



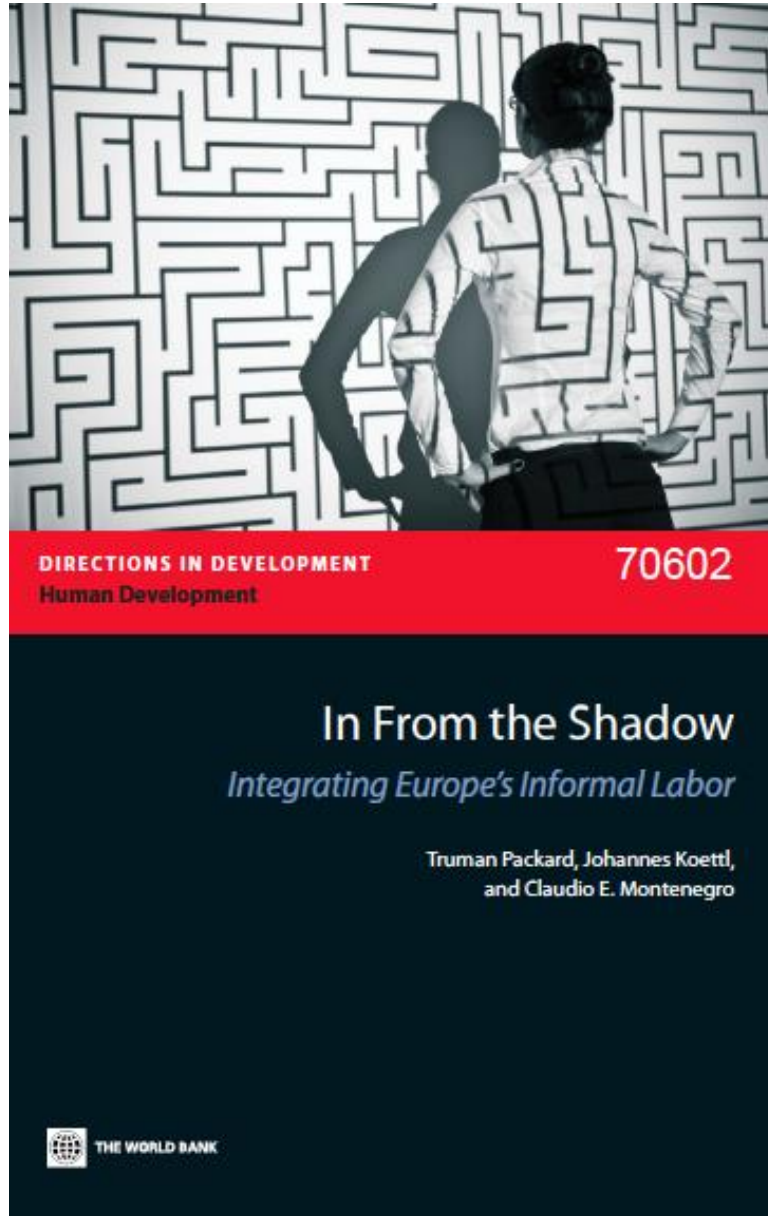
**WORLD BANK GROUP**  
Social Protection & Labor

# The Policy Challenges of Informal Employment in Transition Countries

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# In From The Shadow

Integrating Europe's Informal Labor

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Washington, DC: World Bank

<https://openknowledge.worldbank.org/handle/10986/9377>

# Overview

## Patterns of informal employment

- Definitions, extent and characteristics of informality

## Structural drivers of informal employment

- Labor regulations, labor institutions, labor taxation, and social benefits

## The role of tax morale

- Governance, accountability, and voice

## Conclusions

- Key messages





# Patterns of informal employment



# Definition: three components of informal employment

## Informal wage employment

- No written labor contract
- No social security contribution
- (firm size)
- (underreported wages)

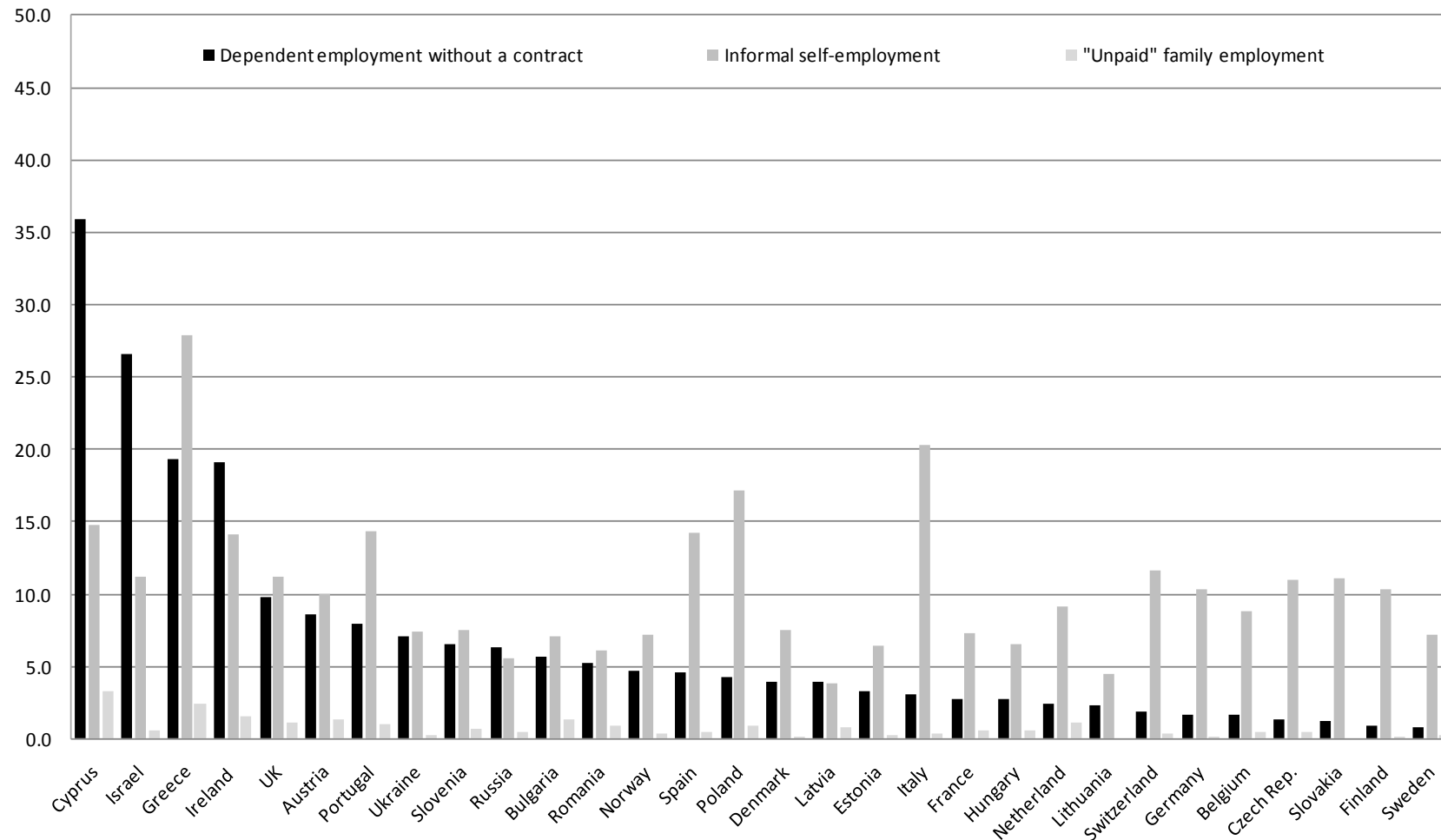
## Informal self-employed and employers

- Owners of unregistered businesses
- (profession)
- (number of employees)

