

Empowerment of the poor in informal employment

by Allan Larsson | January 20-21, 2006

1. WHAT IS THE PURPOSE OF THIS PAPER?

The purpose of this background paper is to give input into the first meeting of the Commission on the Legal Empowerment of the Poor (Legal Empowerment), as a contribution to the planning of the work of the Commission.

2. WHY DEAL WITH LABOUR IN THE COMMISSION ON LEGAL EMPOWERMENT?

Legal Empowerment has the mandate to:

- examine ways to secure broader access to legal, fungible property rights over real and movable assets
- examine ways to provide broad access to legal organisational forms suited to the poor so that they can combine labour, technology and investment to raise productivity (Legal Empowerment Concept Paper, September 2005).

Labour is the main asset of people, especially the poor, and it is an essential factor of production for firms of all types and sizes. The World Bank found that—for more than 70 per cent of the poor—finding a job, whether salaried or self-employed, is the main way out of poverty (World Bank, *Voices of the Poor*, 2002).

Thus, the role of labour—in the formal as well as in the informal economy—is an integral element in the complex system for the improvement of productivity, the basic element for poverty eradication.

3. THE INFORMAL ECONOMY

The term “informal sector” was first coined by a British economist, Keith Hart, in a study of economic activities in urban Ghana (Hart, 1973). Today, the concept of an “informal sector” seems to be replaced by “informal economy”, which includes “all economic activities by workers and economic units that are—in law or in practice—not covered or insufficiently covered by formal arrangements”, directing both enterprise and work relationships.

In a research paper for the EGDI-WIDER Conference in Helsinki in 2004 on the formal and informal economy, professor Martha Alter Chen presents some statistics on the role of the informal economy in different regions. Informal employment comprises one-half to three-quarters of non-agricultural employment in developing countries: 48 per cent in North Africa, 51 per cent in Latin America, 65 per cent in Asia and 72 per cent in sub-Saharan Africa. Despite early predictions of its eventual demise, the informal economy has not only grown worldwide but also emerged in new guises and in unexpected places (Martha Alter Chen. Harvard University. "WIEGO: Rethinking the Informal Economy").

Informal employment is generally a larger source of employment for women than for men in the developing world. Other than in North Africa, where 43 per cent of women workers have informal employment, 60 per cent or more of women workers in the developing world have informal employment, outside agriculture (Martha Alter Chen. "Rethinking the Informal Economy").

4. WHAT IS THE ROLE OF INSTITUTIONS IN THE FORMAL AND INFORMAL ECONOMY?

Modern economic theory stresses the importance of institutions for the performance of our economies. The key to the high income societies of the Western world is still the development of institutional structures that permit individuals to take actions involving complex relationships with other individuals far removed from any personal knowledge and extending over long periods of time. This is only possible with a third party of exchange: government, which specifies property rights and enforces contracts (Douglass C. North. "Institutions and Economic Growth: A Historical Introduction"). North emphasises that institutions affect the performance of the economy by their effect on the cost of exchange and production.

5. WHY IS THE INFORMAL ECONOMY IMPORTANT?

Effect of informality on income distribution

According to the International Labour Organization (ILO), currently, half the world's workers still do not earn enough to lift themselves and their families above the US \$2 a day poverty line. A report to the International Labour Conference 2003, "Working out of Poverty", noted the frequent overlap of informality and poverty. This issue was further discussed in an ILO report in 2004, "Economic security for a Better World". It sums up the situation in the following way: "The reality is that workers all over the world face degrees of informality, the most formal of which have multiple forms of protection, the least formal none at all" (ILO 2004b: 4). However, "it is too simplistic to equate informality with poverty, even though more of the relatively informal have low incomes. Informality does not map neatly onto income. What seems to be the case is that formality gives greater protection for men than for women... What is key to an understanding of the linkages is that being in an informal labour status means a greater likelihood of income variability and decline... [T]hose in informality worry more than others about what will happen in their old age when they are unable to work..." (ILO 2004b: 4, 60).

Effect of informality on productivity and economic growth

The effect of the informal economy on productivity and economic growth is discussed in a recent McKinsey study. Companies around the world underreport employment, avoid certain taxes, ignore product quality and worker safety regulations, violate copyright and intellectual-property laws, or even fail to register as legal entities. The problem is particularly acute in developing countries, where companies that operate informally produce as much as 80 percent of the output in some industries. Few policy makers are concerned, but they should be. By avoiding taxes and regulatory obligations, informal companies gain a substantial cost advantage that allows them to stay in business despite their small scale and low productivity. This prevents more productive, formal companies from gaining market share. The result is slower economic growth and job creation. (McKinsey Quarterly: The hidden dangers of the informal economy).

