

COMMENTS TO

**RETHINKING THE EFFECT OF INFORMALITY
ON INCLUSIVE GROWTH**

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INTRODUCTION

- This as an excellent paper.
- It provides a useful comparison on **informality and inclusive growth** in Colombia and South Africa and, more generally, in Latin America and Africa
- It uses a conceptual framework and methodology developed by the authors , which draws on previous work, including *Perry and Maloney, 'Exit and Exclusion'*, indicating that :
 - Different types of workers have different reasons for being informal
 - Leading in turn to differences in the consequences of their informality
 - And in the policy responses more appropriate for each case

Conceptual Framework

- Differences in motivations behind three types of informal workers:
 - **Subsistence informality**, which offers a permanent alternative to unemployment for many unqualified workers
 - **Induced informality**: workers segmented from formal employment by high formal market restrictions or by implicit social rules
 - **Voluntary informality**: workers able to compete in the formal labor market but who are voluntarily working in informal employment in order to obtain free-rider benefits.
- The first type of informality leads to inclusive growth.
- The last two restrict formal employment leading to more unequal outcomes.

The need to complement with an analysis of motivations (*and policy implications*) of informal firms

- To fine-tune policies to reduce informality among salaried workers, we need to understand the motivations behind informal firms, as it is them, more than workers, who opt to be informal:
 - Though **most** of those employed by informal firms **are probably subsistence workers**, who can not find a job in the labor market.
 - There may be some that, while able to work in the formal market, **opt to organize (a family firm) or participate in an informal productive 'firm' because of low net benefits of formality** (low benefits of formality and/or high costs and/or low enforcement).
 - **And others are employed in a formal firm** (eg, Argentina in the 90's), **colluding with the owner in not paying SS contributions in exchange for a higher salary.**

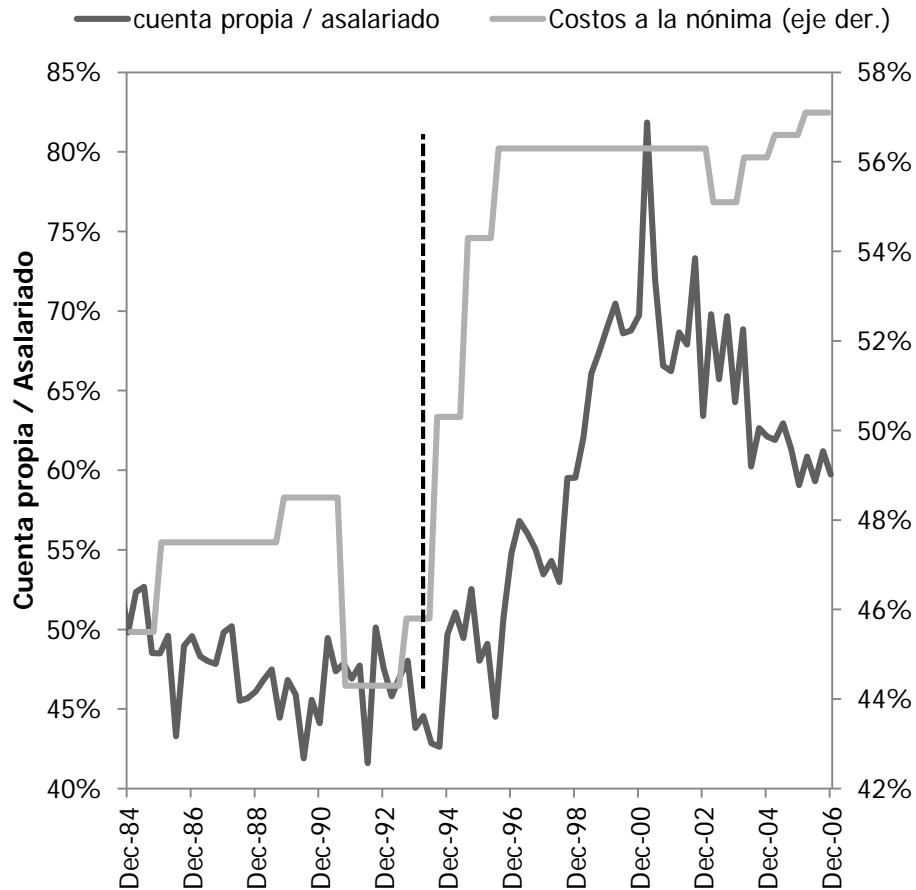
Policy prescriptions for wholly or partially informal firms (*and, hence, for reducing informality among salaried workers*)