## Unpaid family workers

# Informal wage employment by written labor contract criterion....

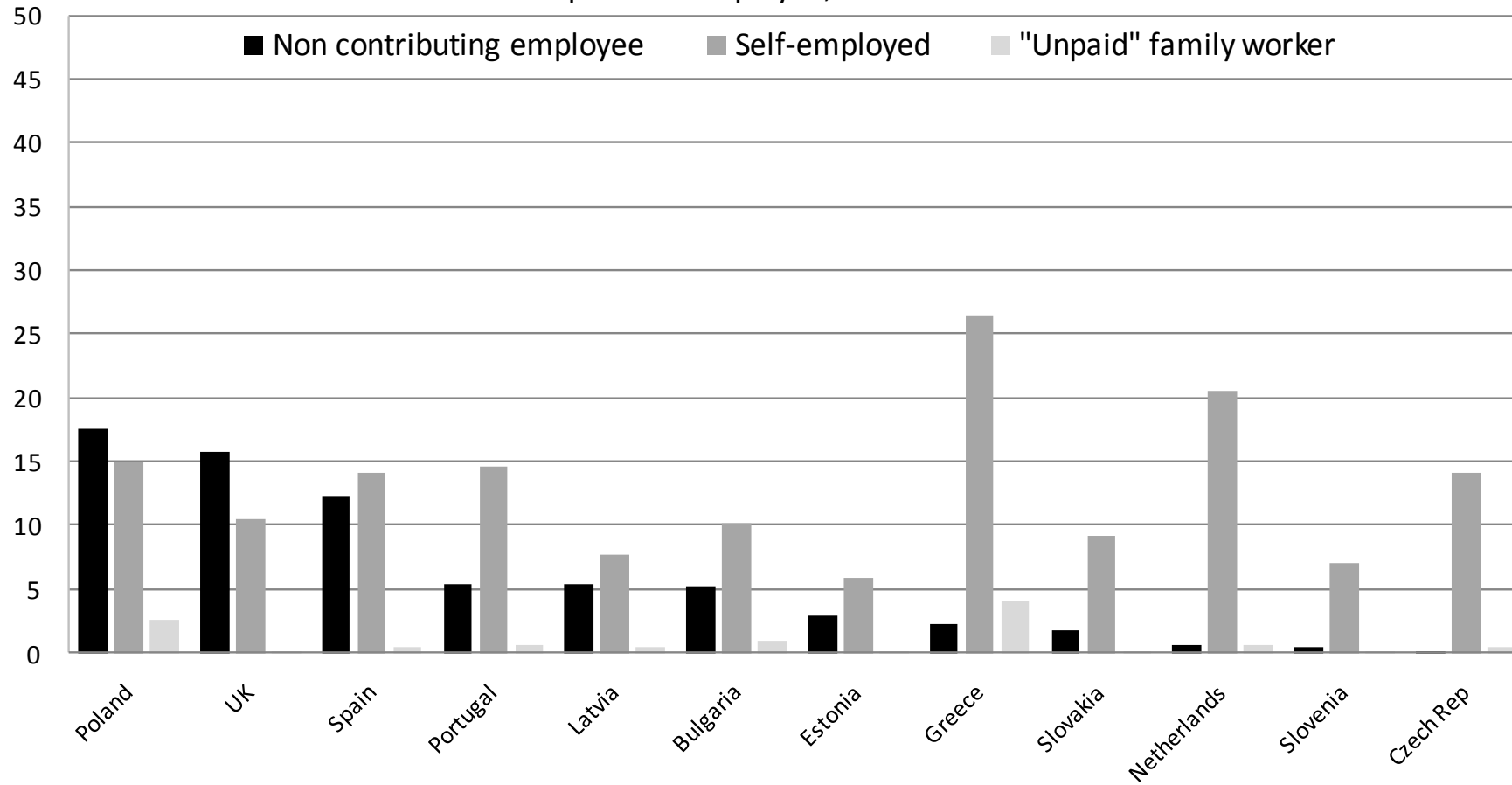
Percentage of the labor force in shadow employment: Labor contract criterion for dependent employed, ESS 2008/09



Source: Hazans 2011 based on ESS (2008/09), for this report

# ...and social security criterion

Percentage of the labor labor force in informal employment: Social insurance criterion for dependent employed, EU SILC 2008



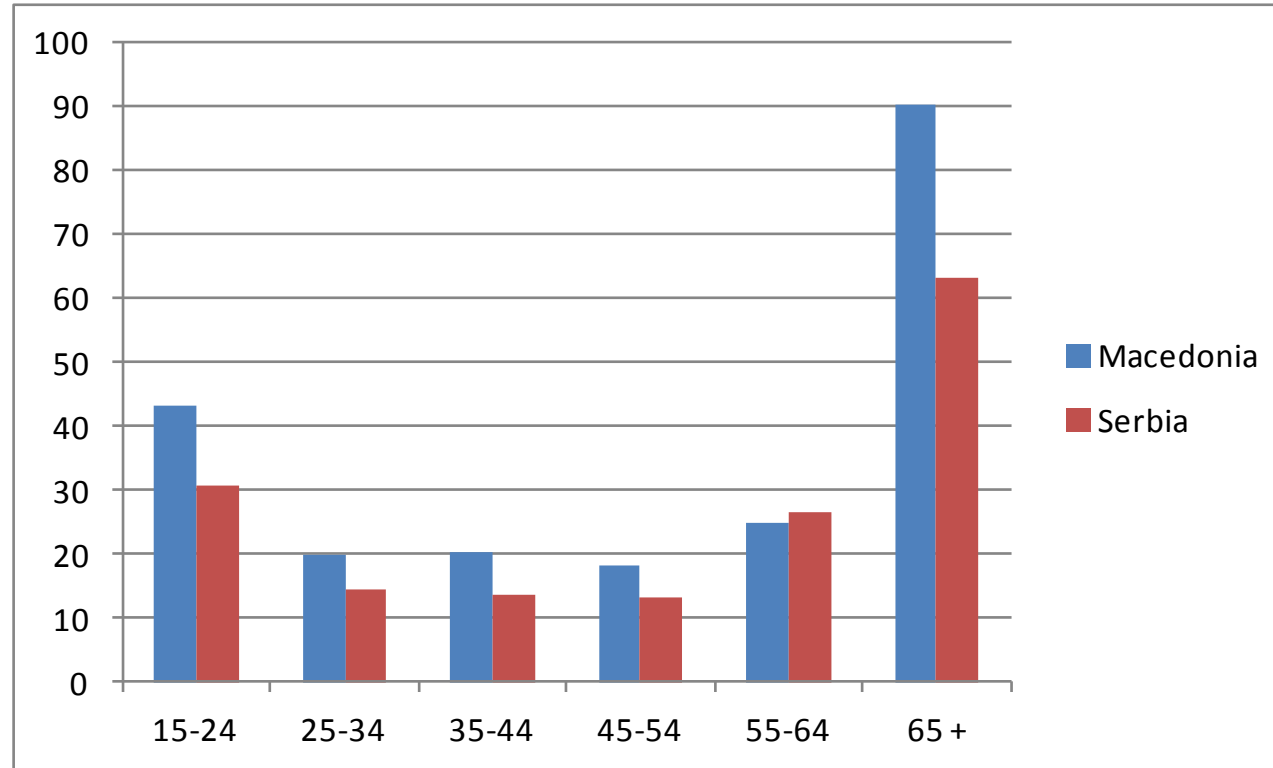
# Informality rates higher for men and low-wage earners

	Bulgaria	Czech Republic	Estonia	Latvia	Poland	Slovakia	Total
<b>Male</b>	19.5%	17.1%	10.8%	15.9%	42.6%	14.2%	<b>31.5%</b>
<b>Female</b>	12.9%	8.9%	4.6%	8.6%	35.5%	6.0%	<b>23.7%</b>
<b>By income</b>							
0 % of AW or less	79.8%	100.0%	67.8%	82.8%	92.7%	80.5%	<b>91.7%</b>
1 to 24 % of AW	37.6%	23.3%	29.1%	29.0%	66.6%	18.5%	<b>55.4%</b>
25 to 49 % of AW	17.1%	14.9%	5.9%	15.2%	40.4%	11.8%	<b>30.0%</b>
50 to 99 % of AW	11.8%	10.3%	3.0%	9.7%	29.2%	8.0%	<b>19.5%</b>
100 to 200 % of AW	11.2%	13.7%	6.9%	7.1%	29.3%	10.9%	<b>20.9%</b>
200 % of AW or more	29.8%	27.1%	24.2%	9.8%	25.7%	21.6%	<b>25.4%</b>
<b>Overall</b>	<b>16.5%</b>	<b>13.6%</b>	<b>7.7%</b>	<b>12.3%</b>	<b>39.5%</b>	<b>10.4%</b>	<b>28.0%</b>

