependent workers who do not have protection. In 1995, in recognition of the growing number of workers who work under various types of contractual arrangements without labour protection, the Governing Body of the International Labour Organization (ILO) decided to place “contract labour” on the Agenda of the 1997 International Labour Conference. In so doing, it designated “contract labour” as a standard-setting item which would require a “double discussion” procedure (over two consecutive ILCs) leading to a Convention and/or Recommendation.

At the 1998 International Labour Conference, during the second reading of the text, the tripartite Committee on Contract Labour failed to reach consensus on a standard on “contract labour”. There were several reasons for this failure, including terminological difficulties: in particular, from terms like “contract labour” and “contract worker” whose meaning is not legally precise or the same in different languages. Many worker and

government representatives were concerned that a third category of worker, between employee and self-employed, would be recognized in law. Most employers were strongly opposed to any consideration of the boundary between labor law and commercial law, out of concern that the ILO might start regulating commercial relationships. Although the Committee could not reach consensus on a Standard, it was able to adopt a Resolution, at the ILC 1998, that “invite(d) the Governing Body of the ILO to place these issues on the agenda of a future session of the International Labour Conference with a view to the possible adoption of a Convention supplemented by a Recommendation if such adoption is, according to the normal procedures, considered necessary by that Conference”.

Following up on the 1998 Resolution, and building on the work commenced by the Committee on Contract Work, the International Labour Office has undertaken a variety of measures, including: commissioning 39 national studies (1999/2000); convening a series of informal regional meetings (1999); and convening a tripartite meeting of experts on “Workers in Situations Needing Protection” (May 2000). In 2001, the ILO Governing Body decided to place “The Scope of the Employment Relationship” on the Agenda of the 2003 ILC. In preparation for this General Discussion, the Office produced a comprehensive Report summarizing the findings of the national studies and the perspectives of the various experts (see ILO 2003).

#### The Employment Relationship and Protection of Workers -

The rise in the number of dependent workers who lack labor protection is attributed to one or another or a mix of the following factors:

##### a. Legal Factors

- the scope of the application of the law is too narrow (or too narrowly interpreted)
- the law is ambiguously formulated or applied
- the law is not enforced or complied with

##### b. Empirical Reality

- the employment relationship is deliberately disguised by giving it the appearance of a relationship of a different legal nature (e.g. commercial)
- the employment relationship is objectively ambiguous so there is doubt about whether or not an employment relationship really exists
- the employment relationship clearly exists but it is not clear who the employer is, what rights the worker has, and who is responsible for securing these rights

Clearly, there are short-comings in labor law relating variously to how labor law defines and classifies employment relationships; how the definitions/classifications encoded in labor law are interpreted and applied; and whether the law, as interpreted, is enforced or complied with. Equally clearly, there are deliberate efforts by employers to disguise or

mask the employment relationship. And, finally, there are objectively ambiguous employment relationships.

### *Disguised Employment Relationships*

“To disguise an employment relationship is to create an appearance different from the underlying reality, for the purpose of extinguishing or attenuating the legal protection” (ILC 2003: 28). Deliberately hiding or disguising the employment relationship can be done in several ways, including cloaking it in another legal guise or giving it another form where the worker has less protection. The most radical way is to give the appearance of a relationship of a different legal nature: most notably, by giving the appearance of a commercial relationship rather than an employment relationship. The other way is to manipulate the existing employment contract so as to deny rights and benefits to dependent workers: for example, by revising the contract to limit it to a determined period or to a specific task but then repeatedly renewing the contract. A third way is to mask or disguise the identity of the employer (see “triangular relationships” below).

### *Objectively Ambiguous Employment Relationships*

There are also many cases where the employment relationship is not deliberately disguised but where the main elements that characterize the employment relationship - notably subordination and dependence - are not readily apparent. Doubts about the employment relationship arise in two basic types of instances: when dependent workers gain some autonomy or when self-employed workers become economically dependent. For example, some dependent workers perform work at a physical distance from the enterprise that employs them, while using the equipment and/or raw materials of the enterprise, following its instructions, and being subject to its control (over the quality of goods produced and the method of payment) but having full autonomy as to how to organize the work. And, it may be added, often having full responsibility for many non-wage costs of production: workspace, utilities, and maintenance of equipment. “Economically dependent” workers – that is, ostensibly self-employed workers who are permanently dependent on one or two clients – are found in the most diverse sectors, including: health professionals who work for health centers; sales representatives; newspaper distribution workers; taxi-drivers; skilled homeworkers, involved in information communication technology; as well as technical and professional consultants. The set of national studies commissioned by the International Labour Office indicates that this latter phenomenon – “dependency within independence” – is widespread and appears to be on the rise.

It is also the case that dependent workers may be forced, by their former employer, to “transfer” to working for contractors or “convert” to being self-employed. These related phenomena are quite widespread in the transport industry whereby truck drivers in transport firms are given little choice other than to work for a sub-contracting firm or to become self-employed. This has resulted in a marked rise in the number of so-called “owner drivers” driving trucks on behalf of another person or a firm under a so-called

“transport” contract (such owner drivers are often then classified in the service sector, rather than the transport sector).

