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# Identifying the Types of Informality in Colombia and South Africa

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# Types of informality and indicators

TYPE OF INFORMALITY	DIMENSION	INDICATOR
Voluntary	Choice	Preferences for informality- surveys
		Transition between informality and formality
		Pro-Cyclicality as indicator of non-voluntary informality
Induced	Barriers to Formality	Indicators of segregation: Relative probability of informality of different social groups
		Legal Minimum wage/average wage
		Payroll taxes/commercial profits
Subsistence	Productivity	Incidence of informality for very low productivity groups
		Productivity and wages too much below minimum legal wages

# CHOICE INDICATORS

# Surveys help in identifying characteristics of voluntary unemployment

- **Colombia:** In household surveys, 36% of informal workers express preference for informal jobs according to two questions:
  - *Would informal workers reject a formal job at a higher wage?*
  - *Do informal workers mention the impossibility of finding a formal job as a reason for being informal?*
- **South Africa:** In survey of Employers and Self-employed (2013), 22% of informal business owners, express preference for informality.
- **Both in Colombia and South Africa,** these numbers suggest that voluntary informality is much lower than in Mexico or Brazil
- **Voluntary informality is much higher among well educated workers**
  - ✓ In Colombia, Logit regression models suggest that voluntary informality is more likely to happen among
    - ✓ workers with tertiary education,
    - ✓ women who are not household heads (secondary earners),
    - ✓ older workers (45 years+), and
    - ✓ workers in big and border cities (where there may be more alternatives?).
  - ✓ In South Africa, preference for informality among informal business owners with tertiary education is 51%, much higher than the average (22%)

# Transition matrices between formality and informality suggest low voluntary informality

## Colombia

		2013			
		Unemployed	Informal	Formal	Inactive
2010	Unemployed	18	35	19	27
	Informal	4	72	14	10
	Formal	3	20	72	6
	Inactive	4	26	3	67

## Colombia with tertiary education

		2013 (tertiary)			
		Unemployed	Informal	Formal	Inactive
2010 (Tertiary)	Unemployed	11	30	14	45
	Informal	1	66	26	6
	Formal	1	12	83	4
	Inactive	2	30	11	57

## South Africa

		2012				Row Total
		Unemployed	Informal	Formal	Inactive	
2008	Unemployed	27	20	22	32	100
	Informal	12	27	26	35	100
	formal	6	9	74	11	100
	Inactive	20	14	10	56	100

Source: Authors calculations, National Income Dynamics Study (SALDRU), 2008 and 2013.

Notes: 1. Weighted using calibrated panel weights. 2. This data differs from the national South African definition of informality in that firm size is not known. Individuals working in firms with more than four people are not automatically excluded from the definition of informality and therefore the informality rate is slightly larger using this data.

Shares of workers transiting from informality to formality in both Colombia and South Africa are lower than in countries in which voluntary unemployment is higher:

- México (30% no-skilled, 54% skilled)
- Argentina (18% no-skilled, 36% skilled)

# Procyclicality as a signal of dominance of voluntary informality

- **In general**

- ✓ Pro-cyclicality of informality suggests that a growing economy provides opportunities to voluntary informal workers.
- ✓ Counter-cyclicality suggests that a growing economy reduces subsistence and induced informality

- **In Colombia:**

- ✓ Informality is counter-cyclical in average, which suggests that subsistence and induced informality dominate.
- ✓ Among workers with higher education, informality is procyclical, which suggests dominance of voluntary informality in that group

- **In South Africa:**

- ✓ Paradox: Informality is not countercyclical in average, which contrasts with Colombia and other signs of dominance of non voluntary informality.
- ✓ This can be explained by barriers to informality in SA, which inhibit informality from acting as a cushion (instead of unemployment) in economic downturns.

# Conclusion on choice indicators

While there is evidence of voluntary informality among highly educated workers, this type of informality is not the dominant one in neither Colombia nor in South Africa.

# **BARRIERS TO FORMALITY INDICATORS**



# Implicit Barriers to Formality

(mlogit econometric analysis)

- **Gender, Colombia:**

- Women are more likely to be informal than men, even after controlling by other determinants (education, experience, etc).
- Even women that are household heads are more likely to be informal than men (although they have similar preferences for informality).

- **Gender, South Africa:**

- Women that are household heads tend to be informal instead of unemployed
- Women that are secondary earners tend to be unemployed instead of informal.

- **Ethnicity:**

- Risk of informality is higher for minority ethnics in Colombia and for non-whites in South Africa.