Source: Authors' calculations based on EU-SILC and OECD

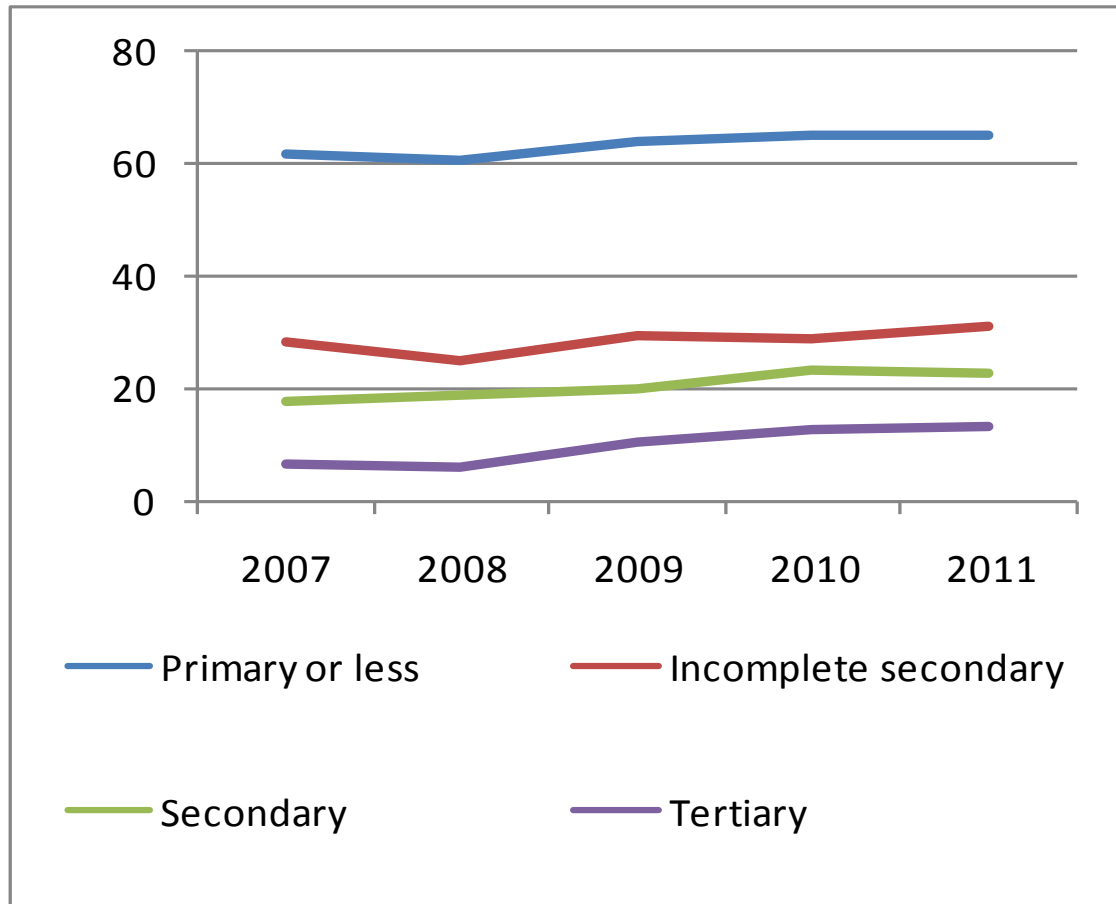


# Those with less attachment to the labor market (young and old) have higher informality rates

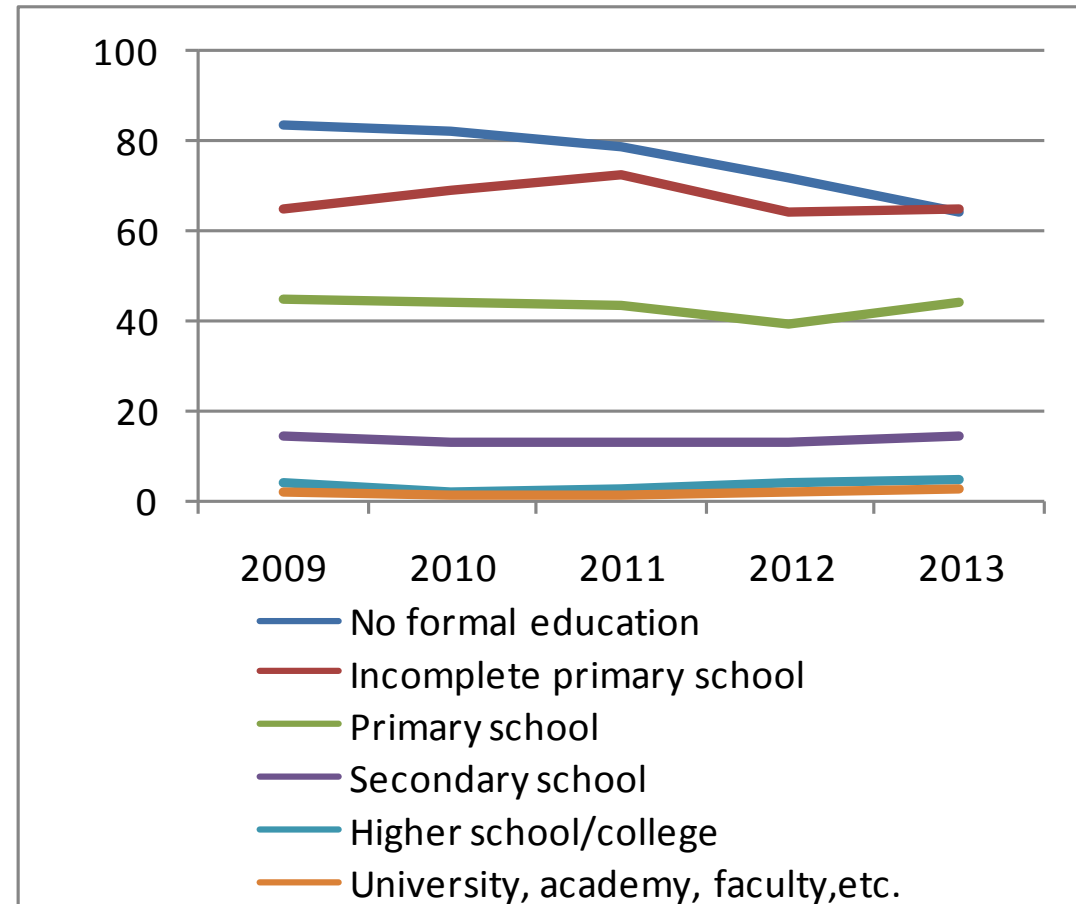


