

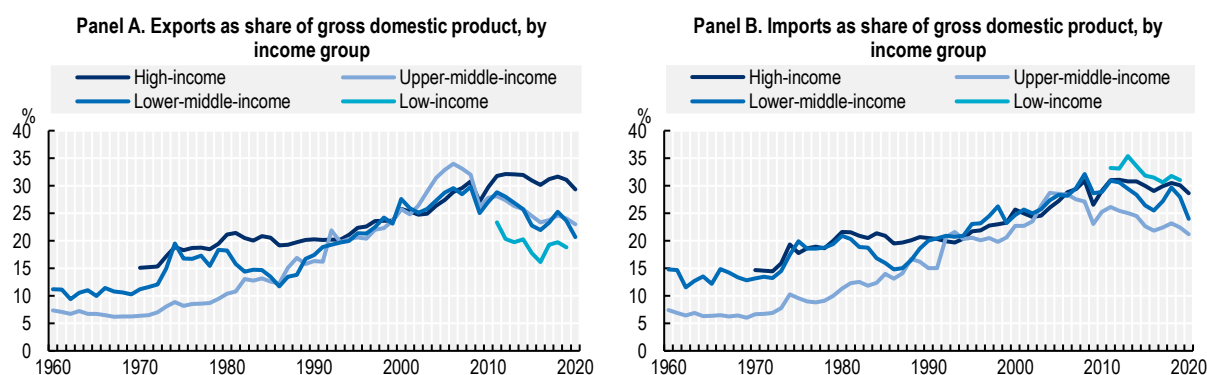
4 Informal employment in the global economy

This chapter analyses the relationship between informal employment and economic globalisation. First, it shows that economic globalisation does not necessarily translate into more formal jobs, especially in the least developed countries. It documents that the effects of global trade on informal employment depend on whether greater integration into the world economy is led by import or export liberalisation. These effects also depend on the type of industry, on geographical location, and on type of affected workers and enterprises. Second, this chapter examines informality within global value chains (GVCs), showing that its prevalence is affected by the types of linkages (backward or forward), production organisation within the value chain, purchasing practices, possibility of upgrading, and the sector of activity. Finally, the chapter discusses the role of public and private actors in ensuring that globalisation brings formalisation benefits and improves working conditions for all workers, including informal workers.

Economic globalisation does not automatically translate into more formal employment

Economic globalisation – the interconnectedness of countries through international flows of goods, services and capital – reached unprecedented levels around the beginning of the 21st century. On the eve of the COVID-19 pandemic, developing countries were much more integrated into the global economy than was the case previously. Many developing countries conducted deliberate large-scale trade liberalisation, including within the General Agreement on Tariffs and Trade (GATT), or the World Trade Organization (WTO), liberalised trade within regional trade blocs, or integrated regional and global value chains. Despite international trade – one of the components of globalisation – slowing down since the economic recession of 2008 in both developed and developing countries (Figure 4.1), the technological change continued reducing transportation, communication and financial transaction costs. As such, increasing interdependence between countries and regions continued throughout the beginning of the 21st century.

Figure 4.1. International trade grew steadily between 1960 and 2020



Note: Income group weighted averages, based on World Bank national accounts data and Organisation for Economic Co-operation and Development (OECD) National Accounts data files.

Source: World Bank (2021^[1]), *World Development Indicators* (database), data.worldbank.org/products/wdi.

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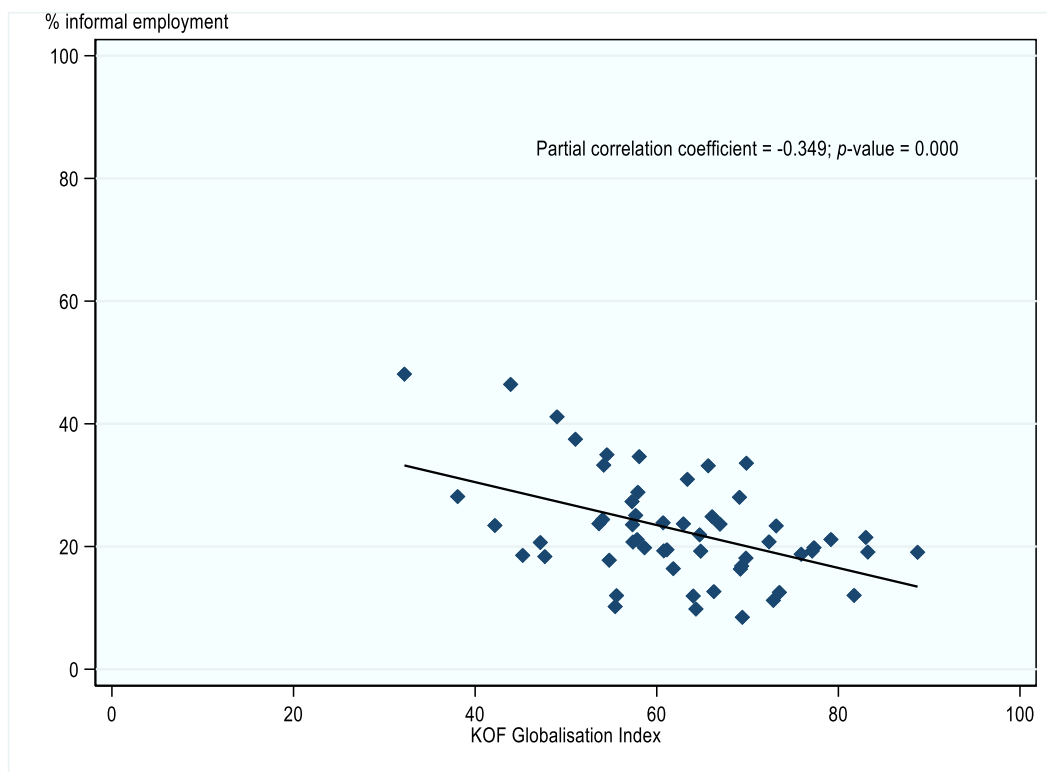
The period 2020-2023, marked by the COVID-19-induced crisis followed by Russia's war of aggression against Ukraine, underscored the high degree of this interconnectedness but also disrupted it. The consequences of these crises on trade varied across regions. During the pandemic, Africa's exports declined by more than the global average of countries with similar export composition (AUC/OECD, 2022^[2]). In Asia, trade rapidly rebounded from 2021 onwards, with merchandise exports in the People's Republic of China (hereafter: China), India, Indonesia, Malaysia, Thailand and Viet Nam quickly exceeding their pre-pandemic levels (OECD, 2022^[3]). Yet, until late 2022, the zero-COVID policy in China continued to disrupt GVCs. In Latin America and the Caribbean, economies such as Brazil, Chile, Peru and Uruguay, where China is a crucial trading partner, saw a substantial drop in trade, which negatively affected these economies (OECD et al., 2022^[4]). The Russian invasion of Ukraine also disrupted trade in fertilisers and several types of crops and oils, and led to soaring prices in energy and agro-food crops and products throughout the world (OECD, 2022^[5]).

Increased economic globalisation is not associated with greater formalisation in less developed countries

Globalisation can be a powerful promoter of economic growth, and can enhance productivity and efficiency. However, its impact on job creation in developing countries, and especially on the quality of jobs, including their formality aspect, remains unclear. Since the 1980s, for much of the developing world, integration with the global economy created significant challenges in terms of handling the adjustment dynamics and distributional consequences of formal and informal employment. On the one hand, branches of multinational enterprises in developing countries tend to offer better working conditions than local companies, including hiring workers formally and promoting skills development. Access to foreign markets and partners often led to the establishment of local formal enterprises, skills and technology transfer, and promoted the formalisation of informal enterprises, thus leading to the growth of formal employment. On the other hand, globalisation also results in more intense competition, which pushes some local enterprises out of the market and forces workers who lose their jobs into informal employment. It can also incentivize other enterprises to rely increasingly on lower-cost informal workers, whether through subcontracting or through informal employment relationships within formal establishments (Bacchetta, Ernst and Bustamante, 2009^[6]; Chen and Alter, 2002^[7]; Cisneros-Acevedo, 2021^[8]). Vulnerabilities to the disruptions of GVCs, including the supply of intermediate inputs, put further pressure on enterprises to cut costs and reorient their production to local, and often informal, markets.

As a result, the overall effect on informal employment is frequently ambiguous; moreover, the effect is not uniform across countries. Generally, a higher degree of globalisation is associated with lower informality in upper-middle-income and high-income countries (Figure 4.2). However, this relationship does not hold for lower-middle-income and low-income countries (Figure 4.3). The partial correlation coefficient between informality and globalisation is substantially lower in the sample of poorer countries than in the sample of richer countries, and is not significantly different from zero, keeping other confounding factors constant. In other words, globalisation does not seem to benefit poorer countries in terms of formal employment as much as it benefits richer countries.

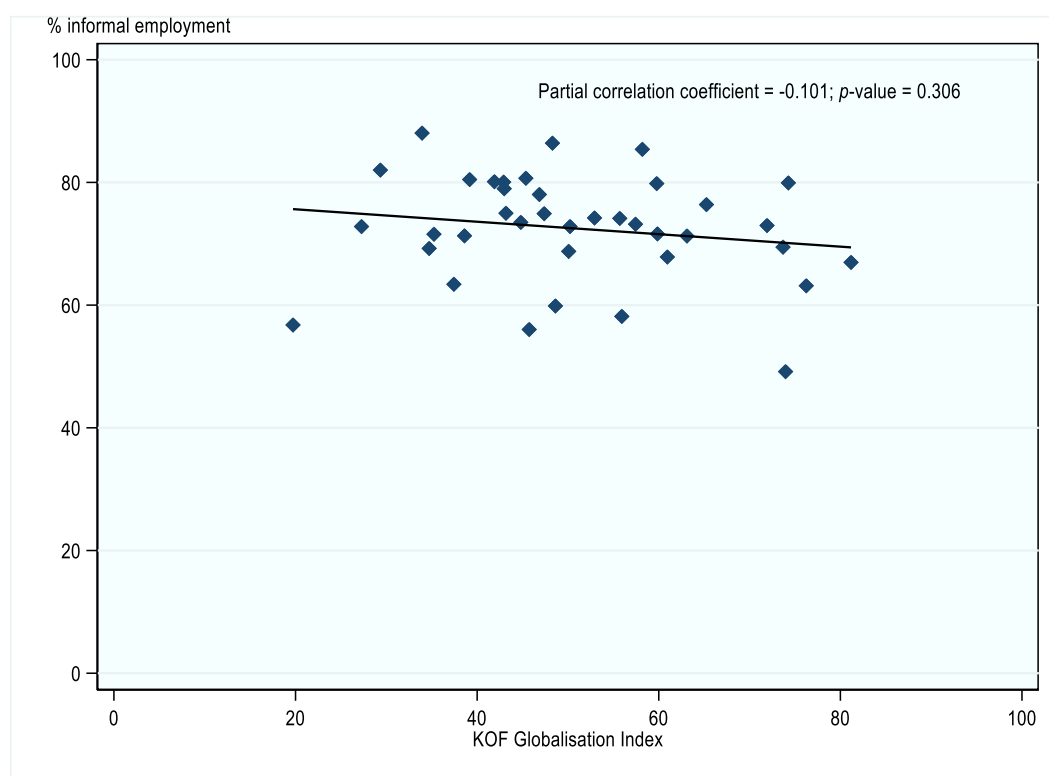
Figure 4.2. Globalisation and informal employment in upper-middle-income and high-income countries are negatively correlated



Note: Globalisation is measured by the KOF Globalisation Index, which includes the following components: trade in goods, trade in services, trade partner diversification, foreign direct investment, portfolio investment, international debt, international reserves, and international income payments. For both variables, residual rather than actual values are reported (note that the mean of each variable is added to its residuals). Thus, the figure can be interpreted as the relationship between the two variables keeping a set of controls constant. Those controls are: gross domestic product (GDP) per capita (2017 PPP), life expectancy, population growth, age dependency ratio, and the World Bank 2017 Ease of Doing Business Index. The sample includes 56 countries with available data for 2018.

