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INFORMALITY IN LATIN AMERICA: FACTS AND OPPORTUNITIES

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1. Introduction

This paper deals with informality in Latin America. Its main purpose is to contribute to the understanding of the informal economy and to provide a framework for policy design. It is organized in five sections. The first three sections contain a diagnosis of informality. The first presents an estimate of the size and evolution of the informal economy and of country diversity. The second analyzes the heterogeneity within informality by occupations, by the degree of legal recognition of the employment relationships and by the relative concentration of vulnerable groups: women, indigenous population and international migrants. In the third section consequences of informality and its results in terms of low incomes and restricted access to social and labor protection are examined.

Causes of informality are reviewed in the fourth section. Diverse interpretations are discussed in the framework of their historical sequence starting with the association of informality to insufficient growth and productive employment creation, following with globalization, decentralization of production and labor processes and flexibility in labor markets to increase international competitiveness and ending with regulations and government intervention. These major scenarios correspond to different theories of informality, while a more recent one places the emphasis on informality as a voluntary decision of exit and not only as the result of exclusion. As informality cannot be fully explained by a single interpretation, for policy purposes it is necessary to identify the relevance and importance of the multiple factors introduced in the conceptual debate.

Finally, the paper suggests responses and present experiences. The responses can contribute to the design of a comprehensive strategy to decrease informality, while incorporating the prevailing heterogeneity of causes and needs. In addition, specific policy experiences in Latin America are included to provide some guidance about their effectiveness. The paper ends with main conclusions.

2. Informality: dimensions, structure and country diversity

The informal economy in Latin America accounted for 63.3 per cent of non-agricultural employment in 2005². The informal sector reached to 50.7 per cent, while 12.6 per cent were unprotected waged workers occupied in formal enterprises³. The informal sector was 80 per cent of the informal economy, but the remaining 20 per cent were informal workers in formal enterprises.

² The informal economy is defined as all those workers without an employment relation subject to the standards established by the labor legislation, independently of where they work (ILO, 2002). In this paper it is measured as the sum of those workers in the informal sector (self-employed, employers and workers in micro enterprises and domestic services) plus all other waged workers without a labor contract or without protection. It refers only to non agricultural employment.

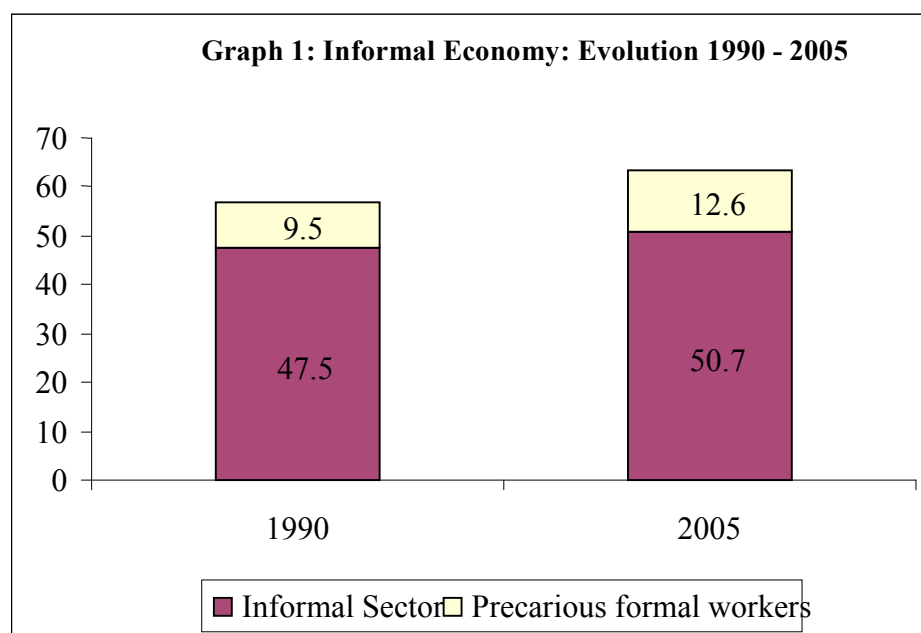
³ Protection is measured as contributing to a pension system.

The informal economy expanded from 57 to 63.3 per cent of non agricultural employment between 1990 and 2005, as a result of increases of the informal sector and precarious workers in formal enterprises. Although they both contributed to the expansion of the informal economy, the rate of growth of the latter was almost five times that of those employed in the informal sector (table 1, graph 1).

Table 1
Informal Economy in Latin America, 1990-2005
(as percentages of urban employment)

	1990	2005
Informal Economy	57.0	63.3
Informal Sector	47.5	50.7
Precarious formal workers	9.5	12.6

Sources and notes: ECLAC on the basis of households' surveys and Tokman, 2007. It includes 16 countries in 2005 and in 1990 for the informal sector. Precarious formal workers in 1990 refer to 5 countries. The percentage for 2005 does not significantly differ for 5 or 15 countries.



The situation among countries is diverse. While in Chile 38 percent of urban employment was in the informal economy in 2005, in Bolivia and Peru the percentage reached to 87.4 and 83.4 respectively. Three groups of countries can be distinguished. The informal economy exceeds 65% in Andean and Central American countries (Venezuela, El Salvador, Guatemala, Nicaragua, Ecuador, Paraguay, Peru and Bolivia). In Brazil, Mexico and Argentina the informal economy reaches between 55 and 65%. The remaining group of countries, Uruguay, Panama, Costa Rica and Chile, registers an informal economy below 50% and in Chile, below 40% (see graph 2 and table 2).

The differences in size of the informal economy are also observed in relation to the informal sector with the exception of the intermediate group which includes the three bigger countries in the Region. The first group, with the highest levels of informal economies, also shows the highest informal sector and precarious labor in formal enterprises. At the other end, the group of more formalized countries, register the smallest informal sectors and, in particular, a high degree of formality among wage workers in formal enterprises. On average, around 93% of workers in formal enterprises have a recognized employment relation and register access to social and labor protection. The intermediate group (Argentina, Brazil and Mexico) register a lower informal sector, but the percentage of unprotected workers in formal enterprises reaches around 15% (see graph 2 and table 2).

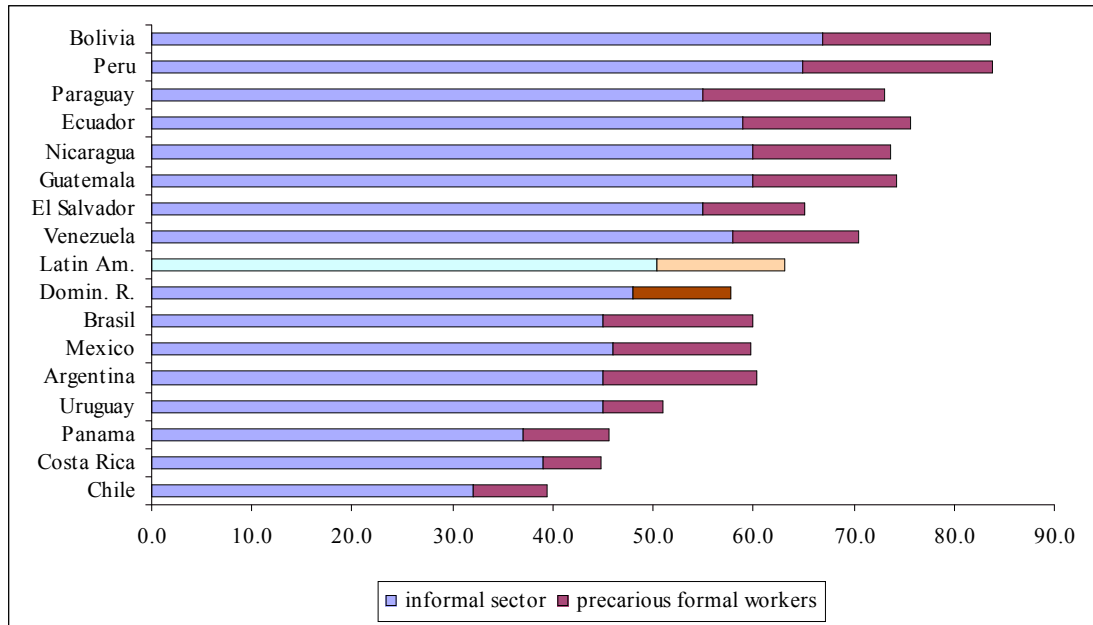
Differences among countries can be explained by the evolution of the modernization process. Countries that register smaller informality are those that today are the most urbanized and where most of employment is under wage worker relations. In countries with an informal economy of low or medium size, the urban population reaches between 80 and 90% of total population and waged workers account for 70 to 80% of non agricultural occupation; while in countries with highest informality, 40 to 50% of the population still lives in rural areas and between 40 to 50% of employment in urban areas is not a wage worker. This also contributes to explain differences in access to labor and social protection, which in the case of the former group of countries is on average four times higher when referred to national coverage and 2.5 times in relation to employment in urban areas.