# The more education, the lower informality

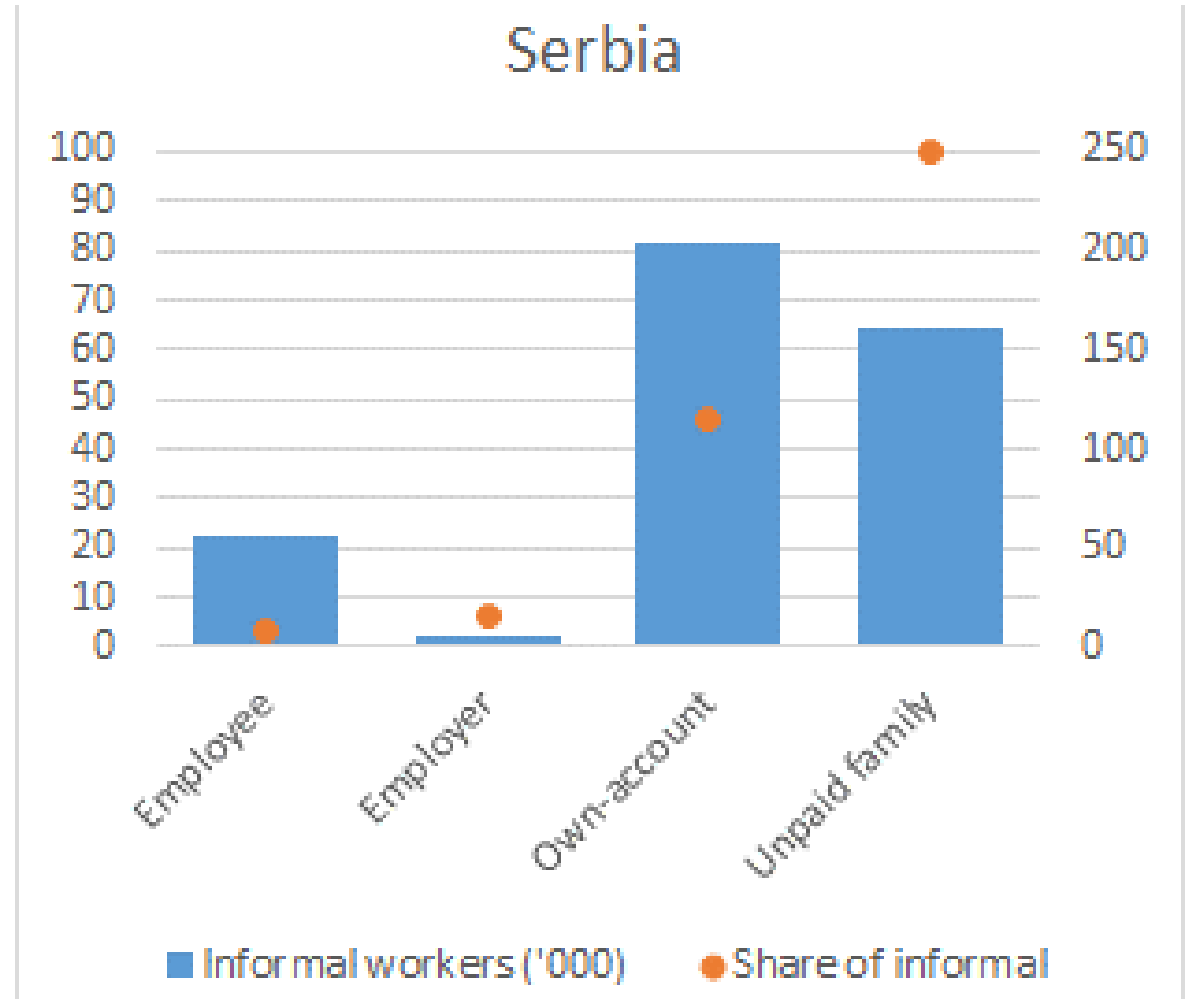
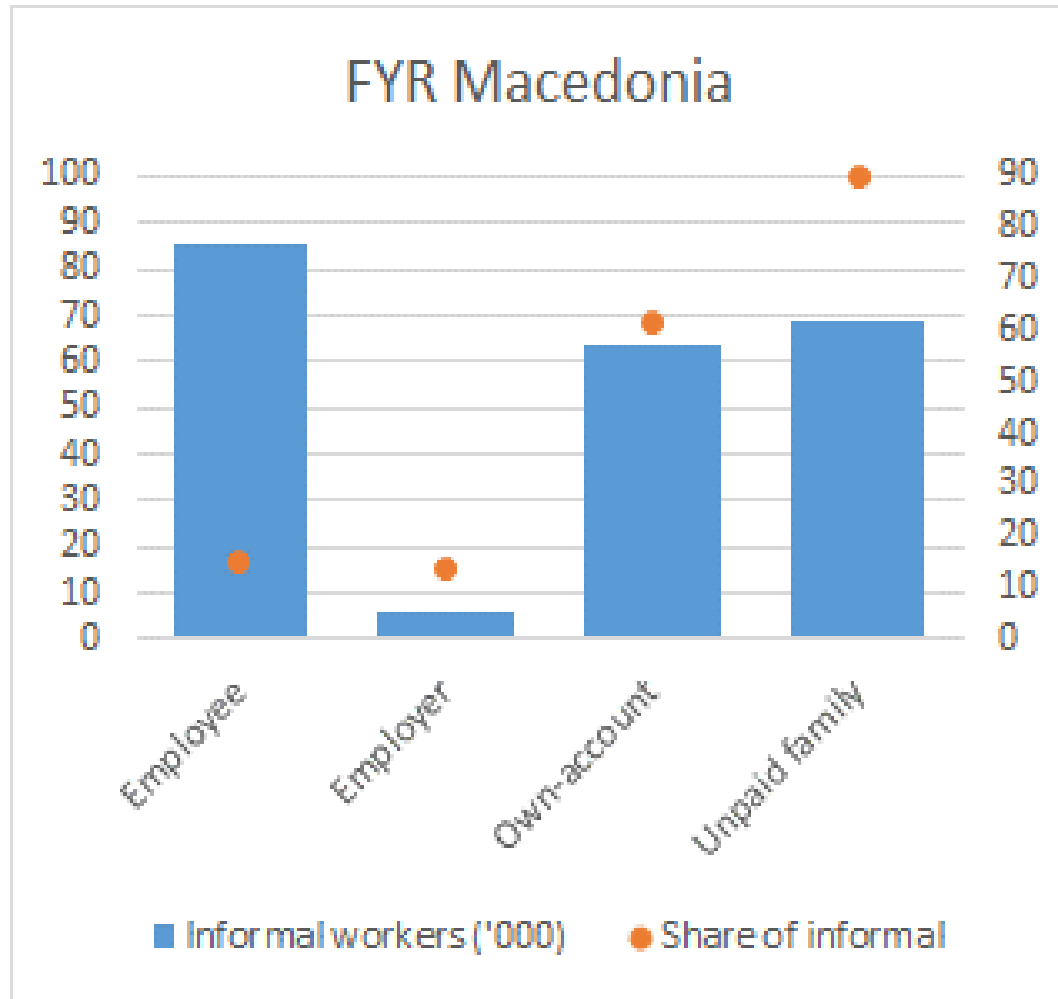
Macedonia: Informality rate by education



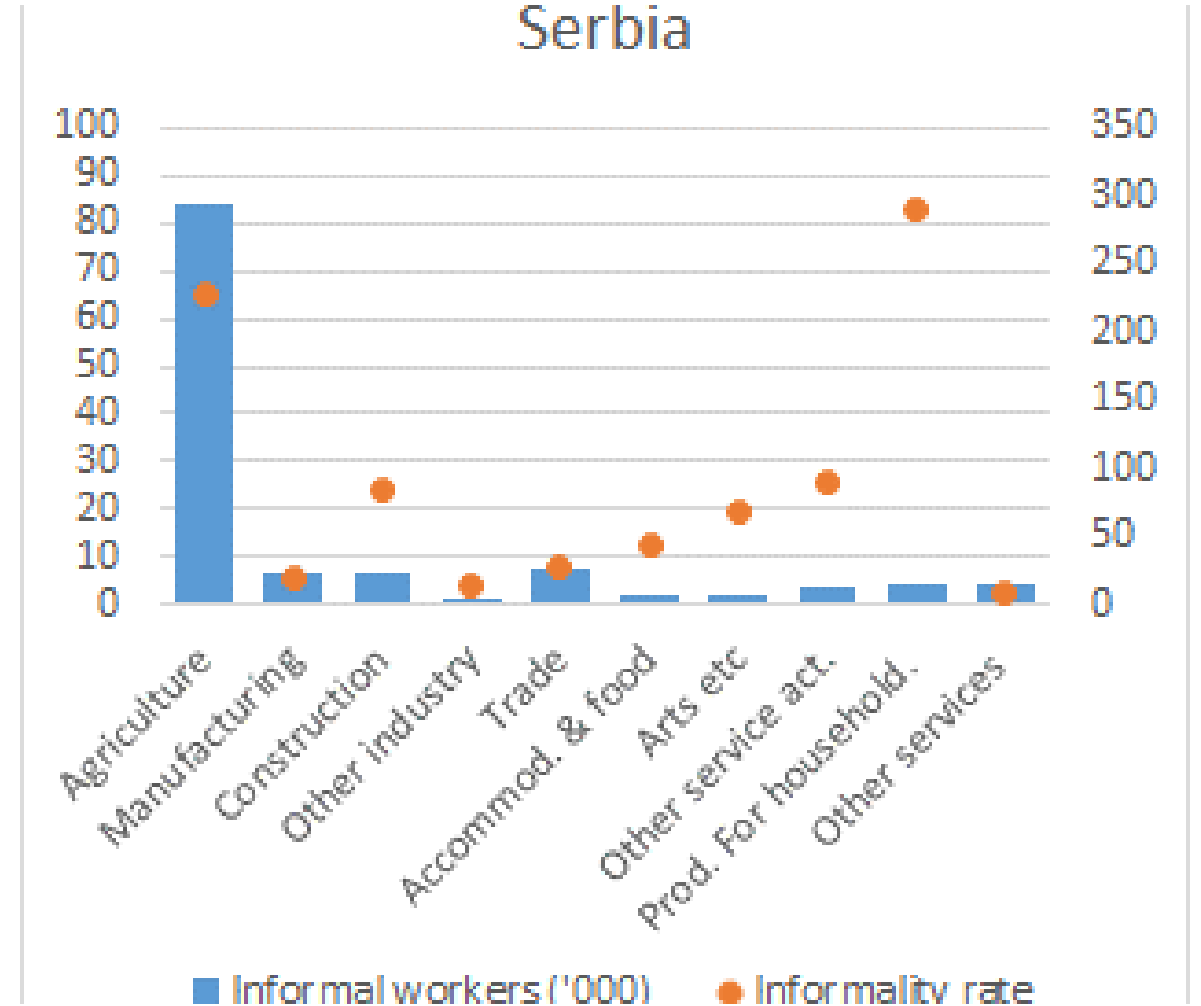
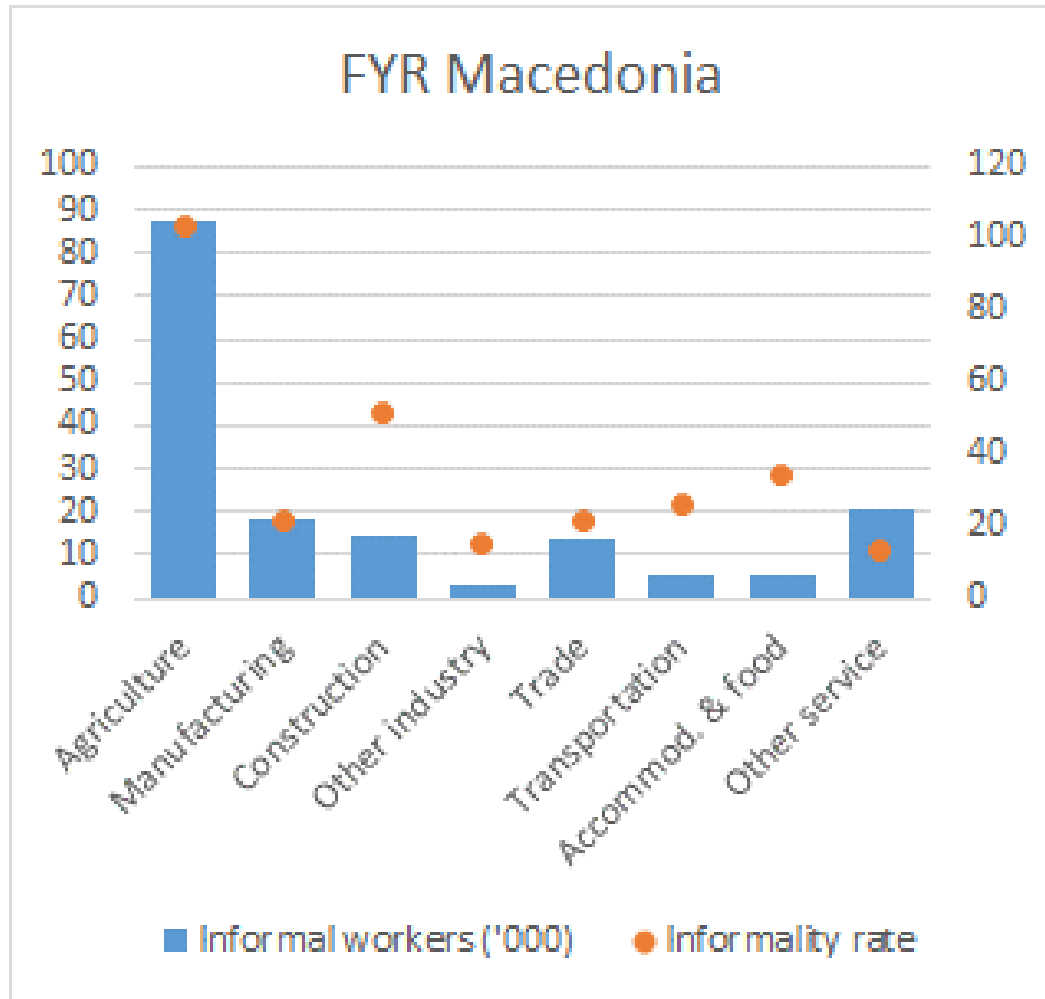
Serbia: Informality rate by education