Source: Informal employment: ILO (2018^[9]), *Women and Men in the Informal Economy: A Statistical Picture*, www.ilo.org/global/publications/books/WCMS_626831/lang--en/index.htm; for GDP per capita (2017 PPP), life expectancy, population growth, and age dependency ratio: World Bank (2021^[11]), *World Development Indicators* (database), www.data.worldbank.org/products/wdi; for ease of doing business: World Bank (2021^[10]), *Doing Business* (database), www.doingbusiness.org; for the KOF Globalisation Index: Gygli et al. (2019^[11]), <https://kof.ethz.ch/en/forecasts-and-indicators/indicators/kof-globalisation-index.html>.

Figure 4.3. Globalisation and informal employment in lower-middle-income and low-income countries are virtually unrelated



Note: Globalisation is measured by the KOF Globalisation Index, which includes the following components: trade in goods, trade in services, trade partner diversification, foreign direct investment, portfolio investment, international debt, international reserves, and international income payments. For both variables, residual rather than actual values are reported (note that the mean of each variable is added to its residuals). Thus, the figure can be interpreted as the relationship between the two variables keeping a set of controls constant. Those controls are: GDP per capita (2017 PPP), life expectancy, population growth, age dependency ratio, and the World Bank 2017 Ease of Doing Business Index. The sample includes 39 countries with available data for 2018.

Source: Informal employment: ILO (2018^[9]), *Women and Men in the Informal Economy: A Statistical Picture*, www.ilo.org/global/publications/books/WCMS_626831/lang--en/index.htm; for GDP per capita (2017 PPP), life expectancy, population growth, and age dependency ratio: World Bank (2021^[11]), *World Development Indicators* (database), www.data.worldbank.org/products/wdi; for ease of doing business: World Bank (2021^[10]), *Doing Business* (database), www.doingbusiness.org; for KOF Globalisation Index: Gygli et al. (2019^[11]), <https://kof.ethz.ch/en/forecasts-and-indicators/indicators/kof-globalisation-index.html>

This chapter examines the reasons for this disparity. It shows that the linkages between informality and globalisation are complex. They are related to the nature of trade and trade liberalisation asymmetries (whether in exports or in imports), the organisation of trade through GVCs, and the specificities of particular sectors. All of these reasons also relate to specific characteristics of economies at various income levels. In poor countries with a low-skilled workforce, enterprises operate in a more extractive mode, exporting raw commodities with limited added value, and not necessarily relying on a large formal labour force. Deficiencies in infrastructure to support higher value-added industries contribute to this dynamic.

The higher degree of informality in a specific country in turn may also preclude it from greater participation in the global economy. This is due to various reasons. The large informal economy can prevent countries from developing a sizeable and diversified export base, and limit their ability to benefit fully from their integration into the world economy (Bacchetta, Ernst and Bustamante, 2009^[6]). Informality also limits enterprise size and productivity growth: enterprises operating in the informal economy are often small and face numerous barriers to growth, such as access to finance and to information, limited or inadequate training, inability to attract and build talent, and susceptibility to shocks. This prevents them from achieving

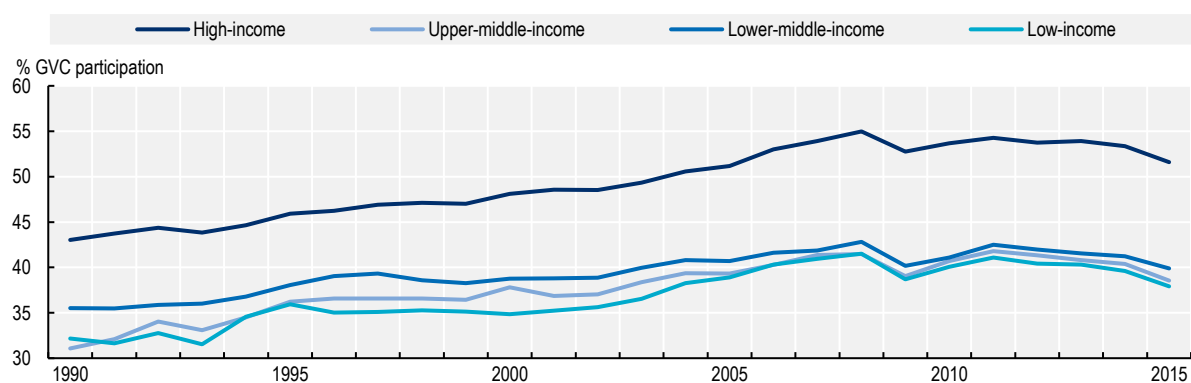
high productivity and from offering high-quality goods and services, leading to a low capacity to export. Informality may prevent the successful reallocation of resources within the informal economy. Informality is also strongly linked to income inequality, which in turn restricts access to education and health, and eventually blocks access to capital and skills, and as a result, decreases trade. A high informality rate limits the generation of public revenue, limits government resources to expand and create infrastructure, technology and so on; lack of fiscal space means that capacity to act is lower. In short, informality in itself is an obstacle to countries' full and fruitful participation in the world economy.

GVCs originating from India and Indonesia exhibit some of the highest risks of linkages between trade and informal employment

International production and trade are increasingly organised through GVCs. By 2020, international trade in final products represented only about 30% of all trade, whereas up to 70% of international trade involved a variety of production processes and exchanges spanning multiple countries, before being incorporated into final products (OECD, 2020^[12]).

GVC participation can be measured as a situation where value added crosses at least two borders. Applying this definition, such complex processes also substantially grew in importance (Figure 4.4). The size of GVCs, which corresponded to 43% of gross exports in high-income economies and roughly 35% in middle-income economies in 1990, increased to 53% and roughly 40%, respectively, by 2015.

Figure 4.4. GVC integration is a defining factor of globalisation



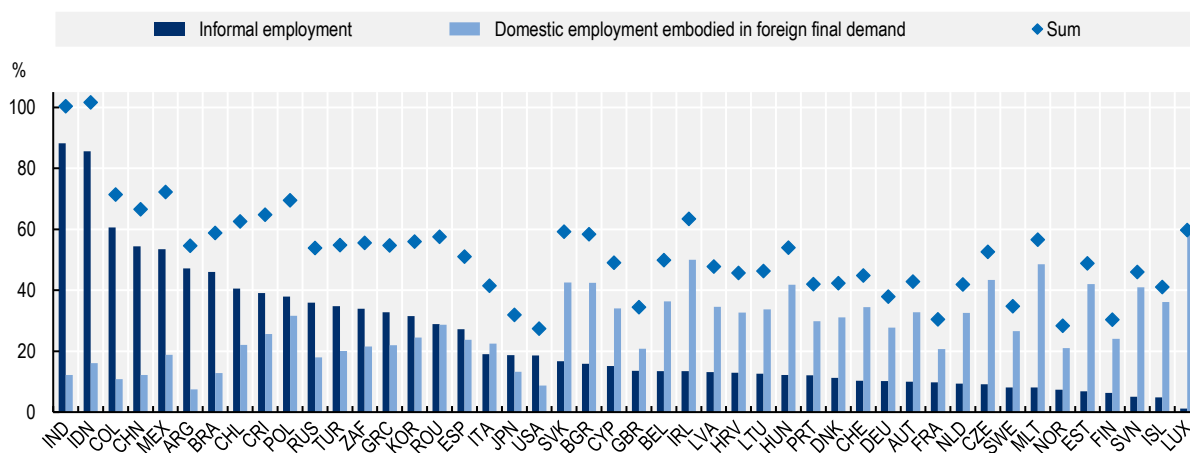
Note: GVC participation is defined as exported value added which crosses at least two borders. Here, it is expressed as share of gross exports. Source: Authors' computation based on Eora26 data obtained in Belotti, Borin and Mancini (2020^[13]).

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Measuring informal employment in GVCs is not easy, as it presupposes disentangling employment in jobs related to GVCs from those that are not. The best place to collect such information is enterprise-level, job-specific statistics. In the absence of such information, it is also possible to compare, on a more aggregate level, the share of informal employment in a country with the share of trade-related employment. Inter-country input-output analysis (an analysis based on linkages between industries within and across countries) allows estimation of the percentage of total employment that is embedded in foreign final demand. If the sum of the informal employment rate and of the trade-related employment rate in a given country is greater than 100%, then at least some of the GVC-related employment is definitely informal. Also, the greater the sum, the higher the probability that at least some GVC-related employment is informal. As shown in Figure 4.5, one cannot rule out that informal employment and GVCs are related. GVCs

originating from India and Indonesia exhibit the highest risk of informality footprint. In more advanced economies, where law enforcement and state institutions may be stronger, it is possible that all GVC-related jobs are formal, while informality is found elsewhere in the economy.¹

Figure 4.5. Informal employment and GVC-related employment, by country



Note: Both informal and domestic employment embodied in foreign final demand are expressed as a share of total employment. If the sum of these indicators is larger than 100%, one can interpret these results as evidence of overlap between informal employment and trade-linked employment.

Source: Informal employment: ILO (2018^[9]), *Women and Men in the Informal Economy: A Statistical Picture*, www.ilo.org/global/publications/books/WCMS_626831/lang-en/index.htm; domestic employment embodied in foreign final demand (%): OECD (2019^[14]), *Trade in employment (TiM): Principal indicators* (database), https://stats.oecd.org/Index.aspx?DataSetCode=TIM_2019_MAIN.

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The effects of global trade on informal employment are context-specific

Trade liberalisation, as one of the aspects of economic globalisation, is often seen as beneficial for the overall economy, favouring economic growth, efficiency and innovation (OECD, 2018^[15]; Goldberg and Pavcnik, 2016^[16]). However, not everyone benefits from trade equally. Trade-induced changes in production activities require reallocation of resources, which in turn leads to economy-wide adjustments in terms of employment quantity and quality, generating winners and losers from trade liberalisation not only across countries but also within countries.