Table 2: Informal Economy by country, 2005

Country	Informal sector	Informal worker	Informal economy
Chile	30.6	7.4	38.0
Costa Rica	39.9	5.7	45.6
Panama	40.5	8.5	49.0
Uruguay	44.3	6.0	50.3
Argentina	41.2	15.2	56.4
Mexico	42.9	13.7	56.6
Brazil	43.6	15.0	58.6
Dominican R.	49.3	9.8	59.1
Latin America	50.7	12.8	63.5
Venezuela	52.0	12.5	64.5
El Salvador	54.6	10.1	64.7
Guatemala	57.6	14.2	71.8
Nicaragua	59.9	13.6	73.5
Ecuador	57.9	16.7	74.6
Paraguay	61.3	18.0	79.3
Peru	64.6	18.8	83.4
Bolivia	70.9	16.5	87.4

Notes: CEPAL based on national households surveys of each country. Percentage of urban employment. Arithmetic Mean for Latin America

Graph 2: Informal Economy by country: 2005



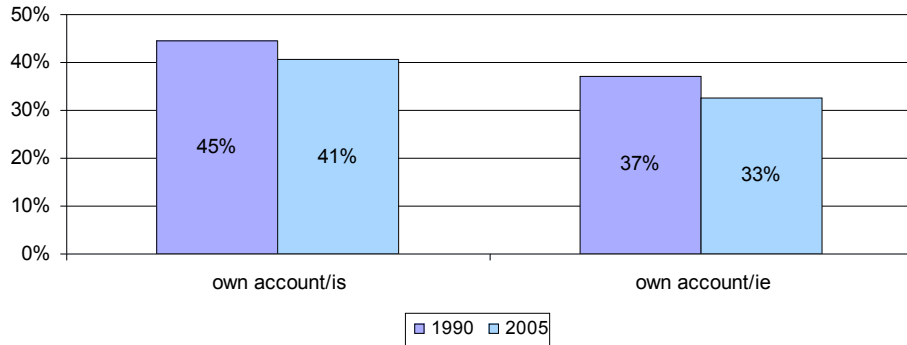
3. Diversity and heterogeneity of informal employment

i) Occupational categories: structure and evolution

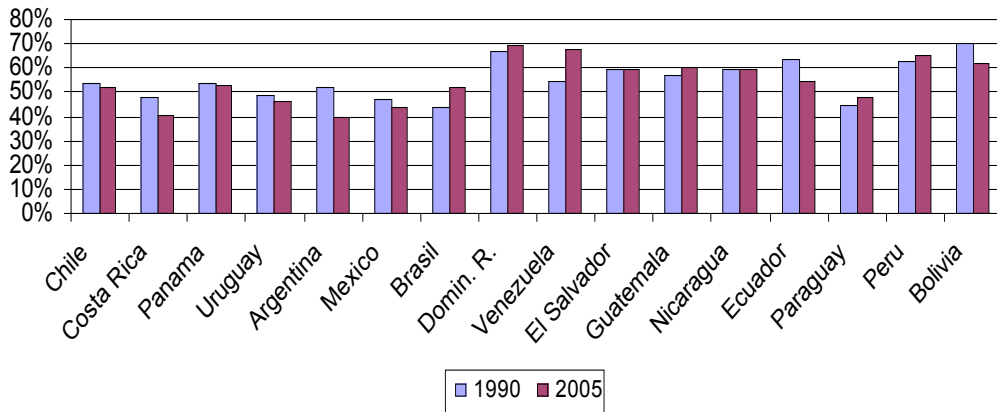
Differences in size and structure of the informal economy between countries is high, but in addition labor insertion by employment categories add a new dimension to diversity. Self-employment accounted for 43% of informal employment in 2005 constituting the largest proportion, closely followed by wage workers that amount to 42%; while 9% was in domestic services and the remaining were micro entrepreneurs. Wage workers are less homogeneous than what the percentage suggests, since more than half among them are employed in micro enterprises and 48% are occupied in formal establishments in a precarious situation. The data available suggests that the share of self employment has decreased between 1990 and 2005, both as a result of a relative decrease of self employment and an expansion of informal wage workers (see, graph 3).

The averages hide different country situations. Self employment accounts for more than half of the occupation in the informal economy in countries like Peru, Bolivia, Dominican Republic and Venezuela, while they are less than one third in Argentina, Mexico and Costa Rica. This suggests that the higher the informal economy and particularly, the informal sector, the more significant is the existence of independent employment. The share of wage workers in the largest countries of the Region (Argentina, Mexico and Brazil) is above average and in the case of the former country represents more than half of informal employment (see, graph 4).

Graph 3: Self employment evolution 1990 - 2005



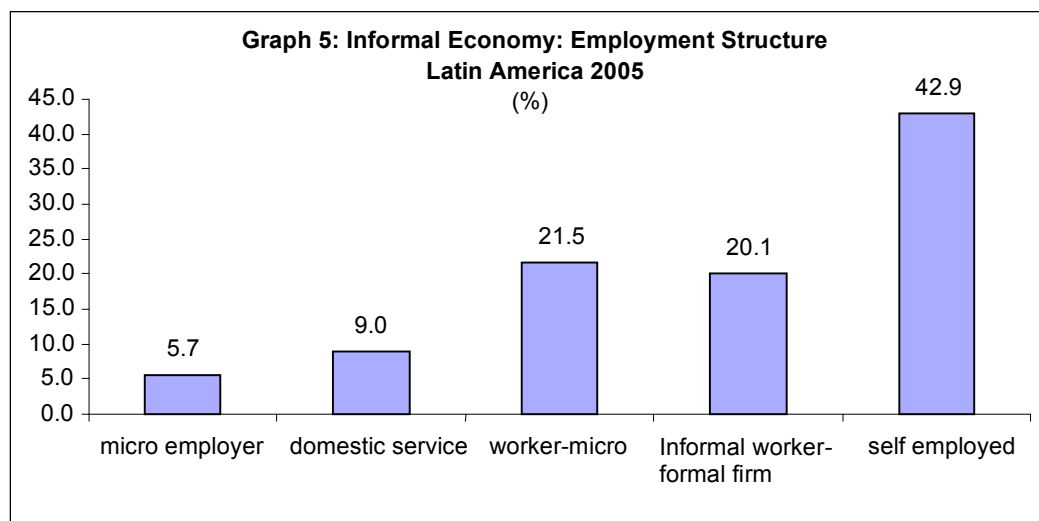
Graph 4: Self Employment evolution by country 1990 - 2005
(as % of informal sector)



It is also important to note the diversity of country situations in relation to where the wage workers are employed. The employment relation is not usually legally recognized in micro enterprises; while in formal enterprises, the probability of recognition is higher, but their obligations are not always fully complied. The data suggests that in the three largest countries mentioned, the share of informal employment in formal enterprises significantly exceeds the average, reaching the highest value in Argentina of 27%. This suggests that enforcement of labor contracts in those countries is weak. The opposite can be observed in countries like Costa Rica and Uruguay. In both, informal employment is concentrated in micro enterprises, while the share of informal employment in formal enterprises is around 12%, almost half of the average value. This confirms that not only employment relations are explicitly recognized in those enterprises but also, that they are largely enforced. In the rest of the countries, the data suggests that the structure of wage workers between enterprises (micro and formal) is similar, although the importance of

wage workers in total informal employment varies according to countries (see, graph 5).

Domestic services account on average for 9% of informal employment but the share increases in the higher income-less informality countries, reaching an average in those countries of 14%. In the rest of the countries, the average is around 5.6%. Paradoxically, the demand for domestic services in higher income countries is filled by women immigrants' native of those lower income countries. Micro entrepreneurs represent between 5 and 6% of informal employment in most countries, with the exception of Costa Rica where they reach around 13%.



ii) *Informality and legally recognized employment relationship*

The occupational insertion and the legal recognition of the existence of an employment relation constitute a requisite to have access to social and labor protection. The unemployed in Latin America countries generally faces a double exclusion: lack of jobs and of social protection. This is the result of the almost inexistence of unemployment insurances and of the reduced coverage of non contributive social protection. The way of insertion to the labor market also matters, resulting in significant differences of access to stable and protected jobs.

Those occupied in the informal economy have a restricted access to protection given the inexistence of an employment relation in the case of the self employed and because the wage workers, when employed in micro enterprises, only have partial access or in the case of workers in formal enterprises their employment relation is precarious resulting in partial compliance of labor and social obligations and job instability. Even if an employment relation for wage

workers exists, it is not usually recognized by a written labor contract or the existence of such contract does not ensure full protection and stability or the responsibility for the obligations is diluted between different related enterprises.

Sixty two per cent of the workers have a written labor contract, while 38 percent works without a contract. 74% of those who work with contracts, such a contract are for an indefinite duration and the rest is under atypical contracts. More than half of wage workers in Latin America are employed either without contracts, or working under atypical contracts (Tokman, 2007). Such proportion varies from a minimum of 21% in Argentina to a maximum of 74% in Bolivia.

Sixty eight per cent of workers in micro enterprises are employed without a labor contract. Around 10% work under an atypical contract and while the rest posses a permanent contract, low capacity of cost absorption in micro enterprises result in a reduced level of compliance. Although permanent contracts theoretically ensure job stability by high firing costs, there full application in micro enterprises cannot be afforded.

On the contrary, 74% of workers in formal enterprises perform under a recognized employment relation and around half of them have a permanent contract. The other half is either without a written contract or has an atypical one. Workers under this situation are also informal in spite of working in formal establishments. They are affected not so much because of the non recognition of their employment relation, but mostly by lack of compliance.

Informality, particularly, in formal establishments has increased in the 90's in Latin America, because of labor reforms promoting the introduction of atypical contracts as an instrument to increase flexibility and to reduce labor costs. Eleven of the 17 LA countries introduced labor reforms of different scopes affecting 70% of wage employment (M. L. Vega, 2005). Countries like Colombia, Argentina and Peru, among others, introduced new modalities of special labor contracts that involved a reduction in firing costs and contributions to social security (Tokman, 2007). In the case of Peru it also promoted labor decentralization by creating firms supplying temporary workers, firms providing services and workers cooperatives. They constituted, in fact, ways to legally operate beyond labor regulations.

As a result, contract structures became more flexible and labor costs decreased during the reform period. Wage employment increased, but mainly under atypical contracts. Employment without contracts or unregistered expanded, reaching 74% in Peru in 2000 and 43.4% in Argentina in 2004. Labor costs decreased due to the increase of workers under atypical or without contracts since they allow for reductions of 60 and 40% respectively, in comparison to a permanent contract. In Argentina, the decrease of non wage labor costs was from 53% to 40% between 1990 and 2003; and in Peru the cost reduction was from 34 to 22%, between 1989 and 2001 (J. Chacaltana, 2005).

iii) *Informality: women, indigenous population and migrants*⁴.

Women tend to be more concentrated than men in the informal sector and particularly, in domestic services and self employment in commerce and services. There is also a direct relation between the importance of the indigenous population and the size of the informal sector. The migrants' labor insertion in the countries of arrival tends to diverse according to the characteristics of the migrants and the migration policy followed in each country.

Women tend to be occupied more than men in the informal sector. On average 55.1% of non agricultural labor were women in informality, as compared to 46.6% registered for men. Differences between countries are highly significant. Women in countries were the informal economy and the informal sector reach the largest dimensions are also overrepresented in those activities. Seventy nine percent of women in Bolivia, 73% in Peru and, in general, more than 65% in Andean and Central American countries are employed in the informal sector. The percentage decreases to around 40% in countries where the size of the informal sector is smaller, as Chile, Costa Rica and Argentina.