# Informal employment is mostly non-wage work....

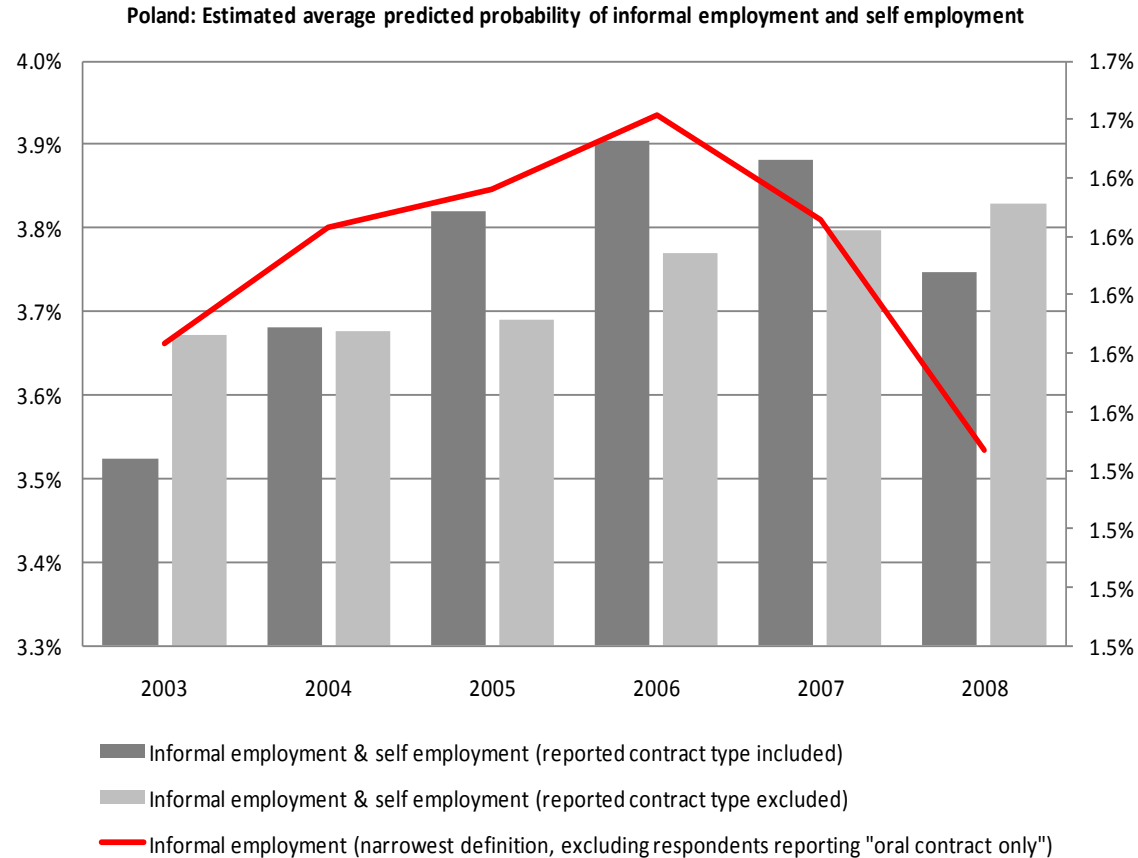


# ...in the agricultural sector

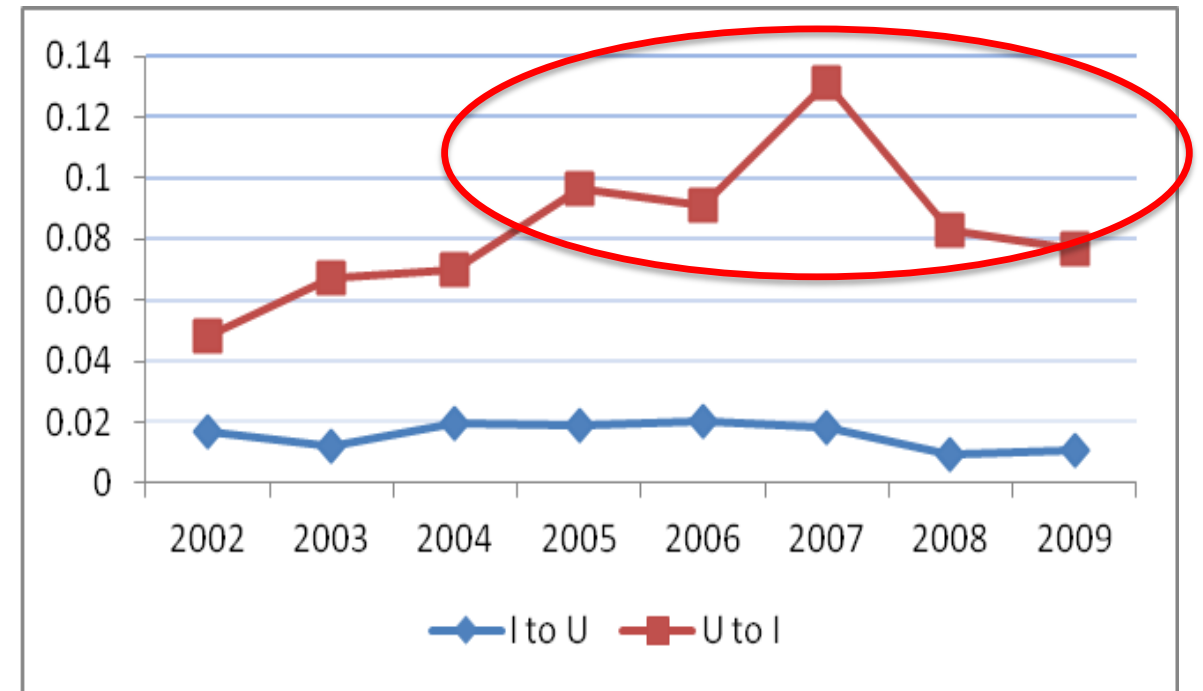


# Pro-cyclical nature of informality in Europe

## Poland informality rates



## Romania transition rates



Note: instantaneous transition rates - intensity matrices for each two consecutive years

