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Striving for Better Jobs: The Challenge of Informality in the Middle East and North Africa Region

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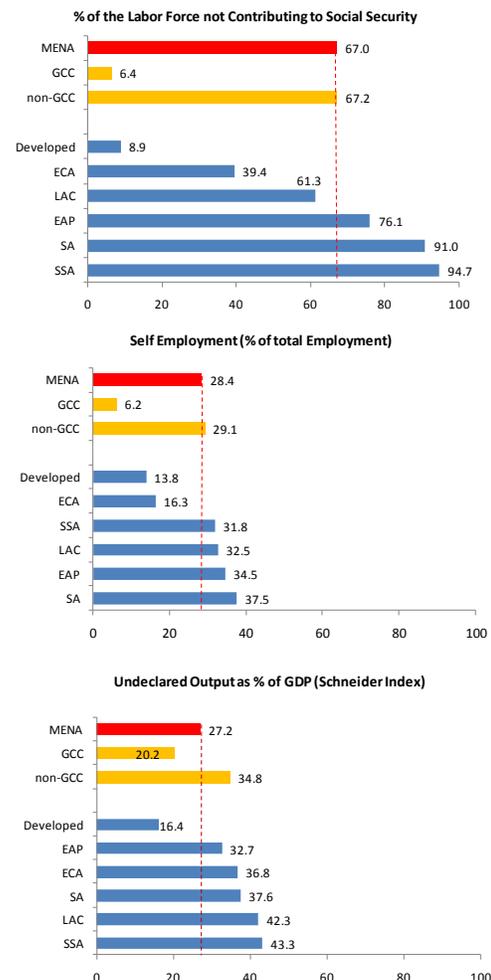
Introduction: This Quick Note provides an overview of the World Bank report *Striving for Better Jobs: the Challenge of Informality in the Middle East and North Africa*². The report was completed as a revolutionary wave of demonstrations and protests swept across the Arab world. Millions of young people were chanting “dignity” and “social justice” in the region, underlining deep-seated feelings of exclusion and inequality of opportunities. Demanding democracy, human rights, and better governance, young Arabs were also striving to realize their economic aspirations in a region rich in human and physical capital. However, while there has been economic growth for a number of years in MENA countries, this has not led to an adequate number of good jobs and has succeeded, at best, in generating low-quality, informal jobs.

Levels and Trends of Informality in MENA:

The report looks at informality through a human development angle, focusing on informal employment. Informality is a complex phenomenon, comprising unpaid workers, wage and self employed workers without social security or health insurance, small or micro-firms operating outside regulations and large registered firms that partially evade corporate taxes and social security contributions. Three indices are commonly used to measure informality: (i) the Schneider Index, which estimates the share of production not declared to tax and regulatory authorities; (ii) the prevalence of self-employment, and (iii) the share of employed workers without social security coverage. Defining

informality as “lack of social security coverage” captures well the vulnerability associated with informal employment and is the definition used in the study.

Figure 1: Informality in MENA vis-à-vis other regions



A typical MENA country produces one-third of its GDP and employs 67 percent of its labor force

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²To be available shortly at Worldbank.org/MENA.

informally. Therefore over two-thirds of workers in may not have access to health insurance and/or are not contributing to a pension that provides income security after retirement. Fiscally speaking, one third of economic output is undeclared, with predictable impact on government revenue. Yet, the share of self-employment to total employment in MENA (29 percent) remains lower than developing regions like Latin America and South Asia (33 and 38 percent).

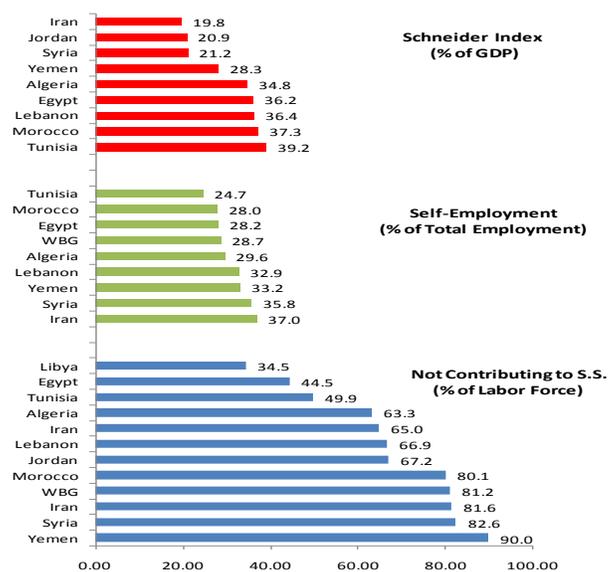
Informality in MENA has been rising in recent years: Data indicate that informality has been increasing rapidly in the entire developing world, as measured by the annual growth rate of the Schneider index between years 1999 and 2004. Using this proxy, the increase in informality in the MENA region (at 0.42 percent per year) is comparable to that in Europe and Central Asia (ECA) but lower than that in Latin America, East Asia, South Asia, and Sub-Saharan Africa. On the contrary, when measured by the share of self-employed to total employment, informality has been decreasing in all developing regions but MENA.