The concentration of women in the informal sector has not changed significantly between 1990 and 2005, although the level of informality increased for both, women and men. Most of the countries present the same evolution except for Chile, Argentina and Brazil where the share of informality decreased during the period and particularly, that of women. At the other extreme, in countries like Bolivia and Peru, informality increased and especially the concentration of women, registering 79 and 73% of women occupied in the informal sector. Opportunities for women employment outside informality are limited, while in countries where informality is lower the share of women employment in formal activities is higher. In particular, women employment in the public sector and in private enterprises account for almost half of the women occupied.

Informal employment for women is also significantly concentrated in two occupations: self employment in commerce and services and domestic services. On average, two thirds of the women in the informal sector are in these activities. Only in Costa Rica and Uruguay the share of women in these sectors is below 60%, while the percentage is above 70% in most countries. Self employment in commerce and services accounts for around 90% of women employment in these two sectors in countries with high informal sector. Domestic services constitute an alternative for between 35 to 40% of women in

⁴ The analysis in this section refers only to the informal sector because of the lack of disaggregated data of informal workers in formal enterprises.

countries of smaller informal sector and higher income level such as Chile, Argentina, Uruguay, Brazil and Panama.

Indigenous population in Latin America is estimated between 30 and 50 millions people (CEPAL, 2006). Around 80% still lives in rural areas in small countries, but a significant number is in urban areas. Four countries concentrate near 25 millions (Peru, Mexico, Bolivia and Guatemala). There is a positive correlation between the importance of indigenous population in each country and the size of the informal sector. In Bolivia, 62.2% of the population is indigenous people and the informal sector reaches 71%, both the highest in the Region. In Peru the indigenous population is estimated at 8.5 million, accounting for 32% of the population and the informal sector is the second highest with 65% of non agricultural employment. The same is observed for the rest of the countries where indigenous populations is important, a significant presence of informality is also found. In fact, a pioneer work on the informal sector (Matos Mar, 1984) argued that the urban informal sector in Lima was the result of the invasion of the indigenous rural culture to the city. The argument further developed the thesis that informality was a hybrid culture resulting from the adaptation of rural indigenous migrants to the culture of the marginal population in the city.

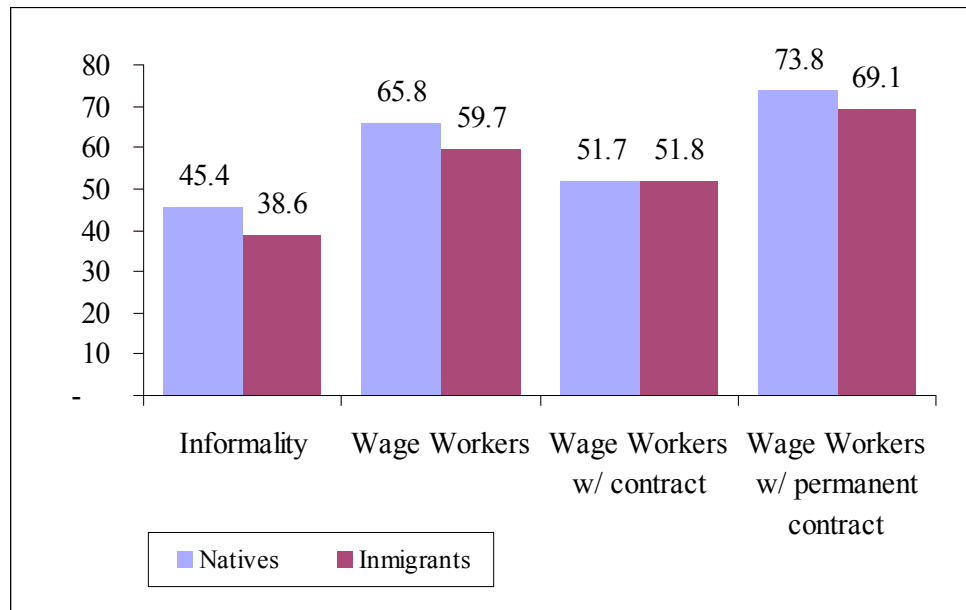
A third dimension to analyze is the labor insertion of international migrants. In a recent paper, (Tokman, 2008), labor participation, occupation and unemployment of international migrants in twelve Latin American countries was made. Special attention was given to test whether, as it is sometimes assumed, the migrants were occupied in informal activities given the easier access and the personal characteristics of the migrants.

Several conclusions were reached. First, differences of participation and occupation rates between natives and migrants were not significant. Immigrants participated more than natives in the labor market, as a result of their age structure, but were more successful in finding jobs, facilitated by their higher educational level. Unemployment, on average, was similar for both.

Second, when access to jobs was differentiated according to the type of job occupied by migrants as compared to natives, the findings suggest that a larger share of immigrants found jobs in the formal sector. Thirty nine per cent of immigrants were occupied in the informal sector, while 45% of the natives were there. This finding apparently contradicts the hypothesis of job discrimination against migrants. However, it has to be taken into account that migration policies in most LA countries require a labor contract to be able to obtain a residence visa. This leads the migrants to search preferably for such jobs and in case of failure; they become clandestine workers and residents. In both cases, they are probably omitted from the surveys.

Third, immigrants have less access to wage jobs. Sixty six per cent of natives were wage workers compared to 60% of the immigrants. There were no differences in relation to the contract situation, since around half of them had a labor contract independently of their origin. However, natives have more access than migrants to permanent contracts, 74 against 69%.

Graph 6: Labor Insertion by occupation



Source: Tokman, 2008

4. Consequences of informal employment: low incomes and restricted access to social protection.

Occupation in the informal sector results in lower incomes. Average incomes per head in the formal sector were 80% higher than in the informal in 2005. This is the result of productivity and human capital differences. Income gaps by occupational positions are also significant. Employers in formal firms (more than 5 employees) earn 2.2 times the income perceived by an employer in a micro enterprise and more than 7 times the income of a self employed. Income differentials between wage workers in firms of more than 5 employees and those occupied in micro enterprises amount to 1.8 times. While the income gap between employers and workers in the formal sector is 5.1 the differential decreases to 3.7 when it is referred to informal enterprises. This suggests that equity is higher in informality than in the formal sector. However, a better distribution of incomes within the informal sector is accompanied by higher poverty intensity.

More than 28% of the people employed are below the poverty line in LA. Those working in formal jobs and particularly, public sector employees are less affected, while workers in formal firms are also below the average. Poverty intensity in the informal sector is around 37%, affecting all workers without

large differences related to their employment status. While near 40% of the workers in micro enterprises are poor, 39% of those working in domestic services and in between 34-37% of the self employed are in a similar situation. The majority of the poor are employed in the informal sector, but still a significant proportion is in poverty even if they work in formal firms or in government. In the majority of the countries the most affected group is in domestic services, mostly women; while in several of them, self employed are as important.

Wage gaps between formal and informal are also significant. A worker occupied in the former earns 90% more than a worker in the latter. Differences between sectors show that women register a larger gap than men, 2.3 compared to 1.5; and that gender intra sector differences are smaller in the formal sector than in the informal (1.2 and 1.8). On average, wages earned by workers contributing to social security are twice those that do not contribute. The gaps are larger in the formal sector than in the informal. In fact, the average wage level of non-contributory workers in formality is even smaller than that perceived by contributory workers in informality (CEPAL, 2006).

Low incomes and higher poverty intensity are determined by the type of labor insertion. Labor insertion, in turn, constitutes a major determinant to contribute to social security. Contributory coverage reproduces the labor market features, since workers with more experience or more educated and inserted under a labor dependent relation in larger size enterprises or in sectors with greater job stability, register a higher probability to contribute. Only 13.5 per cent of the non professional self employed in the informal sector are covered by contributory social security. When wage workers in informal firms are included the coverage increases to 21.7 per cent. This coverage is still far below the 68.2 per cent registered by those working in private formal enterprises and the 83% coverage of those working in the public sector (Tokman, 2007)⁵. Labor insertion and type of employer and enterprise are important.

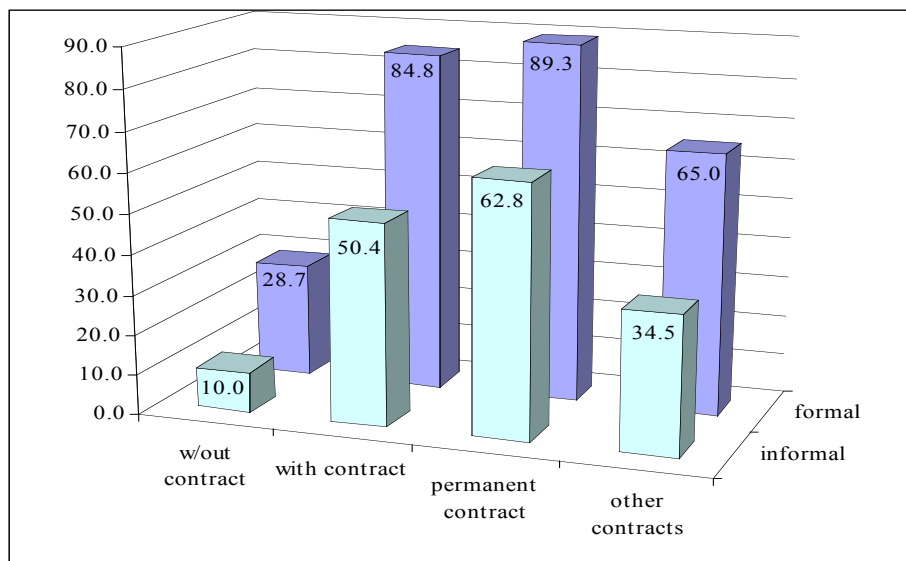
As we have seen above, the legal recognition of the existence of an employment relation is a major determinant of access to social security coverage. In addition, the type of the contract also matters. On average, only 19.3 per cent of workers without contracts are covered by social security; while the coverage increases to 80.4% when they work under a written labor contract. Of those with contracts, 74 per cent have permanent ones and their coverage reaches near 85% of the workers in these conditions. The rest have other type of less protected contracts and their protection coverage decreases to 61%.

