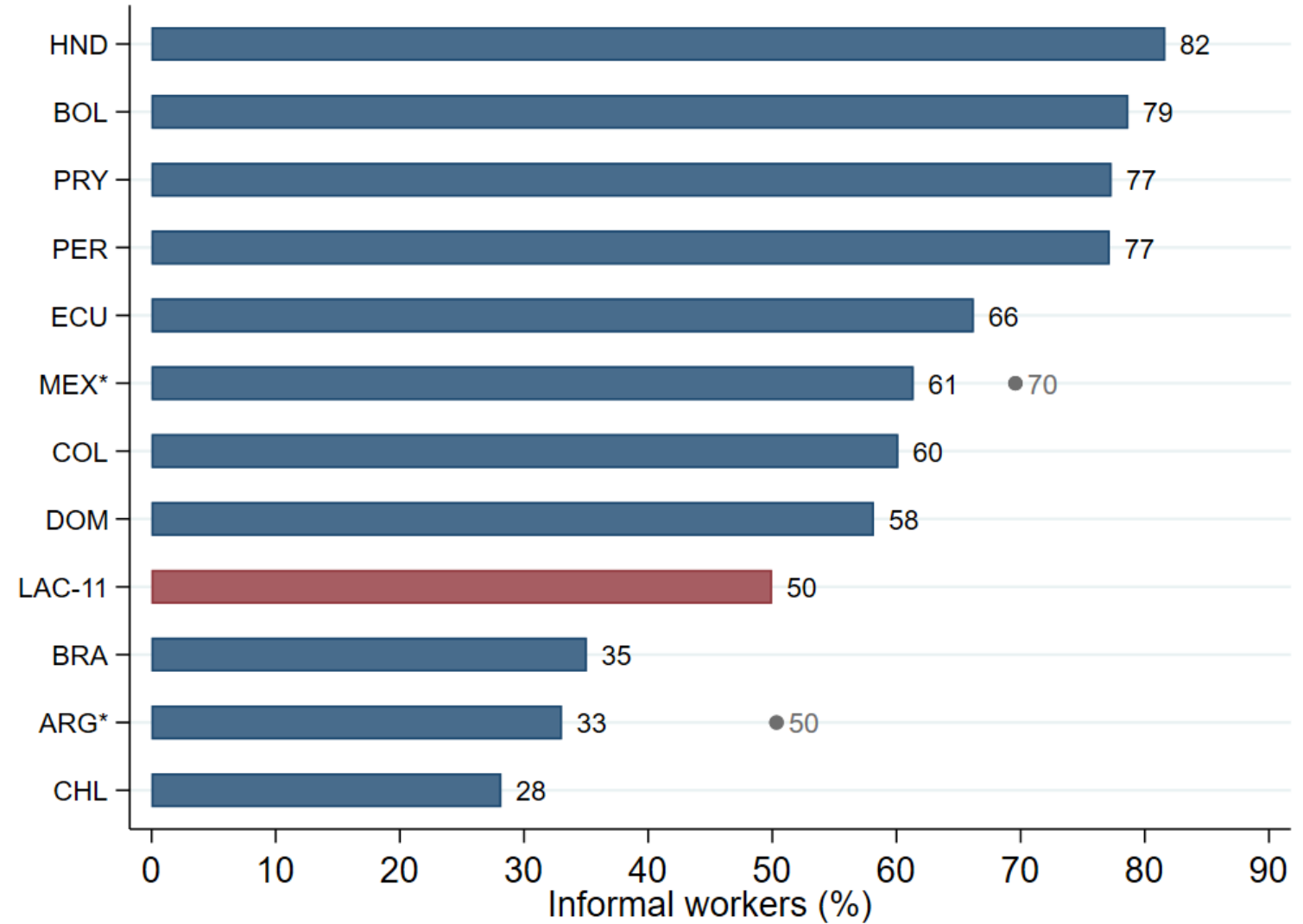


Setting the stage for a conversation on labor informality in LAC

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Labor markets
in LAC are
highly informal



Source: *De jure* regulatory frameworks and author's calculations based on National Household Surveys.

Message 1: **Not all labor informality is explained by non-compliance.** This is in contrast with other behaviors of non-compliance we also call informality.

Social security (SS) regulatory frameworks often exclude self-employed workers from mandatory SS contributions or require conditions to include them that are seldom met.

Other groups are also excluded, with variation across countries.