There are important variations in the prevalence of informality across countries in the region: Countries in the MENA region are quite heterogeneous in terms of size, role of the public sector, availability of resources and labor, economic development, and productive and demographic structure, all of which influence the size of the informal economy. Informality is higher in countries such as Morocco and Yemen, where the share of agricultural employment relative to total employment is high, and lower in Jordan and Egypt, where the public sector accounts for 30 to 35 percent of overall employment. A country's productive structure is also an important driver of informality. For example, energy rich countries (e.g., Iran, Syria) tend to display high rates of informal employment (about 80 percent) but have rather low informal output as a share of GDP (about 20 percent, as measured by the Schneider Index) (see Figure 2).

MENA's Informal Workers: Informality is highest among the working poor. In MENA informality generally decreases as wealth increases. Nevertheless, in some countries, informality is so widespread that it remains significant even among wealthier segments of the population (Figure 3). Also, Lower education is strongly and linearly associated with higher rates of informality in most

countries, an association that seems to be driven primarily by more educated workers joining the public sector (particularly in Egypt, Jordan, Morocco, and Syria). Informality rates among workers who completed primary and/or basic education (accounting for at least 50 percent of all the employed in most countries) are generally much higher than among workers who completed secondary and/or tertiary education.

Figure 2: Informality rates for selected non-GCC countries

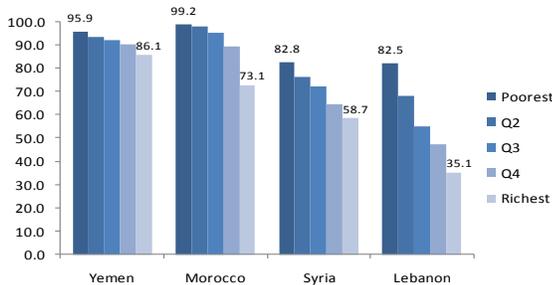


Note: Time periods are as follows: Schneider Index, average 2001-2004; Self-employment; 1999-2007; Not contributing to social security (S.S.), 2000-2007.

Informality and Public Sector Employment: Informal employment is highest among youth and there is a key transition from informal employment into public sector employment as young individuals reach prime age adulthood. Informality rates are very high among youth between the ages of 15 and 24. After age 24, informality decreases rapidly until individuals reach 40 to 45 years of age. After age 45, informality rates fall to between 20 and 30 percent. In some countries, this rapid decrease in informality rates goes hand in hand with a rapid rise in public employment. These trends are very different from Latin America. For example, in Mexico, informality rates also decrease by age but the observed transition is not between informality and public employment, but between informality and self-employment, with many of the young becoming

entrepreneurs and contributing to private sector jobs (Perry et al., 2007).

Figure 3: Informality rates by quintile of per capita consumption for selected countries



Note: Consumption aggregate was not available for Morocco for 2010 at the time of completion of this report. Morocco data is from the 2001 Living Standards Measurements Survey (LSMS).

Where do informal workers work? Informal workers are mostly employed in small firms, with a distribution that is skewed towards firms with less than five workers who are likely engaged in low productivity activities. Estimates from Morocco, Egypt, Jordan, and Iraq indicate that controlling for other observable characteristics, workers in medium size (10-50 workers) and large size (over 50 workers) firms are, respectively, 16 to 21 and 17 to 53 percent less likely to work without social security coverage than workers in small size (5-9 workers) firms.

Informality is prevalent among firms in MENA: Among currently formal firms with more than twenty workers, MENA has the highest share of firms that start informal (25 percent) and the longest operating period without formalization (4 years) among developing regions. Among registered firms, approximately one-fifth of their sales and workers are not reported. Micro and Small firms, which account for a large share of enterprises and private sector jobs in the region, are mostly unregistered and employ workers informally. While a great deal of heterogeneity exists in the region, high taxes and entry regulation are consistently identified by entrepreneurs as top constraints to formalization.

Informality in MENA: Exclusion of Choice? Informal workers earn lower salaries than formal workers with similar skills: the estimated premium associated with formal jobs varies from 10 percent for all workers (aged 15 to 65 years) in Syria to over 50 percent in Moroccan youth (15 to 34 years). The formality wage gap persists even when accounting

for differences in individual characteristics (age, education, measured ability) and firm type. Most measures of job quality, including amount of annual leave and other benefits, as well as access to training, suggest poorer working conditions in informal jobs. This is also reflected in direct and indirect measures of job satisfaction. For example, Moroccan youth working in informal jobs reported being significantly less satisfied than youth working in formal jobs. In Egypt and Lebanon, informal workers are uniformly more likely than formal workers to want to change jobs or to be searching for a new job.