⁵ A multivariate analysis also confirms that the probability of coverage falls significantly for the self employed the domestic services and workers in informal firms. A positive influence is observed for public employees, workers in formal firms and professional or technical work (CEPAL, 2006a).

Chile and Panama achieve near-universal social security coverage for workers with permanent contracts (96-97 per cent) and coverage for workers on other contracts is also high (92 and 82 per cent, respectively). By contrast, in Argentina, only 82 per cent of workers on permanent contracts are covered and only 18 per cent of those on atypical contracts. Working without contract in Argentina amounts to working without any sort of social protection, since only 8 per cent of employees doing so are covered.

Contracts can have a different effects depending where the job is performed, being public or private and being a micro enterprise or a formal firm. While a permanent contract for workers in a formal firm means coverage of 89%, a similar contract in a micro enterprise result in 63 per cent coverage. A similar situation happens with atypical contracts that can ensure coverage of 65 per cent if it is performed in a formal firm or reduce the coverage to almost half if applied to workers in informal enterprises (see, graph 7). Indeed, a worker in an informal firm with a permanent contract would gain coverage by moving to a formal enterprise, even with an atypical contract (63 to 68 per cent). On the other hand, it is also clear that coverage with atypical contracts in formal firms is lower than working under a permanent contract. Workers in this situation do not enjoy full protection or stable jobs. In fact, these contract arrangements have increased as a result of the labor reforms and the strategic adaptation to competitive markets under globalization. As a result a new feature emerged in labor markets: that of informal workers performing in formal enterprises, even if the employment relation is legally recognized by a written contract.

Graph 7: Social Security Coverage by sectors and contracts



Note: coverage refers to percentage contributing to a pension system by contractual situation. Average for seven countries

5. *Causes of Informality*

The conceptual understanding of informality is of fundamental importance, not only out of theoretical curiosity but particularly, because it constitutes a requirement to define policies to improve the life of the informal. The task is not simple, given the variety of definitions that were introduced during the last four decades. The debate has evolved and it is increasingly recognized that there is no single interpretation, but rather that different visions can contribute to a more pragmatic approach.

Following the definition of the informal economy that is the most comprehensive available, main determinants from different interpretations can be identified. The informal economy is inclusive of *all economic activities by workers and economic units that are, in law or in practice, not covered or insufficiently covered by formal arrangements*. It includes both enterprise and work relationships, and it does not eliminate the informal sector but expand it to include all that are not sufficiently covered even if they are in formal units of production. It provides a framework to capture spurious decentralization associated to externalization or even subcontracting inside formal units of production.

This definition was adopted by the International Labor Conference in 2002 (ILO, 2002) recognizing that besides informal units of production, informal employment relationships also exist in formal enterprises. After three decades of introducing the informal sector, the ILO officially recognized the need to extend the content to include all employment relationships not fully covered wherever they exist.

Growth and macroeconomic context

The historical sequence after the Second World War in Latin America countries is well known. It was a Region of middle-income countries highly dependent of international markets for commodities and from developed countries for investment and technology. At the same time, industrialization took place under highly protected internal markets. A rapid growth of urban population, mainly as a result of migration from rural areas during the 1950 to 1980 period, confronted with a restricted capacity of labor absorption due to low investment, inadequate technology and insufficient growth. During the three decades urban population grew at 4% per annum and the share of people living in the cities increased from 45 to 68%.

The newcomers were forced to create their own occupations to generate an income that could allow for survival. Given their low human capital and the lack of access to capital, the activities generated were mostly in jobs of easy access and low capital and skill requirements, mostly domestic services for women and self employment or micro enterprises for men. The informal sector was defined⁶ as a way to do things with scarce resources to generate and income for survival (ILO, 1972). The need to find a way to survive, producing or selling things with limited access to resources and markets, was attributed to the structural determinants in dependent countries (Souza and Tokman, 1976). Informality expanded from 29% of urban employment in 1950 to around 31% in 1980.

At the beginning of the following decade a major crisis was confronted initially with a standard macroeconomic adjustment and debt renegotiation but followed by a structural adjustment. The package included opening of the economies, deregulation and liberalization in a world context that was increasingly globalize. Informality became more visibly and significant given the effects of adjustment on employment creation. In fact, informality played a significant role containing unemployment, Eight of each ten new jobs created were informal, twice its contribution in the previous period. From the 90's up to the present Latin American countries joined globalization and sound macroeconomic policies in a world marked affected by recurrent crisis. In spite of the recovery of growth and employment that took place, informality continued to expand, although at a lower pace. At the same time, globalization brought a new international scenario that affected the organization of labor and production and labor reforms were introduced to improve the capacity to compete and to adjust to shocks.

i) Globalization, decentralization and flexibility.

Adjustment to oil shocks in developed countries brought back a different view of informality that was already present in the early ILO conceptual discussion. The autonomy attributed to the definition of the informal sector, particularly in the Kenya Report⁷, was questioned because of the existence of abundant labor that allowed the organized sectors to appropriate the economic surplus (Lubell, 1991).

Towards the end of the 70 and 80's these interpretations acquired more diffusion linked to the decentralization of production and particularly, of labor processes to improve profit margins in big enterprises. Subcontracting forms popular in the XIX century (textiles and clothing) were updated to become a

⁶ It followed the ILO/Kenya concept of "the working poor", but placed in the context of structural analysis of employment and development in dependent countries built around CEPAL.

⁷ It must be clarified that although the PREALC definition in Latin America accepted the Kenya conceptual analysis, there was no claim of autonomy but rather that interrelationships with the rest of the economy existed both in product and labor markets (Tokman, 1978).

diversity of subordinated relations from direct subcontracts to activities that apparently are autonomous but in fact, contribute to reduce labor costs (clothing, provision of manpower by intermediaries, informal distributors) and/or to supply raw materials at low price (including, waste recyclers). The relation between informal enterprises and especially, the workers and formal firms constituted the answer to the need of adaptation to globalization and to changes in the international division of labor (Portes, Castells and Benton, 1989). Informality plays a double role: cost reductions and weakening of trade union power. Furthermore, it is a universal feature since it takes place in both, developed and developing countries.

It must be noted that the questioning to the informal sector was already intense since its introduction and still continues up to the present. Many authors emphasized the subordinated employment relations linked to the decentralization of labor processes (Gerry, 1974 and 1978; Hugon, 1977; Bromley, 1978, among others). Labor reforms in search of flexibility, including decentralization of labor processes, added a new feature at least in Latin America. The introduction of atypical contracts increased job precariousness and instability. They affected mostly, although not exclusively, workers in formal firms (Tokman, 2007). The ILO expanded definition of informality from the sector to the economy was partly in recognition of this trend, but also of the linkages and coexistence of different modes of production at global level (Moser, 1978; Castells and Portes, 1989; Chen, Vanek and Carr, 2004).

ii) Regulations and Government

In parallel, another interpretation emerged trying to explain the causes of informality and rapid expansion during the period of adjustment. It allocated the responsibility for informality to the law and regulations and to inefficient government intervention. Rather than focusing on changes in formal activities and its consequences on the informal, the emphasis is placed in looking for answers as to why the informal sector is unable to develop. Inadequacy of regulatory frameworks is identified as the main determinant of the inability to expand informal productive activities (De Soto, 1986). Such inadequacy derived from the colonial heritage resulting in regulations and bureaucratic structures that imply high costs in time and resources.

Regulations were designed bearing in mind larger enterprises and more organized sectors, being inadequate for the needs and conditions of micro enterprises. In addition, the legal recognition of property following formal methodologies impedes its use as collateral to gain access to capital. Land and property of the poor were the result of squatter settlements or allocation without proper recognition of property titles. Numerous laws and regulations involved and government inefficiency result in long and costly processing of recognition. To develop businesses under these conditions was a proof of the entrepreneurial talent and effort available in the informal economy. At the same time, some

firms find necessary to evade regulations and work outside legal regimes becoming informal. However, this entails costs of losing the advantages of legality and may result in smaller growth.

The informal entrepreneurs able to survive in such an antagonistic environment were identified as the main asset for development in Latin American countries. The “other path” constituted an alternative strategy to development through liberalization, government reforms and legal recognition of the assets of the poor.

There are 2.6 times as many regulations in Latin America as in the OECD countries; only in Africa and the Middle East are such regulations more numerous (Loayza, Oviedo and Serven, 2006). These regulations apply generally to all enterprises, but the smaller ones are disproportionately affected as they do not have the means to overcome the obstacles for doing business (ILO, 2006). High levels of regulations are associated with lower growth and expanded informality. Regulatory quality also matters. The higher is the capacity of governance, the smaller the effect on informality.

The approach started by De Soto was expanded, becoming an important framework of analysis for the World Bank and the OECD. Djankov, La Porta, Lopez de Silanes and Shleifer (2002) focused on the regulation of entry collecting information for 85 countries on three key indicators: legal requirements to start a business, costs and minimum time involved. These were analyzed from an efficiency perspective of regulation theories to confront market failure problems and from a political perspective to enquire who benefited from regulations. The conclusions reached were that theories of regulation failed to protect public interest, since countries with heavier regulations also have higher corruption and large unofficial economies. They also found support to public choice theories given that regulation benefits were appropriated by political leaders and their friends.

Botero, Djankov, La Porta and Lopez de Silanes (2004)⁸ analyzed labor regulation following a similar approach as in their previous work. They added a legal theory perspective to examine the influence of each country legal tradition in shaping the type of regulations. The main finding was that the patterns of regulation across countries are shaped by transplanted legal structures. This coincides with a key argument presented by De Soto that attributed to the Colonial Heritage the over-regulation and bureaucratic administration of Peru. They did not find much support for conventional versions of the efficiency theory and in particular, that heavier regulation of labor negatively affects labor force participation and unemployment, especially of the young. These two contributions evolved into the Doing Business Report including ten areas of regulation and indicators for 175 countries.

⁸ The indicators included were: labor laws regulating individual labor contracts and collective relations and social security legislation.

Loayza, Oviedo and Servén, (2006) also followed the same line of analysis focusing on the impact of the regulatory environment on growth and the size of the informal economy. In particular, they find that product market or labor regulations leads to an expansion of informality but this effect, as well as the impact on growth, is strongly related to the regulatory quality. In particular, when good governance exists fiscal regulations decrease informality.

