

1 Overview

This overview summarises the key findings and policy recommendations of the report.

Tackling the vulnerability challenge in the informal economy has been on the policy agenda since the mid-20th century (OECD/ILO, 2019^[11]). Despite numerous commitments by many countries, progress towards the sustainable formalisation of economies is slow. Informal employment is extremely persistent and, for a large majority of workers in the informal economy, is often associated with low-paying work. In contrast, meagre formalisation gains are often reverted by national, regional and global crises, such as the COVID-19 pandemic (OECD, 2023^[2]). Still today, nearly 2 billion workers, representing close to 60% of the world's employed population, are in informal jobs and the majority are low-paid (OECD, 2023^[2]).

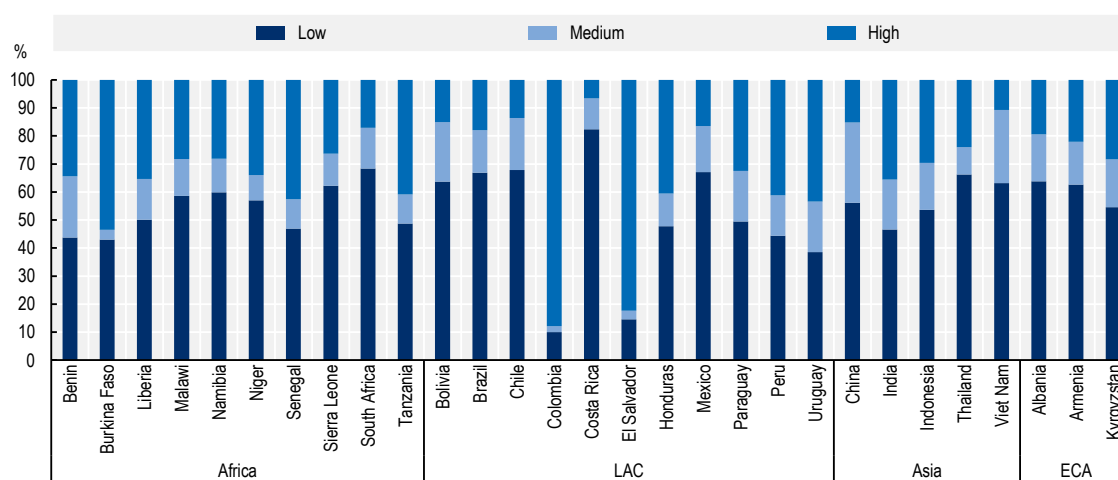
This report investigates why the vulnerability challenge in informal employment is so persistent. It highlights the specific types of risks that make it difficult for informal workers and their children to break free from informal employment and build better lives. In particular, it shows that the combination of low-paying work and informality makes the mere formalisation of jobs unlikely to eliminate on its own the vulnerability challenge of a large majority of informal workers. As this report argues, alleviating the double burden of informal employment and low-paying work is critical and calls for policy solutions that go beyond the formalisation agenda and embrace the goal of social justice.

Most informal workers carry the double burden of informal employment and low-paying work

Informal employment is highly heterogeneous (OECD/ILO, 2019^[11]). In many countries, it features multiple tiers, but quite often, it has just a two-tier structure. The upper tier is composed of workers who are relatively productive (possibly due to higher skills) and who enjoy higher earnings. The lower tier is composed of workers engaged in low-productivity, low-paying work, possibly due to a lack of skills but also due to the lack of opportunities elsewhere and, sometimes, to unfair remuneration practices.

Figure 1.1. Distribution of informal workers by size of labour earnings

Percentage of informal workers by earnings category



Note: Earnings categories are defined based on the total earnings distribution: low earnings are from the bottom of the distribution to 50% of the median earnings level; medium earnings are from 50% of the median to 150% of the median; and high earnings are 150% of the median and above. LAC – Latin America and the Caribbean; ECA – Europe and Central Asia; Bolivia – Plurinational State of Bolivia (hereafter Bolivia); China – People's Republic of China (hereafter China).

