

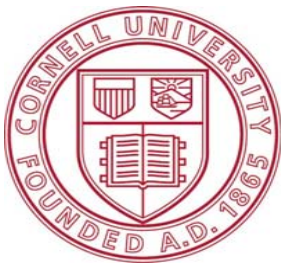
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# **Informality and Vulnerability in Developing Countries**

**Gary Fields**  
**Cornell University**

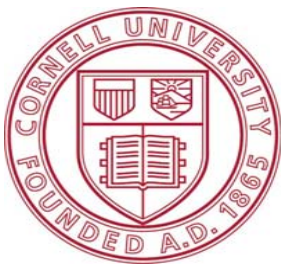
**May, 2006**



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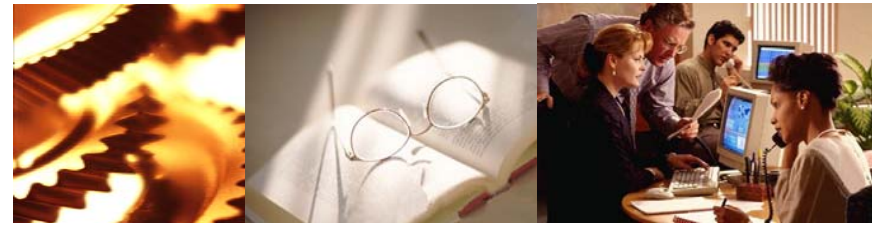
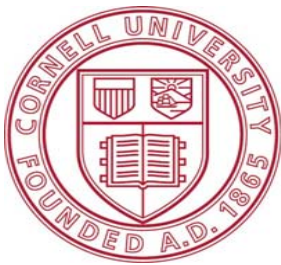


# *I. Informality*



## **Informality: Many different definitions**

- **Enterprises employing five or fewer workers (ILO, ECLAC).**
- **Workers who do not hold labor cards. (Brazil)**
- **Firms not registered with the government and not paying taxes. (Many countries)**
- **Drugs, prostitution, and other illegal activities. (Many countries)**

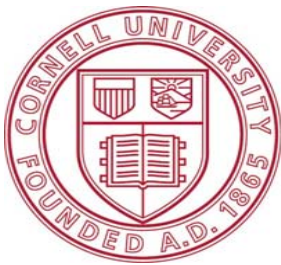


**My preferred definition (including both wage employment and self employment):**

**Formal sector jobs are characterized by:**

- **Reasonably certain duration of employment &**
  - **Relatively high wages &**
  - **Relatively good working conditions**

**Informal sector consists of jobs lacking these characteristics.**

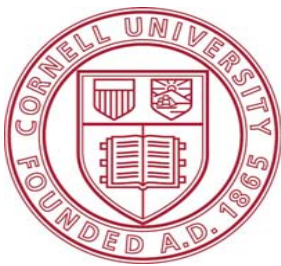


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**Informal sector has a fundamental duality:**

- 1. Free-entry segment**
- 2. Upper-tier segment**

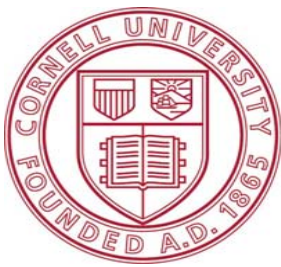


## **Free entry part of the informal sector:**

- **“All” who want to work in that sector can work in that sector (though not necessarily in any given job in that sector).**
  - **Wages are relatively low.**

## **Upper tier of the informal sector:**

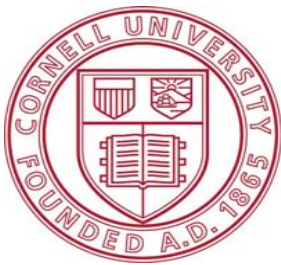
- **Entry is limited by requirements of financial capital and/or human capital.**
  - **Wages can be relatively high.**



## **Why people are in the free entry part of the informal sector:**

- 1. In the aggregate, job opportunities in the formal sector are insufficient to employ all who want to work there.**
- 2. Being employed in the informal sector (and searching part time for formal sector jobs) is preferable to open unemployment (while searching full time).**
- 3. These workers lack the human and financial capital needed for entering the upper tier of the informal sector.**