Opportunities and risks of workers in informal economy

Protective security, which is common to workers in the formal sector, is often not available or accessible to workers in the informal economy, which exposes them to greater risks. Besides that, workers in the informal economy enjoy fewer opportunities. Examples of these are: health hazards, damage to working capital, no protection of property rights, no minimum wages, less secure contracts, fewer benefits, poorer working conditions, underutilization of capital, lack of old age security, less access to information, less bargaining power, less access to capital and fewer career and market opportunities.

6. A NEW DEPARTURE: CONSENSUS BETWEEN EMPLOYERS AND WORKERS

In 2002, the International Labour Conference (ILC) adopted a resolution on Decent Work and the Informal Economy, representing a new departure in addressing the topic. In a paper for the EGDI Helsinki Conference Anne Trebilcock, ILO, describes the fact that delegates coming to the topic from often different perspectives could agree on conclusions as “a landmark for moving forward” (Anne Trebilcock. “Decent Work and the Informal Economy”).

- For employers, the great entrepreneurial potential, creativity and work ethic of people in the informal economy was important. While concurring that governance was a key issue, they rejected an exclusively labour-rights based approach, and noted that while addressing needs of people in the informal economy is important, it is also important that entrepreneurs not be driven out of existence.
- Workers stressed the need for national, legal and institutional frameworks. They expressed the view that there were only two ways to address the informal economy: one being good law and its proper application and the other being self-organization and collective action. They traced the origin of decent work deficits to good governance deficits.

Both labour markets and product markets have become more complex and governments have been struggling to keep pace. Whether *de facto* or *de jure*, too many people remain without legal protection and recourse to rights that should empower them, according to Anne Trebilcock, who identifies the essential questions addressed by the ILC conclusions in the following way: How can people, whether their work is designated 'formal' or 'informal', be both empowered and protected? How can entrepreneurial innovation and creativity to create decent jobs be fostered?

7. A NEW DEPARTURE: CLOSE LINKAGES BETWEEN FORMAL AND INFORMAL ECONOMIES

In a review of the 2002 ILC conclusions, Lin Lim, ILO, has noted that the new conceptual framework depicts a continuum of production and employment relations. It does away with the idea that there are distinct formal and informal "sectors" without direct links and instead stresses that there are "linkages, grey areas and interdependencies between formal and informal activities".

The framework views formal and informal enterprises and workers as coexisting along a *continuum*, with decent work deficits most serious at the bottom, unprotected, unregulated, survivalist end, but also existing in some formal jobs as well, and with increasingly decent conditions moving up towards the formal protected end. By highlighting the dynamic linkages between formal and informal activities, the policy issue can be more realistically framed: the issue is not whether informal workers or informal units have direct ties with the informal economy—clearly they do—but whether those ties are benign, exploitative or mutually beneficial. The policy concern should be to enhance the positive linkages and to ensure that there is decent work along the continuum (ILO 2002b: 38).

8. A NEW DEPARTURE: AN APPROACH BASED ON DECENT WORK DEFICIT

Perhaps the most significant and far-reaching aspect of the Conclusions is the endorsement of an approach based on decent work deficits, according to Lin Lim. The Conclusions noted that "it is necessary to eliminate the negative aspects of informality while at the same time ensuring that opportunities for livelihood and entrepreneurship are not destroyed, and promoting the protection and incorporation of workers and economic units in the informal economy into the mainstream economy". They also state that "especially in countries struggling with abject poverty and with a large and rapidly growing labour force, measures should not restrict opportunities for those who have no other means of livelihood. However, it should not be a job at any price or under any circumstances". A clear challenge for follow-up is to demonstrate how job quantity and quality can go together and how respect for basic labour rights would promote productivity growth. A related challenge is to ensure that activities targeting the informal economy do

not lead to the growth of poor quality jobs but instead to the upgrading of jobs. The Conclusions call for an upward transition and not a downward pull along the continuum of decent work.

9. ALTERNATIVE POLICY RESPONSES

This section contains a brief summary of seven contributions to the further development of policy responses:

9.1 World Commission on the Social Dimension of Globalization: Expansion both of property rights and of core labour rights

The WCSDG report, “A Fair Globalisation—Opportunities for All”, published in 2004, highlighted the fact that most workers and economic units in the informal economy have difficulty accessing the legal and judicial system to enforce contracts, and that their access to public infrastructure and benefits is limited. A variety of bureaucratic and other restrictions create barriers and difficulties which hinder formalization, growth and sustainability.