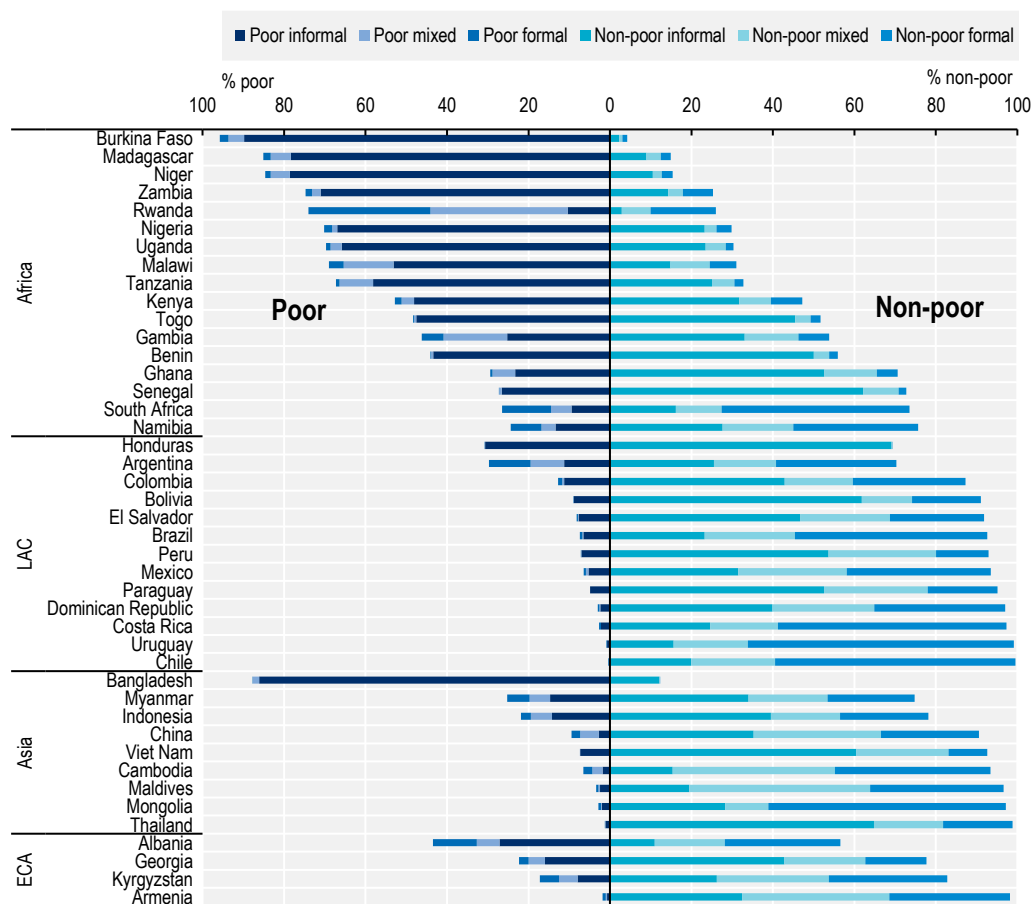
Source: Authors' calculations based on (OECD, 2021^[3]), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/key-indicators-informality-individuals-household-kiibih.htm>.

In the vast majority of countries with available data, the lower tier is larger in size than the upper tier if judged by earnings, whereas what could constitute a middle tier is quite compressed. Across countries with available data, an average of 54.0% of informal workers earn less than 50.0% of the median earnings level, and as such can be considered in the low tier of informal employment. The percentage of such workers is as high as 80.0% in Costa Rica (Figure 1.1).

While all informal workers grapple with more socio-economic risks than workers in formal employment, those in the lower tier of informal employment, along with their household members, are particularly vulnerable. They have a heightened risk of household poverty (Figure 1.2), and are also particularly vulnerable to health problems, poverty in old age and poorer educational outcomes for their children. In the absence of adequate social protection, upskilling opportunities, and measures against unduly low pay, they lack the means to mitigate these risks independently. When considered collectively, these risks and the sub-par outcomes experienced by most informal workers highlight the substantial societal and individual costs associated with informal employment and low-paying work.

Figure 1.2. Household poverty risk increases with households' degree of informality

Distribution of people by the poverty and informality status of their households



Note: Poor households are those that fall below the international poverty line of USD 3.20 (United States dollars) Purchasing Power Parities (PPPs). LAC – Latin American and the Caribbean; ECA – Europe and Central Asia.

Source: Authors' calculations based on (OECD, 2021^[3]), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/key-indicators-informality-individuals-household-kiibih.htm>.

For informal workers in the lower tier, moving into formal employment is difficult and does not guarantee a better income

The two-tier nature of informal employment is best illustrated by the extremely low number of transitions out of informal employment. When workers change their employment status, they are most likely to move between informal jobs and non-employment, with lower chances of transitioning to formal employment. Workers with the highest chances of accessing formal employment are employees and workers living in urban areas. Moreover, a higher level of education is the best guarantee of accessing and remaining in formal employment.

When they do occur, transitions from informal to formal jobs do not guarantee income improvements for all workers. Switching to formal employment has the greatest potential to improve the incomes of those workers who are already high earners – in the upper tier of informal employment – but not of the poorest workers in the lower tier. Moreover, in some countries, formalisation does not lift the poorest workers out of the lowest income quantile, possibly because of the generally low pay in some occupations, but also due to the absence of a statutory minimum wage. In contrast, transitions to informal employment generally worsen earnings and, in some settings, increase the likelihood of slipping into poverty.