**(One alternative: The Roy model.)**



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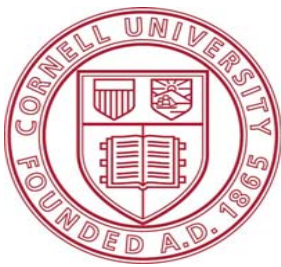
**Debate in the empirical literature about the relative importance of these two segments:**

**Maloney versus others.**

**What is true of Mexico?**

**To what extent do the Mexico results generalize to other countries?**

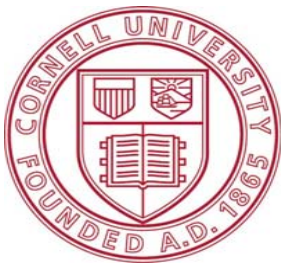




**A high priority research need on informality:**

**Developing policy-relevant theoretical models  
that have:**

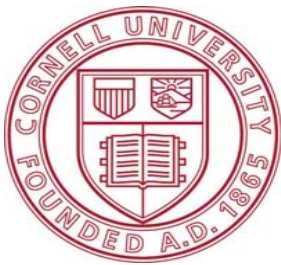
- a) Two informal sectors**
- b) Formal sector jobs**
- c) Unemployment**
- d) Appropriate wage determination mechanisms for  
each segment**
- e) Heterogeneous workers**
- f) Carefully specified rules for intersectoral mobility**



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## *II. Vulnerability*



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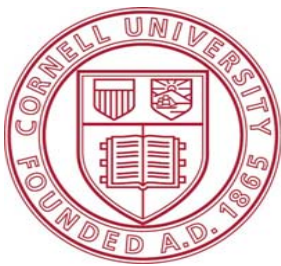
**Four points:**

**Vulnerable to what?**

**Vulnerable  $\neq$  poor.**

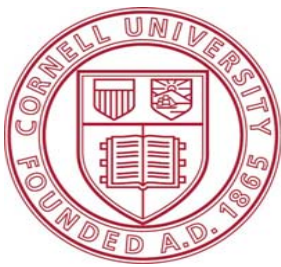
**Vulnerability is not limited to the poor.**

**Not all poor are vulnerable.**



## **Important empirical findings on vulnerability:**

- 1. A considerable number of those who are not poor are vulnerable to falling into poverty.  
(Chronic Poverty Research Centre)**
- 2. Vulnerability reflects lack of assets, not just low incomes.  
(Carter and Barrett)**
- 3. Falling into poverty is determined in large part by initial income and changes in the employment status of the household head (formal/informal/unemployed).  
(Fields et al.)**



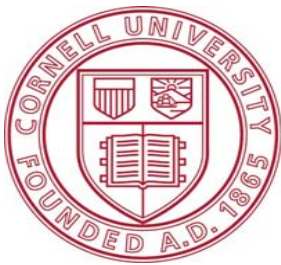
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**Observations about these findings:**

**All are drawn from panel data.**

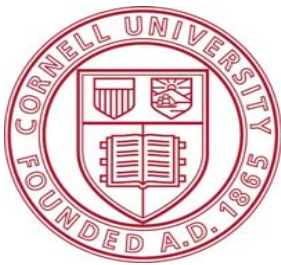
**Panel studies have taught us things that cross-section studies would not have.**



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# *III. Learning from Panel Data Analysis*

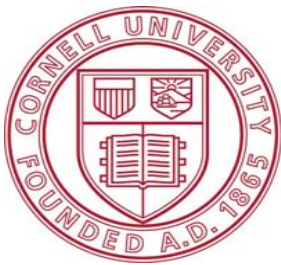


## **Growth and Income Mobility: What We Might Expect from Theory**

- 1. Cumulative advantage**
- 2. Poverty trap**
- 3. Labor market twist**

**Together, these act to produce a pattern which Nobel laureate James Meade (1976, p. 155) called “self-reinforcing influences which help to sustain the good fortune of the fortunate and the bad fortune of the unfortunate.”**