The importance of governance and the lack of strong evidence about the impact of labor regulations on growth and informality in the studies mentioned calls for caution on conclusions and policy design. As argued by the UN Commission on Legal Empowerment of the Poor (2008a), evidence from the Investment Climate Assessment Surveys run by the Bank, locate labor regulations at the eleventh place in the list of obstacles reported for growing business. In addition, some components of labor regulation (such as, protective collective relations) are associated with a larger informal economy, while this is not the case with others.

This approach is partially shared by the OECD (2004) calling for the need to include governance issues and particularly, the improvement of the administrative capacities of the tax authority. It also recommends a comprehensive and gradual policy strategy that takes into account the interactions between employment regulations, tax collection and informal employment. This requires adequate policy mixes and good management of incentives. For instance, while de-regulation may sometimes be appropriate, the major need is for better quality regulations which promotes tax collection and other objectives, but with low compliance costs. It should also be taken into account that in developing countries, the self employed are generally independent workers without employees, with low earnings and unable to pay significant amount of tax.

iii) Exit or exclusion?

A more recent study on informality in Latin America by World Bank experts (Perry, Maloney et al, 2007) contributes an additional factor within the overall conceptual framework analyzed before. It remarks the voluntary nature, particularly of independent workers, to work informally because the income earned is higher than what they could obtain by working within the legal framework. It claims that this is particularly the case in countries where access to social protection benefits in formality is limited and there are universal alternatives or non-contributory programs that can compensate for the lack of coverage. Exit is a rational decision in an environment of inadequate and costly regulations and coexists with exclusion resulting from labor market segmentation and constraints to doing business at small scale.

We have also argued (Tokman, 1978) that a family micro enterprise could also constitute an efficient option in a context of scarce resources and jobs by better responding to the needs of the family. This is so because it allows matching the time available in the family with the scarce resources available. It allows mobilizing family labor, introducing consistency among functions at the enterprise and the household. Women can conciliate roles of housewife, mother and work and for son and daughters of schooling and work. It could also use the family house as the business place and the means of transportation available for domestic use to also respond to the micro enterprise requirements. It introduces a degree of flexibility that make feasible to introduce consistency between roles and resources. This is a usual case of small business particularly, in retail trade.

The guiding motif in the exit interpretation would be the higher income earned by opting for this solution. The data available on income differentials between sectors and occupational categories contribute additional evidence to the analysis. On average for Latin America, those occupied in the formal sector perceive an average income 80% higher than that received by those working in the informal sector. This in line with productivity gaps among units of production according to size, differences in human capital and collective bargaining capacity, non existent in informal enterprises. Independent workers and informal micro entrepreneurs income is 28% higher than the average income of the informal sector and 57% higher the wage of informal workers in informal enterprises. However, this wage is 13% lower than if employed as a worker in a firm of more than 5 employees. There is an incentive to formalize, although at the cost of loosing autonomy and the advantage could disappear if there is some partial time available for work in the family that can be mobilized.

Differences between independent workers and informal micro entrepreneurs are significant. A non professional independent worker could, on average, triple his income if he could become a micro entrepreneur. His present income is 16% higher than the wage of an informal worker, so there are no incentives to move to that job, but it could be attracted by a wage worker job in a formal firm that would allow him to get an income increase of 36%. Exit is not supported by the data. On the contrary, informal micro entrepreneurs would not have incentives to move to a wage worker position, since even if formal, it would reduce its present informal income to one third. His options would be to grow with the micro enterprise becoming formal, since there is a direct association between formality and firm size. This is observed in micro enterprises and with higher intensity, in bigger size firms (see, table 3).

Regional averages do not necessarily represent country situations. The following table allows concluding the following. First, in all countries included independent workers would triple their income if they become micro entrepreneurs; the potential benefit been even larger in Venezuela. Second, independent work constitutes a valid option or at least, neutral relative to informal wage work in the majority of countries. Only in Venezuela, informal

wage workers receive an income one third higher than an independent one. Third, only in Argentina and Chile, there would not exist incentives to move to a formal wage worker position. In these countries it might be argued that exit rather than exclusion prevails. However, the movement of the self employed to micro-entrepreneurship is not easy nor sufficient wage workers posts are available in the formal economy. The lack of productive jobs constitutes the main constraint and the result is exclusion, rather than choice.

Table 3: Income differentials between independent and wage workers, 2005

Country	self-employed/ worker <5	self-employed/ worker>5	self-employed/ employer<5	self-employed/ employer>5
Argentina	2.17	1.35	0.38	0.21
Bolivia	0.86	0.40	0.31	0.11
Brazil	1.27	0.70	0.32	0.16
Chile	2.36	1.30	0.32	0.15
Costa Rica	0.89	0.53	0.50	0.29
Ecuador	1.00	0.60	0.36	0.17
El Salvador	0.96	0.62	0.33	0.28
Guatemala	0.82	0.37	0.26	0.10
Honduras	0.59	0.30	0.24	0.13
México	1.74	0.93	0.35	0.09
Nicaragua	1.05	0.59	0.33	0.05
Panamá	0.84	0.45	0.30	0.14
Paraguay	0.83	0.47	0.27	0.07
Peru	0.89	0.40	0.30	0.09
Dominican Republic	1.53	0.79	0.38	0.25
Uruguay	1.29	0.64	0.34	0.21
Venezuela	0.67	0.42	0.14	0.08
arithmetic average	1.16	0.64	0.32	0.15

Source: CEPAL, based on household surveys of each country

Note:

self-employed/worker<5: Independent worker relative to wage worker in micro enterprises with less than 5 employees

self-employed/worker>5: Independent worker relative to wage worker in enterprises of more than 5 employees

self-employed/employer < 5: Independent worker relative to employer in micro enterprises with less than 5 employees

self-employed/employer > 5: Independent worker relative to employers in enterprises of more than 5 employees

The voluntary option to become a self-employed instead of entering the labor market in a different occupational category is also argued in the referred study on the basis of the employment profiles during the working life. Although self-employment is not the preferred insertion at early ages, it increases in a continuous trend with aging and become the main source of informal employment. Entry into wage work in informal firms shows an opposite behavior. While it is the preferred option to enter the market, it starts to decrease after the 19-23 years old because of mobility either to formal wage

work or to self employment. This is sustained in the Perry, Maloney et al report (2007) based on the evolution of the employment profiles by category for Argentina, Brazil and Mexico, by reported reasons by age for self-employment for the two latter countries and by the distribution of reasons for preferring a job as independent worker.

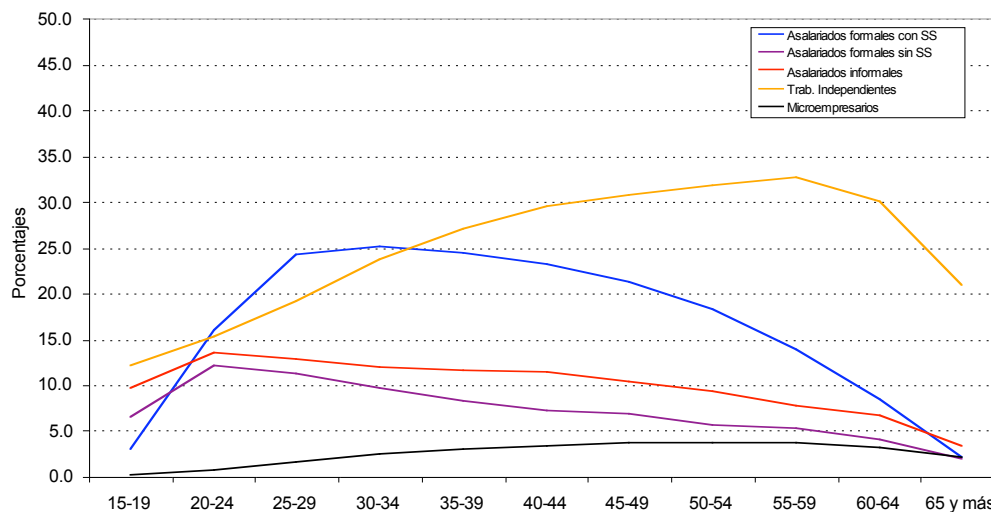
When this hypothesis is tested with the data available from household surveys for 17 Latin American countries⁹, the evolution suggest a different behavior either for the average and for each country included with only a few exceptions. As can be seen in the following graphs, self-employment and informal wage work either in informal firms or in formal firms¹⁰, constitutes the most important entry points to the labor market. Around 28.4% of the young people in active ages between 15 and 19 years old enter to the labor market in the informal economy. They constitute around 90% of those occupied in that cohort: 38% among them are self-employed, 20.8% become informal workers in formal firms and 20% enter as informal workers in informal firms. Only 0.4 is registered as a micro-entrepreneur. Those that obtain their first job as formal wage workers are less than 10% (see Graph 8 and 9).

Self-employment and informal wage work constitute the main options for newcomers to employment, but most among them end-up in the informal economy. Is the decision made a voluntary one, or employment in the informal economy is the only option for the younger people? The evidence is that the options are largely within the informal economy. The argument made is that those who enter into self-employment take a voluntary decision based on cost-benefit analysis and it is sustained on the increasing trend to enter into self employment, while the opposite pattern is observed for informal wage workers. This requires further consideration.

Graph 8: Employment profiles during working life
(As percentages of the working age population)

⁹ The countries included are Argentina, Bolivia, Brazil, Costa Rica, Chile, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru, Paraguay, Uruguay and Venezuela.

¹⁰ Wage work in formal firms without social security coverage is taken as proxy for informal wage worker in formal firms. The profile for the self-employed is differentiated from the micro-entrepreneur.