### *“Triangular” Employment Relationships*

Whereas the employment relationship has traditionally been thought to concern two persons – the employee and the employer – there are more complex situations in which a third party or multiple parties are involved. In such situations, the employees of one enterprise (the “provider” enterprise) provide services or labor to another enterprise (the “user” enterprise). Such “triangular” or multilateral” relationships have always existed but seem to be on the rise (ILC 2003: 42). The best know examples are the use of contractors and private employment agencies. Another popular arrangement is franchising under which the franchiser normally exercises substantial control over the franchised business, including its employment policy and finances. Whereas many such relationships involve a civil or commercial contract between the user and the provider enterprises, this is not always the case.

For the employee in such “triangular” or “multilateral” relationships, the questions become: who is my employer? what are my rights? and who is responsible for ensuring them? From a legal standpoint, it is not always clear what the answers to these questions are: this is because both the “provider” and the “user” enterprise assume certain functions of a traditional employer. Providing answers to these questions is further complicated if the so-called user-provider relationship reflects an attempt to conceal the user’s identity as the real employer. For instance, in some such cases, the provider is actually an “intermediary” of the supposed user.

In summary, worker protection is centered mainly on the employment relationship, whose essential characteristics have a universal dimension under labor law and collective bargaining agreements. However, there is growing uncertainty as to the legal status – dependent versus independent – of many workers which, in turn, leaves many dependent workers outside the protection of labor law or collective bargaining agreements. The specific focus of the ILC 2003 General Discussion on “The Scope of the Employment Relationship” was the growing phenomenon of dependent workers who lack labor protection. The fundamental purpose of the 2003 General Discussion is “to help to achieve more clarity in employment relationships and, ultimately, adequate and effective labour protection for dependent workers who are unprotected” (ILO 2003: 58).

### Closing the Gap between Law and Reality -

Given the changing nature of the employment relationship, there has been a growing gap between the scope or coverage of labor law and the reality of work today. To ensure that a greater share of workers are protected, there is a need to close this gap.

The General Discussion at the ILC 2003 was designed to help close this gap for dependent workers. In its Report for the General Discussion, the International Labour Office has formulated a four-prong approach to closing this gap:

## 1. Clarifying the Scope of the Employment Relationship

The first part of the strategy is to clarify and to supplement, as needed, the scope of the application of labor law. To do so, the most common forms of disguised, ambiguous, and multilateral employment relationships needed to be identified and examined. These forms should then be compared and contrasted with the scope of the employment relationship under existing labor law to identify which cases fall within or outside the existing scope of the law. This would serve to isolate the technical gaps between the law and the reality and to determine whether the gaps are due to the law per se or to interpretations of the law. It is the case that, in many countries, labor lawyers tend to default to the more conservative interpretation of the law.

## 2. Adjusting the Boundaries of the Legislation

For those cases which do not fall within the scope of the existing law, efforts should then be made to extend the boundaries of the law to include them. This would involve delineating more clearly and appropriately the boundary between dependent and independent work and, then, reclassifying certain types of work (e.g. homework) that fall in the “gray” middle between the two. In the case of ambiguous employment relationships, where some or all of the elements of the employment relationship are obscured or missing, the law would need to be adjusted to enable a clearer identification of where and when the employment relationship exists. Related to these questions, there is a parallel debate as to whether to encode these changes in the law or in voluntary codes of conduct (developed through consensus by representative bodies of employers and workers).

## 3. Regulating “Triangular” Employment Relationships

In a typical “triangular” employment relationship, the employee has several interlocutors. The central question is which of these should be considered the employer. Different countries answer this question in different ways: some have defined the “user” as the employer; others have defined the “provider” as the employer; while still others hold the “user” legally responsible for the non-compliance of the “provider”. A related question is what are the “user” and “provider” responsible for: payment of wages, provision of benefits, contributions to social protection? Again, different countries have answered these questions in different ways.

## 4. Promoting Compliance and Enforcement

The fourth part of the strategy would be to promote application of existing or newly-revised labor law by tackling both the deliberate avoidance of the law and the failure to enforce the law. This could be done through providing information and consultation on the status of workers; imposing penalties for deception or fraud

regarding the identity of the employer; promoting collective legal mechanisms; strengthening of labor inspection.

The ILO Report on “The Scope of the Employment Relationship” summarizes a range of recent national strategies along these lines as detailed in the 39 country studies. These examples illustrate the possibility of pursuing, at the national level, a mixed approach combining the various strategies outlined above. In the concluding section of its Report, the International Labour Office provides some guidelines for future national and international action. At the national level, each member State is asked to examine the growing difficulties caused by disguised, objectively ambiguous, and triangular employment relationships and to develop solutions and apply relevant standards suited to their own situation. At the international level, coordination between member States is encouraged. To assist member States and to promote coordination between member States, the Report recognized that the ILO can play a major role by collecting and exchanging information and promoting good practices; providing technical cooperation, assistance, and guidance; and promoting the adoption of instruments by the International Labour Conference. The goal of future action at all levels should be to develop policies to ensure that laws regulating the employment relationship cover as many dependent workers needing protection as possible.