The difficulty of acquiring and updating skills and subsequent skills mismatches constitute a significant challenge for workers in the informal economy

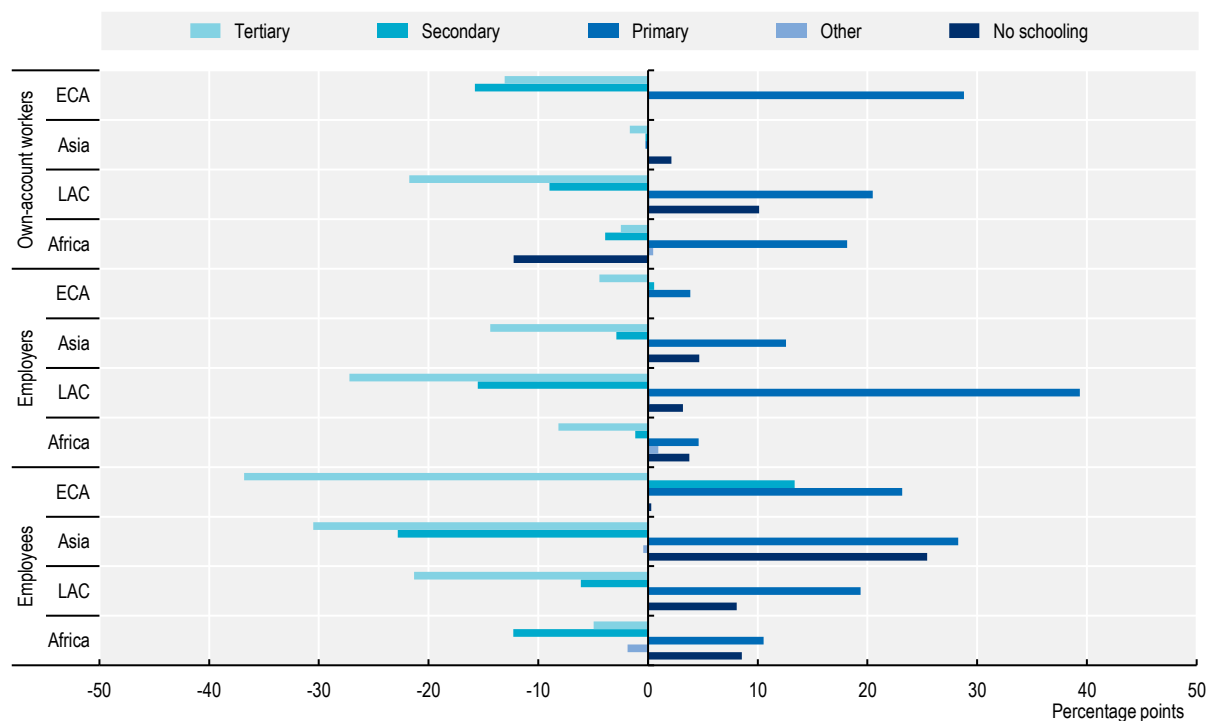
One significant barrier for informal workers seeking formal jobs is the lack of skills. Most informal workers, especially those in the lower tier, not only have low levels of education but they also have fewer opportunities than formal workers to develop their skills. This significantly affects their prospects for formalisation and better pay.

Informal workers have lower levels of education compared with formal workers

Approximately 45.0% of informal workers globally have only primary education or less, whereas this figure is only 7.0% for formal workers. In almost all regions and employment statuses, a higher percentage of informal workers has limited or no schooling, or only primary schooling, whereas formal workers tend to have higher levels of secondary and tertiary education (Figure 1.3). Conversely, informal employment is particularly prevalent among individuals with no education, accounting for 94.0% of such cases globally, with variations between regions. The share of informal employment decreases slightly to 85.2% among those with primary education and drops further to 52.1% for those with secondary education. Still, even among individuals with tertiary education, 24.2% are found in informal employment.


Figure 1.3. Education gaps between informal and formal workers

Difference in the distribution of informal and formal workers in various employment statuses, by educational attainment (circa 2019)



Note: Contributing family workers are not represented, as all of them are considered to be in informal employment.¹ LAC – Latin America and the Caribbean. ECA – Europe and Central Asia.

Source: (OECD, 2021^[3]), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>.

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Informal workers also have lower chances of upgrading their skills

Outside the education system, workers can upgrade their skills either through employer-provided training, public training programmes, or other formal or non-formal forms of learning.

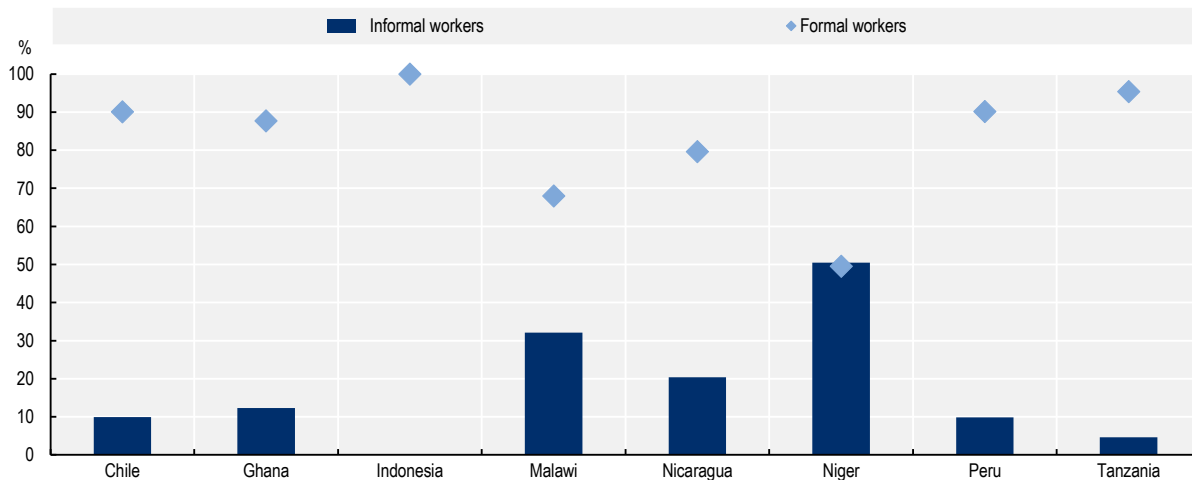
Evidence from African francophone countries shows that, in 8 out of 11 countries surveyed, at most 5% of workers in informal employment participated in job-related professional training in the last 12 months, financed by their enterprise or a partner. This proportion is 3-15 times lower than that of workers in formal employment. The situation among women is the most critical, as they face more limited access to training regardless of the formal or informal nature of their employment.