The Issue of Low Mobility across informal and formal jobs: In instances where the data allowed for analysis, mobility from informal to formal jobs was found to be extremely limited. For example, between 2008 and 2009, an informal worker in Egypt had a 4 percent chance of moving to a private sector formal job and a 5 percent chance of moving to a public sector job. The implied average job duration of informal salaried work is about 3 years in Egypt and is reported to be about 4 ½ years in Lebanon and Syria, both longer than the duration observed in countries such as Mexico, where workers move out of informal salaried jobs within 2 years (see Maloney, 1999).

Barriers to Coverage and Policy Options: The report identifies five key policy options, detailed below:

(1) Designing reforms that foster competition - Reforms to entry regulations have been shown to have positive, albeit moderate, effects on formalization. Reforms options include: (i) reducing the costs of registration, and the number of procedures and minimum capital requirements; (ii) providing information on procedures and benefits of being formal, and training entrepreneurs (on filling forms, etc.); and (iii) facilitating registration by establishing one-stop shops. Overall, removing barriers to entry for firms will also need to include a fairer and less discretionary application of regulation to reduce the rents of those incumbent firms who have achieved a privileged relationship with the administration.

(2) Realigning incentives in the public sector - Reforming the civil service is a key priority. In some countries, the public sector continues to employ a

large share of workers with wage scales that reward education level and tenure, but not performance. Moreover, placement often depends on connections and is virtually irreversible, and social security benefits are generous. As a result, the public sector “package” is desirable in comparison with other employment alternatives, which induces queuing. In turn, this contributes to unemployment amongst graduates and fosters informality. Linking the public sector wage scale to competence and performance, easing the rigidity of civil service contracts, and realigning the social security access are likely to reduce the gap between public and private sector and thus limit the incentive to work informally while queuing.

(3) Moving to labor regulations promoting labor mobility and supporting workers in employment transition - Keeping the cost of labor at a realistic level via affordable social security contributions and relaxing wage rigidities are likely to reduce informality. In some MENA countries, firing regulations remain strict and firing costs are high. Centralized wage setting, as in Tunisia, leads to informality by setting artificially high wage floors for some occupations and skill levels. The tax wedge between the employer’s labor cost and workers’ pay could also be reduced through reforms that lower social security contributions (as in Egypt) or by shifting a portion of labor taxes towards other general revenue sources, such as consumption or property taxes. Engaging in an inclusive social dialogue is critical to sustaining these reforms. The traditional tripartite structure convening governments, unions, and employers is likely to favor the status quo of protective regulation. Including outsiders could shift the dialogue towards facilitating entry into labor markets, improving mobility, and a more equitable distribution for less favored populations.

(4) Enhancing informal workers’ productivity through training/skills upgrading - Evidence from skills upgrading efforts uncovers success factors for informal, rural employment. Informality’s low productivity dimension is especially notable in poorer MENA countries and in rural areas where workers with little literacy and education work in micro entrepreneurship and low-yield agriculture. Targeting some well designed skills upgrading interventions to these workers can be beneficial. However, low levels of literacy, travelling

restrictions, and language barriers all limit access to and usefulness of traditional, class-based training programs for informal workers, especially in rural areas. Programs such as India’s Barefoot College and Yemen’s Agriculture and Fishing Fund suggest that how training is delivered (hands-on, community-based, combining learning with earnings) matters. Training is most effective if provided with placement services, i.e. job search assistance and soft skills training.

(5) Reforming existing social insurance systems and introducing new instruments for coverage extension - Adequate coverage extension in MENA is only likely if efforts go beyond providing traditional social insurance and target informal workers and those outside the labor force. Coverage extension via social insurance systems is important but complex. All of MENA has achieved expansion of social insurance schemes, mostly pensions, beyond the civil service but in a fragmented manner, and legal and actual coverage remains limited. Except Egypt and its recent social insurance reforms, all MENA countries have defined benefit pension systems with design elements that contravene international best practice. Controversially, social insurance coverage could be uncoupled from formal employment for some workers. Also useful are Matching Defined Contributions (MDCs), i.e. voluntary defined contribution savings with old-age or other benefits, and the government or employer providing matching individual contributions. Piloting MDCs targeted to informal workers with small but positive savings capacity could give policy makers insights to increasing coverage. However, in the short run, non-contributory schemes, i.e. social pensions, will play a key role.

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