- **Subsistence informal firms:**
 - Should probably be left unmolested by inspectors
 - But **programs to help them increase their productivity** will increase incomes (more inclusive growth) and may eventually permit some of them to become larger-formal firms.
- **Productive informal firms**
 - Better **support programs for small formal firms** (eg, access to credit , marketing and training –entrepreneurs and employees), to increase benefits of formality
 - **Reducing costs of formality** if they are too high
 - **Enhancing law enforcement** if they are not.
- **Partially formal firms:**
 - The policy recommendation is probably always to **enhance enforcement** (eg, the Argentina case in the nineties)
 - Though **reducing excessive labor costs** and **improving SS benefits** may help

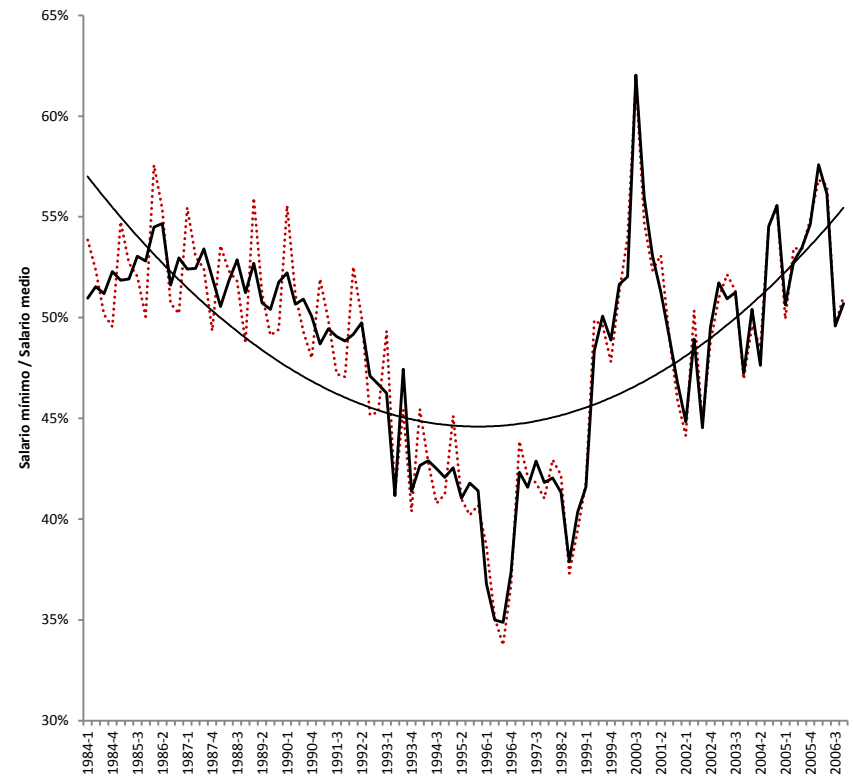
POLICY CAUSES OF 'BAD' LABOR INFORMALITY

- The paper underscores the importance of **excessively high minimum wages** -in relation to average productivity-, **especially when coupled with high taxes on formal labor**
- Such a combination is especially perverse because it drives into informality mostly low-income unqualified workers.
 - A qualified worker may end up receiving a lower salary (*as market clears taking into account the labor tax*) but still above the minimum wage, or the firm may have to incur in an additional cost if the worker is so qualified that he/she is indispensable.
 - **But formal firms would not find profitable to pay a high labor cost (a high-minimum wage plus high labor taxes) for a worker with low productivity.** Hence, **workers with low qualifications may be massively driven into involuntary informality.**
 - However, there would always be workers with such low productivity (**subsistence workers**) that will not be employed in the formal sector even under a regime with no formal labor taxes and reasonable minimum wage and SS contributions.
- In a similar vein, **high unemployment subsidies** in South Africa may help explain the high unemployment levels, and **high health subsidies for the informal** helped explain informality in Colombia and Mexico

Colombia: increase in informality associated to increase in non-wage labor costs and minimum/average wage)