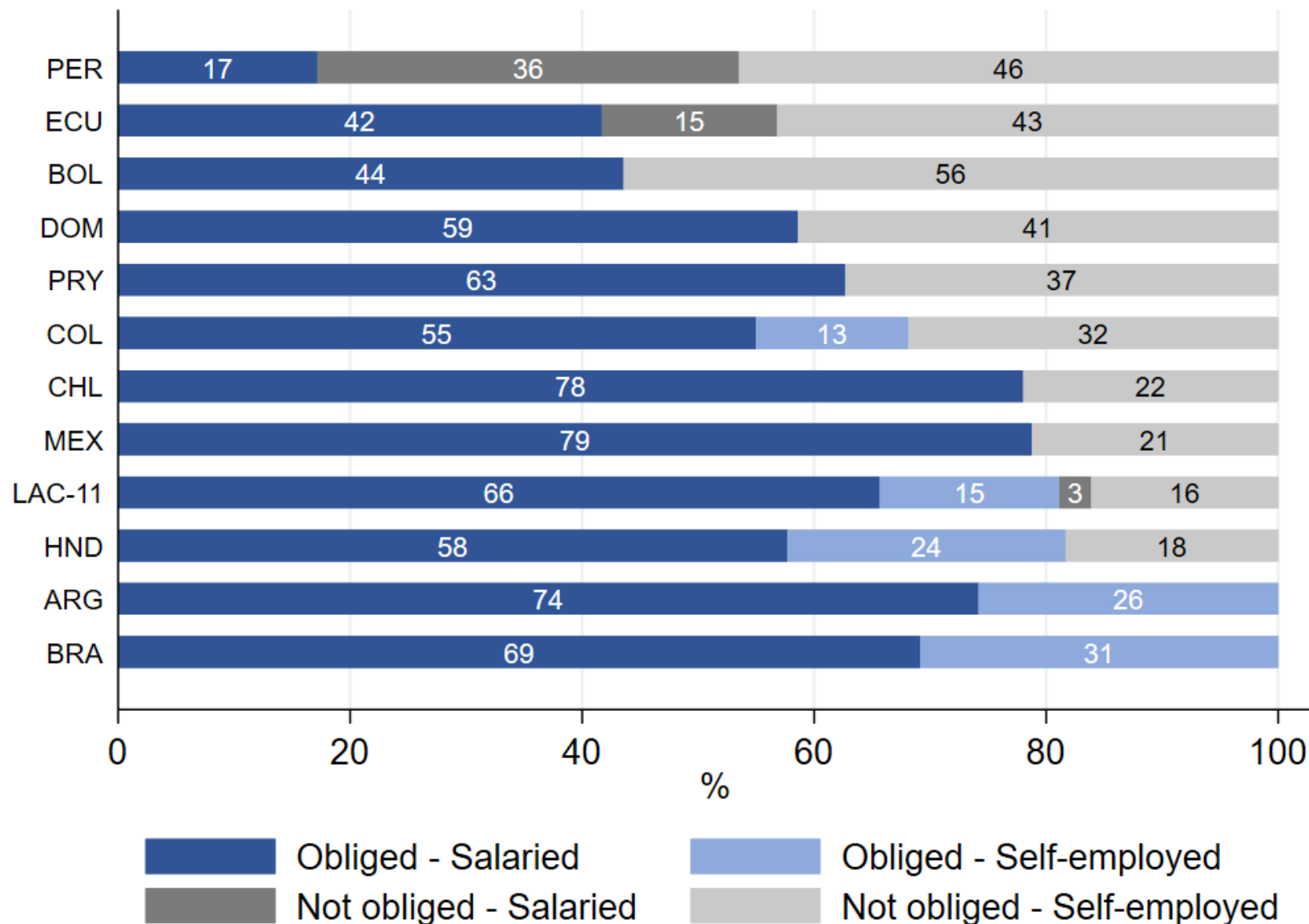
- **All workers:** Argentina and Brazil.
- **Only salaried workers:** Bolivia, Dominican Republic, Mexico and Paraguay.

Special cases:

- **Chile:** Salaried workers and *self-employed workers with taxable income below 4 minimum wages.*
- **Colombia:** Salaried workers and *self-employed workers with earnings at or above the minimum wage.*
- **Ecuador:** Only *urban salaried* workers.
- **Honduras:** Salaried workers and *self-employed workers above the poverty line.*
- **Peru:** *salaried workers in large, medium and small firms and public sector*

Labor informality results from non-compliance with regulatory obligations.

But also from outright exclusion, by regulatory design, from the possibility of working formally.

