

# GLOBALIZATION AND INFORMAL JOBS IN DEVELOPING COUNTRIES

A joint study of the International Labour Office and the Secretariat of the World Trade Organization

▶ What do we know about the effect of trade opening on informal employment, wages and working conditions in developing countries?

▶ To what extent are trade performance and development prospects impaired in the presence of a large informal economy?

▶ How can domestic policies reduce the cost of adjustment to trade opening in developing countries?

▶ How could trade reforms be designed and accompanied by other policies to promote adjustment favourable to a reduction in informal employment and an improvement in working conditions?

▶ How can the design of trade and social policy be improved so as to support sustainable development and make developing countries less vulnerable to shocks like the current global crisis?



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A joint study from the International Labour Organization and the World Trade Organization has found that high incidence of informal employment in the developing world suppresses countries' ability to benefit from trade opening by creating poverty traps for workers in job transition.

The study is a product of the collaborative research programme of the ILO International Institute for Labour Studies and the WTO Secretariat. It focuses on the linkages between globalization and informal employment and finds that informal employment is widespread in many developing countries, leaving thousands of workers with almost no job security, low incomes and no social protection.

The report starts with a presentation of some of the key facts on globalization, trade and informal employment in developing countries. For the purpose of this study, data on informal employment have been collected from various sources. The presentation of the key facts is followed by a discussion of the reasons why informality matters.

Chapter 2 considers various views on informality and the multiplicity of definitions. It also addresses the related issue of the measurement of the informal economy. Chapter 3 contains a review of the literature on the effects of trade opening on informal employment and wages. Both theoretical arguments and empirical evidence are surveyed.

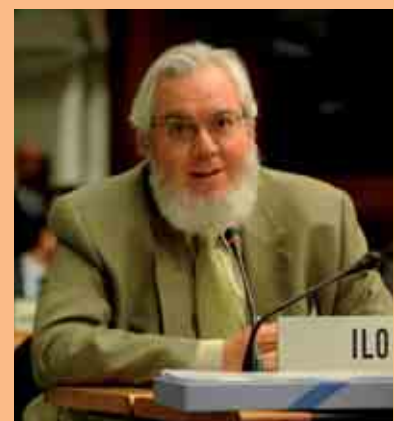
The reverse linkage that goes from informality to trade and growth is addressed in Chapters 4 and 5. The discussion focuses first on the theoretical transmission mechanisms before reviewing the empirical literature on the impact of informality on trade and growth performance. It is complemented with an examination of how informal employment evolves over the business cycle and how it affects countries' vulnerability to economic shocks. Chapter 6 presents a novel empirical analysis of the linkages between trade and the incidence of informality based on data collected from all available sources.

The report concludes with a discussion of policy issues. Chapter 7 first discusses how formalization policies could contribute to a successful integration into the world economy. It also examines whether trade policies can be implemented in such a way as to minimize adjustment costs and the risk that workers move to the informal economy. Finally, it stresses the importance of coordination between trade and labour market policies.

*"We consider this study a useful and timely initiative that will promote a better understanding of the complex linkages between trade and employment in developing countries."*



Pascal Lamy  
WTO Director-General



Juan Somavia  
ILO Director-General

## Key elements of the Study

- ▶ Informal employment involves private, unregistered enterprises which are not subject to national law or regulation, offer no social protection and involve self-employed individuals, or members of the same household. Levels of informality vary substantially across countries, ranging from as low as 30% in some Latin American countries to more than 80% in certain sub-Saharan African and South Asian countries. In most cases, informality has remained high and has even increased in some countries, particularly in Asia.
- ▶ The analyses on the effect of trade opening on the size of the informal economy suggest that the effect of trade opening on informality depends crucially on both country-specific circumstances and the design of trade and domestic policies. The empirical analysis in this study shows that more open economies tend to have a lower incidence of informal employment. The short-term effects of trade reforms may in the first instance be associated with higher informal employment. But longer-term effects point in the direction of a strengthening of formal sector employment, provided that trade reforms are more employment friendly and the right domestic policies are in place.
- ▶ Reducing informality can release additional productive forces, enhance diversification and strengthen the capacity to trade internationally. Adverse effects of informality can mainly be related to the absence of productivity gains and low average firm size resulting from barriers to firm growth in the informal economy. Entrepreneurship and risk-taking is reduced when informality is high, partly as a result of badly designed tax systems, weak social protection and poor business regulation. Also, informality prevents countries from fully benefiting from trade reforms by creating poverty traps for workers in job transition.
- ▶ The higher the incidence of informality, the greater the vulnerability of developing countries to shocks like the ongoing global crisis. Countries with larger informal economies suffer more frequently from shocks and experience lower sustainable growth rates. Also, informal employment reduces the effectiveness of automatic stabilizers.
- ▶ Integration into world markets and tackling informal employment through decent work policies should be considered complementary. Facilitating formality of firms and jobs helps a country to benefit fully from trade openness, improves living standards and gives workers access to decent working conditions. Social protection is also crucial for supporting transitions and realising the gains from open trade. Greater attention should be devoted to social protection policies as well as to the design of trade reforms.
- ▶ The study suggests that trade reforms should be designed and implemented in an employment-friendly way, making the reallocation of jobs more conducive to formal employment growth.

World trade has expanded significantly in recent years, making a major contribution to global growth. Economic growth has not led to a corresponding improvement in working conditions and living standards for many workers. In most developing countries, job creation has largely taken place in the informal economy, where on average around 60 per cent of workers are employed. Most of the workers in the informal economy have almost no job security, low incomes and no social protection, with limited opportunities to benefit from globalization.

This study focuses on the relationship between trade and the growth of the informal economy in developing countries. Based on existing academic literature, complemented with new empirical research by the ILO and the WTO, the study discusses how trade reform affects different aspects of the informal economy. It also examines how high rates of informal employment diminish the scope for developing countries to translate trade openness into sustainable long-term growth.

The report analyses how well designed trade and decent work policies can complement each other so as to promote sustainable development and growing prosperity in developing countries.

**Further information:**

*Globalization and Informal Jobs in Developing Countries* is a joint study of the International Labour Office (ILO) and the Secretariat of the World Trade Organization (WTO).

The Study is available in English, French and Spanish:

Globalization and Informal Jobs in Developing Countries  
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Mondialisation et emploi informel dans les pays en développement  
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