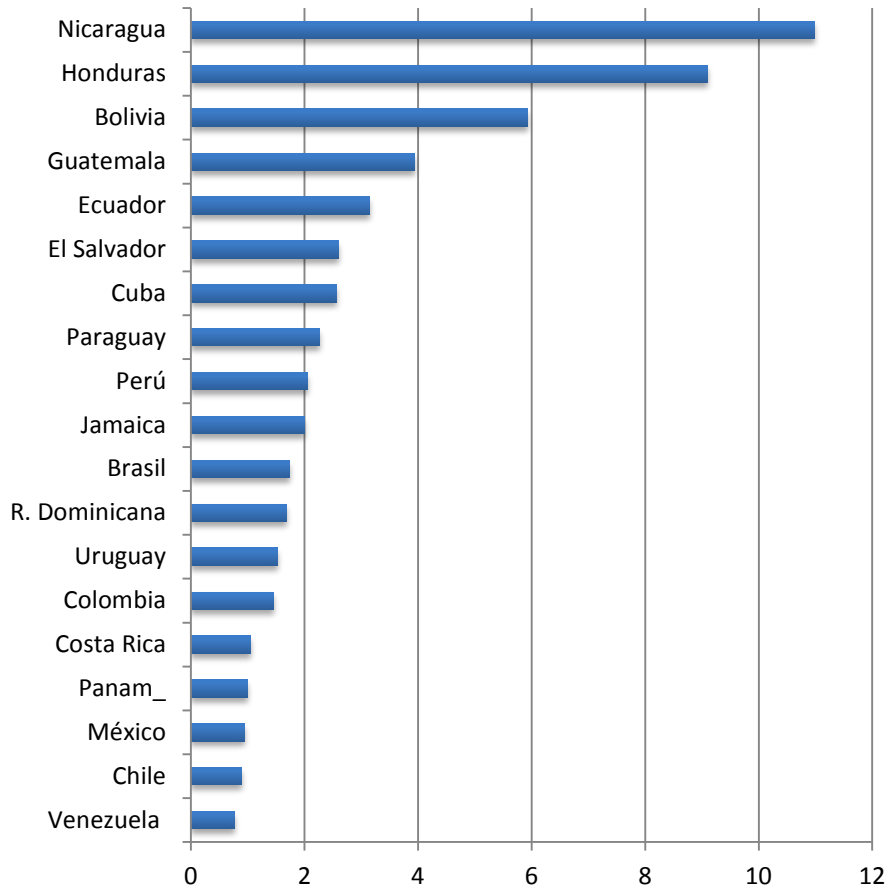


Minimum Wage/ Average Wage

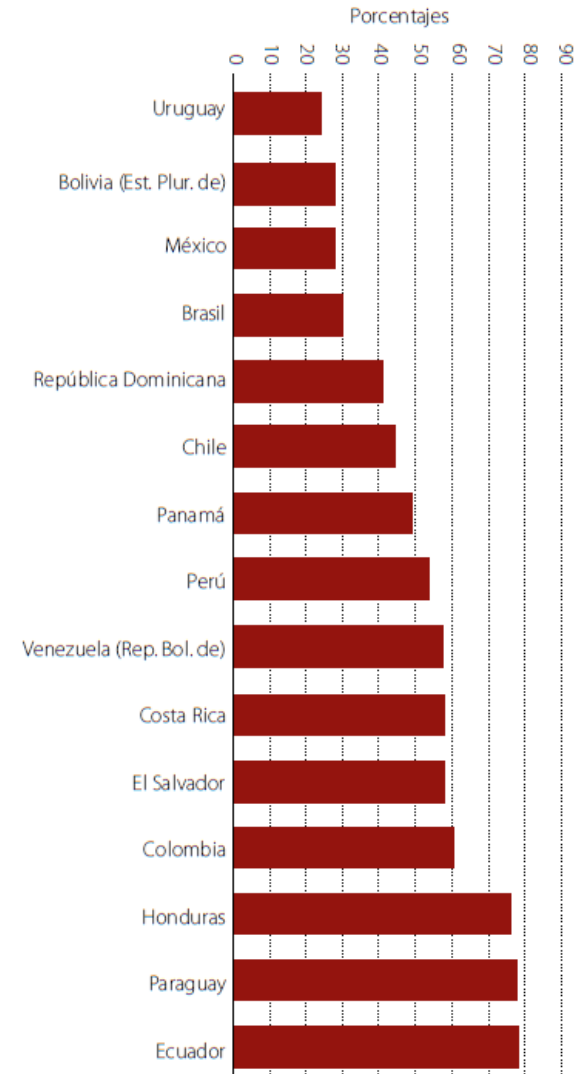


Colombia: High minimum wage

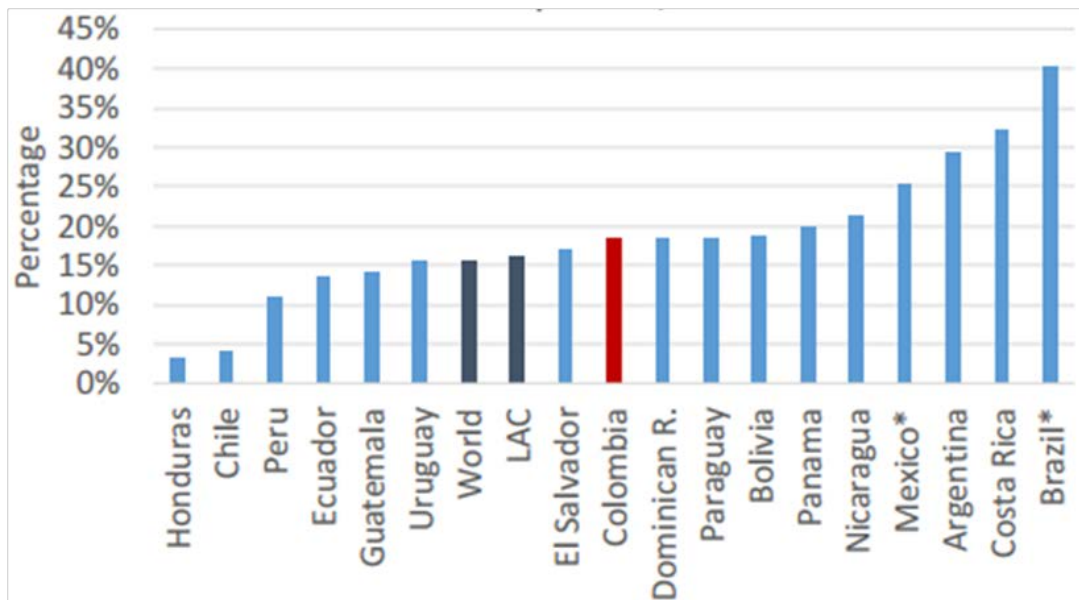