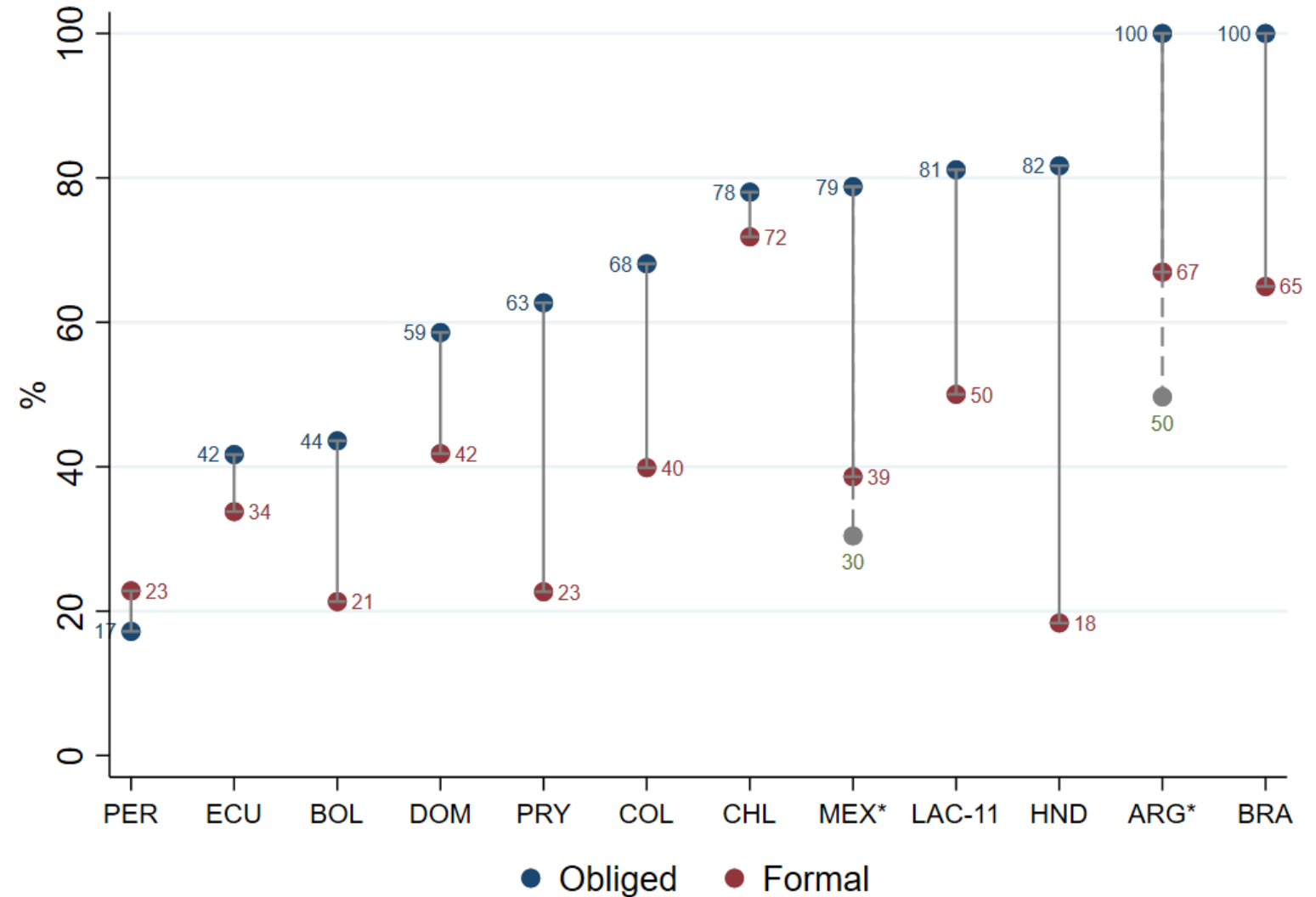


Source: *De jure* regulatory frameworks and author's calculations based on National Household Surveys.

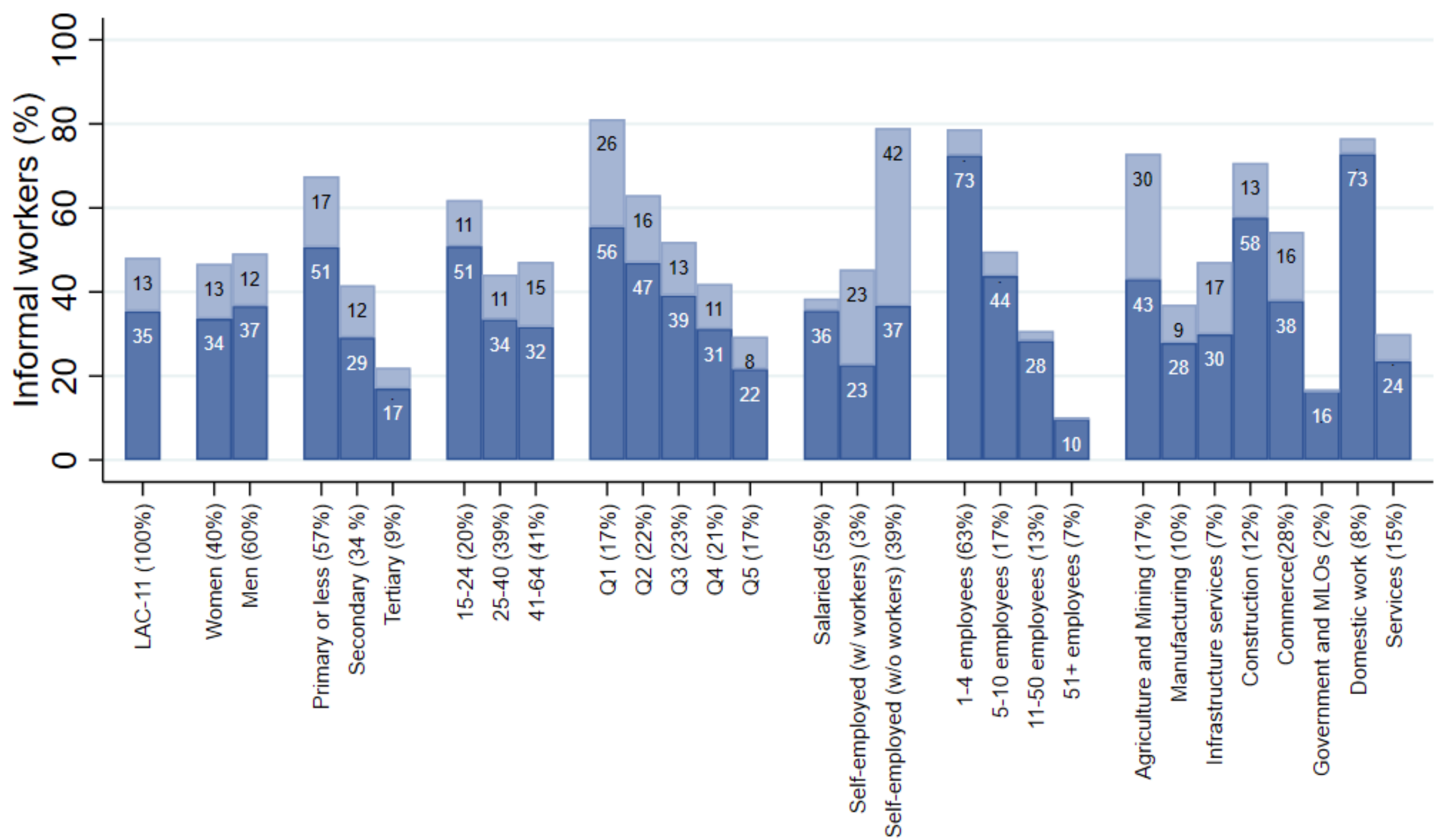
Workers obliged to contribute and formal workers (%)