With respect to informal employment specifically, from a theoretical point of view, trade liberalisation can either increase or decrease informal employment in a specific country permanently, depending on the models' assumptions (Goldberg and Pavcnik, 2003^[17]; Goldberg and Pavcnik, 2004^[18]). Empirically, the key difference appears to be in the nature of the trade liberalisation – whether it concerns imports or exports. Trade liberalisation induced by the reduction of export tariffs, and therefore the expansion of export opportunities, seems to decrease informal employment share in the affected sectors and regions. In contrast, trade liberalisation caused by the reduction of import tariffs, and therefore the expansion of imports, tends to increase the share of informal employment in the affected sectors and regions.

Increased export opportunities tend to boost formal employment opportunities

Several country studies show that a reduction in tariffs imposed on a country's exports by its trading partners leads to a reduction in the share of informality (Table 4.1).

Table 4.1. Effect of a reduction in trading partner tariffs on informal employment

Country covered	Empirical study	Time period	Focus	Data used to measure informal employment	The reduction in partner tariffs leads the informality share to...
Botswana	McCaig and McMillan (2020 ^[19])	1995-2006	Entire economy, mining and manufacturing	Labour force survey (Central Statistics Office of Botswana)	Decrease, in the clothing industry
Brazil	Paz (2014 ^[20])	1989-2001	Tradable sectors	Household survey (PNAD)	Decrease
Mexico	Aleman-Castilla (2006 ^[21])	1989-2002	Entire economy, urban areas only	Labour force survey (ENEU)	Decrease, for export-oriented industries, less so for industries facing high import competition
Mexico	Ben Yahmed and Bombarda (2020 ^[22])	1993-2001	Manufacturing, services, urban areas only	Labour force survey (ENEU)	Decrease, for women
Viet Nam	McCaig and Pavcnik (2018 ^[23])	1993-2004	Entire economy, tradable sector, manufacturing	Household survey (VHLSS)	Decrease, influenced by movements from informal microenterprises to formal larger enterprises within manufacturing

Note: This table includes non-exhaustive examples of empirical evidence published in peer-reviewed academic journals. In all studies, the effect of trade liberalisation is isolated from other confounding factors.

Source: Authors' compilation.

For instance, in the case of Botswana, informal employment in the clothing sector decreased as a result of the elimination of US duty fees, mandated by the 2000 African Growth and Opportunities Act in the United States (McCaig and McMillan, 2020^[19]).

Tariff reductions by Brazil's partners on the country's exports throughout the 1990s resulted in a decrease in the informal employment share in manufacturing, as well as an increase in formal employees' wages (Paz, 2014^[20]).

In Mexico, following the entry into force of the North American Free Trade Agreement (NAFTA), lower tariffs imposed by the United States on Mexican exports led to a decrease in informality (Aleman-Castilla, 2006^[21]; Ben Yahmed and Bombarda, 2020^[22]). The effects of export opportunities, however, differed across workers and enterprises. The most export-oriented industries (such as textiles, apparel and leather), as well as women, benefitted the most from lower tariffs imposed on national exports (Aleman-Castilla, 2006^[21]; Ben Yahmed and Bombarda, 2020^[22]).

For Viet Nam, the United States-Vietnam Bilateral Trade Agreement reduced export tariffs for Viet Nam. This induced a positive export shock from Viet Nam, and led to a substantial reallocation of workers from informal microenterprises to formal sector enterprises in manufacturing. Such reallocation was mainly induced by the expansion of existing formal enterprises, and a new entry of enterprises directly into the formal sector, rather than the formalisation of informal microenterprises (McCaig and McMillan, 2020^[19]).

In contrast, import competition can increase informal employment

Trade liberalisation induced by a country's own tariff reductions on imported goods is generally found to increase informality due to increased foreign competition. Numerous studies (reviewed in Table 4.2) show that import competition may lead to formal employment losses, and subsequent reallocation of labour to sectors and occupations where informality is more prominent. This may happen for a variety of reasons, including the fact that local industries may not be mature enough to compete with the influx of better-established enterprises and brands. Import competition may also increase pressure on enterprises to cut costs and therefore cut corners on labour protections, either inducing them to employ labour informally, or outsource their activities to informal enterprises, home-based workers and self-employed micro-entrepreneurs.

Indeed, in Argentina, tariff cuts throughout the 1990s led to an increase in informality in some of the most exposed sectors (Acosta and Montes-Rojas, 2014^[24]; Cruces, Porto and Viollaz, 2018^[25]). For example, between 1992 and 2003, the import tariff on clothing dropped by 8 percentage points, while the sector's informality rate increased by 30 percentage points. The detrimental effect was concentrated among small enterprises (Cruces, Porto and Viollaz, 2018^[25]), whereas industries with high investment rates were able to neutralise and reverse this effect (Acosta and Montes-Rojas, 2014^[24]).

Similarly, a reduction in import tariffs was also found to increase informality in Botswana following trade liberalisation within the Southern African Customs Union in the 1990s (McCaig and McMillan, 2020^[19]).

In Brazil, recent studies identified an increase in the overall informality level following important trade liberalisation (Bosch, Goñi-Pacchioni and Maloney, 2012^[26]; Paz, 2014^[20]), including in the medium and long term (Dix-Carneiro and Kovak, 2019^[27]), even if formal employment changes within the manufacturing sectors specifically were less affected (Goldberg and Pavcnik, 2003^[17]).

In Colombia, although the increase in informal employment was modest (Attanasio, Goldberg and Pavcnik, 2004^[28]) and occurred in the setting of rigid labour markets, it dissipated following labour market liberalisation reforms (Goldberg and Pavcnik, 2003^[17]).

Two exceptions stand out: Egypt (Selwaness and Zaki, 2015^[29]; Ben Salem and Zaki, 2019^[30]) and Mexico (Aleman-Castilla, 2006^[21]; Ben Yahmed and Bombarda, 2020^[22]). These countries experienced a decrease in informality following their own reductions to import tariffs in the trading sector in urban areas. The informality reduction effect in Mexico was, however, observed only among large enterprises with more than 50 employees, with the strongest effect observed in enterprises employing more than 250 people (Ben Yahmed and Bombarda, 2020^[22]). Informality reduction occurred due to the formalisation of the existing informal workforce of large enterprises, rather than increased hiring of formal workers by large enterprises.

In South Africa, tariff reductions implemented since 1995 reduced both formal and informal employment among the most exposed workers, thus resulting in an adverse labour market effect but not in a relative increase in informality (Erten, Leight and Tregenna, 2019^[31]).

Table 4.2. Effect of a reduction of own import tariffs on informal employment

Country covered	Empirical study	Time period	Focus	Data used to measure informal employment	The reduction in own import tariffs leads informality to...
Argentina	Acosta and Montes-Rojas (2014 ^[24])	1992-2003	Tradable sectors	Household survey (EPH)	Increase on aggregate; decrease for sectors with high investment rates
Argentina	Cruces, Porto and Viollaz (2018 ^[25])	1981-2001	Entire economy	Household survey (EPH)	Increase in sectors most exposed to liberalisation, particularly if the sector is dominated by small enterprises. General equilibrium counteracting effect at aggregate level. Increase in informality also in non-tradable sector.

Botswana	McCaig and McMillan (2020 _[19])	1995-2006	Entire economy, mining and manufacturing	Labour force survey (Central Statistics Office of Botswana)	Increase
Brazil	Bosch, Goñi-Pacchioni and Maloney (2012 _[26])	1983-2002	Entire economy	Labour force survey (PME); household survey (PNAD)	Increase
Brazil	Menezes-Filho and Muendler (2011 _[32])	1986-2001	Tradable sectors	Household survey (PME)	Remain unchanged
Brazil	Goldberg and Pavcnik (2003 _[17])	1987-98	Tradable sectors	Labour force survey (Monthly Job Survey)	No effect within the manufacturing sectors
Brazil	Paz (2014 _[20])	1989-2001	Tradable sectors	Household survey (PNAD)	Increase
Brazil	Dix-Carneiro and Kovak (2019 _[27])	1992-2010	Tradable sectors	Census (IBGE)	Increase, and the effect increases across time, suggesting no reallocation
Colombia	Goldberg and Pavcnik (2003 _[17])	1984-98	Tradable sectors	Household survey (NHS)	Increase, but a labour market liberalisation cancels the effect
Colombia	Attanasio, Goldberg and Pavcnik, (2004 _[28])	1984-98	Tradable sectors	Household survey (NHS)	Increase
Egypt	Selwaness and Zaki (2015 _[29])	1998-2006	Tradable sectors	Egyptian Labor Market Panel Survey (ELMPS)	Decrease
Egypt	Ben Salem and Zaki (2019 _[30])	1998-2012	Manufacturing sectors	ELMPS	Decrease
Mexico	Aleman-Castilla (2006 _[21])	1989-2002	Entire economy, urban areas only	Labour force survey (ENEU)	Decrease, but the opposite is true for sectors facing high import competition, unless these sectors also benefit from lower tariffs on their inputs
Mexico	Ben Yahmed and Bombarda (2020 _[22])	1993-2001	Manufacturing, services, urban areas only	Labour force survey (ENEU)	Decrease, especially for men; increase for low-skilled women in services. Reallocation within and between sectors.
South Africa	Erten, Leight and Tregenna (2019 _[31])	1994-2004	Entire economy	Labour force survey (PALMS)	Remain unchanged, but overall negative effect on employment (formal and informal)

Note: This table includes non-exhaustive examples of empirical evidence published in peer-reviewed academic journals. In all studies, the effect of trade liberalisation is isolated from other confounding factors.

Source: Authors' compilation.

The aggregate effects hinder important heterogeneity across industries, geographical regions, workers and enterprises

Several studies show that the effect of trade liberalisation is not uniform across the economy, because it usually does not concern all sectors in the same way; because production is often clustered geographically; and because capital reallocation is slow, and labour market mobility is imperfect. Likewise, its effect on the informal economy varies across workers, enterprises, industries, and geographical regions within the same country.

Given that labour mobility between industries is usually low because of worker protection and industry-specific skills, the within-industry effects of trade liberalisation are often larger than the between-industry effects (Attanasio, Goldberg and Pavcnik, 2004_[28]; Ben Yahmed and Bombarda, 2020_[22]; McCaig and McMillan, 2020_[19]). It is the workers in sectors and industries most affected by trade liberalisation who experience more intense competition the most (Goldberg and Pavcnik, 2007_[33]).

