

## WHY INFORMALITY?

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## ROADMAP

1. The contours of informality
2. The economic implications
3. Informality and Central Banks
4. Informality as equilibrium

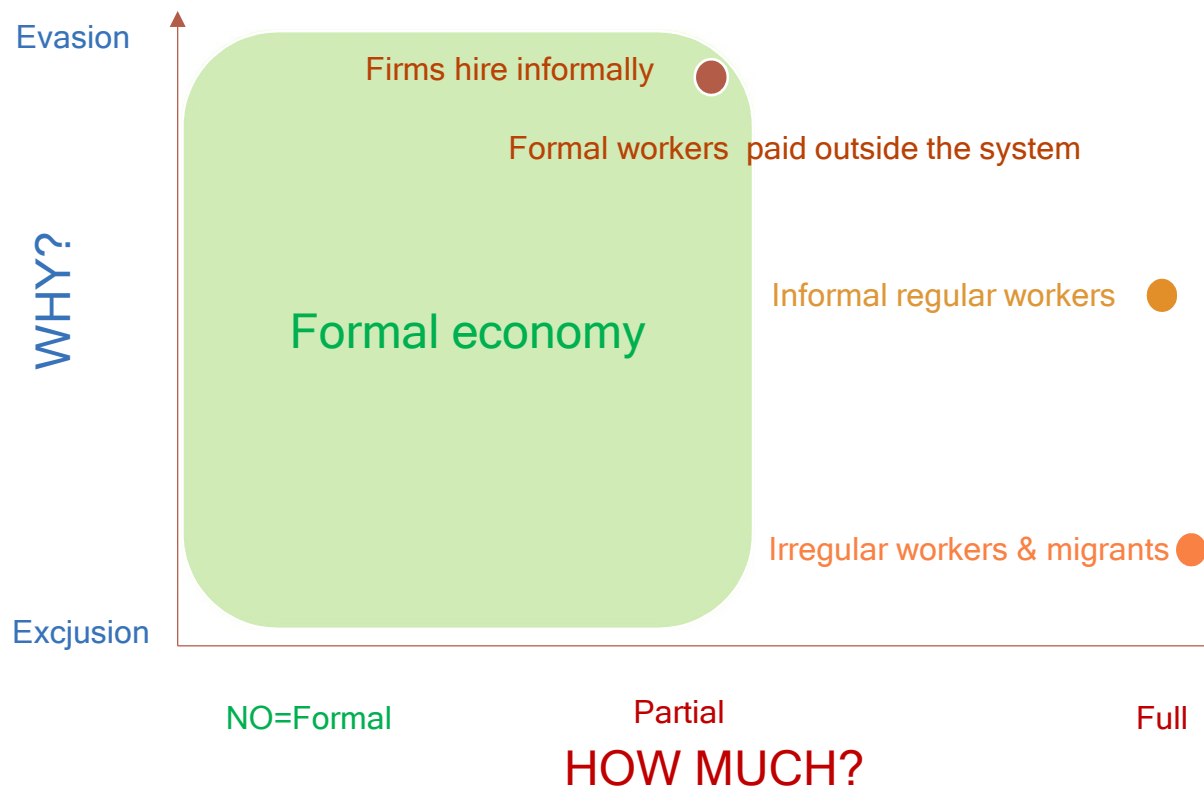


## Definition of Informality (ILO):

Employment or production outside the established norms:

- No subject or compliance with labor legislation
- No payment or taxes and/or social contributions
- Mostly, subsistence activity
- N.B. illegal activities excluded

