

Do economic reforms hurt or help the informal labor market?

The evidence is mixed on whether and how economic reforms benefit informal labor

Keywords: economic reforms, informal labor, governance

ELEVATOR PITCH

The evidence is mixed on whether informal labor in developing countries benefits from trade and labor market reforms. Reforms lead to higher wages and improved employment conditions in the informal sector in some cases, and to the opposite effect in others. At a cross-country level, lifting trade protection boosts informal-sector employment. The direction and size of the impacts on informal-sector employment and wages are determined by capital mobility and the interactions between trade and labor market reforms and public policies, such as monitoring the formal sector. To guarantee best practice policymakers need to take these interdependencies into account.

KEY FINDINGS

Pros

- ⊕ Trade reform and capital mobility have important implications for informal sector labor through direct production relationships and indirect linkages.
- ⊕ Trade reforms and better access to credit improve the wage and employment conditions of unskilled workers in the informal sector.
- ⊕ Following a phase of high capital mobility, informal firms register higher labor productivity despite an influx of workers to the sector.
- ⊕ Labor market reforms that follow trade reforms are expected to raise the informal wage.

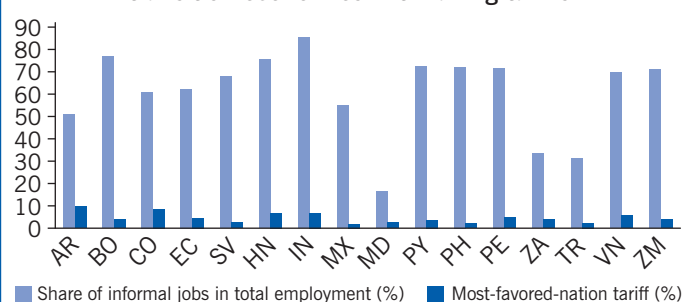
Cons

- ⊖ Without sufficient capital mobility, job losses in formal sector industries lead to lower wages in the informal sector.
- ⊖ Expansion of informal activities following trade reform results in lower productivity and economic growth.
- ⊖ Improper implementation of labor market reforms may aggravate informality within formal units and exacerbate wage and employment conditions in informal firms.
- ⊖ Without unemployment insurance, trade reforms that increase foreign competition may push the government toward greater acceptance of informal arrangements.

AUTHOR'S MAIN MESSAGE

Because so many people in developing countries work in the unregulated informal sector, even small gains in real wages can improve the welfare of millions. Thus, it is vital to understand the impact of economic reforms on the informal sector. Accompanied by capital mobility, trade reforms can improve wages and employment conditions among unskilled informal workers; accompanied by monitoring of formal firms, labor market reforms can improve worker welfare by reducing employment duality between formal and informal sectors. Easing credit constraints for informal businesses and discouraging formal firms from using informal labor are important.

The share of informal jobs is high in many developing and transition economies with falling tariffs



Source: Calculations based on data from ILO, Laborsta Database, 2009/2010. Online at: <http://laborsta.ilo.org>; and World Bank, WDI Database, 2009/2010. Online at: <http://data.worldbank.org/news/world-developmentindicators-2010-released>