Significance of the Topic -

*Links with Debate on Informal Employment*

At the International Labour Conference 2002, there was a General Discussion on Informal Employment. In its Report on Informal Employment and Decent Work, the International Labour Office endorsed a new broad definition of informal employment that includes both: self-employed workers in informal enterprises (defined as small unregistered enterprises) and dependent workers in informal jobs (defined as those without protection). This new broader definition should serve as a unified framework that includes not only unprotected informal workers in the South but also unprotected non-standard workers in the North.

The ILC '03 General Discussion on the Scope of the Employment Relationship focused on a sub-set of informal and non-standard workers: namely, dependent workers in informal jobs (i.e., those without protection). It did not focus on self-employed workers who lack protection. It should be noted, however, that the tripartite Committee on Informal Employment at the 2002 ILC drew an important distinction between two types of self-employed workers: employers or owner operators who hire others; and own account workers who do not hire others. In drawing this distinction, the Committee on Informal Employment noted in its Conclusions that own account work is often precarious and that own account workers are often unprotected (see clause 4 of the Conclusions).<sup>1</sup>

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<sup>1</sup> Clause 4 of the Conclusions to the ILC 2002 General Discussion on Decent Work and the Informal Economy reads: “Workers in the informal economy include both wage workers and onw-account workers. Most own-account workers are as insecure and vulnerable as wage workers and move from one situation to the other. Because they lack protection, rights and representation, these workers often remain trapped in poverty.”

Future efforts to extend protection to unprotected workers will need to address the issue of unprotected own account workers.

In brief, many of those who work in the informal economy, be they disguised dependent workers or own-account workers in economically poor and dependent situations, would be greatly helped by forms of social protection that are not exclusively – or are less exclusively - linked to employee-status.

In sum, the following points are of particular importance for both unprotected non-standard workers in the North and unprotected informal workers in the South.

- in most countries in the world, social security protection and other forms of social protection are linked to employee-status;
- this means that whoever is not considered to be an employee very often lacks any social protection; however,
- given the costs of social security premiums (especially in developed economies and social systems), employers often seek to evade their obligations as employers by disguising the employer-employee relationship; therefore,
- the solution to the lack of social protection is not to make everybody into an employee (which in any case is not possible); rather,
- other solutions are necessary to extend social protection to as many workers as possible.

### *USA as Example*

Disguised, ambiguous, and multilateral employment relationships are common around the world, in both developing and developed countries. The United States is no exception. One of the country studies commissioned by the International Labour Office as background documents for its Report on “The Scope of the Employment Relationship” was on the USA (Alan Hyde 2002). That paper provides ample evidence that the issues addressed at the ILC '03 General Discussion are highly relevant to the world of work in the US today. Most notably, there is an on-going debate in the US around the distinction between “career” jobs and “contingent” jobs. Both categories are occupied mainly by dependent workers whose status as employees is not disputed but whose rights to protection under the law are. Contingent work represents a form of contract manipulation that excludes the worker from the benefits of labor legislation and collective bargaining provided to regular employees. This is also the case with many forms of contract work.

In the United States, over the past two decades or so, there has been a significant change in the employment relationship for many once-regular employees. Katherine Stone of Cornell University has studied the ways in which the employment relationship has been transformed and the implications of this transformation for the laws that govern social protection, workplace discrimination, and employee representation. Stone documents the *types of changes* that have taken place in the employment relationship. Her starting point

is the regular job with a single firm and a long-term “psychological contract” between the employee and the firm: in return for loyalty to the firm, the employee was guaranteed job security, promotion opportunities, and longevity-linked pay and benefits. Such jobs and firm-employee loyalty emerged during the industrial era in the United States and other developed countries.<sup>2</sup>

What then have been the major changes in the employment relationship in the United States over the past two decades? The main change is from long-term firm-worker attachment towards short-term employment relationships. Between 1983 and 2002, for all men over 20, there have been dramatic declines in *job tenure* and in the numbers who had been with their *current employer for 10 years or more*. These declines were particularly significant for men in the age groups over 45, precisely the group who were the beneficiaries of the old long-term employment relationship. Because women were not generally part of the long-term employment system, they have not experienced such marked declines and even a modest rise in some age groups. However, the overall percentage of women working for ten years or more for the same employer is significantly lower than men in every age-group.

There are several common defining features of the new employment relationship. First, employers promise their employees employability, not job security. More specifically, they promise learning opportunities, not long-term employment. Second, they promise networking opportunities (with customers, suppliers, and even competitors), not promotion opportunities. Thirdly, they do not keep employees on the payroll when the demand for their products or services decreases. Rather, much of the risk faced by the firm is placed squarely on the employee.