Evasion explains, on average, only 62% of informality in the region.

38% of informality occurs in compliance with the law.




Source: *De jure* regulatory frameworks and author's calculations based on National Household Surveys.



Source: *De jure* regulatory frameworks and author's calculations based on National Household Surveys.

 Obligated

 Not obligated



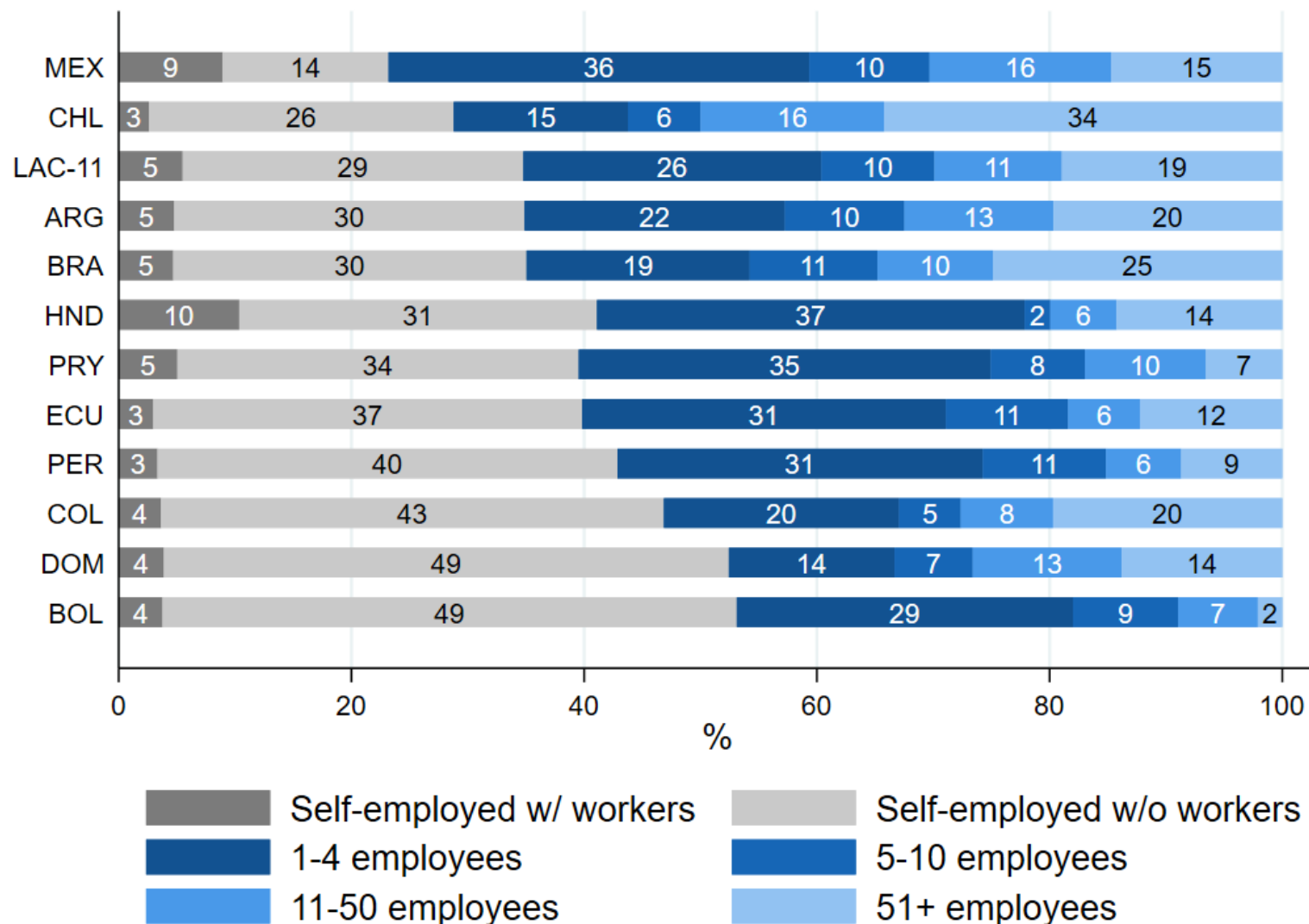
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Message 2: Contributory Social Security Systems and labor market **regulatory frameworks ignore the reality of labor and output markets.**

