

MEASURING INFORMAL EMPLOYMENT IN OECD COUNTRIES

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Background

1. The OECD has undertaken two studies in recent years on informal employment in OECD countries. The first was published in the 2004 *Employment Outlook*. It presented a review of existing evidence on the existence of informality in OECD countries, along with some new cross-country estimates on under-payment of social security contributions compiled from national accounts data. The second study was published in the 2008 *Employment Outlook*. It looked in more detail at informal employment in seven of the lower-income OECD countries: Czech Republic, Hungary, Korea, Mexico, Poland, Slovak Republic and Turkey. The chapter relied mainly on estimates from household microdata sources and focused on the links between labour market and social policies and informality.

Defining informal employment in developed countries

2. The international statistical definition of informal employment serves as a useful basis for thinking about informality in developed countries. In previous work at the OECD, we have used a rough working definition that informal employment is employment engaged in the production of legal goods and services but where one or more of the legal requirements usually associated with employment are not met. This would include employees not registered for mandatory social security, paid less than the legal minimum wage or employed without a written contract where this is a legal requirement; employees and the self-employed who fail to declare some or all of their income for tax purposes (e.g. working cash-in-hand); fully unregistered firms and their employees; and the so-called “false self-employed”, among others. Of course, not all these groups are easy to identify or quantify, leading to the use of proxy measures (see next section).

3. Compared with developing countries, the weight of importance of each group is likely to be different in developed countries. “Partial” forms of informality (e.g. working only a proportion of total hours for cash) are likely to be more important in developed countries than fully informal jobs. In particular, the relative scarcity of fully-informal firms means that definitions based on firm size or registration necessarily neglect to capture the large proportion of informal workers who are engaged in otherwise formal firms.

* The views expressed are those of the author and do not represent the views of the OECD or its member countries.

4. While we would not consider legal, but non-standard, employment practices such as casual or temporary employment *necessarily* informal, non-standard employment is of interest in its own right. Non-standard arrangements might include variations from regular employment contracts, work outside normal working hours (e.g. shifts, weekends, part-time) or work outside normal workplaces (e.g. home-based or outwork).

Measuring informal employment

5. Initial work by the OECD focused on estimating theoretical social security contributions (based on wage and salary income from the national accounts) and comparing these estimates with data on actual social security receipts. This approach requires certain assumptions being made about the income distribution of the workforce (in many OECD countries, social security contributions are not exactly proportional to income due to caps) and relies on common definitions and data sources for national accounts to enable accurate international comparisons. While the exercise undertaken for OECD (2004) was useful, disparities in the way wage and salary income data were collected mean that the estimates are unreliable for a number of countries. For example, the results showed that social security evasion was much higher in Denmark than in Turkey, whereas we know from labour force survey data that around 30% of the labour force in Turkey are not registered for social security at all.

6. From a policy perspective, an overall measure of the extent of informal employment is arguably less important than knowing which types of informal employment exist and what types of workers are prone to be employed informally. This is particularly the case in developed countries, where the mix of informal employment appears to vary widely. Therefore, aggregate estimates of informal employment or the size of the informal sector based on modelling exercises are probably of little practical use for researchers and policy makers trying to understand the causes of informal employment within a country. While internationally comparable aggregate estimates may be attractive from a research perspective to understand why informality is higher in some countries than others, such estimates are unlikely to be fully comparable.

7. Instead, measures derived from household-based surveys appear to be the most useful for understanding and addressing informal employment. To this end, methods pioneered in work in developing countries using microdata sources (e.g. SEDLAC) should be used to guide work in developed countries. Microdata not only allow researchers to look in detail at the extent of alternative types of informal employment, but allow cross-tabulation and analysis to understand the characteristics of those who work informally, which is vital for understanding welfare and policy implications.

8. The lack of adequate measures in household data for many developed countries necessitates the use of proxy measures. In our work on OECD (2008), we found that data on registration for/contribution to mandatory social security was much more readily available for middle income countries such as Turkey, Mexico and Korea than for EU member countries. Presumably the assumption is that all (or the vast majority) of employees in developed countries are registered for social security. However, estimates from administrative data prepared by the Hungarian Finance Ministry, for example, show that up to 20% of the workforce in that country lacks social security coverage. Social security coverage seems to be the most desirable measure of informal jobs among employees. We also used data on the existence of written employment contracts as a proxy for informality among employees, but is only a good measure in countries where a written contract is a legal requirement (e.g. central and eastern Europe). In many other developed countries, there is no legal requirement for contracts to be in writing.