What risks that were previously borne by firms have been shifted onto employees? What are the new risks and vulnerabilities associated with this new employment relationship? In addition to job insecurity, there is greater wage uncertainty and inequality. Under the old employment relationship, wages were set by internal firm-related factors such as seniority and longevity. Now they are pegged to individual performance and responsive to market fluctuations. Thirdly, older employees face the risk of having their labour market skills becoming obsolete and having to compete with younger newly-trained employees, as jobs are continuously being redesigned to provide greater flexibility. Fourth, the new employment relationship involves the dissolution of unemployment compensation, workplace accident insurance, health insurance, old-age pensions, and social welfare benefits: as the eligibility requirements and overall design of these systems are premised on the old employment relationship, notably job longevity. In regard to old-age pensions, most employers have shifted from defined benefit plans to defined contribution plans, passing on the risk of the market and bad investment decisions to their employees. And, in regard to health insurance, there has been a marked

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<sup>2</sup> It should be noted that these so-called standard jobs were predominant only in the 1950s and 60s in North America and Europe and that it was mainly white men, not women and minorities, who held such jobs. So many of the new forms of work are either old forms of work that have persisted among women and minorities or old forms of work that have re-emerged.



shift from large risk pools with standard benefits to small risk pools with ultra-flexible benefits.

The new employment relationship has many implications for labour and employment regulation. The prevailing labour law regime in the United States, which provides legal support for collective bargaining, mandates minimum terms of employment, and prohibits employment discrimination, is premised on the industrial era employment relationship. The new employment relationship renders many features of the existing labour regulation obsolete. The new employment relationship, in the absence of new more-appropriate regulation, has serious implications for worker security, including: use of intellectual property law by employers to stop ex-employees from sharing knowledge with their new employers; new forms of discrimination (e.g. ostracism and subtle forms of harassment of newcomers by cliques, patronage networks, buddy systems) that require different remedies; and the undermining of unionization due both to resistance by employers and the inability of unions to adapt to the new boundary-less jobs and workplaces. These and other risks associated with the new work practices have contributed, Stone argues, to rising pay gaps and income inequality.

What types of reforms are required to regulate the new employment relationship and address the associated risks? Stone proposes several types of legal reforms: benefit portability and broader safety nets; new anti-discrimination strategies; the legal right to organize across employer units; and broader notions of bargaining units. In concluding, she calls for labour organizations that operate across-industries and across-firms in local or regional geographic areas.

## **II. COMMERCIAL LAW**

Mainstream understanding of the nature and behavior of firms does not reflect the reality of how many family businesses and own account operations behave. For instance, not all own account operators carry out independently all of the functions associated with firms. Many of them depend on others for some of these functions: for example, many buy raw materials on credit from a single supplier; others sell goods they produce to an intermediary; still others sell goods they are supplied on commission.

Formal commercial contracts governed by contractual law stipulate who controls what and who bears what risks. But under the implicit contracts governing most informal commercial contracts, it is not clear who controls what and who bears what risks. The uncertainty is compounded when an own account operator is not fully independent. Can and should the scope of commercial law be widened to cover semi-dependent, linked or embedded commercial transactions? Can and should labour standards under sub-contracting arrangements be built into commercial contracts and be mandated under commercial law?

Note: I am not an expert on commercial law. These are just some tentative thoughts on the smallest types of enterprises, those without hired workers. Claire Dickerson and ILD

would be best at elaborating the mismatch between commercial law and informal enterprises.

## II. REGULATORY ENVIRONMENT

The question of whether and how to formalise the informal economy has been at the policy core of the debate. Since these schools of thought focus on different segments of the informal workforce – from survivalists to dependent producers and workers to entrepreneurs – they have quite different notions of what formalisation of the informal economy should entail.

- The *dualists* argue that governments should provide credit and business development services to informal operators as well as basic infrastructure and social services to their families.
- The *structuralists* argue that governments should address the unequal relationship between ‘big business’ and subordinated producers and workers by regulating both commercial and employment relationships
- The *legalists* argue that governments should introduce simplified bureaucratic procedures to encourage informal enterprises to register and extend legal property rights for the assets held by informal operators in order to unleash their productive potential and convert their assets into real capital (de Soto 1989, 2000).
- The *voluntarists* focus on bringing informal enterprises under the formal regulatory environment in order to increase the tax base and reduce unfair competition by informal enterprises.

Given the heterogeneity of the informal economy, there is merit to each of these perspectives as each school reflects one or another ‘slice of the (informal) pie’. But the informal economy as a whole is more heterogeneous and complex than the sum of these perspectives would suggest. Therefore, the common policy prescription of “formalizing the informal economy” needs to be reexamined to reflect all forms of informality.

### Rethinking Formalization

To begin with, it is important to recognize that formalisation has different meanings for different segments of the informal economy. To date, the formalization debate has focused primarily on the self-employed in informal enterprises; and often, more specifically, on micro-entrepreneurs who hire others. At a minimum, the formalization debate needs to distinguish between wage workers in informal jobs and self-employed in informal enterprises. Ideally, it should further distinguish between different segments of the self-employed and wage employed in the informal economy: as each segment has its particular needs and constraints.

Secondly, it is important to ensure that formalization offers the benefits and protections that come with being formal and does not simply impose the costs of becoming formal. For the self-employed, formalization should not mean just obtaining a license, registering their accounts, and paying taxes: these represent, to them, the costs of entry into the

formal economy. What they would like is to receive the benefits of operating formally in return for paying these costs, including: enforceable commercial contracts; legal ownership of their place of business and means of production; tax breaks and incentive packages to increase their competitiveness; membership in trade associations; protection against creditors and clear bankruptcy rules; and social protection. What about informal wage workers? To them, formalisation means obtaining a formal wage job—or converting their current job into a formal job—with a secure contract, worker benefits, membership in a formal trade union, and social protection (Chen 2006).