SS systems and labor market regulatory frameworks are designed under the assumption that self-employment is an exception, and most workers are salaried employees.

But 1/3 of workers in LAC are self-employed.

Workers by business size, including self-employment (%)



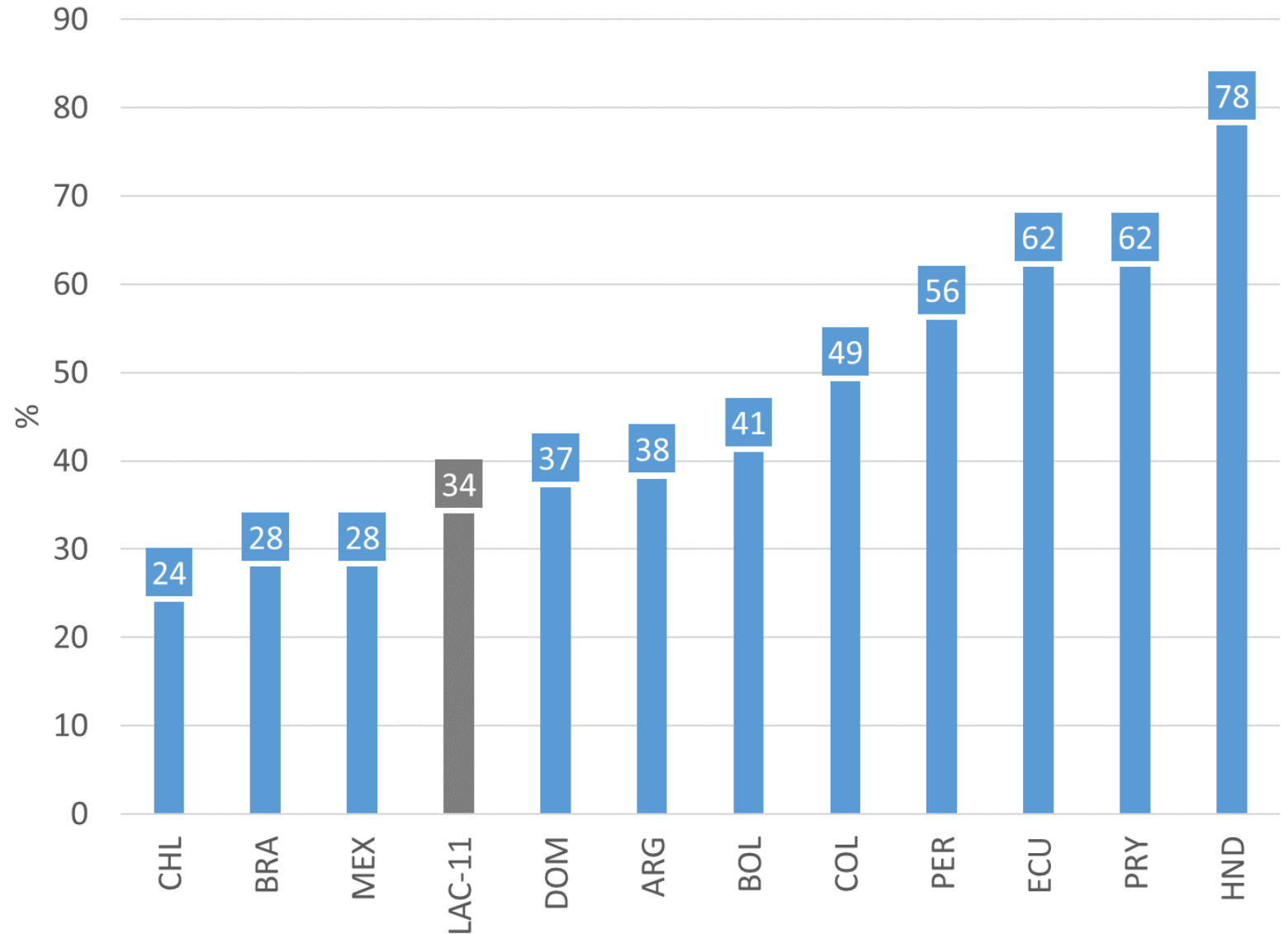
De jure regulatory frameworks protect workers through MW policies.