Workers living in regions with a high concentration of industries that are more involved in trade than others are also affected differently than less exposed regions (Kovak, 2013^[34]; Topalova, 2010^[35]). For example, in Brazil, regions most exposed to the growth of imports, following trade liberalisation in the early 1990s, experienced more prolonged declines in formal sector employment and earnings relative to other regions (Dix-Carneiro and Kovak, 2017^[36]). These regions also saw the greatest rise in the share of informal employment over time. Moreover, the regional dynamics of informal employment were shaped by the interplay of employment in tradable and non-tradable sectors. Formal workers displaced by trade either moved to formal employment in low-paid non-tradable sectors, or – and this is a more systematic effect – first entered non-employment, and then transitioned to informal employment, including in the non-tradable sectors. In fact, if employment fully recovered over time from the trade shock in regions most exposed to trade, this recovery seems to be fully accounted for by the regional increase in informal employment (Dix-Carneiro and Kovak, 2019^[27]). Overall, in Brazil, the long-lasting negative impact of import shocks at the regional level can be explained by the combination of a trade shock with a very low level of mobility between regions (Dix-Carneiro and Kovak, 2017^[36]). In other words, when facing an import shock, workers are more likely to transition to lower-quality jobs (informal and/or with lower pay) in the same region than to move to another region. The deeper cause of this lack of geographical mobility is not well understood, although it could be related to slow reallocation of capital across regions (Dix-Carneiro and Kovak, 2017^[36]). This pattern of low mobility is common in developing economies: internal mobility is generally much weaker in low- and middle-income countries than in high-income countries, according to World Bank research (Grover, Lall and Maloney, 2022^[37]). Trade liberalisation may also affect the nature of informality. For example, in the case of Peru, increased import competition pushed informal enterprises out of the market because their productivity was too low to sustain foreign competition. However, at the same time, formal enterprises started hiring workers informally on a more systematic basis as a result of the pressure of the same competition. As the latter effect dominated, the overall share of informally employed workers in the economy increased, even if the share of informal enterprises decreased (Cisneros-Acevedo, 2021^[8]).

The expansion of global value chains comes with additional challenges to formal and informal employment

Existing evidence suggests that GVCs have the potential to create opportunities for both higher productivity and better-quality employment, including for women and young workers, by allowing workers to access employment requiring a higher level of skill and knowledge; to move to higher-value activities and markets; and to benefit from better practices of suppliers and employers from multinational companies (Horvát, Webb and Yamano, 2020^[38]). The extent to which this is actually happening depends on many factors, however. Challenges to the improvement of working conditions, including formalisation, include the type of linkages that predominate for a specific country (backward or forward), the way production and contractual relationships are organised, the extent to which suppliers and employers comply with national regulations and international labour and quality standards (ILO, 2016^[39]), and the possibilities of upgrading within a value chain. For the new entrants into a GVC from the least developed countries, an additional challenge also lies in their limited productive capacities [especially for artisanal and small-scale players; see (McQuilken and Perks, 2021^[40])]; in inadequate or the simple lack of infrastructure; in finding their niche in GVCs dominated by a few players from advanced economies; and in obtaining a significant share of the total value added produced along the GVC (OECD, 2018^[41]). Given these challenges, the potential for GVCs to improve the quantity and quality of jobs in the least developed countries has, so far, remained limited (AfDB/OECD/UNDP, 2014^[42]).

Expansion of forward linkages has the potential to decrease informal employment, whereas the expansion of backward linkages has an ambiguous effect

Expansion of forward linkages, understood in the broad sense as exported intermediate products, would have similar effects to the expansion of total exports. It has significant potential to decrease informal employment, similar to the mechanism outlined in Table 4.2.

The expansion of backward linkages, understood in the broad sense as imports of intermediate products, may have a more ambiguous effect on informality. On the one hand, empirical studies show that the effect of tariff reductions on intermediate products is substantially larger than the effect of tariff reductions on final products, in what concerns enterprise-level productivity and industry growth and innovation [for a review, see Goldberg and Pavcnik (2016_[16])]. Not only can such trade liberalisation enable domestic enterprises to buy more of the cheaper intermediate products, but they may also buy a cheaper and higher-quality variety of intermediate products that was not previously available on the domestic market. Foreign technology embedded in these intermediate products has significant potential to increase the productivity of enterprises using them as inputs into their products [as was the case in Indonesia; see Amiti and Konings (2007_[43])]. In India, trade liberalisation that encompassed intermediate products enabled domestic enterprises to introduce new products, particularly in sectors that had experienced the largest tariff reductions on their imported intermediates (Goldberg et al., 2010_[44]; Topalova and Khandelwal, 2011_[45]). The improved access to intermediate products can allow enterprises to preserve and expand activities, as well as employment. The composition of this employment effect – more formal or more informal – is unclear.

On the other hand, these effects are not uniform across formal and informal enterprises. Indeed, providing tariff reductions on intermediate goods seems to be of more benefit to existing formal enterprises; additionally, it leads to the expansion and new entry to the market of formal enterprises that use intermediate goods as inputs for either their final goods or as part of a larger GVC [see Nataraj (2011_[46])]. However, if this increases competition with domestic enterprises (whether formal or informal) that are also producing the same type of input, some enterprises may be pushed out of the market. This would lead to loss of employment as well as an increase in informal employment in the non-tradable sector, which would absorb people who are unemployed [an effect similar to that observed in Brazil; see Dix-Carneiro and Kovak (2019_[27])].

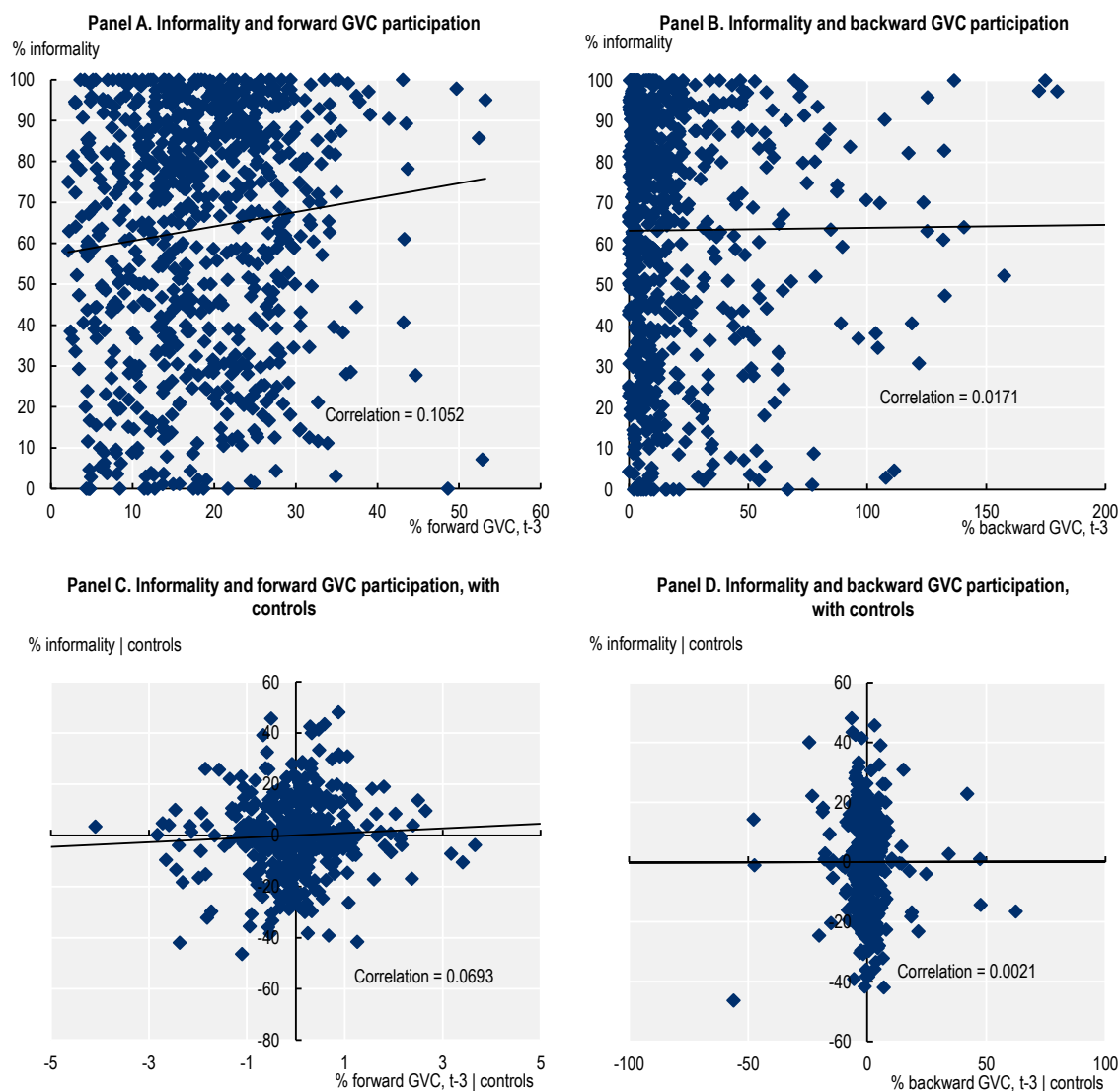
Informal enterprises are usually smaller than formal enterprises, and have a lower rate of using imported goods as intermediate goods. In comparison to formal enterprises, they are less affected by tariff reductions on intermediate goods. For informal enterprises, the reduction in final goods tariffs can increase average productivity by causing the smallest, least productive informal firms to close [e.g. Nataraj (2011_[46])]. This again can decrease the share of informal enterprises among enterprises that produce final goods; however, this might not automatically lead to a decrease in informal employment if displaced workers take up informal jobs elsewhere in the economy.

Evidence from Brazil and Mexico shows that lower tariffs on imported inputs indeed lowered the informality share of the industries using those inputs, with the effect concentrated among enterprises facing the highest import penetration with regard to their final products (Menezes-Filho and Muendler, 2011_[32]; Aleman-Castilla, 2006_[21]). Expansion of backward linkages increased the share of formal enterprises that used cheaper intermediate goods as inputs for final goods production. In the case of Mexico, a likely explanation is that lower Mexican import tariffs reduce costs for US companies operating in Mexico, as it is cheaper to open a plant in Mexico and import intermediate inputs from the United States (Aleman-Castilla, 2006_[21]).

This heterogeneity of country-specific findings reported by the academic literature is also confirmed more globally. Figure 4.6 shows the share of informal employment and lagged GVC indicators for more than 900 country/sector/year observations. It shows that there is no clear, strong link between the expansion of

GVCs and informality, whether one considers forward or backward linkages looking at simple correlations or controlling for confounding factors.

Figure 4.6. The relationship between informality and GVC participation is weak



Note: GVC participation is defined as exported value added which crosses at least two borders. Forward GVC participation is the exported value added of the reference country that is re-exported by at least one trading partner. Backward GVC participation is exported value added which is imported by the reference country. Here, forward and backward GVC participations are expressed as a share of the sector's exports and imports, respectively. In Panels A/B, simple correlations are reported. In the lower panel, residual values of informality and GVC participation are reported, controlling for sector-country and year fixed effects, as well as the logarithm of total trade at the sector/country level. Country coverage (multiple years): Argentina, Armenia, Brazil, Burkina-Faso, Cameroon, Chile, Colombia, El Salvador, Gambia, Ghana, Liberia, Madagascar, Malawi, Mali, Mexico, Namibia, Nicaragua, Niger, Peru, Senegal, Thailand, United Republic of Tanzania (hereafter: Tanzania), Uganda, Uruguay, Viet Nam and Zambia.