# Patterns of informality

- Predominantly male, especially among informal self-employed
- Less attached to the labor market: young (15 to 24) or older (55+)
- Less educated
- Doing manual, low-skilled work
- Non-wage work, in the **agricultural** sector, but also working in construction, hospitality, personal services sectors
- Members of a marginalized group
- Pro-cyclical



## Structural drivers of informal employment



# Structural drivers of informal employment: country context matters!

## In Northern and Western European countries:

- Higher minimum wage associated with **lower** informality
- UI spending: higher informality
- Benefit generosity: **lower** informality
- Tax wedge: lower informality
- Union density: **higher** informality

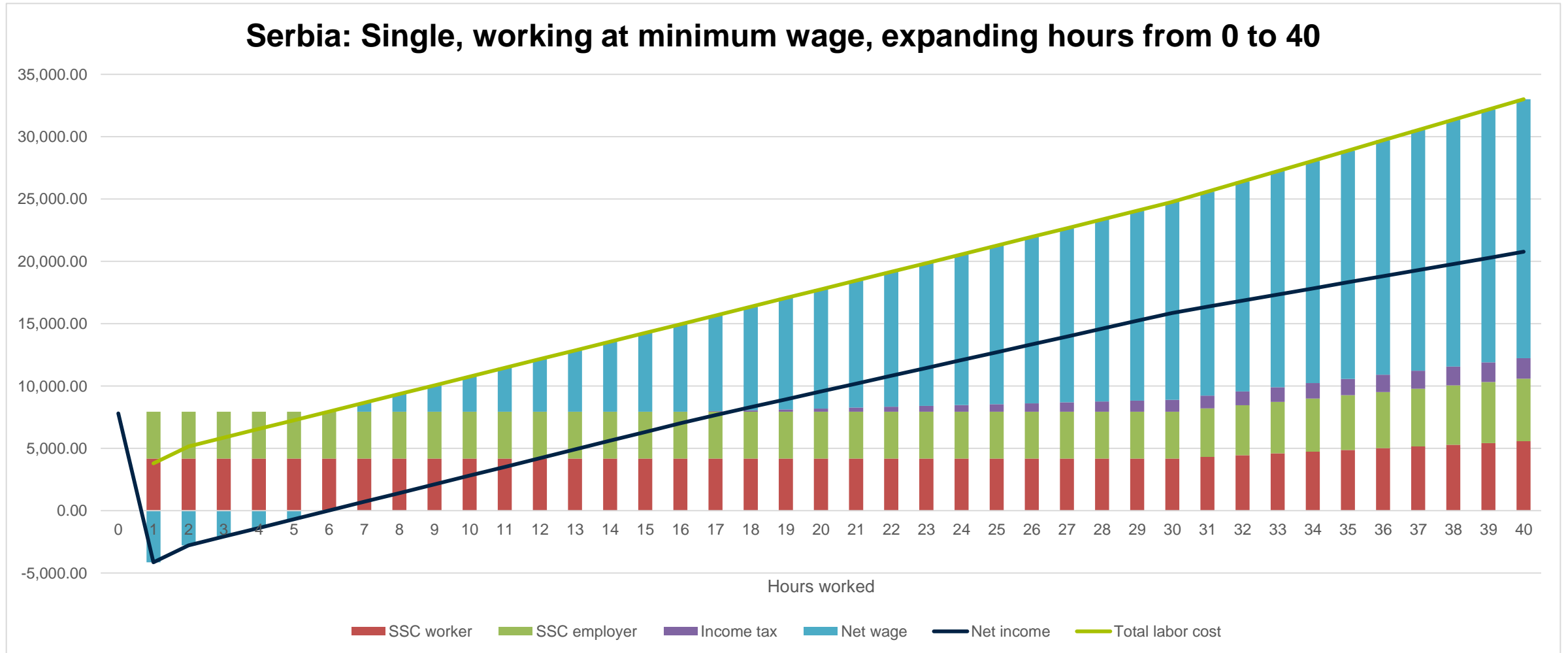
## In Southern and Eastern European countries:

- Higher minimum wage associated with **higher** informality
- UI spending: **lower** informality
- Benefit generosity: no association
- Tax wedge: lower informality
- Union density: **lower** informality

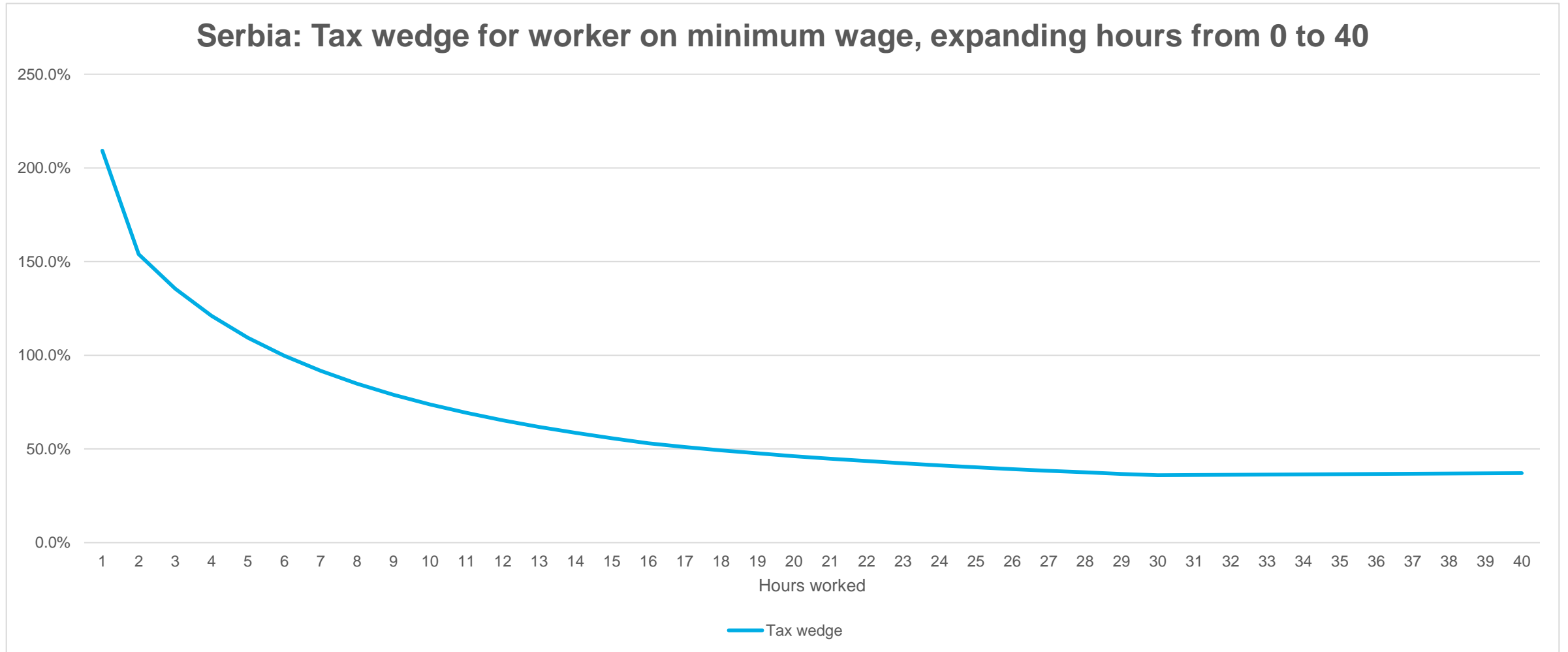
More stringent EPL consistently associated with higher informality