Training options differ across sectors of activity and types of enterprise. Enterprises in the services sector, as well as enterprises that were formal when they began operations (as opposed to informal enterprises that only became formalised at a later stage) have higher chances of offering training to their employees.

Informal workers are also less likely to benefit from training and skills programmes provided through public labour market programmes. For example, in Indonesia, 100% of such labour market beneficiaries are formal workers. In Chile, Ghana, Peru and Tanzania, around 90% of such labour programme beneficiaries are formal workers (Figure 1.4). In Niger, state-provided labour market programmes such as vocational training or skills development are provided equally to formal and informal workers. However, to the extent

that there is a larger share of informal workers than formal workers in the economy, in order to attain equity (rather than equality), more training needs to be provided to informal workers also in Niger.

Figure 1.4. Share of workers who benefitted from vocational training or a skills development programme, by formality status



Source: (OECD, 2021^[3]), *Key Indicators of Informality based on Individuals and their Household (KIbIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIbIH.htm>.

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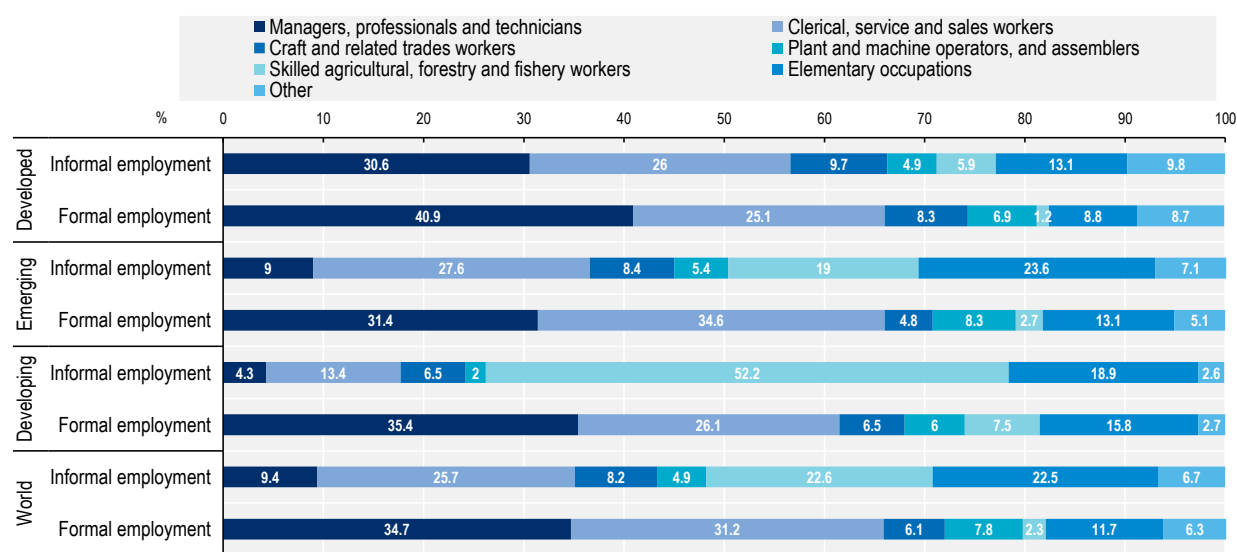
In addition, learning on the job remains limited for informal workers. When on-the-job learning does happen, the lack of official certification makes it difficult for informal workers to prove their skills when they aspire to transition into formal employment.

While the advent of digital technologies created many opportunities for learning in general, including for workers in the informal economy, it remains to be seen whether the completion rates and certificate uptake are sufficient to help informal workers progress in the labour market, and how the obtained skills can be recognised and validated.

Even if informal employment cuts across all occupations and skill levels, formal jobs typically require higher-level skills and qualifications

Globally, among workers in informal employment, there are higher shares of workers in elementary occupations, of craft and related trades workers, and of skilled agricultural, forestry and fishery workers, than among workers in formal employment (Figure 1.5). Among workers in formal employment, there is a higher share of managers, professionals and technicians, as well as clerical, service and sales workers, than among workers in informal employment. These jobs typically require a different (often higher) order of a wide range of skills. These differences are observed among countries at all stages of development, but they are especially pronounced in developing and emerging economies.