Source: For the percentage of informal employment at the sector level: OECD (2021^[47]), *Key Indicators of Informality based on Individuals and their Household (KIIbIH)*, <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIbIH.htm>. For GVC indicators: Belotti, Borin and Mancini (2020^[13]) based on Eora26 data.

Production organisation within GVCs may have additional, unique effects on informality

Throughout the world and throughout different value chains, the quality of employment in jobs linked to GVCs depends on many factors. While the amount and type of trade is one factor, the way production is organised, and, relatedly, the employment status of workers are other key factors shaping working conditions in GVCs generally and the formality of employment more specifically.

In a GVC, production activity can be organised in two main ways: (i) lead firms co-ordinate production along the supply chain through direct ownership of their overseas subsidiaries and affiliates; and (ii) outsourcing, where lead firms (buyers) do not have ownership or a direct contractual relationship, except with first-tier suppliers (Abramovsky and Griffith, 2006^[48]; ILO, 2016^[39]). Increasingly, outsourcing without direct ownership is overtaking lead firms' ownership, and is spreading to sectors where it was not present previously.

In the first scenario, workers are hired in the wholly owned subsidiaries and affiliates of the lead firms. This creates an employment relationship, with lead firms or their subsidiaries and affiliates having a direct responsibility for employees. Lead firms have a high chance of complying with labour regulations in host countries; they can also co-ordinate and control the standards of production and of employment conditions across their subsidiaries. Some multinational lead firms may also have dedicated strategies to ensure decent working conditions through private standards and codes of conduct, as well as training and skills development; in addition, they may offer working conditions more akin to working conditions in their home countries. All enterprises in OECD member countries are in effect encouraged by their countries to operationalise the recommendations of the *OECD Guidelines for Multinational Enterprises* (OECD, 2011^[49]). As a result, employment relationships with locally based workers have a higher chance of being formal and of providing decent working conditions. Numerous studies have found that foreign affiliates of multinational enterprises offer better employment conditions than those offered by domestic enterprises, and such affiliates also pay higher wages [for more information, see (Javorcik, 2015^[50]; ILO, 2015^[51])]. They are also more likely to employ formal labour. At the same time, it is often hard to assess whether there is a causal effect of GVC participation on better working conditions, as enterprises participating in GVCs are usually more productive than non-participating enterprises, and may have already been offering better working conditions before participating in GVCs as lead or supplier firms (*ibid*).

In the second scenario, that of outsourcing and subcontracting without ownership, buyers do not enter into an employment relationship, and therefore do not have formal responsibility for the supplying company or workers in subcontracted enterprises. The subcontracting practices involve recourse to numerous small and medium-sized enterprises (SMEs), workshops, dependent contractors and home-based workers, often unbeknownst to the lead firms (ILO, 2016^[39]). In principle, businesses, regardless of the level of control and ownership, are expected to exercise responsible business conduct and risk-based due diligence, and to use their leverage to change corporate behaviour along the value chain for the better. They have the responsibility to identify, prevent and address risks that negatively affect workers, as they are linked with the suppliers by a business relationship. However, in practice, the lead firms find it challenging to control and enforce compliance with labour regulations in all smaller production units. Workers also cannot necessarily benefit directly from the good practices of the lead firms. Moreover, these smaller production units are excluded – *de jure* or *de facto* – from the local labour and social security laws and regulations (Aleksynska and Eberlein, 2016^[52]), either because of their size, or because of the particularity of their status (i.e. dependent contractors or home-based workers).

Increased fragmentation of production contributes to the creation and entrenchment of the practice of small-scale production. When SMEs and other small units of production join a GVC, there are often several layers of enterprises that separate them from the lead firm, with the first-tier supplier or even a second-tier supplier mediating the inclusion of the production unit within the GVC (Navas-Alemán and Guerrero, 2016^[53]). This “distance” to the lead firm is key with regard to the opportunity to benefit from the good practices of the lead firm with respect to labour protections. This is because the lead firm has fewer

chances to know about the existence of more “distant” production units, and also because of the pressure exercised by the intermediary enterprises in order to reduce costs and deliver quickly (Barrientos, 2013^[54]; Navas-Alemán and Guerrero, 2016^[53]). In these settings, there is a more frequent recourse to informal work, or to non-standard employment arrangements that are partially or not fully covered by labour regulations. Moreover, low barriers to entry in labour-intensive low-skilled sectors have the potential to increase price competition between suppliers, with a race to the bottom in profits, wages, and working conditions, including formality (ILO, 2016^[39]).

Even if the development of GVCs through outsourcing and subcontracting contributes to income generation and employment creation, with SMEs being the primary sources of job creation (including for women and youth), it will not necessarily lead to formalisation or the improvement of working conditions. Suppliers in the lowest tiers risk having the lowest chances of upgrading their working conditions, including formalisation, when compared with suppliers in other tiers.

Purchasing practices in GVCs are one of the main sources of informal employment

The rate of informality among those in temporary employment is five to six times higher, on average, than among workers on open-ended contracts. But is temporary employment itself a possible way for a supplier to adapt to certain purchasing practices? A series of case studies, based on interviews, was carried out by the International Labour Organization (ILO) in five major markets (Bangladesh, China, India, South Africa and Türkiye) across ten sectors in 2017-18 in order to investigate this question. Among surveyed suppliers, 62% confirmed that purchasing practices contributed to their decision to hire temporary workers. Such practices included those that put suppliers in a position where they had no other choice but hiring temporary labour: inappropriate lobbying (71%), poor forecasting, and excessive sampling, among others (ILO, 2021^[55]). Since many company initiatives are related to brands, and brands are the ones that, to a large extent, define the purchasing practices, understanding the role of purchasing practices in informality is one of the keys to tackling informality.

Possibilities of upgrading in GVCs can improve formalisation as well as the living standards of informal workers; however, they are not automatic

Increased participation in GVCs, as well as their proliferation and evolution, have created expectations of economic as well as social upgrading of regions and of workers employed by developing country suppliers and subcontractors (ILO, 2017^[56]). Social upgrading through participation in GVCs is viewed as a combination of employment growth and improvement in wages and other working conditions (Milberg and Bernhardt, 2013^[57]). Social upgrading is often linked to upgrading within the value chains, and this upgrading falls into one of three categories: upgrading of processes, upgrading of products, and upgrading of functions (Humphrey and Schmitz, 2002^[58]; Humphrey and Schmitz, 2000^[59]; Navas-Alemán, 2011^[60]). Process upgrading involves doing certain tasks better, and can be measured by better management techniques, worker training and skill upgrading, and adopting better social practices, among others. Product upgrading means producing a product of better quality and of higher value. Functional upgrading happens when the supplier acquires new functions in the value chain activity that it did not possess previously, such as internalising product design, launching a new brand, or co-ordinating its own supply chain.

Process upgrading has the greatest potential to result in social upgrading (ILO, 2017^[56]).² Notably, better working conditions (such as OSH), but also wages, written contracts and formal arrangements, can all be part of process upgrading. Unfortunately, if product upgrading remains limited for many least developed countries (OECD, 2018^[41]), process upgrading is even rarer. This is because process upgrading represents an additional cost to the lead firm, but is not visible to the final consumer, whereas product upgrading responds to consumer demand for better-quality products. This is especially true in sectors such as agro-food. Dedicated policy efforts to increase consumer awareness, including with the support of local and

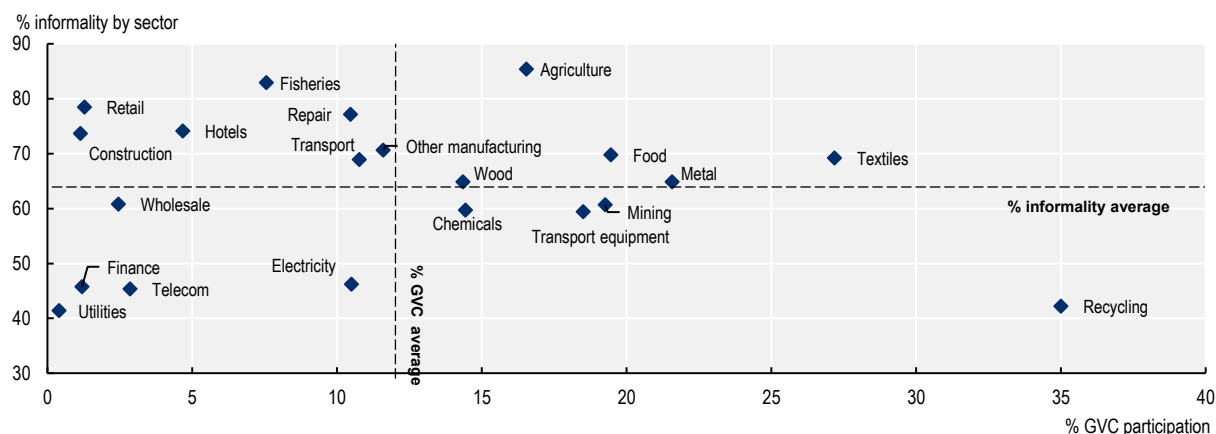
international non-governmental organisations (NGOs), may be a powerful way of ensuring that both product quality and employment quality issues are considered seriously throughout the GVC.

Informality in GVCs remains highly sector specific

The amount of trade, the way production is organised, upgrading process and governance issues also differ tremendously from one sector to another. In addition, inherent specificities of each sector continue to leave a major footprint on the share of informal employment in a specific GVC. Figure 4.7 relates total GVC participation to the percentage of informal employment in 26 sectors, averaged over 25 developing countries with the most recent available data. Figure 4.8 also looks separately at forward and backward linkages. Considering this relationship, one can identify four types of sectors: (i) sectors with higher-than-average levels of informality and of GVC participation (agriculture, food and beverages, textiles, wood, and metals); (ii) sectors with lower-than-average levels of informality and of GVC participation (utilities, electricity, and certain higher-value-added services such as finance and telecommunications); (iii) sectors with higher-than-average informality but lower-than-average GVC participation (fishing; lower-value-added service sectors such as retail, hotels, repair, construction, transportation and other manufacturing); and (iv) sectors with lower-than-average informality but higher-than-average GVC participation (chemistry, transportation equipment, mining and recycling).

Employment across sectors and occupations also varies greatly for men and women. Given this situation, integration into the GVC, coupled with the informality footprint in each specific value chain, can have a differentiated effect for men and women (ILO, 2015^[51]). In many countries, women tend to be more concentrated than men in lower-wage, lower-status forms of employment. In addition, whether and how women benefit from possible GVC-induced employment depends on the specific sector, occupation and production mode therein.