### Types of informal workers

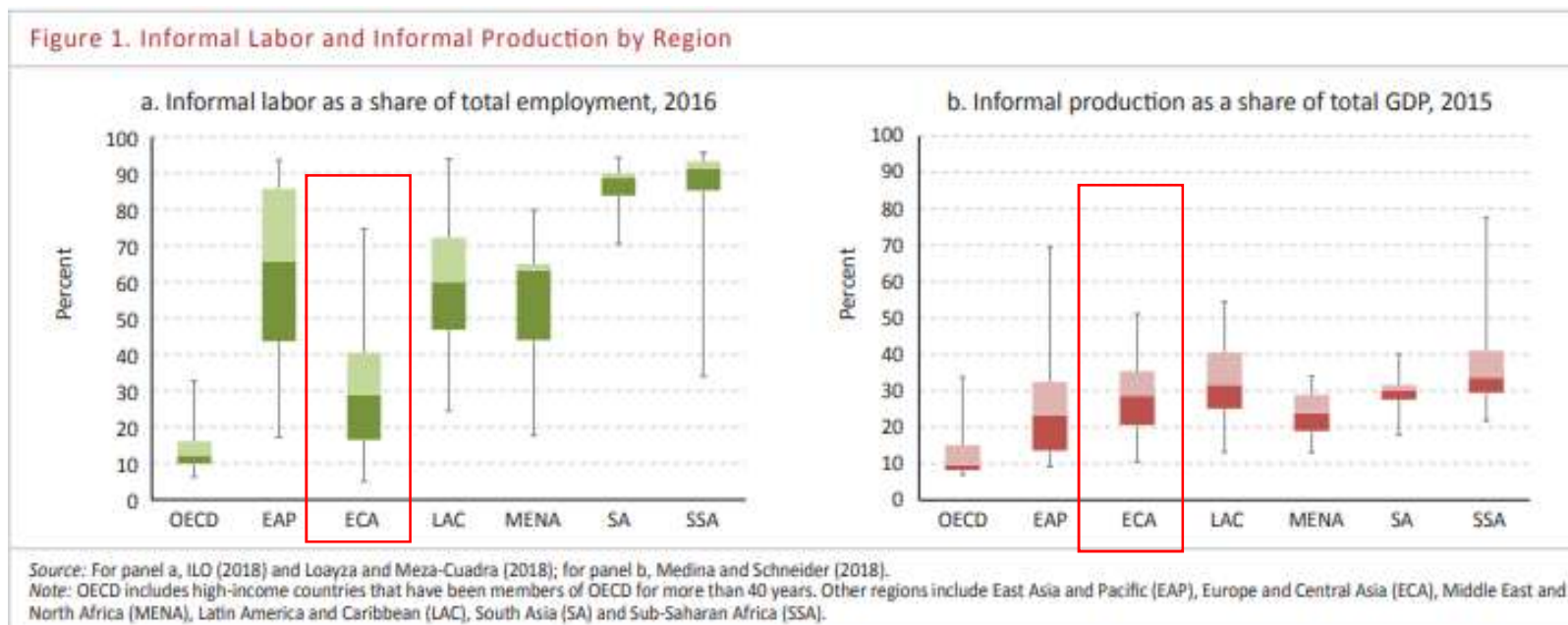


# THE CONTOURS OF INFORMALITY

## The prevalence of informal labour

- 10-15% in OECD countries (underground or black economy)
  - Formal workers and firms engaged partially in informality,
  - Irregular informal workers << irregular migration
- 70% in emerging and developing countries (systemic informality)
  - Lower in Eastern Europe (30%)
    - Informal workers performing informal jobs