- Single MW:
 - **Bolivia, Colombia, Ecuador, Paraguay, and Peru:** Set once per year.
 - **Argentina:** Monthly adjustments.
 - **Chile:** May be adjusted more than once per year with Congressional approval.
- MW varying across categories:
 - **Brazil:** One federal MW with States authorized to set higher MWs. (5 States have higher MWs varying by sector of activity). 24 MW in total.
 - **Dominican Republic:** Different MWs for government, free zones, free zones in vulnerable areas, and private sector, the latter varying across 3 firm sizes. Special MW treatment for Hotels and Restaurants, also varying across 3 firm sizes. (Updated every two years).
 - **Honduras:** MWs varying across 11 sectors of activity and 4 firm sizes. 33 MW in total.
 - **Mexico:** One general MW, and a special MW for the Northern free trade zone municipalities (2,446).

SS systems and labor market regulatory frameworks are designed under the assumption that most workers earn at least the (a) minimum wage.

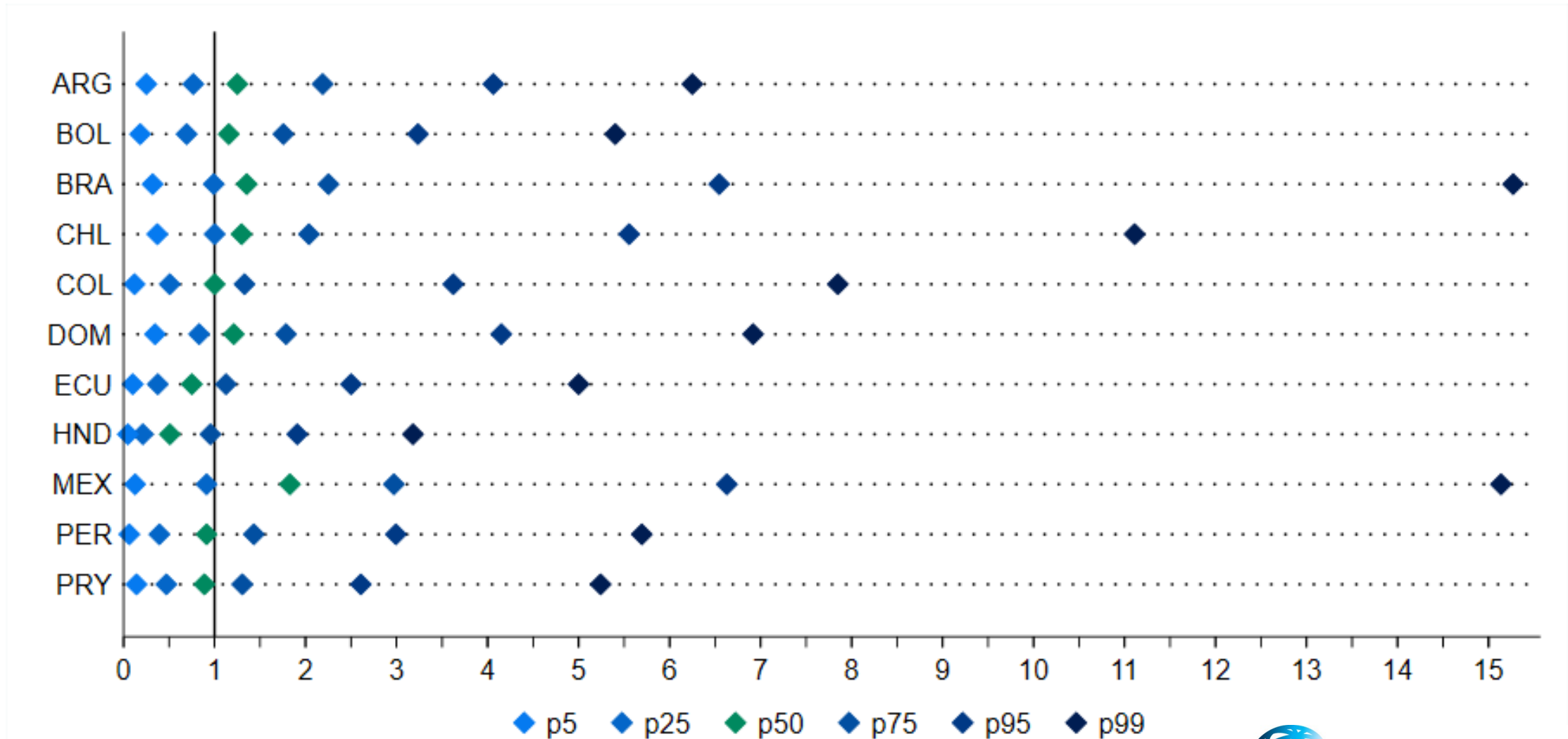
But more than 1/3 earn less.

Workers earning less than the minimum wage (%)



Source: *De jure* regulatory frameworks and author's calculations based on National Household Surveys. DOM: MW for small private firms. HND: MW for businesses of 1 to 10 employees in manufacturing, construction and commerce.