What is required is an approach to formalization of the informal economy which is comprehensive in design but context-specific in practice. A comprehensive design for formalising the informal economy should include the elements listed in Box 1:

### **Formalization of the Informal Economy: A Comprehensive Approach**

#### *1. Formalisation of Informal Enterprises*

- registration and taxation:
  - simplified registration procedures
  - progressive registration fees
- legally-recognized property rights
- benefits of operating formally:
  - access to finance and market information
  - access to public infrastructure and services
  - enforceable commercial contracts
  - limited liability
  - clear bankruptcy and default rules
  - access to government subsidies and incentives, including procurement bids and export promotion packages
  - membership in formal business associations
  - access to formal system of social security

#### *2. Formalisation of Informal Jobs*

- legal recognition and protection as workers
- rights and benefits of being formally employed:
  - freedom from discrimination
  - minimum wage
  - occupational health and safety measures
  - employer contributions to health and pensions
  - right to organize and bargain collectively
  - membership in formal trade unions

In formalizing specific groups of informal workers, policy makers and practitioners should choose appropriate elements from this framework and tailor interventions to meet

local circumstances. Consider, for example, the specific conditions of several informal occupations in which large numbers of working poor women tend to be concentrated:

### **Street Vendors**

The common problems faced by street vendors around the world include:

- insecure place of work: due to competition for urban space
- capital on unfair terms: due to dependence on wholesale traders
- uncertain quantity, quality, and price of goods: due to dependence on wholesale traders
- lack of infrastructure: shelter, water, sanitation
- ambiguous legal status: leading to harassment, evictions, and bribes
- negative public image

What do street vendors want in exchange for registering their businesses and paying taxes?

- secure vending sites
- access to capital on fair terms: a loan product tailored to their daily need for working capital
- bargaining power with wholesale traders
- infrastructure services at vending sites: shelter, water, sanitation
- license to sell and identity cards
- freedom from harassment, evictions, and bribes
- positive public image

### **Waste Collectors**

It is estimated that one per cent of the world's urban population lives off collecting and recycling waste. Waste collectors commonly suffer:

- very low average earnings
- fluctuations in quantity, quality, and price of waste
- harsh working conditions and related occupational hazards
- negative public image

In communities where both women and men (and children) collect waste, women (and children) often sort the waste – thus adding to their exposure to the waste and associated health risks - while the men sell the waste. Since they have to move around different neighbourhoods to collect waste, women (and girls) face teasing, touching, and other forms of sexual harassment (Paula Kantor, personal communication 2005).

Given these conditions, many waste collectors would like to find alternative employment opportunities. This can be done within the waste recycling sector by training them in waste-recycling skills or by organising them into cooperatives and negotiating contracts for these cooperatives to provide cleaning services to or collect waste from government and private offices or institutions.

What would formalization mean for those who continue to work as waste collectors?

- legal recognition and positive public image as waste collectors (who contribute to the upkeep and cleanliness of the cities they work in)
- ID cards to protect them
- bargaining mechanisms to negotiate with a) those to whom they sell the waste they collect and b) municipal officials and police
- organization and bargaining power
- appropriate implements and protective gear (gloves and aprons) to help them avoid dangerous and toxic waste

### **Industrial Outworkers**

Industrial outworkers, whether in the garment, shoe, or electronic sectors, face a number of common problems:

- low piece-rates and earnings
- irregularity of work
- irregular and (often) delayed payments
- costs of providing/maintaining workspace, utilities, and equipment

In addition, some endure harsh or dangerous working conditions: for example, shoe makers are exposed to toxic glues. Many also suffer sore backs and deteriorating eye sight from working in badly-equipped and poorly-lit workplaces (often their own homes).

What would formalization mean for industrial outworkers?

- regular, secure, and enforceable work orders
- regular and timely payments
- piece rates that are equivalent to minimum wages
- occupational health and safety measures
- capital to improve their workspace (often their home) and upgrade their equipment

### **Construction Workers**

In many developing countries, where the industry has not been mechanized, the construction workforce is comprised largely of casual day labourers, often migrants. Many such construction workers are unskilled and engaged in lifting and carrying loads of cement, bricks, and concrete. In some countries, depending on local social norms, women represent a significant share of the unskilled construction workforce.

What are the common problems of unskilled construction workers?

- irregular days of work
- low and erratic earnings
- arduous and hazardous work: frequent accidents and occasional deaths
- lack of occupational health and safety measures
- lack of accident or disability insurance

What would formalization mean to construction workers?

- more regular work

- higher wages
- skills training: masonry, carpentry, and other construction skills
- safety regulations
- accident insurance and workers' compensation
- ID cards
- registers or other proof of days of work

### **Horticulture Export Workers**

In Latin American and (less so) Africa, there has been a notable increase in women agricultural workers in the non-traditional agro-export sectors: specifically, in the production and packaging of fresh flowers, fruit, and vegetables (see chapters by Deere and Whitehead in this volume; also see Barrientos and Barrientos 2002, Barrientos et al 2004).