The Commission argued that informal activities have to become part of a growing formal sector that provides decent jobs, incomes and protection, and that such a transformation has to be an essential part of a national strategy to reduce poverty. A balanced approach to upgrading the informal economy would require the systematic extension of property rights to be accompanied by similar action on core labour rights for all persons engaged in informal activities. There is a particular need to ensure that workers and employers in the informal economy have the right to freedom of association and collective bargaining. Women and youth, who make up the bulk of the informal economy, especially lack representation and voice. There is likewise a need to build adequate social protection systems.

There is also a need to reverse the trend towards the erosion of collective organizations of both workers and employers, and of collective bargaining. Such reform must emphasize dialogue and greater efforts by the organizations concerned to adequately reflect the concerns of all sections of the society. Stronger social dialogue is an essential means for building a common perspective among different interests within countries on how to achieve both social and economic goals (World Commission on the Social Dimension of Globalization. “A Fair Globalization—Creating Opportunities for All”. 2004).

9.2 Professor Martha Alter Chen: A broad reform agenda, negotiated solutions

In her research paper for the EGDl-WIDER Conference in Helsinki in 2004, professor Martha Alter Chen discusses an appropriate policy response, which promotes more equitable linkages between the informal and formal economies, a policy response that balances the costs and benefits of working formally and informally.

She recommends turning the whole formalization debate on its head by recognizing (a) that it is unlikely that most informal producers and workers will be formalized, although efforts should be made to do so; and (b) that there are costs of working informally which

need to be addressed. The policy challenge then is to decrease the costs of working informally: or to reduce the 'decent work deficits' of working informally.

Reflecting the Decent Work agenda of the ILO, the *overarching* policy goals of an informed and comprehensive policy approach toward the informal economy should be to: promote opportunities, secure rights, protect informal workers, build and recognize the 'voice' of informal workers. Special efforts should be made to promote the opportunities, rights, protection and voice of women in the informal economy, who are often among the most disadvantaged.

Virtually all policies affect at least one segment of the informal economy. However, four areas of policy have a particularly significant impact on the informal economy: macroeconomic policies, labour policies, urban regulations and social protection measures. Other functional areas of policies that have particular relevance for informal enterprises and the informal workforce include microfinance and enterprise development, infrastructure and services, social policies, property rights, intellectual property rights. Most sector-specific policies also have effects on the informal economy.

Clearly, there is no universal policy prescription for the informal economy. However, the following guiding principles should be seen as essential aspects of a positive policy process: It should be participatory and inclusive, context-specific, gender sensitive, and it should be based on an informed understanding of the economic contribution of informal workers. It should also serve to mainstream the concerns of the informal workforce in those institutions that deal with economic planning and development.

9.3 Professor Rehman Sobhan: Address the structural injustices

In another contribution to the EGDI conference professor, Rehman Sobhan, chairman of the Centre for Policy Development in Dhaka, argued that any credible agenda which seeks to end poverty must address the structural injustices which perpetuate poverty. Such a strategy must aim to enhance the capacities of the poor to participate in the process of growth by empowering them to participate, on more equitable terms, in the dynamics of the market economy. To enhance the capacity of 40–50 per cent of the population to participate in a market economy is likely to be the most effective policy instrument to sustain economic growth as well as to eradicate poverty. Such an approach towards policy design suggests that the eradication of poverty should remain central to the design of macro policy reform rather than its by-product. Policy interventions, to redesign the structural sources of poverty, bring into consideration issues of social, political as well as economic reform. (Rehman Sobhan. "A Macro Policy for Poverty Eradication through Structural Change". Centre for Policy Dialogue, Dhaka. EGDI-UNU-WIDER Conference, September 2004).

9.4 World Bank economists: Reform labour regulation, improve social protection

The role of trade unions and worker protection for economic development has been subject to research for a long time (see, for example: Göte Hansson. *Social Clauses and International Trade*. St. Martin's Press). This subject is the central theme of a background paper for the World Development Report 2005. Gaëlle Pierre and Stefano Scarpetta have made an analysis of "how labour market policies can combine workers' protection with job creation". Without being an official World Bank publication, it reflects the thinking and policy recommendations of the World Bank. When summarizing the study, the authors note that the labour markets of most emerging economies during the last decades have been exposed to growing pressures to modernize and increase their adaptability, resulting in a significant degree of flexibility in most labour markets. Thus, large numbers of jobs are created and destroyed every year and there is large real wage flexibility. But this flexibility cannot be fully associated with effective reallocation of labour nor to a proper reward mechanism for workers.