Figure 1.5. Distribution of formal and informal employment by occupation



Note: International Standard Classification of Occupations (ISCO-88) classification of occupations. Global and regional estimates based on data for 144 countries representing 92.4% of the world's employed population. Harmonised definition of informal employment and employment in the informal economy. Latest available year.

Source: (ILO, 2023^[4]), *Women and men in the informal economy: A statistical update*.

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In countries with high levels of informal employment, the problem is not simply the absence of formal jobs, but that formal jobs are hard to fill. This is because, often, available formal jobs require skills that informal workers do not have, or cannot prove they have. According to the World Bank Enterprise Survey, which is carried out regularly in more than 100 countries at the enterprise level, countries in which employers believe that the practices of the informal sector are an important obstacle affecting the operation of their business are also countries where a lack of skills in the workforce is the main obstacle.

Skills mismatches affect both formal and informal workers, but in different ways

As a result of these differences in skills supply of informal workers and skills demand in formal jobs, economies with a large share of informal employment face sizeable skills shortages and mismatches. The types of skills mismatches vary across formal and informal workers. Workers in informal employment are particularly prone to undereducation in the majority of countries with available data. The incidence of undereducation is twice as high for informal workers as it is for formal workers in Brazil, El Salvador and Paraguay, and it is three times as high in the Plurinational State of Bolivia (hereafter Bolivia), Nigeria and Zambia. Underqualification of informal workers is proof that they acquire skills in the informal economy, but such skills are not backed by formal credentials. Formal workers, in contrast, are more likely to experience overeducation in all countries with available data. Among formal workers, the incidence of overeducation ranges between 11% in Nigeria and 56% in Zambia. In contrast, in Zambia, 10% of informal workers are overeducated; this is also the average rate of overeducation among informal workers in countries with available data. These patterns hold true for both men and women.

These mismatches aggravate the unemployment problem, hamper productivity and impede socio-economic development. They also become major barriers to public and private sector strategies for formal job creation and the adoption of new technologies, eventually perpetuating the intragenerational cycle of informal employment.

The vulnerability challenge of informal workers is being passed on to their children

The vicious circle of informal employment and low pay is not only intragenerational but also intergenerational. Children of informal workers, especially children of those in the lower tier of informal employment, inherit their parents' vulnerabilities in the world of work. This happens through at least four channels.

More children live in households characterised as entirely informal than in mixed or fully formal households

In developing and emerging economies, the majority of children live in poorer households where all family members are working informally, as opposed to households where at least one family member is working formally. As such, children are disproportionately exposed to informal employment and low-paid parents, as well as the underlying causes of this situation, including lower levels of education and parents' poorer networks and connections to the world of formal work.

The school attendance gap between children from fully informal, mixed and formal households widens as they proceed to higher levels of education

School attendance of children is another indicator that correlates with informality of parents. In some countries, differences in school attendance between children from fully informal households compared with those from mixed or fully formal households are evident from as early as primary and lower secondary schooling, and widen significantly at the upper secondary and post-secondary non-tertiary levels of education. They continue widening, although at a lower rate, at the level of tertiary education (Figure 1.6).

Households with formally working members devote more private resources to educating their children