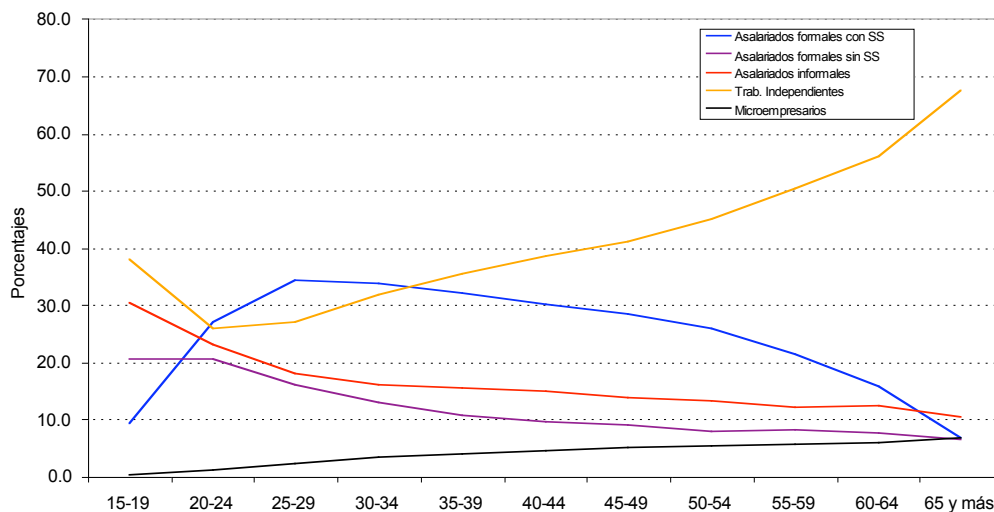


The occupational profiles show an increasing trend up to 20-24 years old for informal wage workers and a continuous decrease afterwards. On the contrary, self employment continuously expands up to the end of the working life. This has been interpreted as an indicator of a voluntary decision to enter into independent jobs. Aggregate job profiles by age, hide country differences. The well behaved evolution is observed in countries where informality is lower and formal firms employ a significant proportion of the active population. Argentina, Brazil and Mexico, selected by the Bank to test the voluntary hypothesis, are among them¹¹. On the contrary, in countries where informality is high¹², self employment constitutes the main occupation. Waged workers in formal firms reach only 11 percent of the active population in the most active age cohorts, and informal employment is largely self employment. Informal wage employment constitutes only an option to independent work up to 20-24 years old.

**Graph 9: Employment structure by job insertion and age
(As percentages of occupied population)**

¹¹ In addition, Chile, Costa Rica and Uruguay are in that group.

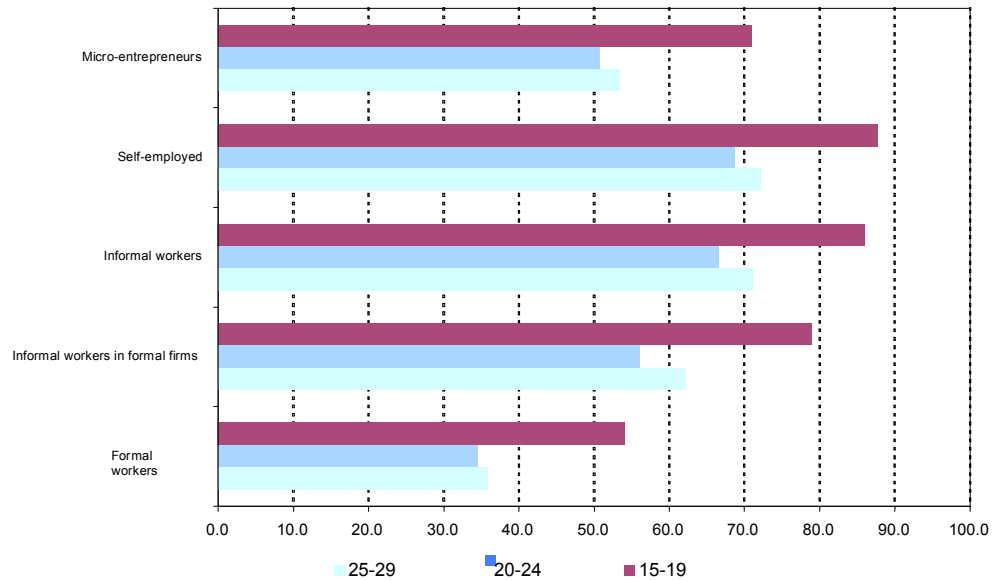
¹² Including, Bolivia, Peru, Ecuador and the Central American countries.



The decreasing trend of informal workers as age increases can be taken as an indicator of a forced decision. The case of the self-employed is not different, if the job structure by age is referred to those already employed. A significant decrease of around 11 percentage points is observed when the youth reach the 20-24 years cohort and it is not until they reach the 40-44 age cohorts that recuperate the entry share. The immediate move out of self employment at early ages suggests that the entry was not a voluntary but rather a forced decision. The jobs preferences are for formal wage work until 30 years old, but as there are not sufficient jobs of good quality available there is no choice but to find an occupation to earn incomes. To become an entrepreneur is only restricted to a small group of people who have that ability and can get access to capital. In fact, although micro enterprises are an increasing source of employment with aging, the maximum share reached at the end of the working life is around 6%.

The problem is not only the availability of good jobs, but also of human capital endowment by age. Entry to the labor market at early ages is concentrated in young people from poor families and accompanied by low educational levels. Eighty eight per cent of those who enter into self-employment in the 15-19 years cohort have not completed secondary education. This percentage is the highest registered in all occupations, only comparable to informal workers in informal firms. The situation improves with age, but still for those in the cohort between 25-29 years old, the percentage reaches 69% and if professionals are excluded it amounts to 72% (see graph 9). Experience also contribute to human capital formation and could contribute to explain why after a decade or more performing as a self-employed incentives to continue increase, particularly considering that better alternative job opportunities are less available for people with low levels of formal education.

Graph 10: Incomplete secondary education by job and age
(As percentages of employment)



Another evidence of voluntary decisions is responses to job preferences. The sources used should be subject to a more rigorous scrutiny since, for instance, open questions like “if you are able to choose, would you rather be a salaried or independent worker” were made in surveys for Argentina, Bolivia and Dominican Republic with responses above 70%. However, the survey for Colombia where the response was conditioned to alternative wages and benefits at the same level of earnings as independent, the preference for independent work was only 41%. Indeed, there is natural bias for independence, but to be realistic that should be related to the income effect of the decision¹³. In fact, the surveys included in the World Bank report show that the main reason to be informal independent are that salaried jobs were not available. In the case of Argentina and Colombia this responses were 59 and 55% respectively¹⁴. Finally, surveys for México and Brazil should also be read with caution since although in the former country, women preference for self employment is based on the need to complement family incomes; this is not the case for younger women (15-18 years old) whose main reason is lack of salaried jobs available. Men preferences for self employment also show a different set of reasons for the youngest, since at early ages the need to complement family income obtained the highest percentage, followed by the lack of salaried jobs available¹⁵. This is consistent with our analysis that especially for early entrants to the labor market; the decision to be independent is mostly explained by other reasons than preference.

¹³ Table 2.5, Perry, Maloney et al, 2007.

¹⁴ Table 2.6, Perry, Maloney et al, 2007.

¹⁵ See tables 2.7 and 2.8, Perry, Malone et al, 2007.

A recent research policy also published by the World Bank (de Mel, McKenzie and Woodruff, 2008) contributes to the understanding of the occupational options and behavior of the self-employed in the case of Sri Lanka. Their findings support our view that informal activities and in particular, that own account workers are mostly marginalized and waiting for an opportunity for wage work arises. The informal economy arises from the failure of the economic system to create enough productive employment (Tokman, 2001). It is not a voluntary decision, but rather a forced one given the lack of sufficient wage work. The data on labor histories showed that few of the own account workers say that they have ever been wage workers, while previous wage work is more common among the enterprise owners.

In addition, they argue that own account workers are not entrepreneurs that would evolve to owners of larger enterprises if the constraints they face particularly, the lack of access to credit and barriers of entry, were raised.

Around two-thirds of the own account workers would be classified as wage workers rather than entrepreneurs. They also found that ability, motivation and competitive attitudes are determinants in differentiating owners of enterprises hiring between 5 and 50 employees and own account workers. On average, own account workers are more like wage workers and the lack of growth derives from their lack of ability or desire to grow, rather than the lack of finance.

Only a minority of the own account workers have characteristics similar to owners of enterprises, but the percentage is still significant. This leads the authors to suggest a policy differentiation. The focus for the majority of own account workers, unlikely to grow, should be on increasing income. For the remaining one-third with greater prospects for growth, the aim should be to promote the transition to employer status.

iv) Multi-determinants and policies

Causes of informality are multiple and the importance allocated to each varies according to the interpretation adopted. Strategy and policies will depend on the decisions about priorities. Following our option of adopting the informal economy definition in a comprehensive manner, we could identify several aspects that have to be included in a strategy and what policies could be more effective to increase formality.

Starting with the more comprehensive reading of informality as a structural result of a type of development that fails to generate sufficient good jobs for all, the first priority would be to adopt a more effective growth and macroeconomic policy. More good jobs, stable and protected, will result in less informality. We know and have been statistically proven, that informality is negatively related to the level of development of the country. The discussion at this aggregate level is necessary, but it goes beyond the objectives of this paper.

A strategy focused on recognition of rights and empowerment of those in the informal economy can provide an integrated framework. People have to be recognized as citizens and be able to ensure the exercise of rights, not only political but also economic and social. This recognition needs to be accompanied by access to justice and freedom of organization. Latin America countries have made progress on civil and political rights. The present challenge is to advance in economic and particularly, social citizenship since they constitute necessary conditions to diminish inequality.

As the Commission on Legal Empowerment of the Poor (2007) recommends, the main objectives are access to opportunities and protection by exercising the legally recognized rights of access to justice, property, labor and the right to develop productive activities. The legal recognition of identity and of organization would allow the poor to actively participate in the reforms and actions to correct failures in markets, in public policies and in regulatory institutions.

The informal economy includes two main forms of exclusion. First, is the existence of a significant and non decreasing informal sector, where most of the jobs are occupied by the poor and lower middle income groups. They are entrepreneurs and workers and many are both: they belong to the excluded, since add unprotected and unstable jobs to low incomes. The second form of labor insertion is in formal enterprises or in productive chains under different subcontracting arrangements without neither job security nor full protection. They all require a comprehensive strategy of social inclusion.

6. Responses and experiences

There is need for a comprehensive strategy to promote inclusion through the recognition of economic and social rights. Heterogeneity prevailing in the informal economy also requires specific reforms and policies that may improve their design if the lessons from experiences are duly taken into account. We suggest to follow a five pillar approach (Tokman, 2008a).

i) Productive development and regulation of informal activities.