What are the common problems of women workers in these agro-export sectors?

- temporary contracts
- uncertain days and hours of work: associated with “flexible” contracts
- piece-rate payments and low wages
- occupational segregation by gender (especially in packing houses)

What kind of formalization would these agricultural workers want?

- permanent contracts
- regular days and hours of work
- wage payments and higher wages
- opportunities to shift to better-paid work within occupation

### **Challenges to Formalization**

Admittedly, implementing a comprehensive yet context-specific approach to formalization will not be easy or straightforward. Among the key policy challenges facing such an approach are what to do about informal employers. Many informal wage workers work for informal firms. The policy challenge is whether and how to make informal employers comply with labour regulations and offer their employees formal benefits and protections. This is what the ILO has referred to as “the dilemma of the informal sector” (ILO 1991). It is genuinely difficult for many informal employers to offer legal benefits and protections to their employees at their present level of operations and profits. This suggests that formalisation may need to be sequenced as follows: by first providing incentives and benefits to informal enterprises that register and then progressively enforcing compliance with taxation and labour regulations (Ibid.).<sup>3</sup> But available evidence suggests that many informal employers are not poor (Chen *et al* 2004, 2005). For this more entrepreneurial class of informal operators, the issue is less whether they are *able* to comply with commercial and employment regulations than whether they are *willing* to comply.

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<sup>3</sup> For a similar argument, including the need for government industrial policies, see Tandler 2004.

Another related challenge is what to do about *formal* employers who hire workers under informal employment relations or sub-contract production to a chain of suppliers. Faced with global competition, formal firms or employers often prefer to hire workers under flexible contracts or to outsource or sub-contract production. In today's global production system, suppliers are often small informal enterprises who, in turn, hire workers under informal contracts or sub-contracts.

In sum, both formal firms and larger informal firms need a special package of incentives and sanctions to encourage them to provide benefits and protections to their workers. Admittedly, there is the risk of offering unnecessary incentives for them to extend benefits/protections to their workers or creating perverse incentives for them to continue to deny benefits/protection to their workers. But, this risk notwithstanding, appropriate labour standards and social protection can and should be developed for informal wage workers through tripartite negotiations, including employers (formal or informal), the government, and informal workers. The Self-Employed Women's Association (SEWA), the well-known trade union of women informal workers in India, has effectively negotiated with the government and employers/contractors to obtain wage increases, annual bonuses, health benefits, and/or pension contributions for a wide range of informal workers, including: day labourers in construction and agriculture; and industrial outworkers who produce garments, embroidered goods, incense sticks, and *bidis* (cigarettes) at home.

Those who run single person or family businesses present a different kind of challenge. To begin with, they do not hire workers. Secondly, they often earn so little that they fall into the lowest tax brackets. What *are* burdensome to these operators are the bureaucratic regulations and fees related to registering their businesses. For them, formalisation requirements need to be made simpler and less costly through, for instance, a single-window registry system and differentiated registration fees (i.e., depending on the size, output, or location of their enterprises). For them, formalisation should be seen as an incremental process that begins by introducing appropriate incentives and benefits of formality and, then, progressively enforces compliance with the costs and regulations associated with operating formally. This would create the conditions under which the working poor in the informal economy would be entitled to the benefits of formality while, at the same time, being enabled to comply with the duties of formality.

### **Limits to Formalization**

As outlined above, formalisation of the informal economy can and should take different forms, including: creating incentives for the informal self-employed to register their enterprises and benefits for them once they do; and creating a mix of incentives and sanctions for employers, both formal and informal, to extend benefits to their informal workers.

However, the limits to formalization need to be understood. Firstly, it should be recognized that formalization is *not* a one-time process involving a specified set of steps. Rather, formalization should be seen as a gradual on-going process involving incremental

steps and different dimensions leading towards varying degrees and types of formality. Secondly, it should be recognized that formalization will *not* proceed quickly or automatically for all those who choose to formalize. The bureaucratic procedures and incentives for registered informal businesses need to be retooled and streamlined. Labour standards and benefits for informal workers need to be carefully negotiated by employers, workers, and government. Thirdly, it should be recognized that formalisation will *not* be feasible or desirable for all informal enterprises or all informal wage workers. Rather, it should be assumed that many informal enterprises and informal wage workers will remain informal or semi-formal for the foreseeable future. In other words, informality – in varying degrees and forms - is here to stay.

Other fundamental challenges, then, are to create more formal employment opportunities and to decrease the costs and increase the benefits of those who continue to operate informally or semi-formally.

### **III. BEYOND FORMALIZATION**

#### **Reorienting Economic Policies**

Clearly, there are limits to thinking of formalization in narrow “one size fits all” or “magic bullet” ways. While streamlining registration procedures for informal enterprises and extending property rights to informal operators are critically important, they are hardly sufficient. The informal economy is simply too big, too heterogeneous, and too segmented for simple solutions. The global development community needs to recognize that to reduce poverty and inequality, including gender inequality, it has to deal with the informal economy in a comprehensive way that goes beyond formalization per se. Too many people – especially the working poor and women in particular – earn their living in the informal economy for it to be treated as a legal problem requiring formalization or a social problem that can be redressed by social policies alone. The challenge is to reorient development strategies – and development economics - to deal front and center with the informal economy.