**Salario real como % del PIB per cápita
(2013)**



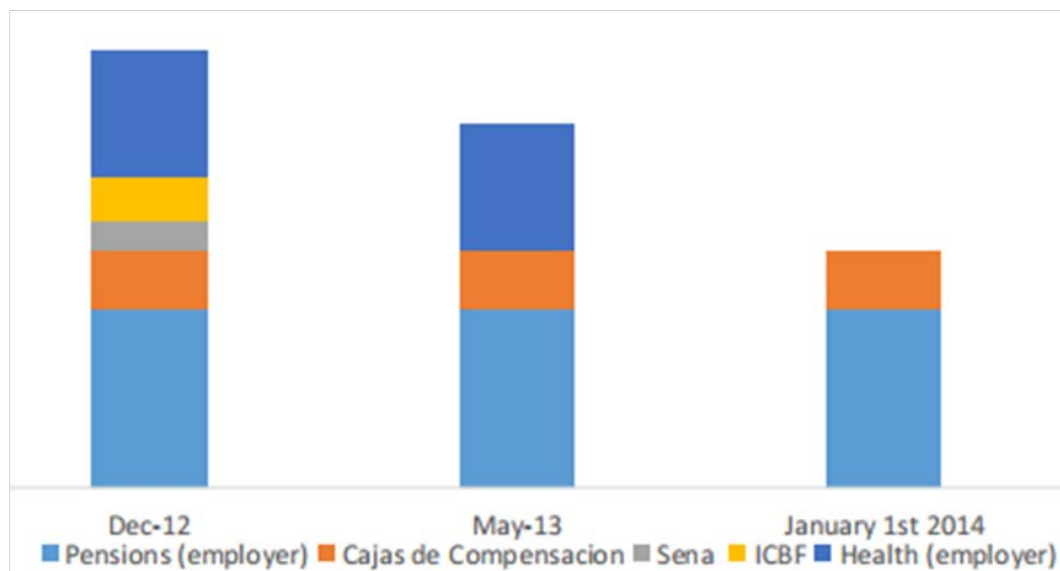
Salario mínimo relativo al salario medio total (2011)