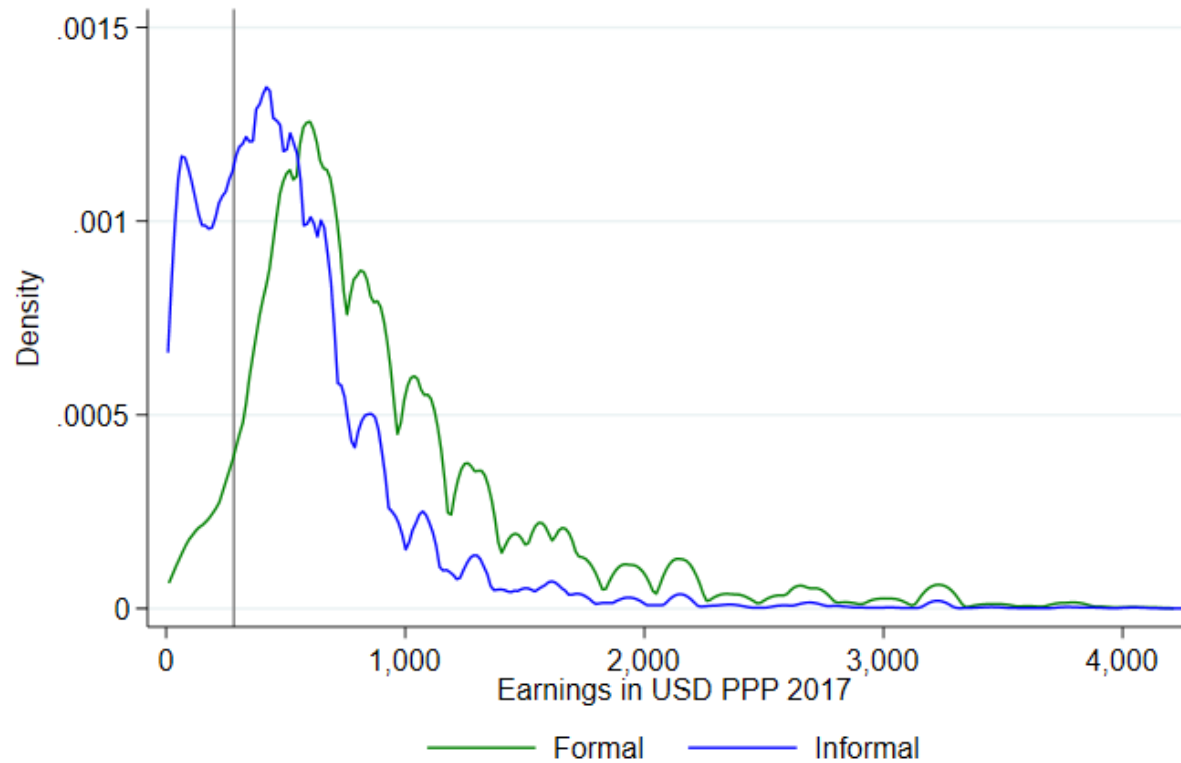
The earnings distributions are skewed to the left. MWs in LAC are, with few exceptions, close to the median.



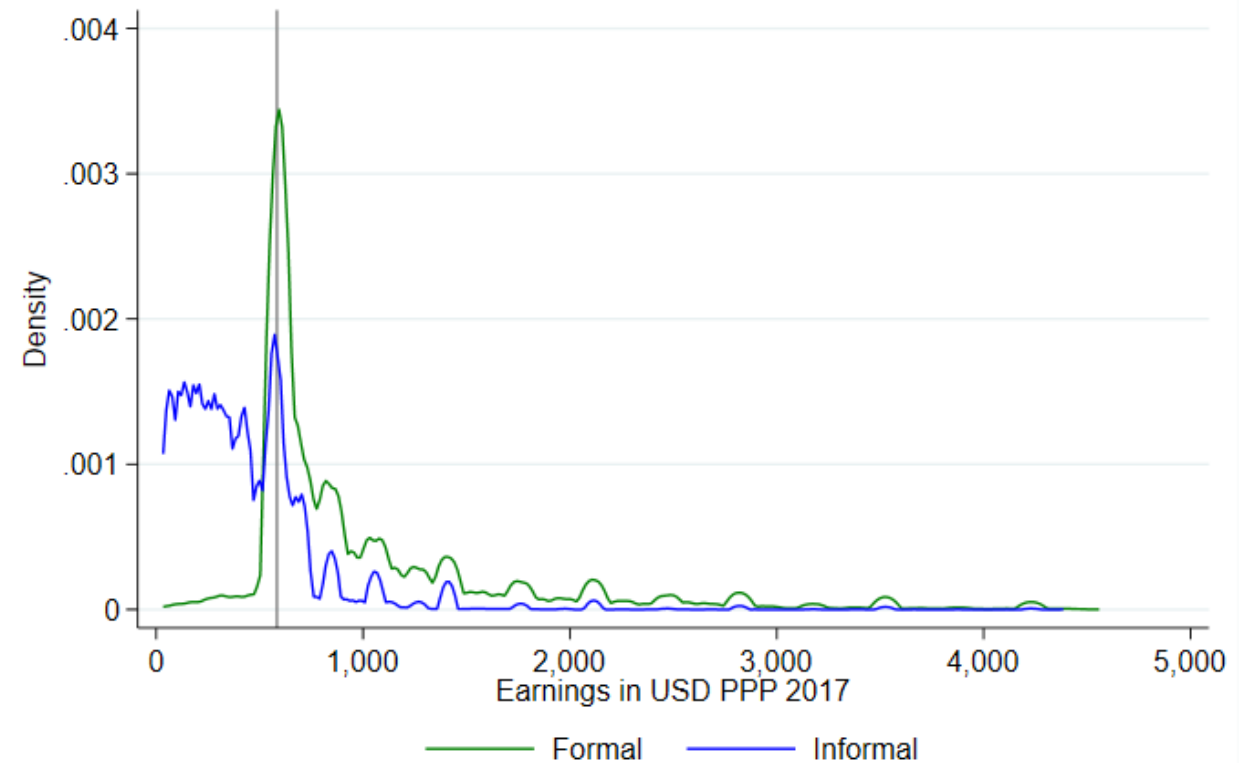
Source: *De jure* regulatory frameworks and author's calculations based on National Household Surveys.