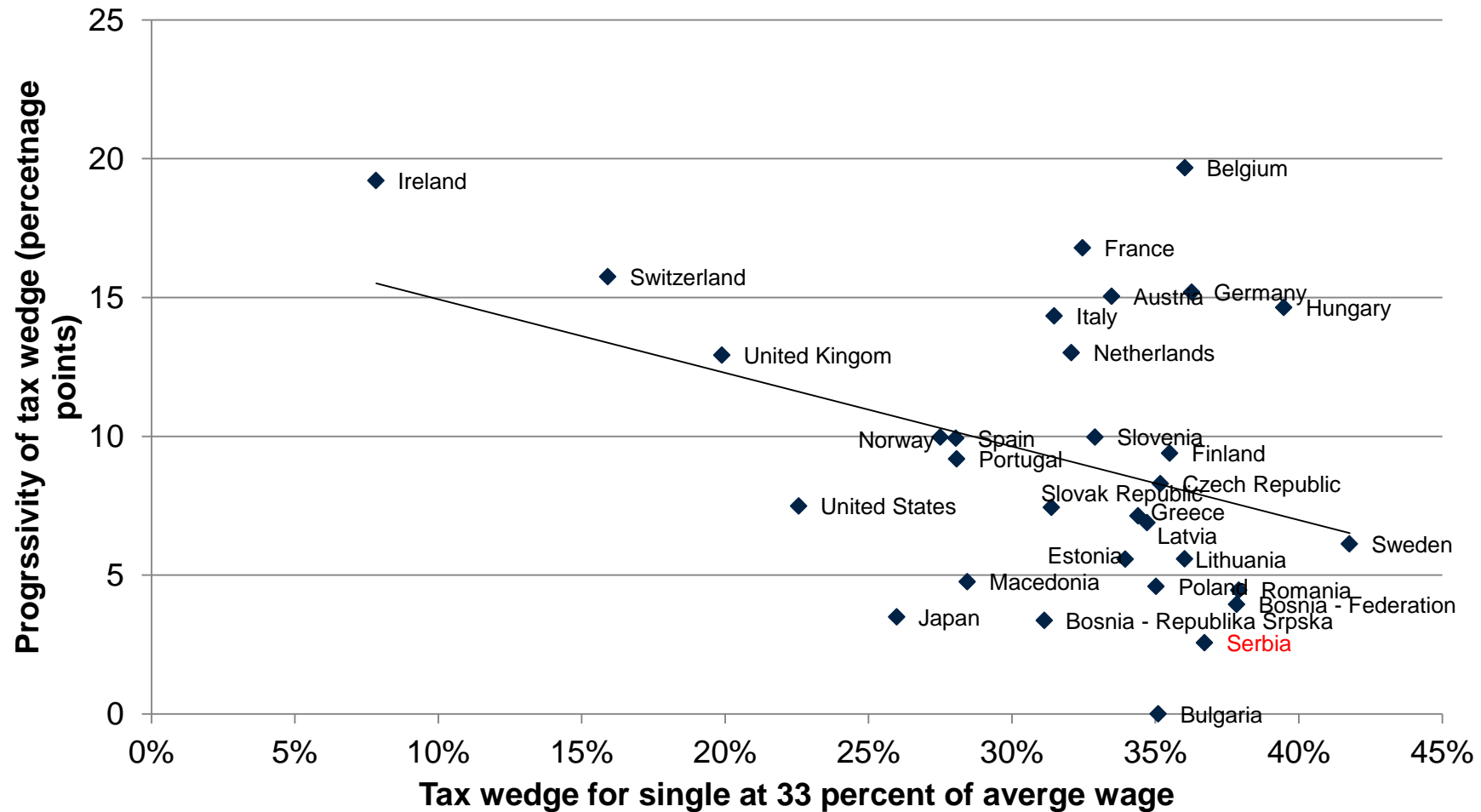
# Labor taxation: unviable tax burden on low-wage (part-time) workers



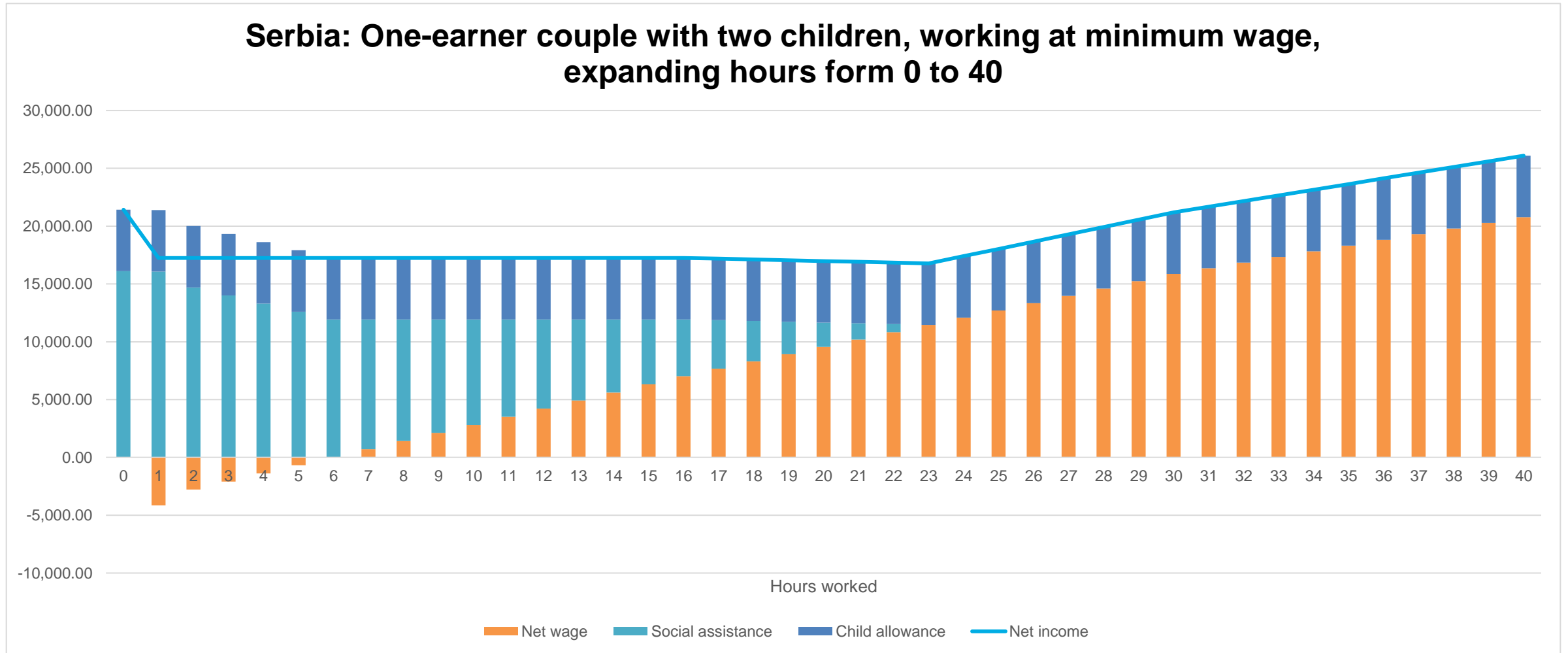
# Unviable tax burden on part-time workers