Payroll taxes as percentage of Commercial profits, 2015



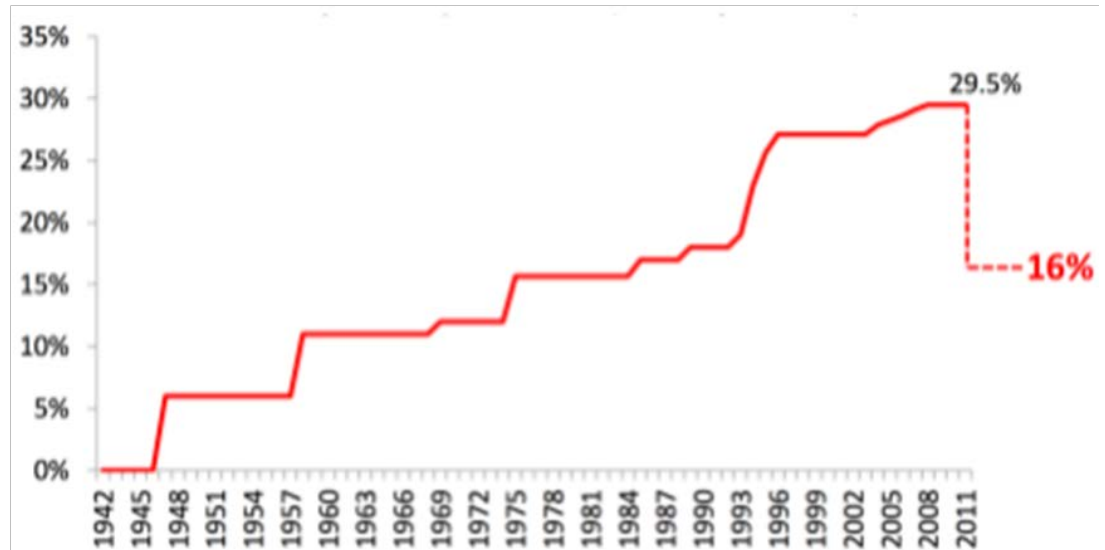
Payroll contributions (employer)



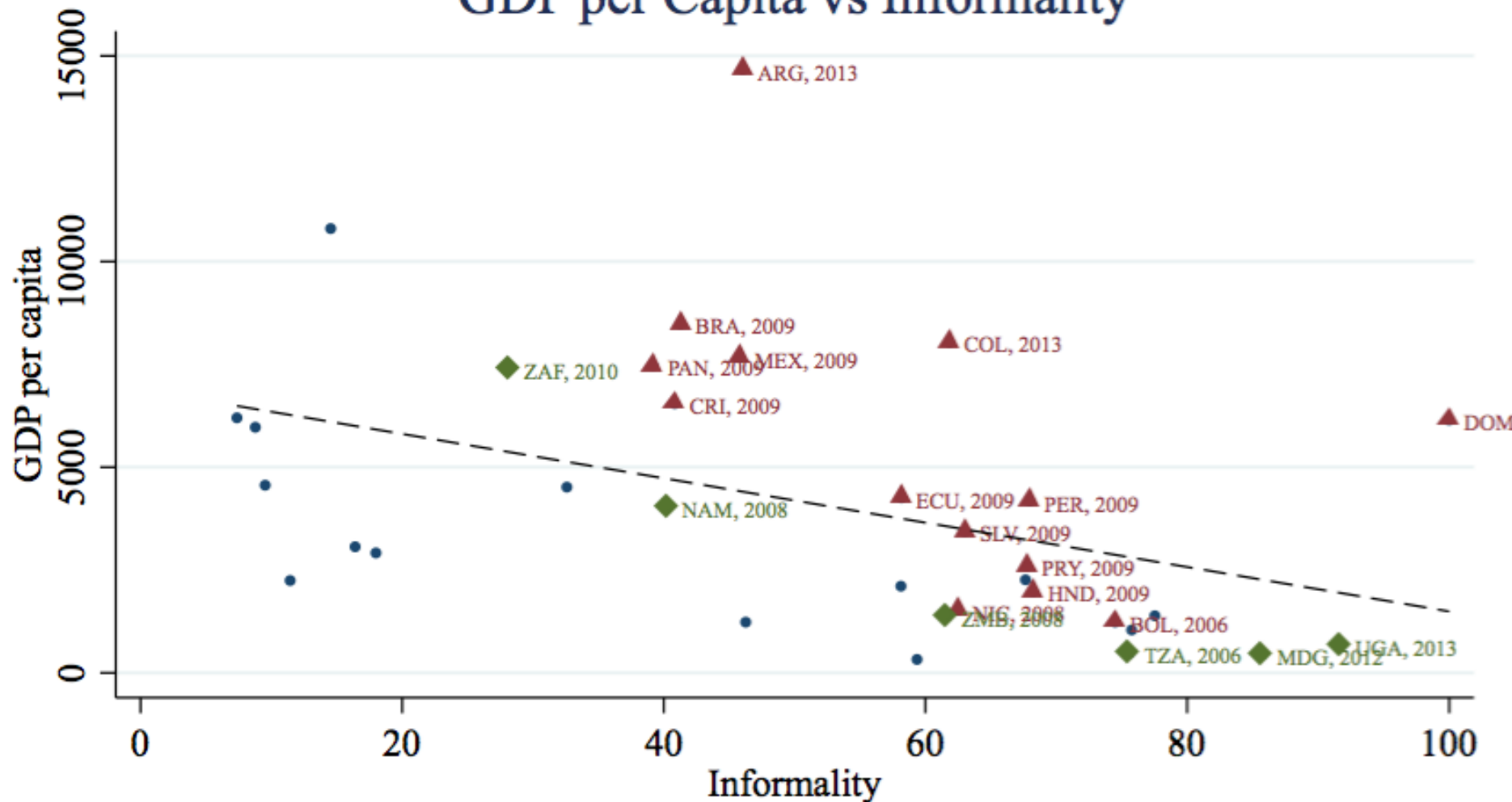
Informality rates: self employment and other employment