The objective is to recognize the right to develop business activities to informal micro entrepreneurs and independent workers to be able to generate adequate incomes and to diminish their vulnerability to abuses and persecution because of their condition of informality. The regulatory framework must be adjusted to enable full compliance, since present regulations were designed for large enterprises and more organized sectors. This would require recognition of rights to do businesses, legal recognition of property, separation of businesses and family responsibilities and the right to sale in public or in private spaces allocated for that purpose. Recognizing entitlements will allow for compliance

with obligations, reversing the prevailing order of searching for compliance of inadequate obligations without providing for the conditions to be enforceable.

Simplifying administrative procedures constitute a requirement to facilitate legal recognition. Bureaucratic barriers to initiate or close micro enterprises and the time and cost for processing should also be reduced. Legal recognition of property opens access to credit, more appropriate regulations enable business development and greater readiness to assume risks exists when family property is separated from business results. Identification of responsibilities for taxation purposes and recognition of employment relationships according to capacity of compliance, can also improve businesses performance by opening access to formal markets and upgrading financial administration; while productivity gains will be achieved given the incentives of greater worker stability in the job and in the enterprise. Street sellers may increase their income by greater security and a reduction of risks involved of operating in a grey area between legal and illegal activities.

A first modality adopted by several LA countries is the introduction of promotion laws for small, medium and micro enterprises. Colombia, Argentina, Mexico, Brazil, Venezuela and Peru focused on micro enterprise development through financing, training, access to public purchases and fiscal and labor incentives.

A second feature included in promotion laws is to simplify requirements and administrative steps to open a micro enterprise. In Brazil, a Special Public Registry was created to grant formal recognition by submission of one document and a declaration of inexistence of legal impediment to participate in a business. In Mexico the law requires to submit to a “single window” the enterprise location plus information on the characteristics of the enterprise. In Peru, registration is made in a Unified Registry and the municipal license constitutes the only requirement to formally recognize it. Simplified accountancy requirements for micro enterprises are included in laws of Brazil, Mexico and Peru; while in Chile a special law was introduced to facilitate family micro enterprises registration by a formal declaration about the legitimate occupancy of the house where the business is performed.

“Single windows” exists in several countries like Bolivia, Costa Rica, Guatemala, El Salvador and Honduras. The results have been significant. In Bolivia, visits were reduced to one third and requirements to a half. As a result, the time involved decreased from 17 days to 4 hours. In Guatemala requirements were reduced from 59 to 9, forms from 10 to 1 and time and cost involved in a similar percentage. In Peru, De Soto (1986) estimated that to initiate a small industrial workshop required to comply with 11 requirements and a delay of 289 days at a cost of 1200 US dollars. The introduction of a single window in 1998 allowed for a reduction to 5 requirements, a delay of 30 days and a cost of near 200 dollars (Chacaltana, 2008). There are also

experiences on laws of administrative silence¹⁶ and on line processing of registration.

Another related area is the introduction of special tax regimes for small and micro enterprises. One modality is to allow for exemptions to specific groups, like artisans and individuals, in the value added tax as in Colombia, Ecuador and Venezuela. In Mexico it is applied to small business in relation to the tax on assets. A second variant is to simplify payments of one or more taxes by applying a fix rate on sales, incomes or expenditure as it is done in Argentina, Costa Rica, Chile, Mexico, Nicaragua and Honduras. In Chile, the special regime for small and micro enterprise aims at decreasing the financial cost for the contributor and to promote the adoption of a simplified accountancy system in an electronic format. Another variant of special tax regimes is the “*monotributo*” introduced in Argentina, Brazil, Paraguay and Uruguay, substituting the payment of all taxes and contributions to social security by a single rate on annual incomes.

Experiences to improve working and income conditions of street sellers are also of interest. Street sellers in Lima constitute a paradigmatic case, given the colonial value of the downtown area and the massive expansion of street sellers. After many unsuccessful initiatives, a program managed by the local government in coordination with all actors involved was introduced. A main component was the relocation of sellers. An abandoned site, also located in the downtown area, was recuperated by the municipal authority investing in infrastructure, police was reinforced and a special security force was created. Today the site has become a dynamic open shopping area. Similar programs were applied, with different degrees of success in cities like Santiago and Bogotá¹⁷.

ii. Labor rights in informal enterprises

Labor law applies only to a small proportion of workers in informal firms; and few among them, are able to meet the obligations arising from an employment relationship. On average for Latin America, 78 percent of wage workers in informal firms do not have a written contract. In addition, a survey of micro enterprises in Colombia showed that only 15% paid any contributions and 76% could not pay total labor costs (Gomez, 1998). In Peru, only 15% of micro

¹⁶ A law of this sort was introduced in Chile in 2003 that reversed the process of registration and authorization, establishing that in case of no administrative answer it is assumed as approved, except for environmental matters.

¹⁷ In Lima street sellers resisted the relocation but a negotiated agreement made it feasible on the basis of the responsibility of the local authority to guarantee the administration, promotion and security of the site. According to surveys, street sellers were afterwards satisfied because sales increased, business perspectives were better and security and health conditions were according to the compromised made. At the same time, investment in recovering colonial buildings and streets increased the tourist attraction of the area. For an analysis and evaluation of these initiatives see chapter 4 in (Tokman, 2001).

enterprises were in a position to absorb all labor costs; to do so 28.6% would have to reduce their profits by half (Yañez, 1998).

Recognition of the employment relationship would contribute to improve labor and social protection. This could be achieved by proving the existence of unwritten contracts, hours worked, regular payments registered in the accounts or by witnesses. This will provide credentials to be entitled of protection and encourage micro entrepreneurs to do business on a proper basis. However, this will be confronted with the inability to absorb costs involved

Another option introduced in some countries, like Peru, is to allow for a special system for micro enterprises. Several labor benefits were eliminated including indemnities for time of service, compensations for arbitrary firing and vacation duration was diminished. Labor costs were reduced from 1.52 to 1.13 of minimum wages and although it does not affect the liquid remuneration it constitutes a cost reduction for the employer and a deterioration of labor rights and future incomes for the workers (Chacaltana, 1998). It also introduces a differentiation of workers rights according to the size of the firm where they are employed and may also result in regulatory inefficiency.

The ILO (1991) has advocated for a single regulatory system to avoid rights discrimination, but it also implicitly recognized the existing financial constraints for full compliance. It introduced a compulsory minimum threshold including the fundamental labor rights as defined in the ILO Declaration of 1998¹⁸. In addition, it could also include basic labor conditions such as: minimum wage, hours of work and work related accidents and illnesses. This floor should be universally applied independently of the size or form of the enterprise in which they work. But progress towards a full labor package should be progressive and monitored taking into account the characteristics of the informal enterprises and may include establishing goals, inspection and a time limit for enforcement.

Some of the characteristics suggested as progressiveness and time limited can already be found in Colombia. A promotional law for micro and small enterprises reduced some of the labor and tax contributions but converge to the general regime after 4 years. Labor inspection adapted to micro enterprises needs has also been incorporated in Chile, by introducing a pedagogic modality that allows substituting pecuniary sanctions for an obligatory attendance to training courses on labor legislation in the recognition that lack of information and of access to professional advice is a main determinant of violations in micro enterprises. In the same line, the ILO (2006) proposed an innovative strategy of labor inspection including different options to facilitate enforcement.

iii. *Labor rights under atypical contracts in formal enterprises*

¹⁸ It includes freedom of association and collective bargaining, elimination of force and child labor and discrimination.

Insecurity and vulnerability are linked to the absence of legally and explicitly recognized employment relations, but also to situations governed by contracts other than the permanent employment contract. Although both situations exist in informal and formal enterprises, the former tends to concentrate the absence of contract, while in the latter atypical contracts are significant.

Atypical contracts in formal enterprises increased as labor policy responses in the 90's to the need of flexibility and reduction of labor costs. Labor reforms searching for "*flexibility at the margin*" resulted in greater workers instability and vulnerability. More recently, recognizing the negative effects on workers and productivity, a new trend emerged to revalue the permanent labor contract, but adapted to the demand for flexibility in more open economies.

Labor reforms introduced by Spain in 1981 and later on, by Colombia in 1990, by Argentina in 1991 and 1995 and by Peru in 1993 followed the strategy of flexibility at the margin. However, Spain, Brazil, and Argentina after the second half of the 90's returned to permanent contracts but adapted to the new requirements. Spain introduced reforms in 1997 and 2006 that incorporated this reorientation. They are geared to limit the expansion of atypical contracts and shifting the priority back to an improved permanent contract. Argentina and Brazil did the same in 1999 and Argentina again in 2000 followed a similar approach as Spain. Introduction of atypical contracts were directly limited in Argentina and by collective bargaining in Brazil. Trial periods were enlarged and hiring and firing costs reduced, to incentive the use of permanent contracts.

The shifting of orientation also contributed to reduce undeclared labor and improve labor inspection effectiveness. In Argentina, for instance, the flexibility reforms were accompanied by an increase in non registered employment from 29% in May 1991 to 38% in October of 2001. Almost half of the increase were workers without contracts in formal enterprises. In 2003 a new policy of reinforcing of labor inspection was introduced that allowed to regularize one third of the informal workers inspected. Non registered employment decreased from 49% in 2003 to around 40% in 2007 (Novak, 2007).

iv. Recognition and regulation of diffuse employment relations

Another policy issue is ill defined employment relationships that are difficult to establish or are disguised or unprotective owing to gaps in regulations or compliance control. The rights and obligations of the parties involved are often unclear and may result in loss of protection to the workers. Such cases are becoming increasingly significant in the context of globalization and decentralization of production, being necessary to ensure workers rights and identify who is the responsible employer. These employment relations can involve multi formal or informal firms, including home work.

A law to regulate subcontracting was introduced in Chile at the beginning of 2007. The law distinguishes between subcontracting and personnel placement. The first refers to an enterprise that hires another to perform a service or execute a task. The subcontractor is the employer of the subcontracted workers and hence, is responsible for the compliance of labor obligations. The second refers to an enterprise that request to another enterprise on temporary services to provide personnel for a given period. The main enterprise supervises the supplied personnel, but it does not become the employer.