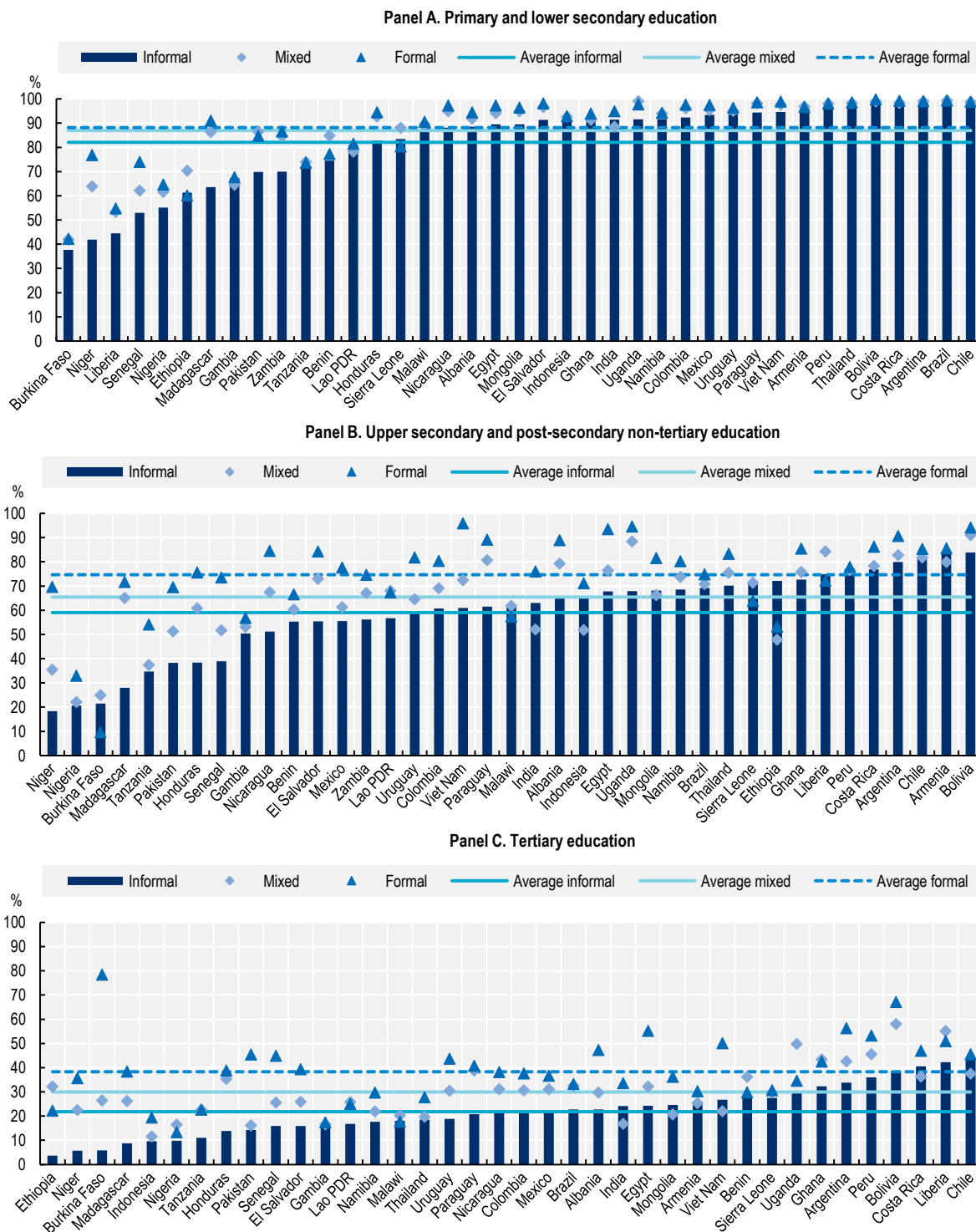
Formally working parents also have more private financial resources to devote to their children's education compared with informally working parents, especially those in the lower tier of informal employment. Moreover, during the lockdowns implemented during the COVID-19 crisis, formally working parents were able to dedicate more parental time to their children's education, sometimes overcompensating for the negative effects of school closures. Financial and time resources contribute to exacerbating inequalities among children from formal and informal households.

Young people from informal households are more likely to be NEET and face longer and more uncertain school-to-work transitions

The educational disadvantage of children from informal households translates into a clear disadvantage for young people. They are more likely to not be in education, employment or training (NEET) and face longer and more uncertain school-to-work transitions. When they undergo apprenticeships, these are likely to be informal. Likewise, the first work experience of young people from informal households is more likely to be informal than formal, thus perpetuating the vicious intergenerational circle of informal employment.

Figure 1.6. School attendance is higher for children living in formal households

School attendance rate, by level of education and household type



Note: Data refer to young people aged 6-24 years. Panel A: International Standard Classification of Education (ISCED) levels 1 and 2; Panel B: ISCED levels 3 and 4; Panel C: ISCED levels 5, 6 and 7. Lao People's Democratic Republic (hereafter Lao PDR).

Source: (OECD, 2021^[3]), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>.