Payroll taxes payable by the employer

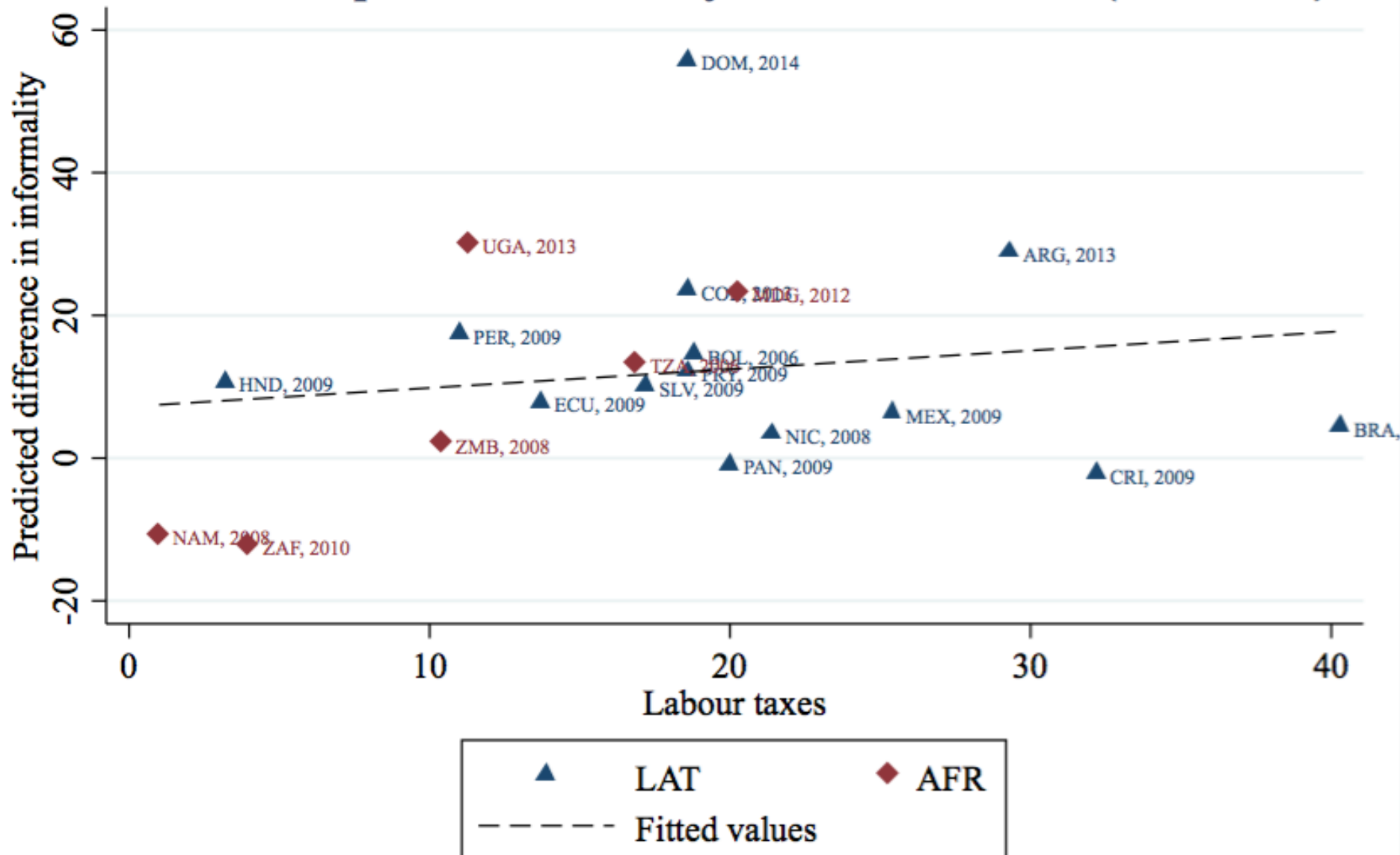


GDP per Capita vs Informality