# Regulatory Barriers to Formality

- **Payroll taxes:**
  - South Africa: very low side of the distribution
  - Colombia: a reform in 2012 reduced payroll taxes payable by employers from 29.5 p.p. of the wages to 16 p.p. but this percentage is still in the upper half of distribution
- **Legal Minimum Wage (compared to average wage or to GDP percapita):**
  - South Africa: medium to low side of the distribution.
  - Colombia: very high side of the distribution
- **Other regulatory barriers:**
  - South Africa: High barriers to informality
  - Colombia: Low barriers and low controls on informality

# Conclusion on Barriers to Formality

- **Colombia:** High payroll taxes and Minimum wages suggests high presence of induced informality
- **South Africa:** Evidence of induced informality is more related to discrimination than to excessive regulation

# PRODUCTIVITY INDICATORS

# High incidence of informality in groups with very low productivity

*Descriptive statistics and mlogit econometric analyses of likelihood of informality vis-a-vis formality*

- **Education:**

- higher risk of informality for individuals with low levels of education in both Colombia and South Africa.

- **Experience (age as proxy):**

- In South Africa informality gets smaller with age,
- In Colombia young and older workers tend to have higher rates of informality. In the younger group it is related with lack of experience (or productivity), while in the older group this can be explained by preferences.

- **Geography:**

- Higher risk of informality in less productive cities and rural areas in Colombia and South Africa.

# Productivity and wages too much below minimum legal wages

- **In Colombia**

- Approx. 48% of informal workers earn less than half the minimum legal hiring cost (so that marginal changes in the legal minimum wage may not have effects)

- **In South Africa**

- it was not possible to use the same indicator due to the existence of multiple minimum wages in the country.

# Conclusion on too low productivity and subsistence informality

Evidence of quite high subsistence informality in both Colombia and South Africa.

# Summary: Types of informality: SA and Colombia

Dimension	Indicator	South Africa	Colombia
<b>Choice and Voluntary Informality</b>	Transition between informality and formality	<b>Medium (26%)</b>	Low (13%)
	Preferences for informality- surveys	<b>Very low (22%)</b>	<b>Low (35.9%)</b>
	Cyclical: coefficient of correlation	<b>Low: Pro-cyclical average</b>	<b>Low: Counter-cyclical average because of regulations</b>
<b>Barriers to Formality and Induced informality</b>	Indicators of segregation: Relative probability of informality	<b>High: Women and Non-whites</b>	<b>Medium: Women and ethnic minorities</b>
	Minimum wage/average wage	<b>Low (17%)</b>	<b>High (66%)</b>
	Labour tax/commercial profits	<b>Low (4%)</b>	<b>Medium high (18.6%)</b>
<b>Productivity</b>	% of workers earning wages < min. hiring cost	<b>N/A</b>	<b>High (48%)</b>
	Relative probability of informality for low productivity groups	<b>High</b>	<b>High</b>



# Size of each type of informality: SA and Colombia

	South Africa	Colombia
Voluntary	Low	22%
Induced	Medium	29%
Subsistence	High	36%
Mixed: Subsistence and Voluntary		13%

# Conclusions

- **We can't treat the informal workers as a single homogenous group.**
  - Informality includes from street vendors to business man evading taxes.
  - The implications of their informality on inclusive growth are different and the policy recommendations to each type of informality are different.
- **Even if informality promotes inclusive growth for vulnerable groups, the cost of informality at a society level should not be ignored**
  - South Africa may take the Colombian experience of deep-rooted informality into consideration.
  - Facilitating the transition from unemployment to informality can be productive only if a smooth transit from informality to formality is also promoted.
- **Colombia can learn from a more flexible setting arrangement of legal minimum wages, general pension schemes and unemployment benefits.**
  - Other institutional arrangements of South Africa, such as an effective inspection and control of informality, should be taken with care if applied to the case of Colombia. They might have negative social outcomes when applied to subsistence informality.

# Policy Recommendations

## 1. Voluntary informality

- Labour law monitoring and control
- More flexibility in formal jobs (e.g. flexible working hours, part-time jobs)

## 2. Induced informality

- Reducing Labour taxes
- Avoiding “excessive” minimum wages (level and setting scheme)
- Reducing legal requirements and facilitating worker’s protection
- Simplifying tax policy and lowering requirements to create firms

## 3. Subsistence informality

- Long term: Increase education and productivity.
- Short term dilemmas: 1) Should subsistence informality be “allowed” without restrictions? 2) How do we protect subsistence informality workers without creating incentives to informality which may discourage formal hiring.

## 4. Mixed informality

- Take care and adjust unwanted informality incentives of social policy schemes (mainly direct transfers, pension systems, subsidized health care schemes )
- Lowering transportation costs, facilitating the creation of formal jobs in low productivity areas and promoting child-care facilities in marginal neighbourhoods

Thank you