While many low and middle income countries have made significant progress in setting rules governing working conditions and the employer-worker relationships, the level of protection prescribed by law in many of these countries are often similar—and in some instances even higher—than the protection mandated in industrial countries. Overly ambitious labour regulations contribute to reduce the reallocation of labour towards productive jobs in the formal sector as they raise labour costs and curb incentives for firms to expand and hire more workers or to adopt new technologies. Other firms opt out and remain uncovered to maintain profitability, facing great uncertainty in their labour relations and constraints in their growth and job creation potentials. Improving the institutional fit of labour regulations with the economic reality of the different countries is one of the main challenges of labour reforms in developing and transition countries.

While greater resources and better targeting of social protection interventions towards the neediest people are warranted to promote labour market adaptability, a better prospect for the poor requires a comprehensive intervention in the investment climate that promotes growth and job creation (Gaëlle Pierre and Stefano Scarpetta. "How Labour Market Policies can Combine Workers' Protection with Job Creation", Background paper for WDR, World Bank. 2005).

9.5 World Development report 2006: Invest in People

The World Development Report 2006, published in September 2005, analyzes the relationship between equity and development and argues that the inequality of opportunity that arises is wasteful and inimical to sustainable development and poverty reduction. It also results in policy implications that centre on the broad concept of leveling the playing field—both politically and economically and in the domestic and the global arenas. The report recognizes the intrinsic value of equity and makes the case for investing in people, expanding access to justice, land, and infrastructure, and promoting fairness in markets.

The report raises the question of whether or not labour market institutions can be designed to be pro-growth and pro-equity. The key to success is to find a balance

between protection and flexibility. The recommendations can be summarized in the following points:

- Reforms need to be coordinated across a variety of labour market institutions, and often also with reforms outside the labour market; one of the strongest lessons from country experience is that piecemeal reform does not work; reforms need to cover a range of labour market policies and to be linked with reforms in social protection systems.
- Building broad societal consensus for reform is often the only way to tackle vested interests, which may require specific measures to empower groups of so-called outsiders who bear the costs of non-reform.
- The short-term costs of reform can be high for certain groups of workers and it may be necessary to compensate these workers; it is best to do this in ways that address the obstacles that losers face in re-entering the labour market (education and training, incentives to mobility, etc.)

9.6 The International Institute for Labor Studies (ILLS): Further Studies

The International Institute for Labour Studies (ILLS) will focus its research programme for 2006-2007 on the causal relationships between selected labour standards and economic development. This work will critically assess competing hypotheses as to whether labour standards are a source or consequence of economic development, or both, and how this relationship is influenced by a wider set of labour institutions, including the type of legal system, institutions for representation and social dialogue and the effectiveness of labour inspection. A related project will examine the role of labour law in development, with particular reference to the informal economy.

9.7 The Government of India: Ready to take action

The Government of India has set up the National Commission on Enterprises in the Unorganized/Informal Sector, chaired by Dr. Arjun Sengupta, as an advisory body and a watchdog for the informal sector. The Commission will recommend necessary measures for bringing about improvement in the productivity of these enterprises. These measures include the generation of large-scale employment opportunities on a sustainable basis, particularly in the rural areas; enhancing the competitiveness of the sector in the emerging global environment; linkage of the sector with institutional framework in areas such as credit, raw material, infrastructure, technology upgrades, marketing and formulation of suitable arrangements for skill development.

10. ISSUES FOR THE COMMISSION'S AGENDA

This brief overview of research and debate on empowerment of the poor in informal employment leads to some questions, which the Commission on Legal Empowerment of the Poor might wish to discuss:

1. What are the relations between the legal recognition of property rights and the recognition of workers' rights in striving for empowerment of the poor?
2. What different policies are needed for empowerment of wage workers and empowerment of the self employed?
3. How should a formalisation of working conditions be designed to function as a driving force for improved productivity and decent work?
4. How can a balance be struck between labour market policies and social protection systems in order to facilitate both protection and flexibility?
5. How can work done by the World Bank, the ILO/IILS, the Government of India and other authorities and organisations on the informal economy be included and further developed by the Commission?

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