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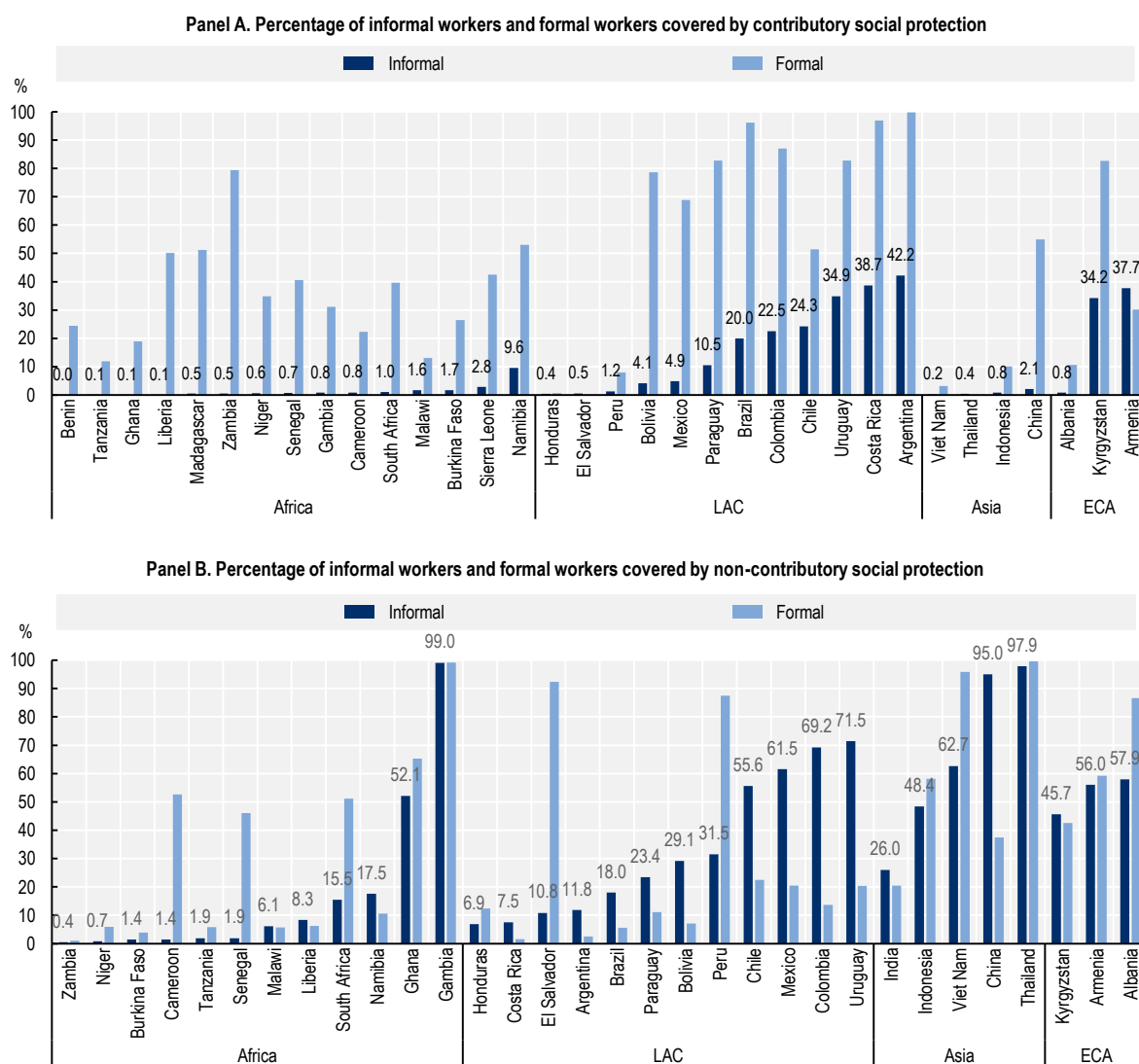
Informality is a major obstacle to universal social protection

One common challenge in most developing and emerging economies with a large informal economy is to remove the many legal, economic and institutional constraints that informal workers face in accessing social protection, and implementing funding mechanisms that are appropriate, fair, efficient and sustainable. To increase the social protection of informal workers and devise informed policies on formalisation, governments, enterprises and workers need in-depth information that captures the heterogeneity of informal workers and takes into account the broader context of their households.

For most workers in the informal economy, social protection coverage is particularly low

Throughout the world, social protection coverage for workers is often inconsistent and sparse. In most countries, informal workers experience a social protection gap. The OECD KIIbIH data show that the large social protection gap between formal and informal workers is largely due to a gap in contributory schemes (Figure 1.7). Remarkably, contributory schemes tend to benefit relatively better-off informal workers, whereas non-contributory schemes typically benefit poorer informal workers. Moreover, urban informal workers tend to have better access to contributory programmes, whereas rural informal workers are better covered by non-contributory programmes.

Figure 1.7. Social protection coverage for formal and informal workers



Note: Contributory social protection programmes include contributory pensions, employment-based health insurance, unemployment insurance. Coverage rates are calculated for direct and indirect beneficiaries of social protection programmes and contributors to social insurance programmes. Surveys for some countries do not include specific questions on all the programmes, and this can affect cross-country comparisons. Non-contributory social protection programmes include universal health programmes, unconditional and conditional cash transfers (including non-contributory pensions). Coverage rates are calculated for direct and indirect beneficiaries of social protection programmes and contributors to social insurance programmes. Surveys for some countries do not include specific questions on all the programmes, and this can affect cross-country comparisons. LAC – Latin America and the Caribbean; ECA – Europe and Central Asia.

Source: (OECD, 2021^[3]), *Key Indicators of Informality based on Individuals and their Household (KIIBIH)* (database), <https://www.oecd.org/dev/Key-Indicators-Informality-Individuals-Household-KIIBIH.htm>.

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Extending social protection requires a mix of contributory and non-contributory schemes

Extending social protection to informal workers – including by means of formalisation – is possible and requires a combination of contributory and non-contributory schemes. To be successful, such expansion must also be rooted in a comprehensive understanding of the situations of different groups of workers, the risks they face, and the different factors contributing to the lack of coverage.

Looking at the distribution of informal workers by household income categories yields useful information with which to determine the appropriate mix of schemes in social protection extension strategies. This is especially important for deciding on the delivery mechanism of means-tested social assistance schemes and other contributory and non-contributory programmes. Strategies to extend social protection to informal workers may be articulated around two pillars: i) extending the coverage of social protection to the large majority of poor informal workers through non-contributory schemes, and ii) extending contributory schemes to non-poor informal workers through a mix of subsidised schemes for the near poor and non-subsidised schemes for those who can contribute.

Moreover, the data show that, in most of the countries covered by the KILBIH, the extension of more universal tax-financed programmes – such as those providing child benefits and social pensions – could disproportionately benefit workers in the informal economy and their families, especially the most vulnerable. This points to the centrality of child benefits and social pensions as a way to extend non-contributory schemes to informal workers and to reduce the vulnerability of informal workers' households without having to resort to detailed targeting mechanisms.