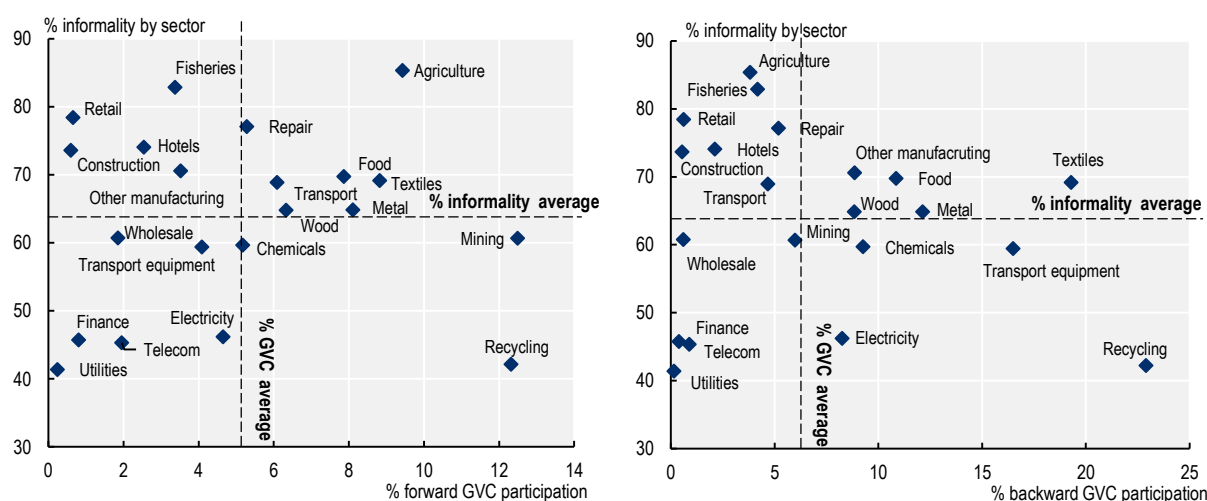
Figure 4.7. Total GVC participation and informality, by sector




Note: GVC participation is defined as exported value added which crosses at least two borders. Here, GVC participation is expressed as a percentage of value added. Country coverage: Argentina (2018), Armenia (2016), Brazil (2018), Burkina-Faso (2014), Chile (2017), Colombia (2018), El Salvador (2018), Gambia (2015), Ghana (2013), Liberia (2016), Madagascar (2012), Malawi (2016), Mali (2012), Mexico (2018), Namibia (2015), Nicaragua (2014), Niger (2014), Peru (2019), Senegal (2011), Tanzania (2014), Thailand (2017), Uganda (2015), Uruguay (2018), Viet Nam (2016) and Zambia (2015).

Source: For the percentage of informal employment at the sector level: OECD (2021^[47]), *Key Indicators of Informality based on Individuals and their Household (KIbIH)*, <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIbIH.htm>. For GVC indicators: Belotti, Borin and Mancini (2020^[13]) based on Eora26 data.

Figure 4.8. Forward and backward GVC participation and informality, by sector



Note: GVC participation is defined as exported value added which crosses at least two borders. Forward GVC participation is exported value added of the reference country that is re-exported by at least one trading partner. Backward GVC participation is exported value added which is imported by the reference country. Here, forward and backward GVC participations are expressed as a percentage of value added. Country coverage: Argentina (2018), Armenia (2016), Brazil (2018), Burkina-Faso (2014), Chile (2017), Colombia (2018), El Salvador (2018), Gambia (2015), Ghana (2013), Liberia (2016), Madagascar (2012), Malawi (2016), Mali (2012), Mexico (2018), Namibia (2015), Nicaragua (2014), Niger (2014), Peru (2019), Senegal (2011), Tanzania (2014), Thailand (2017), Uganda (2015), Uruguay (2018), Viet Nam (2016) and Zambia (2015). Source: For the percentage of informal employment at the sector level: OECD (2021^[47]), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)*, <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>. For GVC indicators: Belotti, Borin and Mancini (2020^[13]) based on Eora26 data.

StatLink  <https://stat.link/2uc9zs>

GVCs stemming from agriculture have some of the largest footprints of informal employment

The agriculture sector is increasingly organised within GVCs (OECD, 2020^[61]). While the agriculture sector represents a relatively small share of total GVC trade globally [with agriculture exports accounting for just 2% of world exports in 2014 (World Bank, 2020^[62])], several countries witnessed significant growth in their agriculture sector in 2000s and 2010s.

The agriculture sector is part of a multitude of GVCs. It has backward linkages, which connect the agriculture sector to chemical and input industries producing seeds, fertilisers and pesticides; to education, research and development, producing agriculture scientists; and to equipment manufacturers producing tractors and other equipment, to name a few. It also has forward linkages, through which agricultural produce is further processed (i.e. used as inputs in the manufacturing of food, beverages, tobacco, clothing, fibre or fuel), transported, marketed, retailed, or used in the restaurant industry and catering.

One of the characteristics of agricultural sector products feeding into GVCs is that, unlike in other sectors, domestic value chains dominate GVCs, especially in what concerns food production, because most of the food production is consumed locally. Even when agricultural food products cross borders, often it is to be used as an intermediate in the final good for the domestic market of the first importing country (Greenville, Kawasaki and Beaujeu, 2017^[63]). In other words, the forward GVC of the agriculture sector tends to be relatively short and less complex than the GVCs in other sectors. However, forward participation is also more important than backward participation, especially in developing countries, as shown in Figure 4.8 (OECD, 2020^[61]).

Another characteristic is that there is substantial heterogeneity across countries in terms of the diversity of agriculture subsectors participating in GVCs, and therefore there is substantial heterogeneity in the employment effects of GVCs. Some countries have a strong specialisation: for example, in Malaysia, GVC engagement in the agricultural sector is influenced mainly by one commodity: palm oil (OECD, 2020_[61]). A similar situation is observed in Colombia (bananas), Côte d'Ivoire and Ghana (cocoa), and Ethiopia (coffee). In other countries, several sectors may participate in GVCs.

Global estimates suggest that trade and agro-food GVCs generate about one-quarter of total agricultural workforce returns (OECD, 2020_[61]). Among agriculture subsectors, wool, oilseeds and plant-based fibres feature the greatest employment reliance on trade and GVCs, while account for up to one-half of all employment.

Shifting from simple agriculture to higher-value-added industries is a common priority in many countries in Asia, such as Cambodia, Lao People's Democratic Republic, or Myanmar (ASEAN Japan Centre, 2020_[64]), as well as in Africa (AUC/OECD, 2021_[65]). These are the sectors that have the most significant potential for additional employment creation, including of better-quality jobs for women and youth, and for skills development.

In many developing countries, the evolution of the GVC in agriculture has been taking place not only through the increase of the yields and exporting of agricultural produce, but also through the upgrading of the quality of products and processes, and through improving capacities in the parts of the value chain beyond agriculture production, such as packaging and food processing, the restaurant industry, and catering. In Asia and in Latin America and the Caribbean (and, to a lesser extent, in Africa), the period since the 1980s seen a rapid development of supermarkets and of new SMEs in the food sector, such as chain restaurants, processors, and modern wholesale and logistics companies (Reardon and Timmer, 2012_[66]). GVC participation has the potential to create employment in all parts of the value chain. About one-fifth of the total returns to labour generated by agro-food exports flows to the services sector, including transportation, retail and wholesale trade, and financial and business services (OECD, 2020_[61]). In developing Southeast Asia, the multiplier effect of food products industries is significant: in Viet Nam, for example, when demand for food products increases by one million Dong, the economy grows by 2.5 million Dongs (ASEAN Japan Centre, 2020_[64]). As a consequence, employment creation occurs throughout multiple sectors.

Despite this evolution, GVCs originating in agriculture account for the largest shares of informal employment when compared with any other type of GVC.

This is related to at least two key reasons: the pervasive informality in the first part of the value chain (namely agriculture production), and the organisation of the GVC, which does not encourage the transition to formality.

Indeed, in 2019, the first part of this GVC – agriculture production – still employed 32% of all workers in low- and middle-income countries, even though this share had decreased by 22 percentage points since 1991 under the effects of structural transformation (ILO, 2021_[67]). Agriculture also remains the sector that has the highest share of informal employment.

The vast majority of agricultural production is organised through small-scale smallholder farming (OECD/FAO, 2019_[68]; OECD, 2020_[69]). Farmers are generally self-employed. In many developing countries, existing social security systems are either not adapted to this employment status, or not adapted to the agriculture sector specifically (or sometimes both). This means that, by definition, farmers in many developing countries are informal. Often, farms also employ farmers' contributing family members.

Farmers participating in a GVCs increasingly hire workers to help meet demand and increase production in fields and plantations. Some agricultural production is also organised through larger family enterprises, farmers' organisations and co-operatives. Some multinational companies have also invested in land and directly manage farms, thereby raising wage employment in agriculture.

Nevertheless, wage employment – which would be more prone than self-employment to formalisation – remains limited. Moreover, even among the wage employees in formal agriculture enterprises, informality is the norm rather than the exception (World Bank, 2020^[62]). For example, a cross-country review of 49 studies related to the commodities and horticulture value chains showed that informal workers make up the majority of the workforce, even in formal enterprises (Chan, 2017^[70]). Due to the seasonal nature of production (which is sometimes extreme, e.g. lychees in Madagascar (ILO, 2017^[56])), large shares of employees are employed on a casual or seasonal basis. This means that workers in such jobs often do not enjoy full employment protection, and may not be subject to social protection, which again renders them informal. Moreover, current evidence from a range of developing countries shows a high prevalence of short-term contracts in the agriculture sector in those countries [for example, in Peru, this is the case for 79% of all men and 84% of all women working on artichoke farms and processing plants (World Bank, 2020^[62])]. Evidence from Côte d'Ivoire and Ghana on participation in the pineapple and cocoa value chains also showed that participation in GVCs is associated with an increase in hiring of casual labour (Amanor, 2012^[71]). But even among workers who do have a longer-term contract, such contracts are often based only on an informal oral agreement (Dihel et al., 2018^[72]), which is usually more difficult to enforce or contest in courts when problems arise.

In addition to this, the organisation of production in a GVC, with some exceptions, generally follows the scenario of outsourcing and subcontracting without ownership of the lead firms in the GVC. Over the period 2018-19, the OECD, jointly with the Food and Agriculture Organization of the United Nations (FAO), conducted a survey of companies interested in implementing OECD-FAO Guidance for Responsible Agriculture Supply Chains. The companies that took part in this survey were all multinationals, and their voluntary participation meant that they were most probably self-selecting given that they were aware of potential labour problems in the GVC. The survey findings showed that, even among these companies, 75% were sourcing from hundreds and even thousands of smallholder farmers, often with no possibility of fully tracing them. For one-half of companies sourcing from smallholders, smallholders' produce represented a majority of the company's production (OECD/FAO, 2019^[68]).