- 4. Unconditional convergence to the grand mean (Galton)**



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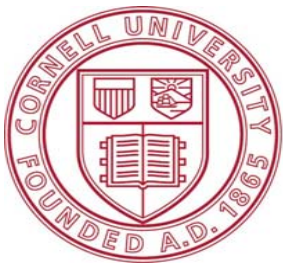


**Two applications of panel data analysis:**

**A. Earnings changes by economic sector  
in South Africa**

**B. Convergent mobility despite steady or rising inequality in  
Latin America**

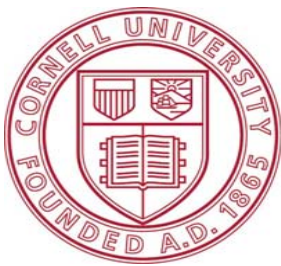




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*A. Earnings changes by economic sector  
in South Africa*



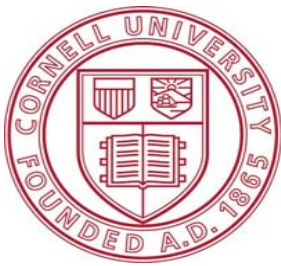
**What we learn about formality and informality  
from panel data analysis in South Africa:**

**The informal sector in South Africa is much more dynamic  
than had been believed.**

**Most of the earnings gains over time took place among those  
who remained informal.**

**It is not necessary to acquire a formal sector job in order to  
achieve earnings gains (but acquiring a formal sector job  
does result in more positive earnings mobility).**

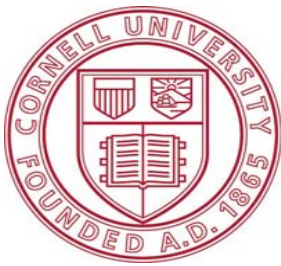
**Those individuals who started formally employed suffered  
earnings *losses* over time.**



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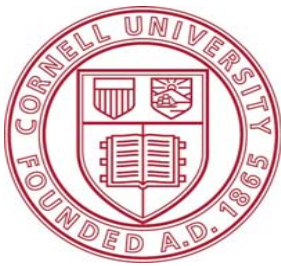
*B. Convergent mobility despite rising inequality in  
Latin America.*



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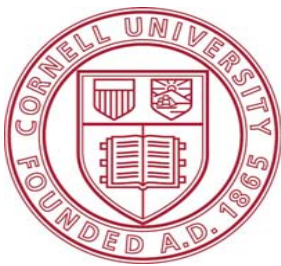
**Inequality rose in Argentina and Mexico,  
followed an inverted-V in Venezuela . . .**



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**And yet, despite rising inequality, mobility was  
convergent in all three.**



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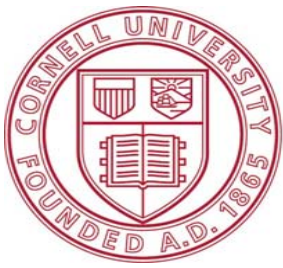


## What we learn for Latin America:

**Relative inequality is high and, in two of the countries, rising.**

**Constant or rising relative inequality implies that in times of economic growth those anonymous individuals at the top end of the income distribution gained more in dollars than those at lower parts of the income distribution.**

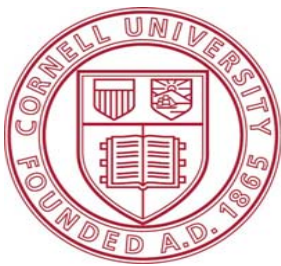
**Yet, when the same people are followed over time, it is those who started in the *lowest* parts of the income distribution who gained the *most* in dollars while those who started at the *top* of the income distribution were the ones who gained the *least*.**



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## *IV. Looking Ahead*



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**Two top research priorities:**

**Theoretical modeling of informal sectors in a  
multisector labor market context.**

**Panel data analysis of individuals' changes in  
earnings and labor market sectors linked to  
education, gender, geographic region, and other  
characteristics.**