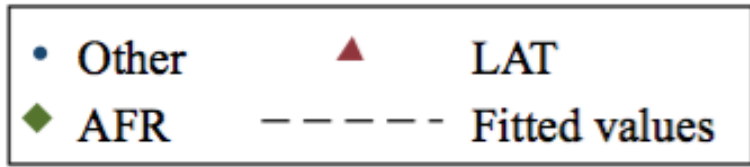
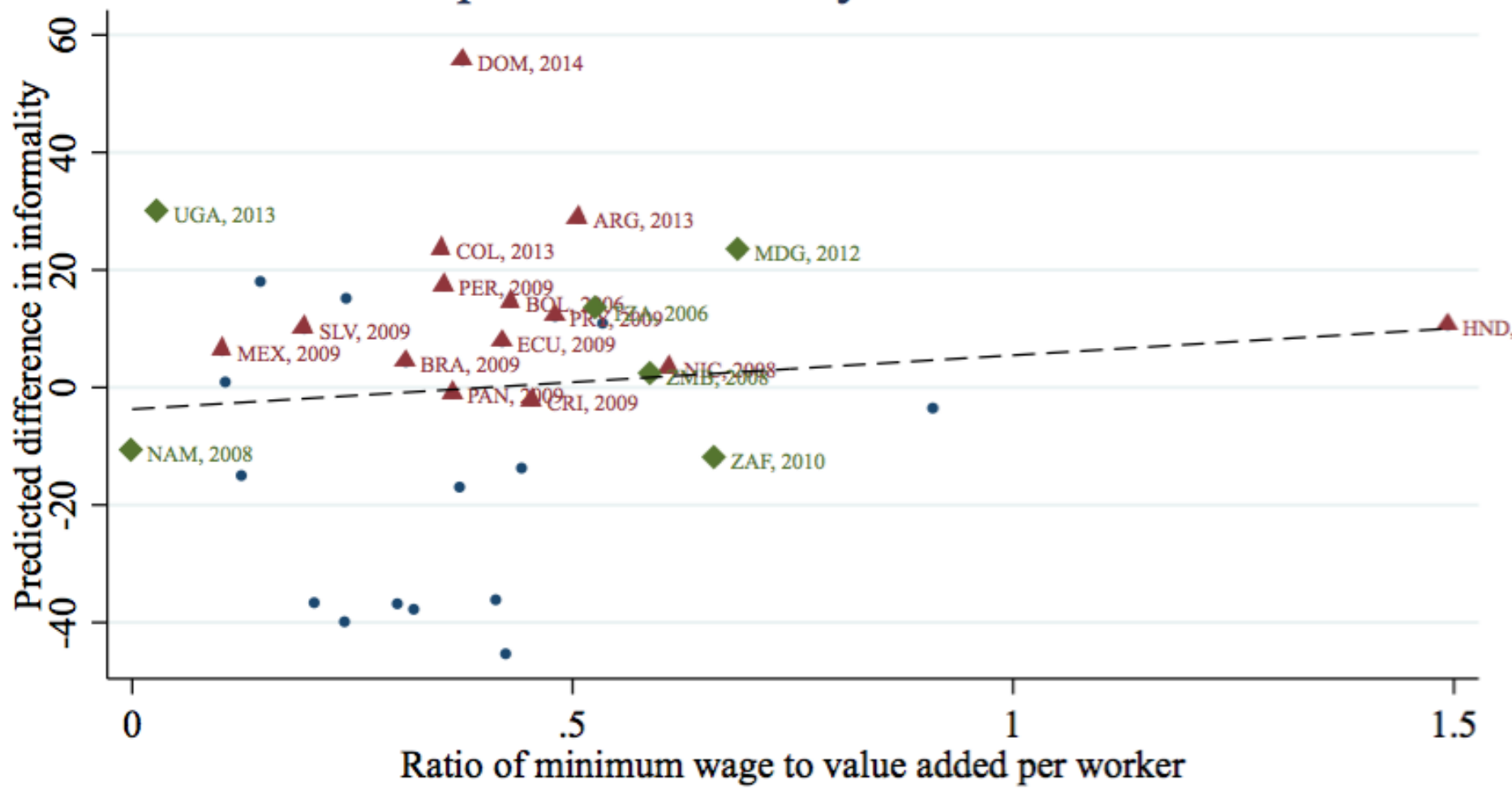
Source: World Bank (2016); ILO (2016)