Indeed, farmers typically do not directly supply their products to multinational enterprises that are part of the GVC. Rather, enterprises source products from third-party suppliers that act as intermediaries. Such intermediaries can include local or international commodity traders, aggregators, wholesalers, and markets/exchanges, aggregating commodities in specific points in the supply chain (OECD/FAO, 2019^[68]). This has a double consequence on the employment conditions of farmers. On the one hand, for multinational companies, it is usually difficult to fully map and trace supplying farmers (OECD, 2020^[73]), and therefore participate to the improvement of their working conditions. On the other hand, many farmers participating in export-related production, including in GVCs, find themselves in the position of being dependent contractors with limited insight or access to market. Even if they may be officially registered as self-employed, paying taxes and social security contributions, they have only one main client (the intermediary) who sets the price for the products. In some instances, this client also controls other aspects of production. This dependency may have adverse long-term consequences if the farmer has limited bargaining power over prices or the quantity of goods. Small-scale farmers may not have enough power to bargain individually. In some countries, they may also be precluded from bargaining jointly, on the grounds of anti-monopoly laws forbidding them to form cartels. As a result, farmers may not be able to increase their profits as much as they could have. In addition, the responsibility between the dependent contractor and the client is not shared, especially with regard to OSH, fundamental rights and principles of work, or social protection (and thus, formality).

The share of informal employment in other parts of agriculture GVCs is also sizeable. For example, processing of agricultural produce (such as rice), pre-processing (such as shrimp peeling), or packaging is often done by subcontracted home-based workers, often women and children (World Bank, 2020^[62]). Indeed, agriculture comprises 16% of homebased employment globally, and up to 30% in Eastern, Southern Europe and Central Asia, 33% in Southern Asia, and 39% in the Middle East and North Africa;

with most of it being informal (Bonnet et al., 2021^[74]). In much of the developing world, final food preparation – including of the exported food that serves as intermediate input – is done on the street and in small-scale restaurants (ILO, 2021^[75]). Restaurants, catering services and food delivery services increasingly feature disguised employment relationships – informal by definition – especially with the advent of digital apps.

Textiles and clothing GVCs embody the hopes and criticism attached to globalised manufacturing processes

As shown in Figure 4.8, textiles and clothing is a sector with higher-than-average backward and forward GVC participation, combined with high levels of informal employment (Figure 4.7). While the exact magnitude of informal employment involvement in this GVC's production processes is difficult to assess, linkages have been clearly documented (Labowitz and Baumann-Pauly, 2014^[76]).

The industry is both a key influencer of labour-intensive export-led growth and, at the same time, the source of multiple scandals relating to working conditions at the lower-value-added parts of its value chain. Significant prevalence of informal employment has been identified, in particular in leather stitching and intricate handwork, such as embroidery and beading, as well as in upstream sectors such as cotton harvesting, often involving homework (OECD, 2018^[77]). Child labour and forced labour have also been recorded in textile and clothing GVCs, according to a joint research effort by the ILO, OECD, the International Organization for Migration (IOM), and the United Nations Children's Fund (UNICEF) (2019^[78]). As such, the sector embodies the hopes and criticism attached to globalised manufacturing processes.

Textiles production is structured across complex value chains that involve an international division of stages of production. These multiple stages differ greatly in terms of skill content and capture of the total value added. Thus, textiles production represents a clear example of a “smiling curve”: a setting where the upstream (research, design) and downstream (retail) parts of the value chain capture larger added-value shares than the middle (manufacturing) part of the value chain (Frederick, 2010^[79]). Manufacturing stages are themselves heterogeneous: synthetic textile fabrics production – which represents the vast majority of all fabrics³ – is capital intensive and is concentrated in high- and upper-middle-income countries, with China, Germany and the United States being the top exporters in 2019.⁴ By contrast, apparel production is much more low-skill and labour-intensive, in particular the “cut, make and trim” stage. Its exports are concentrated, besides China, in lower-middle-income countries, namely Bangladesh and Viet Nam.⁵ As will be discussed, it is this part of the value chain where the highest level of vulnerabilities are found, including regarding informal employment.

The textiles and clothing trade experienced a dramatic increase between 1994 and 2005, when the importing quotas system for these products (the Multi-fibre Arrangement and the Agreement on Textiles and Clothing) was progressively phased out (Lopez-Acevedo and Robertson, 2012^[80]). Over this period, Asian economies became key players in the industry, particularly in China, where textile exports grew 306% between 1995 and 2005. By contrast, countries originally favoured by the quotas system, such as Mexico, lost market power (ibid.).

Since then, textiles and clothing have been seen as the archetypal examples of means to achieve export-led growth and integration in international trade (ASEAN-Japan Centre, 2020^[81]). This trend is characterised by notable upsides, including that workers in the industry tend to benefit from a wage premium for their level of skill (Robertson et al., 2009^[82]). In the case of Honduras for example, *maquilas*, assembly enterprises concentrated in the textiles and clothing area, contributed to a 1.5-percentage-point reduction in poverty (de Hoyos, Bussolo and Núñez, 2008^[83]). As an industry that employs a large share of women, the development of export-led garment manufacturing has had a positive effect on gender equality: in Bangladesh, households in villages more exposed to the garment manufacturing boom were more likely to favour girls' school enrolment, as a consequence of the higher expected returns on skills

development (Heath and Mushfiq Mobarak, 2015^[84]). A link between better access to export markets and formalisation in textiles and clothing is also documented (McCaig and Pavcnik, 2018^[23]): the 2001 Viet Nam-USA bilateral trade agreement resulted in a major decrease in tariffs on the manufacture of textiles and clothing, which is believed to have caused a large drop in informal employment in the sector.

The vulnerabilities of employment in textiles and clothing value chains were highlighted by the collapse of Rana Plaza, an eight-storey commercial building containing a garment factory, on 13 April 2013 in Dhaka, Bangladesh. The related death of 1 132 workers and injury of more than 2 500 workers sparked an international outrage and came as a shock to both multinational sourcing companies and their consumers. This specific incident reveals broader challenges regarding labour rights and working conditions in textiles and clothing value chains.

Garment manufacturing enterprises' tendency to subcontract parts of orders is a pervasive practice aimed at responding flexibly to changes in demand. It is a vector through which informal employment is likely to feed into GVCs through the sourcing from small informal enterprises and from home-based workers. Globally, craft and trades (which include, among others, handicraft, garment and related crafts), are the second major occupation for home-based workers, after services and sales. Twenty-nine percent of the 260 million home-based workers are found in these occupations (Bonnet et al., 2021^[74]). In India alone, it is estimated that 5 million home-based workers are engaged in production for garment and textile supply chains (Anner, 2019^[85]). This creates a strong likely link between informal employment and GVCs, as 90% of home-based workers (across all sectors) in 2019 in middle- and low-income economies were informal workers. This figure is based on surveys carried out in 69 countries; the corresponding figure for all workers in the same survey sample was 77% (ILO, 2021^[75]).

The COVID-19 pandemic had a disruptive impact on textiles and clothing value chains, as textile companies worldwide reported that globally, orders dropped by 31% on average in 2020, with South America (-41%) and Africa (-38%) facing the sharpest declines (ITMF, 2020^[86]). The crisis had a major adverse effect on informal workers. In particular, informal home-based workers suffered simultaneously from a collapse in inputs (i.e. fabrics) largely supplied from China and abrupt lockdowns which made it impossible to bring material home to carry out tasks (WIEGO, 2021^[87]). Additionally, informal home-based were generally ineligible for COVID-19 pandemic relief schemes in most countries (ibid.).

In order to tackle vulnerabilities related to textiles and clothing industry working conditions, a range of initiatives by multilateral, national and private actors have been developed.

Increasingly, trade agreements play a key role in promoting decent working conditions. For example, the European Union's reviewed Trade and Sustainable Development policy aims at promoting, in trade agreements, the implementation of "international labour conventions [...] including respect of core principles of the International Labour Organization (ILO)" (European Commission, 2022^[88]). Trade agreements' labour provisions can play a role in improving working conditions in textiles and clothing GVCs specifically. Introduced originally as a provision in the 2006 Cambodia-USA 2006 Trade and Investment Framework Agreement, the ILO and the International Finance Corporation's Better Work programme aims to improve management practices and compliance with national legislation across 1 700 garment factories in 9 countries. An independent assessment concluded that the programme had made a positive impact on reducing the prevalence of harassment at work, increasing wages, and improving workers' household living conditions (ILO and IFC, 2016^[89]).

A range of voluntary and legally binding due diligence standards have emerged. Adopted in 2017, the *OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector* establishes a common understanding of due diligence in the sector to help enterprises meet the due diligence expectations set out in the *OECD Guidelines for Multinational Enterprises*. The Guidance provides advice in terms of responsible purchasing practices, in particular to develop pricing models that account for the cost of decent wages (OECD, 2018^[77]). In Bangladesh, since the Rana Plaza disaster, buyer-supplier relations and the actions of lead firms with respect to labour governance are believed to

have evolved favourably (Schüßler et al., 2019^[90]). The 2013 Accord on Fire and Building Safety in Bangladesh, a legally binding agreement between lead firms, employers and trade unions to promote occupational safety and health in the textiles and clothing industry, is believed to have played a role in this evolution. At the national level, its adoption is associated with longer-term subcontracting relations, and improved workers' outcomes, namely regarding occupational safety and social benefits (ibid.). Among lead firms, the Accord is believed to have led to revisions in supply chain and sourcing policies among Australian and German enterprises (Schüßler, Frenkel and Wright, 2018^[91]). In 2021, the 2013 Accord was superseded by the International Accord for Health and Safety in the Textile and Garment Industry (International Accord, 2023^[92]). This new framework covers a broader set of occupational health and safety measures. Originally focused on Bangladesh, the Accord has been expanded to Pakistan in 2023 (ibid.).

Key policy messages

For much of the developing world, integration into the global economy creates significant economic opportunities as well as challenges in terms of handling adjustment dynamics and distributional consequences. The benefits of trade, including through GVCs, do not accrue automatically. Their adverse effects, among others, can manifest themselves in an increase in, or persistence of, informal employment, depending on the context. Often, the impact of trade on the informal economy cannot be separated from its impact on employment in general. The trade composition, supply capacities, details of trade liberalisation scenarios, the way production within the GVCs is organised, the governance modes, the possibilities of upgrading within and across the GVCs, the purchasing practices, and the sectors of activity and other specific circumstances such as labour market conditions determine the direction of the effect of trade on employment, and on informality.

The role of governments in mitigating the adverse effects, and sharing the benefits of trade on a more equitable basis, is paramount

Reinforcing the social contract in the open economy requires ensuring that governments have the will and the means to play their role of leaving no one behind. Of course, the fact that informality low levels of development also means that capacity constraints are not uniform across countries.