Source: Loayza (2018), World Bank



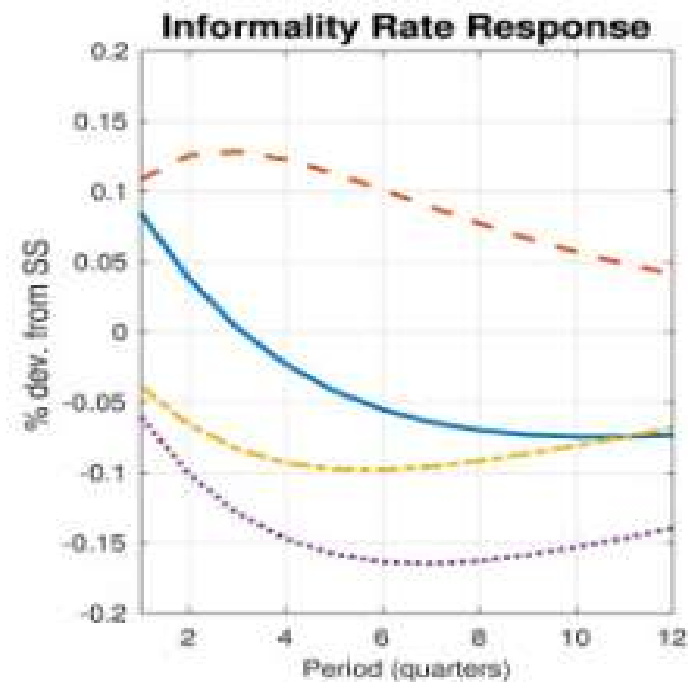
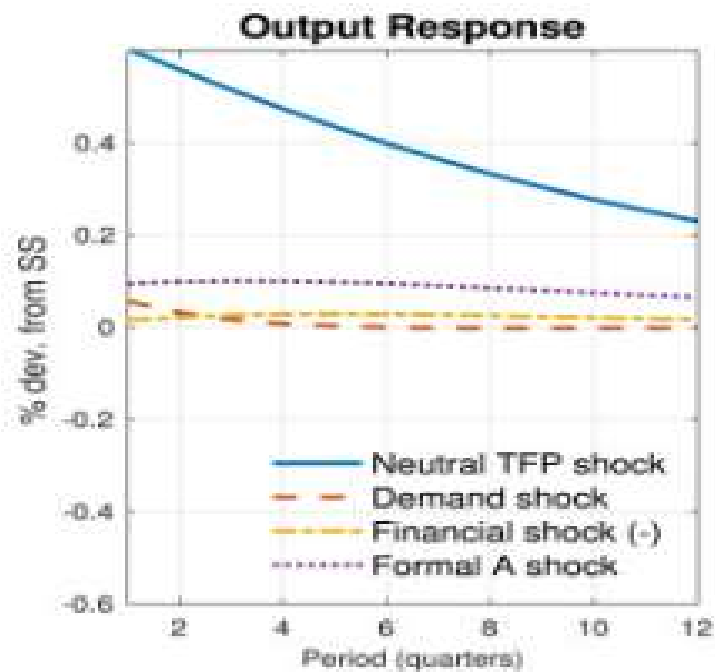
- For the **informals**
  - No protection from law, regulations or the state
  - Poor working conditions, usually
  - No welfare benefits (unemployment, health, pension)
- For the **economy at large**
  - Inefficiency:
    - *individuals or enterprises remain small (fiscal thresholds, visibility)*
      - no formation or human K accumulation
      - use of irregular channels
      - cover up
      - financial exclusion
  - Segmentation of the economy burdens development
  - Low productivity: 25-75% of average in total; decreases with size of informality
  - Loss of **fiscal** revenues, hinders the role of the state.
  - Free riding of resources reduce overall quality and quantity and drains for contributors

- For the informals
  - Reduced cost of hiring, employability
  - Free riding on public goods
- For firms:
  - No regulation, taxation, allow thriving more easily and cheaply.
  - Dynamism, creativity
- For the economy at large
  - Generation of employment, otherwise missing?= a necessary evil
  - Macroeconomic flexibility (more on this, below)

- What are the consequences of informality for the stabilization of the economy?
  - Flexibility v. Policy effectiveness
  - Affects the transmission of shocks
  - ...but also of monetary policy actions
- In Alberola & Urrutia (JDE, 2020) we investigate the issue
  - What means informal in our paper
    - *Dual labour market: formal and informal (no hiring or firing costs)*
      - = Informal is FULLY FLEXIBLE
    - *Financiaci3n exclusi3n for the informals,...excluded from working capital too*
      - = NO DIRECT IMPACT OF FINANCING COSTS
  - What do we do?
    - *Impact of demand, supply and financial shocks and of monetary policy*
    - *See differences with and without informality,*
    - *...using calibrated Mexican data:*