# Labor taxation is high for **low-wage earners** and not very progressive

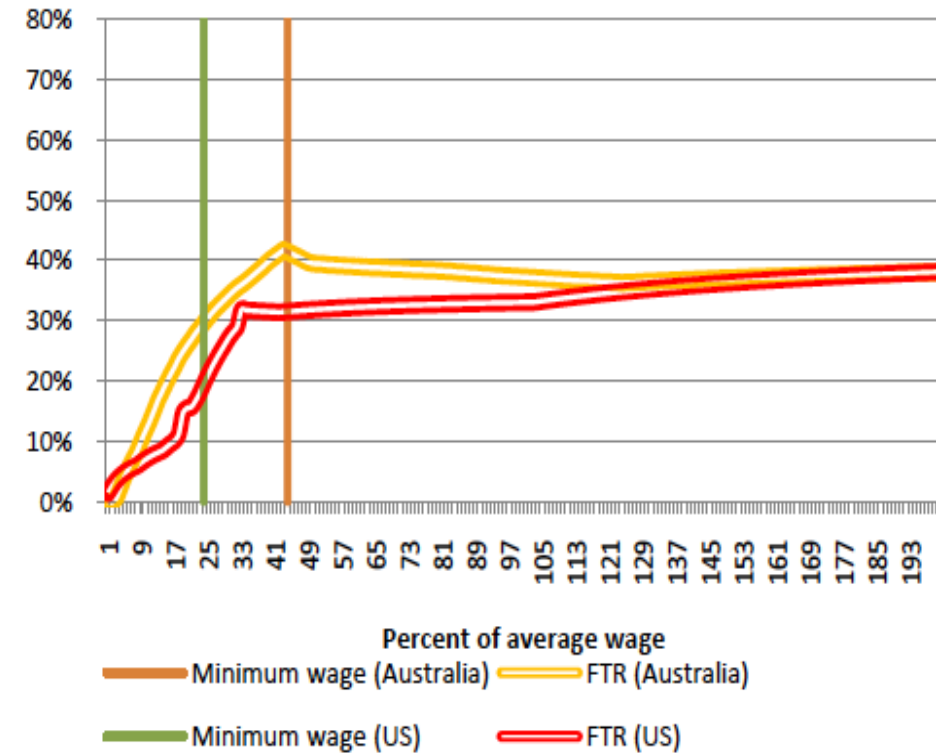
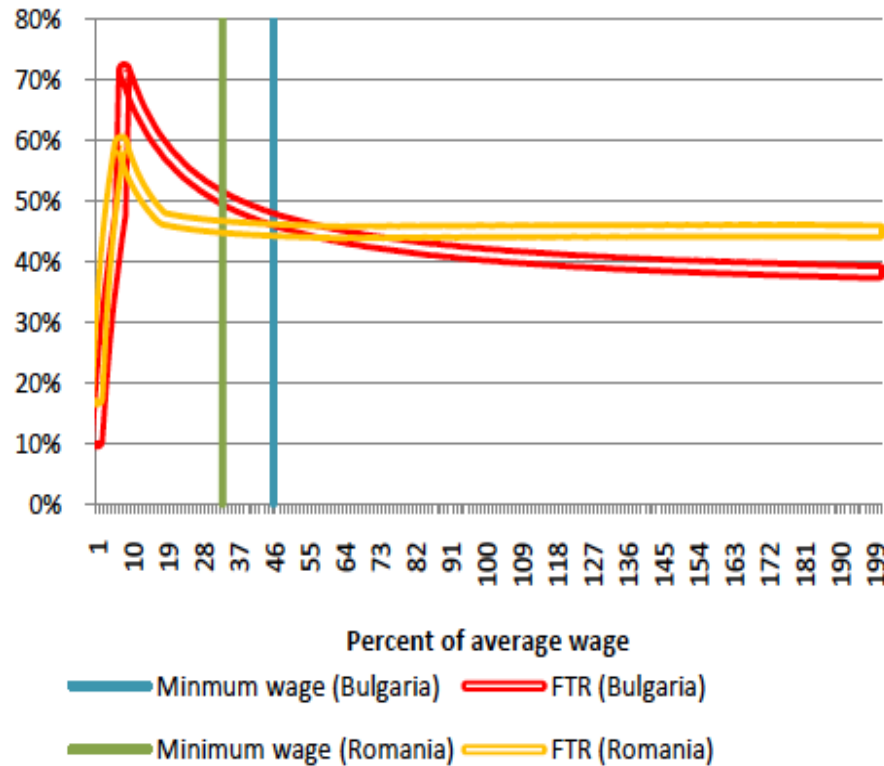


# Social benefits: formal work can DECREASE net income because of withdrawal of social assistance



# Opportunity costs of formal work in transition countries is considerably higher for low-wage earners

Formalization tax rate (FTR) for single with no children across income levels  
Bulgaria, Romania, Australia, and the United States (2008)



# Structural drivers of informal employment

The impact of labor market regulations and institutions depend on country context

- The role of minimum wage and unemployment insurance can differ markedly
- EPL acts as a driver for informal employment everywhere

Disincentives for formal work from tax and benefits are pronounced in Eastern European countries

- Relatively flat labor taxation implies high tax burden on low-wage earners
- Social benefit systems do not encourage accepting low-paying formal jobs

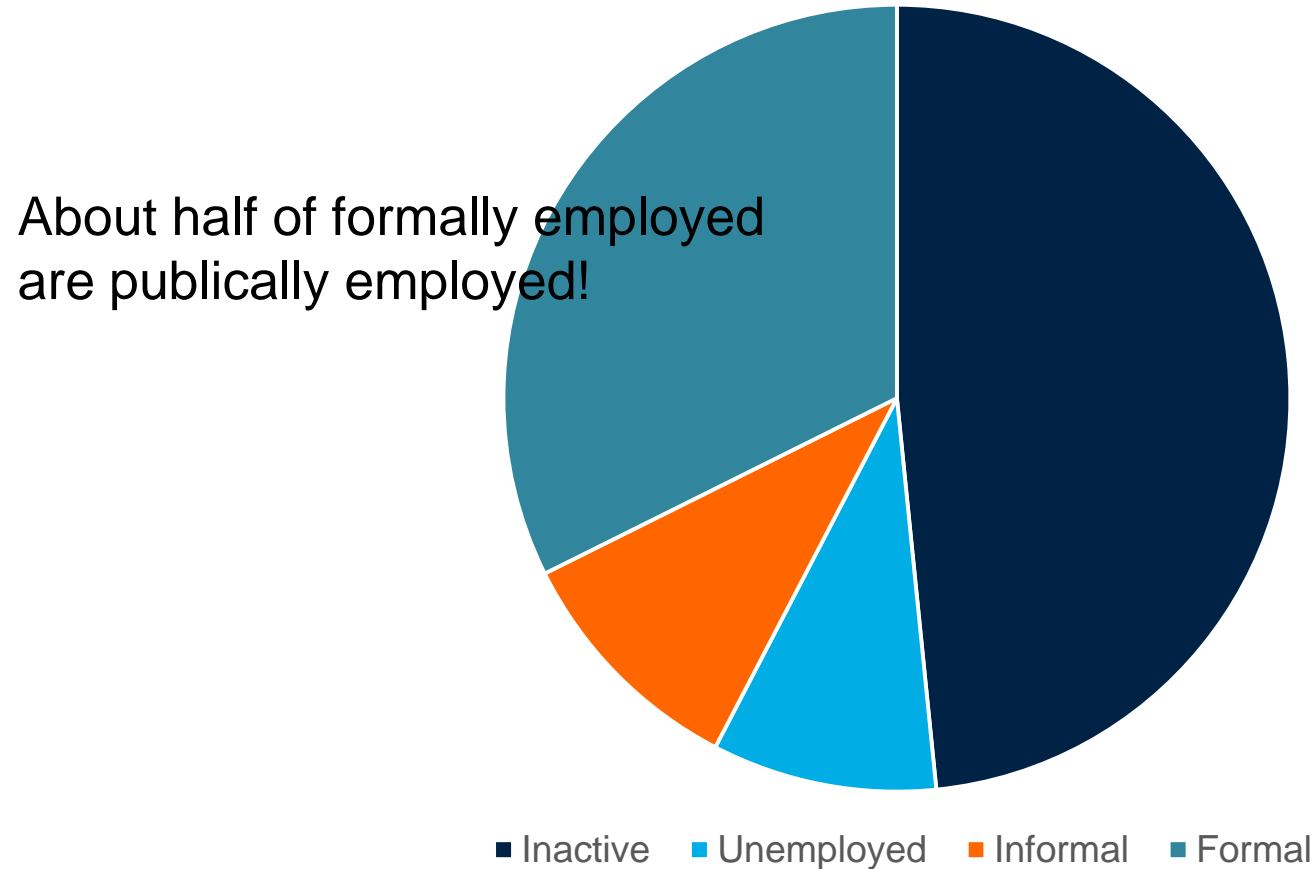


## The role of tax morale



# Informal employment combined with inactivity, unemployment and public employment: who many people contribute to the state?

Serbia adult population (15+) by labor status





# Tax compliance

Traditional cost-benefit approach—based on Becker's (1968) crime and punishment model—inadequate to examine tax compliance

Expand by introducing aspects of behaviour and motivation

⇒ The real puzzle of tax compliance behaviour is why people pay taxes, not why they evade them

Number of empirical studies show a simple but strong inverse relationship between **tax morale** and the size of the shadow economy

# Key question: how to increase tax morale?

- The more people participate in establishing rules, the more people will adhere
- Giving individuals the chance to vote on setting the rules increases their tax morale
- Sustainable tax system is based on taxation that is generally seen as “fair” and government that is considered “responsive”
- Strong connection between paying taxes and delivery of public goods
- The more widespread the knowledge that others are not paying their taxes, the more non-compliance increases
- The way you pay taxes: examples of Japan and Australia

⇒ Governance, accountability, and voice



## Conclusions



# Conclusions

Structural reforms to make formal work viable are necessary

- Taxation
- Labor market regulations
- Social protection policies

But structural reforms alone are not a sufficient

The performance of the government and the trust that citizens put into their government are critical

- Tax morale
- Governance, accountability and voice

# Thank you!

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