Diff. in Expected Informality vs. Labour Taxes (AF & LA)



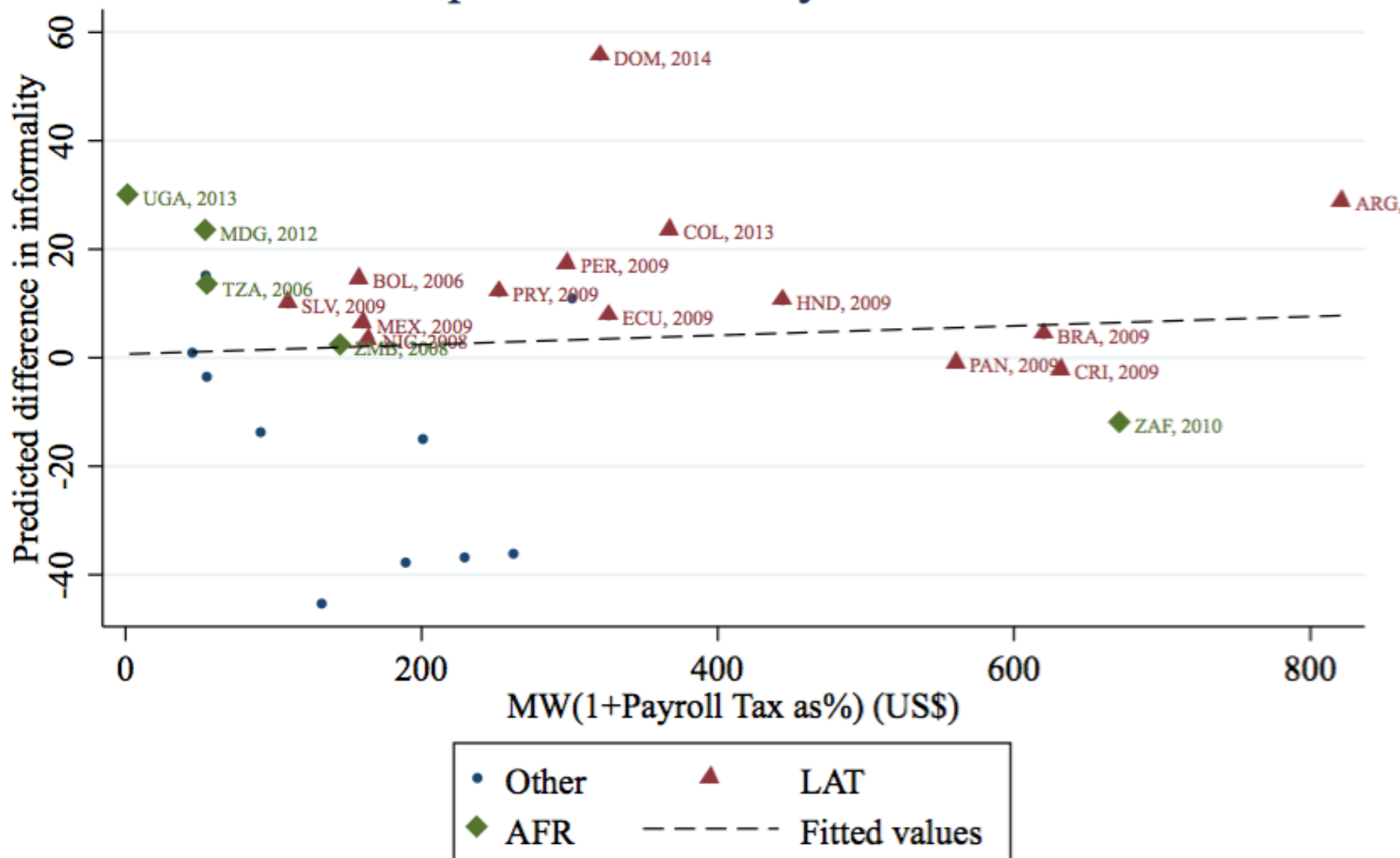
Source: World Bank (2016); ILO (2016)

Difference in Expected Informality vs. Ratio of M.W. to VAPW



Source: World Bank (2016); ILO (2016)

Difference in Expected Informality vs. Labour Cost Indicator



Source: World Bank (2016); ILO (2016)