The law restrict the supplied of personnel to short term tasks and regulate the enforcement of labor obligations by registration and constitution of a guarantee fund. A more interesting aspect is the regulation of subcontracting between enterprises. In this case the subcontractor firm is the employer and responsible for the control of the worker, being the sole responsibility of the main enterprise matters related to security, prevention of work accidents and professional illnesses and hygiene conditions. However, the law changed the previous subsidiary responsibility to a solidarity one for the compliance of labor and social security obligations of the subcontracted workers. The law also introduced the possibility that the main enterprise maintains its subsidiary responsibility if it exercises the verification of compliance of obligations duly certified by the Labor Direction. Furthermore, pending funds can be retained and used in cases of non compliance by the subcontractor.

v. Social protection for informal workers

Social protection coverage (health and pensions, as well as maternity) for informal workers requires a strategy including from expanding coverage of present systems to the development of new instruments like insurances and pooling of resources of the excluded.

From a systemic perspective these rights should be granted to the people as citizens rather than as workers and awarded based on universality principles. This has been the major change in the redesigning of the “traditional model” in Latin America as well as to complete the private defined contribution pension systems adding a solidarity pillar funded from public resources. The World Bank (Perry, G et al, 2007), support this change both for the case of health and pensions coverage. In the case of health care, it is recognized that as shocks that go uncovered impose significant costs to society, there is a case for providing minimum essential direct cover, de-linked from the labor contract and financed through general taxation. Similarly, in the case of old age insufficient incomes, there are social costs involved that justify a minimum income support not associated to the labor contract.

Bolivia is the only country in Latin America that introduced a universal non-contributory pension (BONOSOL) and Brazil has a similar system for rural workers (FUNRURAL). Chile, a pioneer country privatizing the pension and

health systems, is taking the lead introducing a non-contributory pillar that guarantees a solidarity pension to all citizens after 65 years old. Health is covered to a larger extent than pensions and reaches universality by a combination of different systems: a social insurance in Costa Rica that covers contributors and non-contributors, a public funded system in Cuba and a mix of public institutions, social security and private insurances in Uruguay, Brazil and Chile, among others. The latter has strengthened access to public health for all citizens by introducing an attention guarantee of 56 basic pathologies (AUGE) in addition to the existing national health insurance (FONASA).

Independent workers contribute both as worker and employer. This creates a disincentive for voluntary affiliation. In Mexico a subsidy paid by the government covers the equivalent of the employer contribution in the case of independent workers. More recently, Brazil also introduced a simplified program for inclusion of independent workers with a reduction of the contribution from 20 to 10%, similar to the contribution of dependent wage workers. If perceived gross incomes are below a certain limit, small contributors can opt for a simplified regime that substitutes taxes on profits, value added and contributions to social security. Argentina and Uruguay adopted this regime for independent workers reaching a coverage exceeding the one registered in Chile (32-26% vs. 21%); while in the case of wage workers the situation is the opposite (57-77% vs. 85%) (Bertranou, 2007).

7. Conclusions

i) On diagnosis

The informal economy in Latin America is significant and expanded between 1990 and 2005. The informal sector accounts for 80% of those occupied in the informal economy, but informal workers employed in formal firms are growing faster.

The size and structure of the informal economy varies according to countries. Most of the Central American and some of the Andean countries registered the largest size and also the higher level of workers informality and informal sector. They are also the less developed in relative terms. The rest of the countries, mostly the more developed ones, register a smaller size of the informal sector but differ in relation to the share of informal workers in formal enterprises. While some countries like Chile, Costa Rica, Panama and Uruguay managed to reduce both components, the three largest economies (Argentina, Brazil and Mexico) were successful only in reducing the informal sector, but informal workers became increasingly important. The share of the last component more than doubles the size registered in the other countries. This suggests that economic expansion was accompanied by changes in the productive and employment structures, but public policies and government failures were unable to ensure that jobs were stable and protected.

Although informal wage employment accounts on average for more than half of informal employment, self-employment is still large on average and, in the less developed countries in the Region they are still the main source of informality. Wage employment is not homogeneous, since around one fifth is in domestic services and the rest is employed in similar proportions in informal and formal firms.

There is a concentration of vulnerable groups in the informal economy and particularly in the informal sector. Women are overrepresented and highly concentrated in self-employment in commerce and services and domestic services. Two thirds of the women in the informal sector are in these sectors in most countries. Indigenous people are also overrepresented in the informal economy and there is a direct association between the importance of their participation in the population and the size of informality. International migrants do not present major differences relative to natives, but the information available does not include illegal migrants and for those with resident permits, a labor contract is required.

Income differentials between those working in formal enterprises and those in informal firms or self employments are significant for all and each occupation, but differentials within sectors are smaller in the informal sector suggesting more equity. However, as poverty intensity is higher in the informal sector, this only suggests that equity is larger among the poor.

Employment relationships are either non existent or not legally recognized in informal activities since it prevails self-employment and wage work without labor contracts. When it is recognized, atypical contracts are significant although not more than in formal firms. This results in low coverage of labor and social protection.

ii) *On causes and interpretations*

The informal sector existence and expansion as a result of insufficient growth to productively absorb the rapid increase of population in urban areas, remains valid and important. Trickle-down expectations have not worked, but it is also clear that employment creation without sufficient growth is not possible. In addition, lack of productive jobs result in underemployment and not in unemployment, in absence of unemployment insurances or direct public transfers.

Early contributions reading informality as a result of decentralization of labor processes acquired increasing importance in the 80's given the change introduced to the development strategy, passing from closed to open economies. This happened at a time of globalization and universal adjustments introduced in the search of flexibility to increase productivity and competitiveness.

Linkages between home-work and intermediaries of main firms, as well as apparent independent jobs performing work for formal enterprises (as waste recycling and mobile distributors) existed already for a long time. However, technological changes open the possibility to decentralize production and labor processes created new opportunities for linkages between medium and larger enterprises under subcontracting practices. Productivity gains and costs reductions, particularly of labor, were functional and a new space for informality emerged in formal firms. In Latin America this was added to the labor reforms introduced in the structural adjustment package to increase flexibility. The enlargement of informality from the sector to the economy, adopted in the ILO in 2002, explicitly recognized these transformations.

Failures in regulations and government were also recognized as obstacles for business development. In particular, it became clear that micro-enterprise development was hindered by excessive regulations and long and costly processing by the bureaucracy. Informality was partly the result of these policy failures. Interpretations and responses were then incorporated in the reform packages and supported within the liberalization priorities.

The previous interpretation about potential effects on micro-enterprise development assumes that informality is the response to obstacles to entrepreneurial development. However, independent workers are mostly wage workers in informality because of the lack of better jobs, as argued since the introduction of the concept. More recently new findings from the World Bank also support this interpretation by concluding that “two thirds of the own account workers would be classified as wage workers rather than entrepreneurs and “that their lack of growth derives from their lack of ability or desire to grow”.

It is also questionable the exit interpretation proposed by the World Bank that explain the decision of independent workers to work informally as voluntary, because incomes earn would be higher than those earn by working within the legal framework. The data included in this paper shows that, on average, an independent worker perceives an income 16% higher than a wage worker in a micro enterprise (less than 5 employees), but to move to a wage worker post in a larger firm (more than 5 employees) would allow for an income increase of 36%. There are also incentives for independent workers to becoming entrepreneurs, even of micro enterprises, since they would triple their income. However, as noted above, the conditions required for such move are not present in the majority among them; while the data available on jobs structure by age and on preferences is not conclusive.

iii) On policies and experiences

There is need for a comprehensive strategy to promote inclusion through the recognition of economic and social rights. However, given the heterogeneity

prevailing in the informal economy it is also required to introduce specific reforms taken into account the lessons derived from experience.

A first challenge is to ensure the right to develop business activities for informal micro entrepreneurs and independent workers to increase their incomes and reduce their vulnerability. This includes adapting regulatory frameworks to enable the needs and capacities of informal activities recognizing the rights to initiate and develop business, to legally recognize their assets and to separate family and business responsibilities. Simplifying bureaucratic and administrative procedures could also contribute to facilitate recognition and compliance. Special laws to promote small and micro enterprises, the introduction of “single windows” to reduce the time and cost involved in obtaining permits and special tax regimes with incentives and simplified accountancy requirements are among innovations already introduced in several countries. The experiences of supporting street sellers within an integrated perspective responding to their interest with due account taken of public interests, have proven to be effective.

A second pillar is to ensure labor rights of workers in informal enterprises. This should consider the capacity of cost absorption of a full labor regulation package designed for larger enterprises. There is need to legally recognize the existence of employment relations and to ensure compliance with labor obligations to avoid double standards on labor rights. Progress is being made in this direction, by starting with the introduction of a minimum floor of labor standards that include fundamental labor rights (included in the 1998 ILO Declaration), plus selected standards on working conditions (working hours, minimum wage and illness and accidents at work). Progressively, additional standards could be introduced according to the increasing capacity of the firms, but subject to monitoring and a fixed transition period for full implementation. Inspection could also include pedagogic components to educate the entrepreneurs on the content of labor law.

A third pillar refers to promote increased job security and protection for informal workers in formal enterprises. This involves redesigning labor reforms, that searching for flexibility, introduced atypical labor contracts that resulted in higher job turnover and increasing unprotected and unregistered employment. The prevailing experience in countries that followed this approach in the past, shows a re-orientation by returning to the use of permanent labor contracts but adjusted to the needs of flexibility by lowering firing costs, limiting the introduction of temporary or promotional contracts and by transferring the decision about the use of new contracts to collective bargaining.

A fourth pillar refers to multi-firms employment relations. This has been traditionally concentrated in work at home producing for intermediaries or to main firms, but more recently has evolved into subcontracting of formal enterprises of different sizes and the placement of labor through agencies. As a

result, employment relations are hidden or become diffused since responsibilities for the obligations are spread among several firms. There is need for regulation to ensure the legal recognition of the employment relations and particularly, the identification of the responsible agent/s for compliance with the obligations. Labor agencies for personnel placement for short term replacements are also increasingly used to dilute the employment relation and to evade labor obligations.

A last pillar relates to social protection. Informal workers are usually excluded or have limited access to social protection. There is increasing support for introducing protection in health and pensions on universal basis, de-linking labor insertion from access to the benefits. Some countries have moved in that direction, while others has introduced solidarity pensions in contributory regimes. In the case of independent workers subsidies are introduced to incentive affiliation and special tax regimes, including social security contributions, allowed to expand coverage for specific groups such as domestic services and occasional workers.

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