- Informality increases in the face of:
  - Positive neutral supply shocks, short run, negative if in Formal sector
  - Positive demand shocks
  - Favorable financial shocks



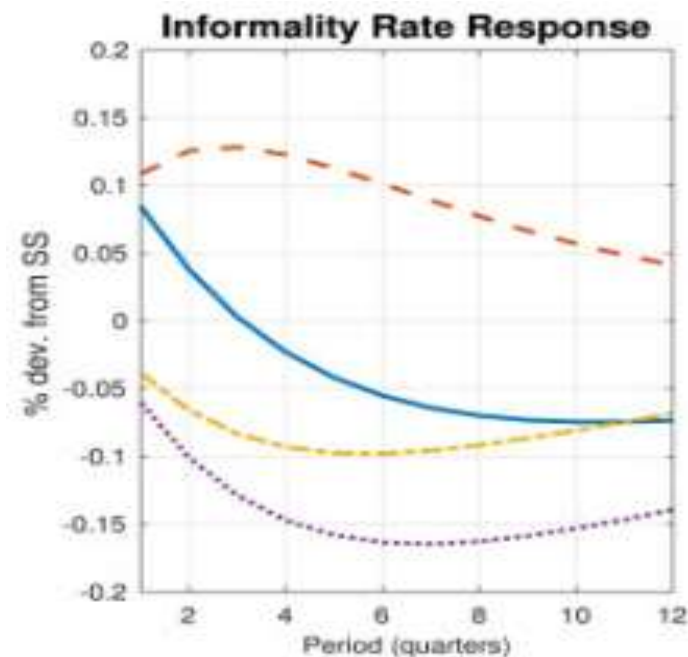
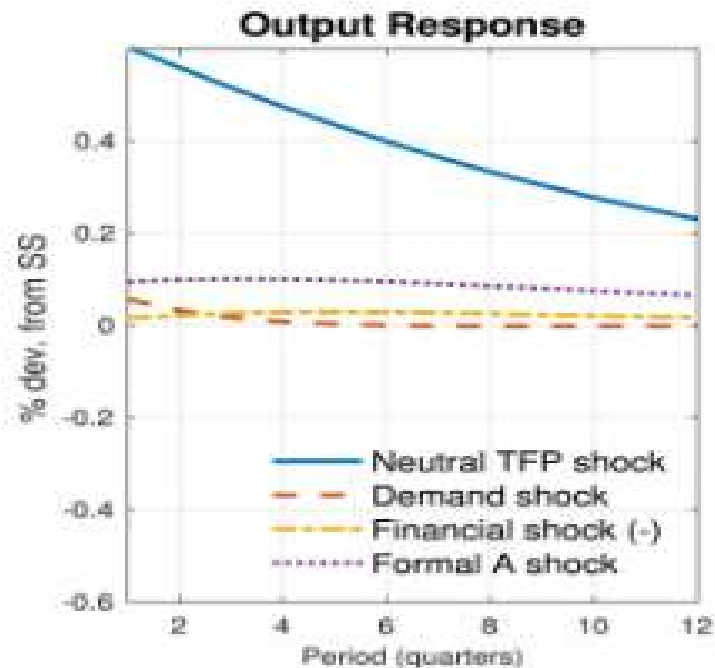
- Informality (relative to no informality):



- Reduces inflation volatility (exception neutral supply shock)
- Reduces consumption volatility



- Increases employment volatility
- Reduces productivity gains



The impact of informality on monetary policy is determined by:

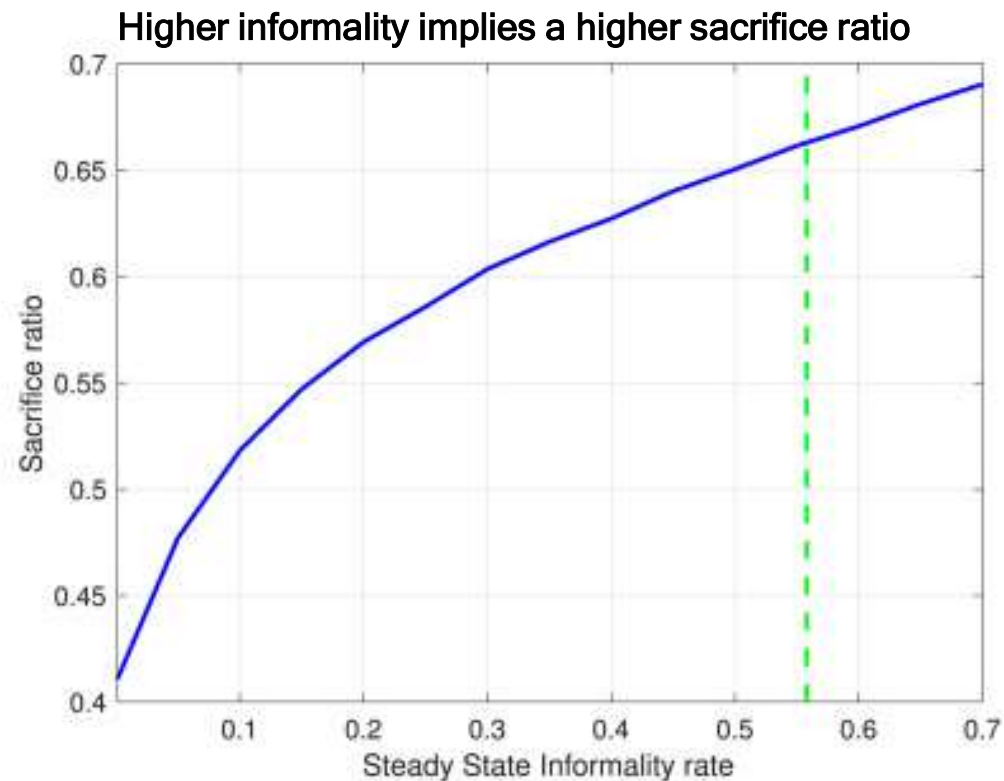
1: The buffering effect:

- Informal sector buffers the impact of most shocks on inflation. This means that the monetary policy has to react LESS to shocks

2. The financial vacuum of the informal sector

- No use of capital means that financial shocks impact only indirectly on the informal sector.
- Change in monetary policy interest rates has a marginal effect on the informal sector.
- So, the monetary policy transmission is WEAKER

- All in all, impact of informality on monetary policy implies:
  - A higher sacrifice ratio (the output/employment cost of reducing inflation), falling on formal firms
  - ...although the economy is less volatile (buffer effect), less need to 'sacrifice'
  - Overall, calibration shows, welfare losses



- Informality is persistent and pervasive, in less developed countries
- At the same time, it hinders development and the role of the state
- Why is it then so difficult to eradicate?

### Informality as a compromise

- Exclusion (barriers to formalise) v. Escape (preference to stay out).
- Cost- benefit; misalignment of incentives.
  
- Tolerance to informality, allows to mitigate social pressures
- Despite long term costs greatly surpass short term benefits
  - classic political cycle downside = political economy of reforms
- Political costs of suppressing informality
  - Workers, employers
  - Economic and fiscal structures (revenues slow, expenditures fast)
  - Anecdotal evidence in Mexico (Deep reform v. permanent subsidies)
  
- How to do it? Align incentives
  - Bridge from informality to formality
  - Grow out of informality? Latin America counterexample
  - Fiscal pact and social contract (Spain, late 70s)

GRACIAS POR SU ATENCIÓN