There are important avenues for the extension of contributory schemes

As countries look at ways in which to extend contributory schemes to informal workers, they need to make several policy choices. One question is whether the extension of contributory schemes can be linked to an identifiable employment relationship between an employer and a dependent worker. Another question is whether informal workers can afford to enrol in contributory schemes. Relatedly, to what extent can the extension of contributory schemes be best achieved through voluntary or mandatory enrolment, and through law enforcement? These are not easy questions to answer, but the KILBIH data provide new information and insights.

On the one hand, the findings point to a large segment of informal workers with limited capacity to pay. For such informal workers, subsidised contributory schemes may well be the only option if they cannot qualify for means-tested social assistance or benefit from a co-payment through an employer's contribution.

On the other hand, the results show that for a significant share of the informal worker population, the extension of contributory schemes can be linked to an identifiable employment relationship between an employer and an employee. Moreover, in some countries, a sizeable proportion of informal employees has some capacity to contribute to social insurance schemes and is already close to the formal economy. For such categories of informal workers, a realistic option could be to promote co-payments from both employers and employees, and to create incentives for formalisation.

The results also indicate that the development of contributory schemes should include programmes that can be attractive to large segments of informal own-account workers who have the capacity to pay but no co-payment possibilities. Still, one of the policy choices that governments need to make for those with the capacity to pay is whether the extension of contributory coverage should be mandatory or voluntary.

Options exist for building sustainably funded social protection systems amidst high levels of informality

Spending on social protection remains very low in developing and emerging economies and significant additional revenues will have to be mobilised in order to finance universal social protection. There is a significant potential to increase revenues in developing and emerging economies, however. Fulfilling that potential requires careful tax reforms, based on the identification of the most suitable tax revenue sources, and with tax compliance and enforcement as core objectives. Finally, while social security contributions can play a key role in financing social protection systems, greater financing for social protection systems should not increase the cost of formalisation.

Policy recommendations

Since informal employment features two tiers, and the workers in each of these tiers have different characteristics and different outcomes (such as pay and exposure to different risks), addressing informal employment requires differentiated policies.

Policies for workers in the lower tier of informal employment and their children

The low availability of formal jobs is probably one of the most important barriers to workers in the lower tier of informal employment to access formal jobs. Alleviating the double burden of informality and low-paying work demands that poverty eradication and job-rich growth be more central in policy making. A first step is to identify the potential of job creation in various occupations and sectors, including those requiring low levels of skill.

Other more micro-level factors make it difficult for informal workers in the lower tier to access more productive jobs. One of these factors is a lack of skills. In view of the prevalence of large unequal opportunities for skills upgrading of informal workers, this report recommends to:

- encourage employer-provided training for formal and informal workers
- make public programmes more inclusive for informal workers and their needs
- recognise prior learning of informal workers.

To help improve the match between the skills supply of informal workers and the skills demand of formal jobs, governments should additionally:

- anticipate change in skills demand, and prepare the workforce accordingly
- strengthen opportunities for all types of learning, including non-formal.

To break the intergenerational cycle of informal employment and low pay, it is also necessary to promote the skills of children by:

- investing in accessible, quality education in order to equip future workers with solid foundational skills that will serve as a basis for future learning
- devoting sufficient resources to education and providing equitable education opportunities
- preventing school drop-outs by improving the quality of schooling, eradicating child labour and combating gender stereotypes
- facilitating school-to-work transitions for young people, especially for those from informal households.

In addition, policy makers should recognise that certain workers will never be able to move into more productive and/or high-paying jobs. Yet, these jobs help sustain livelihoods, and in certain cases may be considered as essential, socially desirable jobs. For these workers, priority should be given to policies that improve overall working conditions and alleviate poverty-related risks. These include:

- setting and enforcing minimum wages
- addressing inequality in remuneration policies
- extending contributory and non-contributory social protection schemes
- improving bargaining power and raising the capacity of low-paid informal workers to influence policy making.

Policies for workers in the upper tier of informal employment

For workers in the upper tier of informal employment, the policies mentioned above may also apply, but the priorities are somewhat different. The characteristics of upper-tier informally employed workers make them more disposed to respond to standard formalisation policies, and their ability to access formal employment is also higher. As a result, they would benefit from additional policy measures, including:

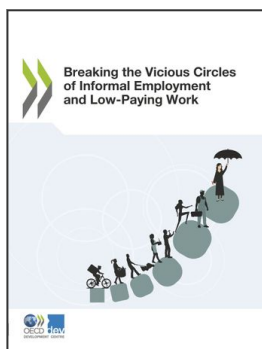
- ensuring adequate legal coverage for informal workers with contributory capacity
- enforcing compliance with labour laws and social security regulations among informal workers who are close to the formal economy.

Notes

¹ These computations were made before the adoption of the new Resolution concerning statistics on the informal economy by the 21st ICLS (2023), which changes the classification of contributing family members, and prescribes that they can be informal or formal.

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