To deal effectively with the informal economy – and those who earn their livelihoods in it - will require a comprehensive economic strategy with three inter-related components:

- # 1 - creating more employment opportunities through employment-intensive growth
- # 2 - formalizing informal enterprises and informal jobs through a context-specific mix of incentives and regulations
- # 3 - improving conditions and increasing returns of those who continue to work informally

Component # 1 requires putting employment creation back at the centre of macro-economic policies, ensuring that employment is labour-intensive, and targeting investments at poor communities and poor areas. Component # 2 requires implementing



context-specific elements of the comprehensive approach to formalization outlined above. Component # 3 requires a complimentary set of policies to help those who continue to operate informally improve their working conditions and get higher returns to their labour: by increasing assets and competitiveness, assuring better terms and conditions of work, securing appropriate legal frameworks, and addressing risk and uncertainty.<sup>4</sup>

### **Reforming the Regulatory Environment**

An essential dimension of this reorientation of economic policies is the reform of existing laws, regulations, and institutions. As the evidence presented in this volume has highlighted, work is increasingly informal in today's global economy, rendering obsolete many of the features of existing legislation, regulations, and institutions modeled on the modern industrial-era job. To legitimize and protect all types of workers today will require, in the end, reforming the laws, regulations, and institutions that govern both commercial and employment relations. Laws, regulations, and institutions governing commercial relations need to reflect the reality that most economic units are very small with few hired workers and that many working poor operate on their own account. Similarly, laws, regulations, and institutions governing employment relations need to reflect the reality that most wage workers are not formal employees. Also, biases in existing laws, regulations, and institutions that favor large enterprises over small enterprises, formal workers over informal workers, and men over women in both categories need to be addressed. In the absence of new more-appropriate laws, regulations, and institutions, most of the working poor in the informal economy will remain unprotected, insecure, and vulnerable.

Changing the existing regulatory regime should not be seen as a pipe-dream. Proposals have been made and measures have been taken to deal with the growing numbers of non-standard wage workers in developed countries. To address the new employment relationship in the United States, which renders obsolete many features of the existing labour law regime, several types of legal reforms have been proposed and/or tested: benefit portability and broader safety nets; new anti-discrimination strategies; the legal right to organize across employer units; broader notions of bargaining units; and labour organizations that operate across-industries and across-firms in local or regional geographic areas (Stone 2004).

The European Union has issued directives on part-time work (1997) and fixed-term employment (1999) to uphold the principle of "non-discrimination" between such workers and workers in formal contracts. The extent to which workers in part-time and fix-term jobs are protected by these directives depends on the degree to which these directives are implemented in member states as well as pre-existing national regulations or collective bargaining agreements in those states. In particular, eligibility criteria such as mandated thresholds of employment continuity, work hours, years of experience need

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<sup>4</sup> For a detailed elaboration with good practice examples of the comprehensive yet context-specific response to informal employment, see Chen *et al* 2005.

to be adjusted to ensure part-time and fixed-term workers are eligible for social protection measures such as unemployment insurance and pensions (Carré 2006).

Some EU countries have extended the right to representation in collective bargaining arrangements to non-standard workers. In some EU countries, depending often on their length of experience, fixed-term workers have the right to attend meetings of workplace representative bodies as well as to vote and present their candidacy in elections. Temp agency workers tend to participate in representation structures, if any, within the temp agency itself, rather than in that of the user firm. In several countries, union membership is not a precondition for coverage under collective bargaining agreements. For the self-employed, the main option is belonging to or building an association of similar workers. But there are a few examples of trade unions reaching out to and incorporating the self-employed (Carré 2006).

In developing countries, there have also been efforts to extend existing labour and social protection regimes to cover informal workers. In Ghana, the Ghana Trade Union Congress (GTUC) carried out a review of national labour laws and found that the laws were outdated, fragmented, and did not the work realities or the Ghanaian Constitution. The GTUC resolved to push for reforms of existing laws to extend protections enjoyed by formal workers to informal workers. The resulting New Labour Act (2003) was negotiated through a tripartite process involving the government, trade unions, and employers. The Act allows temporary and casual workers to benefit from provisions of collective agreements on equal pay for work of equal value, access to the same medical provisions available to permanent workers and a full minimum wage for all days in attendance and public holidays. In addition, the Act mandates that a temporary worker employed by the same employer for a continuous period of six months or more must be treated as a permanent worker (Owusu 2003, Kofi Asemoah, personal communication, 2004; cited in Chen *et al* 2005).

In India, a national policy on street vendors was officially adopted in early 2004. Jointly drafted by the Government of India and the National Association of Street Vendors of India (NASVI), this policy includes provisions mandating legal status, special hawking and vending spaces, fee-based licenses, organization and representation, and social security and financial services for street vendors. Other bills which would provide social protection to and guarantee minimum working conditions for all informal workers were being debated in the Indian parliament in late 2006.