This chapter showed that, in regions and industries affected by trade shocks, informal employment is rarely a choice on the part of workers. Rather, it is often an individual worker survival strategy – as in the case of Brazil, where formal workers displaced by trade enter into informal employment after prolonged non-employment. In such cases, trade liberalisation should be accompanied by adequate social protections such as unemployment support and active labour market policies, including training and skills development. The use of targeted measures is important in order to create local work opportunities in regions with experienced major trade shocks; to create support programmes with a special focus on the most affected regions, workers, industries and occupations; to provide better information on available jobs in other regions and sectors of the economy; to ensure reskilling; and to support inter-regional labour mobility.

By creating new employment opportunities in some regions and sectors, and also by displacing workers in others, globalisation modifies the demand for skills and the skill composition of the workforce. The extent to which this new demand can be met, and skills properly matched, also relates to the issue of informality. Related studies also show that trade-related employment destruction affects disproportionately unskilled workers (for a review, see Marcolin and Squicciarini (2017^[93])), who usually have fewer opportunities to receive formal training, or whose informally obtained skills may not be recognised. In this regard, the following are particularly relevant as complementary policies to trade liberalisation and GVC promotion policies: the availability of vocational training to adult learners (including special provisions for women and

migrant workers); life-long learning targeting skill changes arising from globalisation; the anticipation of skills changes in a country's changing production structure; and skill recognition policies.

Trade liberalisation may also create tight competition among formal enterprises, pushing them to cut corners on labour protection – as in the case of Peru, where formal enterprises started hiring more informal workers following trade liberalisation. In this case, effective labour inspection (with corresponding budgets to carry out inspections) and enforcement of current regulations may be one of the remedies. Regulations should also be conceived and regularly revised through social dialogue with workers and employers.

Trade-induced formalisation, when it happens, occurs primarily through the expansion of existing formal enterprises, formalisation within formal enterprises, and the new entry of enterprises directly into the formal sector, rather than the formalisation of existing less productive informal microenterprises. In such circumstances, there is a strong case for the introduction of policies that ease formal enterprise creation, including decreasing the administrative burden of their creation and the time needed for registration. Support for innovation and the provision of easier access to credit are also important in this regard.

Accompanying trade development within GVC, with the aim of reducing the incidence of informal work and reducing the vulnerability of informal workers should also be done by:

- promoting the use of written rather than oral contracts by foreign enterprises and their local suppliers
- developing policies to regulate sub-contracting and ensure fair treatment of locally employed workers, including dependent contractors
- raising awareness among businesses about the existence of *OECD Guidelines for Multinational Enterprises* (OECD (2011)^[49]) and *OECD Due Diligence Guidance for Responsible Business Conduct* (OECD, 2018)^[94], as well as OECD due diligence recommendations in specific sectors and supply chains, including minerals, agriculture, garments and footwear, extractives, and finance; and working with businesses to ensure that they see value in adhering to the principles prescribed therein. To the extent possible, integrating these frameworks into national binding regulations
- recognising home-based workers and their homes as workplaces
- making voices of different actors, including informal workers' organisations, heard; including them in policy formulation, as well as into the design and oversight of enforcement mechanisms

For these policies to succeed and for the welfare-augmenting effect of integration in the global economy to materialise, a range of other actors also need to be mobilised

Governments are not the only actors responsible for addressing the deficiencies in the social contracts that are influenced by global developments. Strong social contracts presume a reciprocity of obligations between all actors in the society, including government, businesses and the public.

In this regard, the role of multinationals is also key to ensuring formal employment in their subsidiaries, and in promoting and encouraging formal employment and decent work for all workers among the multinationals' suppliers. Multinationals' suppliers' compliance with international and local laws and regulations, the implementation of good practices of formal labour employment from their home countries, and having responsible business conduct embedded within business decisions, operations, and supply chains are key in this respect. Moreover, the purchasing practices of some companies are identified as one of the factors in the potential rise of informal employment. Raising awareness of this, and taking steps to modify purchasing practices in order to improve forecasting can be a viable tool to reduce informality.

International frameworks, such as the United Nations' (2011)^[95] *Guiding Principles on Business and Human Rights*, the ILO's (2017)^[96] *Tripartite Declaration of Principles concerning Multinational Enterprises*

and Social Policy, and the *OECD Guidelines for Multinational Enterprises* (OECD (2011^[49])), contain recommendations on due diligence for responsible business conduct.

The *OECD Due Diligence Guidance for Responsible Business Conduct* (OECD, 2018^[94]), based on the OECD Guidelines, contains specific recommendations that help enterprises implement the Guidelines. These recommendations are enforced by governments on the multinational enterprises operating in their countries or from bordering countries. They aim to help enterprises conduct due diligence in order to identify, prevent or mitigate, and account for current and potential adverse impacts of their activities, consistently with applicable laws and internationally recognised standards. To date, the OECD Guidelines is the only multilaterally agreed and comprehensive code of responsible business conduct that governments have committed to promoting. The OECD Guidelines recognise that businesses create value by generating employment and bringing expertise, technology and financing capacities to regions in order to increase production sustainably and upgrade supply chains. Nevertheless, it is also recognised that businesses have a responsibility to conduct due diligence to identify and prevent risks impacting people and the planet. It contains practical recommendations that help enterprises operationalise the framework for risk-based due diligence in their own operations, supply chains and business decisions. These recommendations are addressed by governments to multinational enterprises operating in their countries or from other adhering countries. They aim to help enterprises conduct due diligence in order to identify, prevent or mitigate, and account for actual and potential adverse impacts of their activities, consistently with applicable laws and internationally recognised standards.

With respect to informal employment specifically, the *OECD Due Diligence Guidance* contains specific examples of adverse impacts of the actions of multinationals on human rights and on employment relations. The *OECD Due Diligence Guidance* explicitly recognises that due diligence should concern the interests of stakeholders affected by enterprises' activities, such as "workers and employees including under informal arrangements within supply chains and trade unions" (OECD, 2018^[94]). To help enterprises identify operations that require prioritisation of assessments, the *OECD Due Diligence Guidance* suggests considering "the operation or business relationship [which] involves an activity or production process that is higher risk (characterised by high employment of informal work, use of hazardous chemicals, use of heavy machinery, etc.)" (OECD, 2018^[94]). Finally, the *OECD Due Diligence Guidance* also recognises that some sectors may be more prone to the risk of informal employment and may require dedicated attention to those risks: "for example, garment products with beading or embroidery hold a higher risk of informal employment and precarious work" (OECD, 2018^[94]).

The OECD has also developed due diligence recommendations in specific sectors and supply chains, including minerals; agriculture; garments and footwear; extractives; and finance. These international frameworks for multinationals are not binding, however. For this reason, it is particularly important to raise awareness among businesses about the existence of these recommendations, and to work with them to ensure that they see value in adhering to the principles prescribed therein. However, some countries have integrated these frameworks into national binding regulations, which aim to enable multinationals to operate on a level playing field [e.g. France, with its Duty of Vigilance law; see also other examples in (Broembsen and Harvey, 2019^[97])].

Disengagement from a business relationship may be appropriate as a last resort after failed attempts at preventing or mitigating severe impacts; when impacts are irreversible; when there is no reasonable prospect of change; or when severe impacts or risks are identified and the entity causing the impacts does not take immediate actions. The decision to terminate a business relationship largely depends on the circumstances and the risk appetite of the supply chain actors, but companies are expected to exhaust other mitigation options before disengaging (OECD, 2019^[98]).

There is also a need to encourage more transparency within multinational enterprises; for example, through reporting publicly (which is a key component of the *OECD Due Diligence Guidance*), and through

social audits, such as the ones conducted by enterprises that participate in the ILO and the International Finance Corporation’s Better Work programme.

In addition to multinationals, other actors – including consumers, informal worker associations and NGOs – can help to ensure that integration into the global economy is beneficial for all.

One of the key determinants of making progress towards addressing informality is strengthening the voice and bargaining power of informal workers. There is a lot of focus in the GVC on the first-tier supplier, whereas informality is much more prominent in lower-tier suppliers. Informality is simply invisible for some workers, such as home-based workers. For this reason, it is important to help informal workers to make their voices heard and to enable them to participate in policy formulation, as well as into the design and oversight of enforcement mechanisms, as they are much more knowledgeable about their needs (Broembsen, 2022^[99]).

This chapter has also demonstrated that within a GVC, upgrading of processes has the most significant potential to stimulate a transition towards formality, and to improve outcomes for informal workers. However, process upgrading is often the most difficult type of upgrading to achieve, as it is the least visible to the consumer. In this respect, consumer awareness regarding working conditions at the very bottom of the value chain can help to create the necessary momentum for improving working conditions and increasing formalisation.

Process upgrading is also linked to process traceability. Some GVCs have too many suppliers, and it may be prohibitively costly for individual lead firms to establish effective process traceability. In such cases, process traceability can be pursued by working with local NGOs in countries where products are sourced. Enterprises can also identify control points in the value chain and conduct an assessment of the due diligence actions of these entities. Also promising are collaborations in industry-wide initiatives through collective action among branded manufacturers, which can facilitate reaching out to a wider community in more uniform ways (ILO, 2017^[56]). In some instances, a “landscape approach” may be useful, whereby social risks (including informal employment) may be identified through a geo-sociological analysis, accounting for the rural dimension, among others, rather than site-by-site assessments of each individual supplier (OECD/FAO, 2019^[68]).

Finally, informality remains highly sector specific. Some sectors are more prone to informality than others. In some sectors, such as agriculture, informality is an “old”, inherent problem. In others, it is “acquired”, as a consequence of displacement or tight competition caused by globalisation, among other factors. Some new sectors and occupations that emerge may be fully informal from the outset. Given this situation, sector-specific approaches to informality should be particularly encouraged, taking into account its sector-specific root causes. Such approaches have the greatest potential to succeed if they are implemented in collaboration with informal workers’ organisations, including those operating within specific sectors.

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Notes

¹ For a limited subset of countries, data are also available for the mid-2000s (Argentina, Colombia, Mexico, South Africa and Republic of Türkiye (hereafter: Türkiye). In these countries the risk of informal employment feeding into exports generally (measured by the sum of informal employment and employment embodied in foreign demand) appeared to slightly decrease in most cases between the mid-2000s and 2018. This very limited number of observations should not lead to any general conclusions, however.

² Examples of process and of other types of upgrading in food and agriculture value chains in Colombia, Indonesia and Madagascar can be found in (ILO, 2017_[56]).

³ Synthetic textile fabrics production represented 62% all fabrics production in 2020 (Textile Exchange, 2021_[101]). Fabrics from natural fibres are less capital intensive and more tied to low- and middle-income countries.

⁴ Source: Observatory of Economic Complexity (2022_[100]) based on “Base pour l’Analyse du Commerce International” (BACI) by “Centre d’études prospectives et d’informations internationales” (CEPII).

⁵ *ibid.*



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