9. We also used self employment, specifically own account and unpaid family workers, as a proxy for informal employment. While not all self employed in developed countries, nor even a majority, are likely to be informal, existing evidence suggests that rates of tax and social security evasion among the self

employed are much higher than for employees. There is also the possibility of “false” self employment where the self employed undertake work that would traditionally be carried out by an employee for the purposes of evading tax, social security or labour regulation. This is very hard to quantify using existing data sources.

10. Identifying workers who have undeclared income is also difficult. Firm-level surveys (e.g. World Bank Investment Climate Surveys) which include hypothetical questions about reporting workers or the wage bill for tax purposes provide some evidence, although such surveys typically include only formal-sector firms (i.e. large or registered businesses). Of more use is the recent work undertaken by Eurobarometer (European Commission, 2007) on undeclared work in the EU based on personal interviews. We found the information on envelope wages or cash-in-hand payments most useful.

Measurement gaps – the “wish list”

11. Adding a simple question on social security registration/contribution to developed countries’ labour force surveys would greatly add to our understanding of this aspect of informal employment.¹ The question of which social security programme (health insurance, unemployment insurance, pensions, etc.) is most relevant arises. For countries where there are data available for more than one type of social insurance scheme, there is a high correlation between informality when measured by alternative schemes. For example in Korea, among employees without pension coverage, 91% have no medical insurance and 91% have no unemployment insurance. Among those without medical insurance, 97% have no pension and 95% have no unemployment insurance. Among those without unemployment insurance, 84% have no pension and 82% have no medical insurance (Korean Labour and Income Panel Study, 2005). One option is to ask whether respondents are registered for *any* social security (such as in the Turkish Household Labour Force Survey). In the case of Korea, 39% of employees are not registered for the pension system, compared with 34% who are not registered for any social insurance (pension, medical, unemployment).

12. False self-employment appears to be a problem in many developed countries. But it is very difficult to identify with existing data sources and may be impossible to pin down completely. One way to improve proxy measures would be to ask self-employed persons whether they primarily work for one customer and/or in a single workplace other than their own premises. From a dynamic perspective, asking newly self-employed persons whether they have previously done the same work as an employee could be useful, although only captures the phenomenon to a limited extent.

13. Extending the Eurobarometer-type survey of cash-in-hand payments to more countries and expanding the sample size would be very useful. Because of the sensitive nature of the information collected, it would be preferable not to include such questions in standard household surveys as they might have the impact of reducing response rates. But the Eurobarometer experience shows that such surveys can be conducted in a stand-alone fashion with relatively high response rates.

14. Anecdotal evidence suggests that multiple job holders have a raised probability of informal employment in their second or subsequent jobs. However, most household surveys collect very little information about the characteristics of secondary jobs. Adding a question on social security registration/contribution in second jobs could be a fairly inexpensive way to determine the extent of informality in secondary jobs. Likewise, surveys about cash-in-hand payments should also include questions relating to secondary jobs.

1. In Australia and New Zealand social security is financed primarily out of general taxation rather than through workplace-based contributions. However, equivalent data could be based on questions about superannuation or PAYG tax registration.

15. In regard to non-standard employment arrangements, existing household surveys already capture these phenomena to a great extent. However, from a welfare and policy perspective, it would be useful to know whether workers in non-standard jobs are there by choice or because of a lack of alternatives. Arrangements outside the norm suit some workers (e.g. students, women with young children), although it is clear that many would prefer to work in standard jobs. Being able to access more information on the issue of choice would help determine whether policy makers should be concerned about the rise in non-standard work and target policy accordingly. Such questions are already included in household surveys relating to part-time employment (e.g. Would you prefer to work more hours?). Similar questions could be adapted to other non-standard working arrangements. It is important in all cases to include a qualifier regarding the impact of changing working arrangements on income as in many cases workers engaged in non-standard practices, such as shift work, are paid extra to do so.

References

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