#### **IV. LABOUR ECONOMICS<sup>5</sup>**

Informal employment is often framed as an outcome of a dual labor market. In dual labor market theory, employment opportunities are divided between a regulated formal labor market and an unregulated informal labor market. Employment opportunities are limited

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<sup>5</sup> This section draws on a proposal for future analytical and empirical research developed by James Heintz of University of Massachusetts/Amherst and Research Coordinator, WIEGO.

in the formal labor market (often assumed to be a result of regulatory distortions). Those who cannot find a formal job are employed informally.

Although dual labor market theory provides some insights into labor market dynamics in developing countries, it also imposes conceptual constraints that can obscure our understanding of the structure of informal and formal labor markets. The research presented in the *Progress of the World's Women 2005* suggests that labor markets are not only segmented in terms of a formal/informal duality, but are also segmented in terms of employment status within the informal economy, in terms of industrial sector, and in terms of gender. There is a need to extend the analysis of a dual labor market to that of a “multi-segmented” labor force.

Many factors could be behind the segmentation observed in the background country studies carried out during the process of writing *Progress of the World's Women 2005*. For example, many economists would argue that the earnings differentials observed most likely reflect differences in education and human capital (the assumption being that human capital determines the returns to labor). Others might argue that segmentation arises from imperfect capital and financial markets – earnings are limited because financial markets exclude informal operators, preventing them from investing and improving productivity. However, other factors could play a role: the behavior and preferences of firms, labor supply decisions, patriarchal constraints, social norms, and the distribution of assets and wealth. Similarly, the literature on the “flexibilization” of labor markets could be relevant here. There is a need to extend the initial work presented in *Progress of the World's Women 2005* to examine the determinants and nature of a multi-segmented labor force.

Economists, development specialists, and policy analysts frequently apply a very narrow conceptualization of labor markets when evaluating the impact of policies or when recommending a particular strategy to policy-makers. Models of labor market are often limited to describing the demand for and supply of wage labor in an idealized market setting in which labor is an input into industrial or agricultural production. Other forms of employment – e.g. self-employment, domestic work, or industrial out-work – are either excluded from the analysis altogether or incorporated into one-size-fits-all models without accounting for the social reality in which these forms of paid work take place. There is a real risk that incomplete labor market models could draw erroneous conclusions about workers’ well-being and the distributive consequences of core policy recommendations.

Some self-employed workers could be described as entrepreneurs: they may be employers or independent operators with access to significant assets. They derive a significant portion of their income from the returns to the capital they own combined with their own labor or the labor of their employees. However, other self-employed workers, including many own-account workers and home-based workers, derive most of their earnings from selling their labor. However, they often do not sell their labor directly as wage labor – they may sell products on a product market within a supply chain, they may be industrial outworkers classified as independent contractors, or they may perform a

retailing function for formal producers without a formal (or even informal) wage relationship.

There is a need to expand the conceptualization of labor markets to include the diverse institutional arrangements through which workers sell their labor. Such an innovation could make a useful contribution to the theory and application of labor economics.

## V. LABOUR STATISTICS

Informal employment encompasses various types of employment. Currently, the data produced are not comparable across all countries or do not always reflect the full range of work arrangements and employment statuses. These conceptual problems, as well as a lack of comparable trend data, have meant that certain key research questions have not yet been definitively answered, specifically:

- What share of the global workforce is formal or informal?
- Is growing informalization a worldwide phenomenon?
- How do patterns of informalization vary from country to country and region to region?
- How do employment patterns impact human development and poverty reduction in different countries?
- In what ways do patterns of labor market segmentation converge across countries and in what ways do they diverge?
- What are the key differences in the process of informalization in the Global North and South?

Ideally, a unified framework would eventually be developed, one that allows for the classification, comparison, and analysis of the full set of employment statuses/work arrangements that exist in both developed and developing countries.

There are three major issues:

- (1) Different terms and classification systems are used to capture informal employment in developed economies in which wage labor relationships dominate. For instance, most developed countries do not use the term “informal employment” but rather some concept of non-standard or atypical employment. There is a need to define a standard set of criteria to define informal employment in developed countries.
- (2) There is a need for greater clarity on the application of current definitions of informal work in developing countries. For example, given current data resources, what are the most appropriate practical methods for distinguishing formal from informal employment within different employment status categories? How do these approaches fit into a comprehensive classification scheme that includes both developing and developed countries?

- (3) The current statistical classification system most relevant for measuring informal employment, the International Classification of Status in Employment (ICSE-93), needs to be improved to better capture the full spectrum of employment arrangements. For instance, the category “employee” needs to be unpacked and disaggregated to capture the full range of wage employment relationships in today’s world.

Some of the different dimensions of work arrangements that need further exploration include the following:

- *Social protection*: What is the key package of social protections that can be used to assess the degree of informality of a particular work arrangement? Can this package be standardized across countries? What are the constraints and challenges?
- *Legality*: what is the role of the legal status of the employment arrangement as an indicator within a unified framework (contract vs. no contract; registered vs. non-registered; legal vs. illegal [e.g. immigration]).
- *Risk and Authority*: To what extent do employed individuals have authority over their work arrangements? How should dependencies that fall outside of a standard wage worker/employer relationship be taken into account (e.g. “self-employed” workers within a complex supply chain)? How are economic risks distributed among the agents that constitute the employment relationship, broadly defined?