Labor informality is not always a synonym for poverty. But informal workers tend to be low-earning workers.

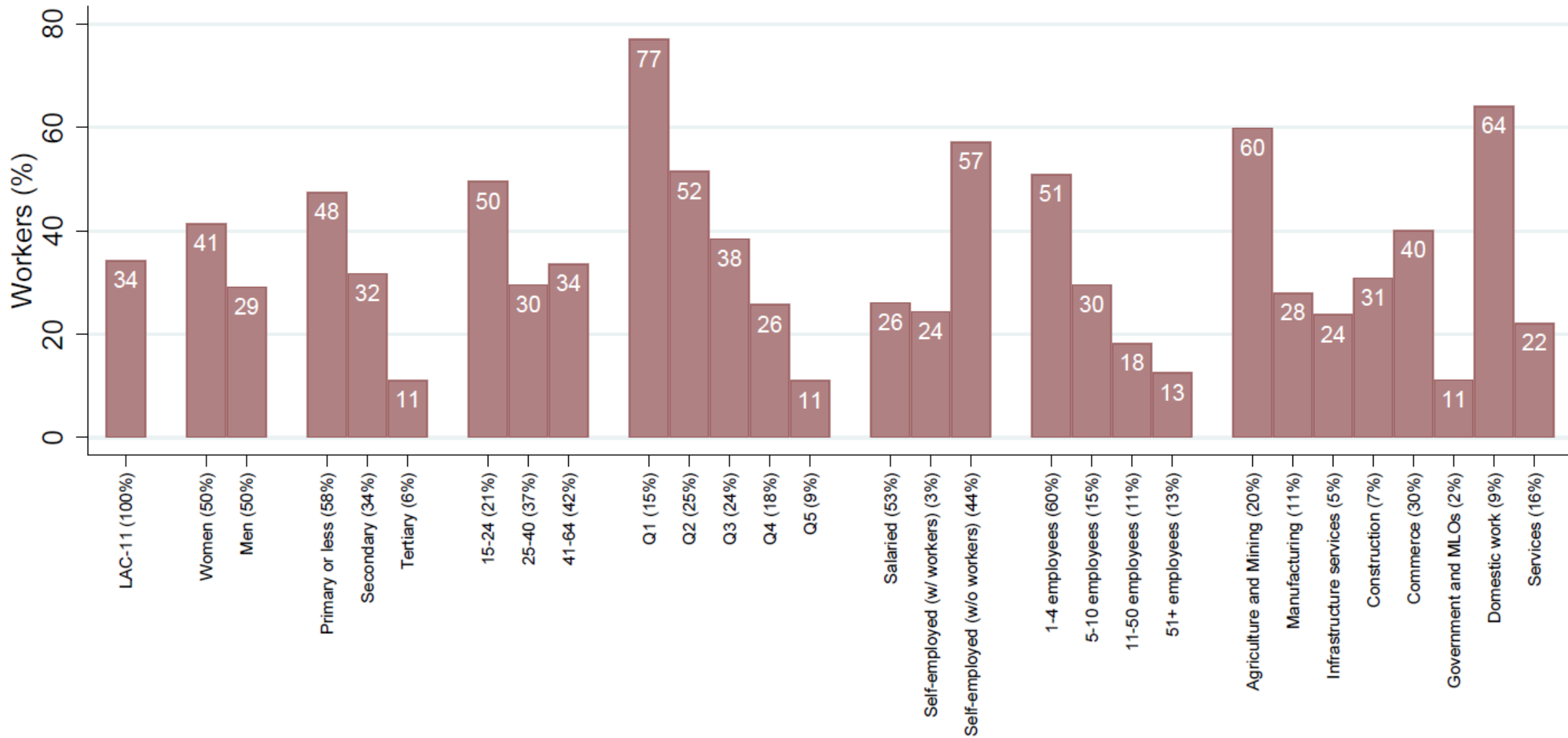
Mexico



Colombia



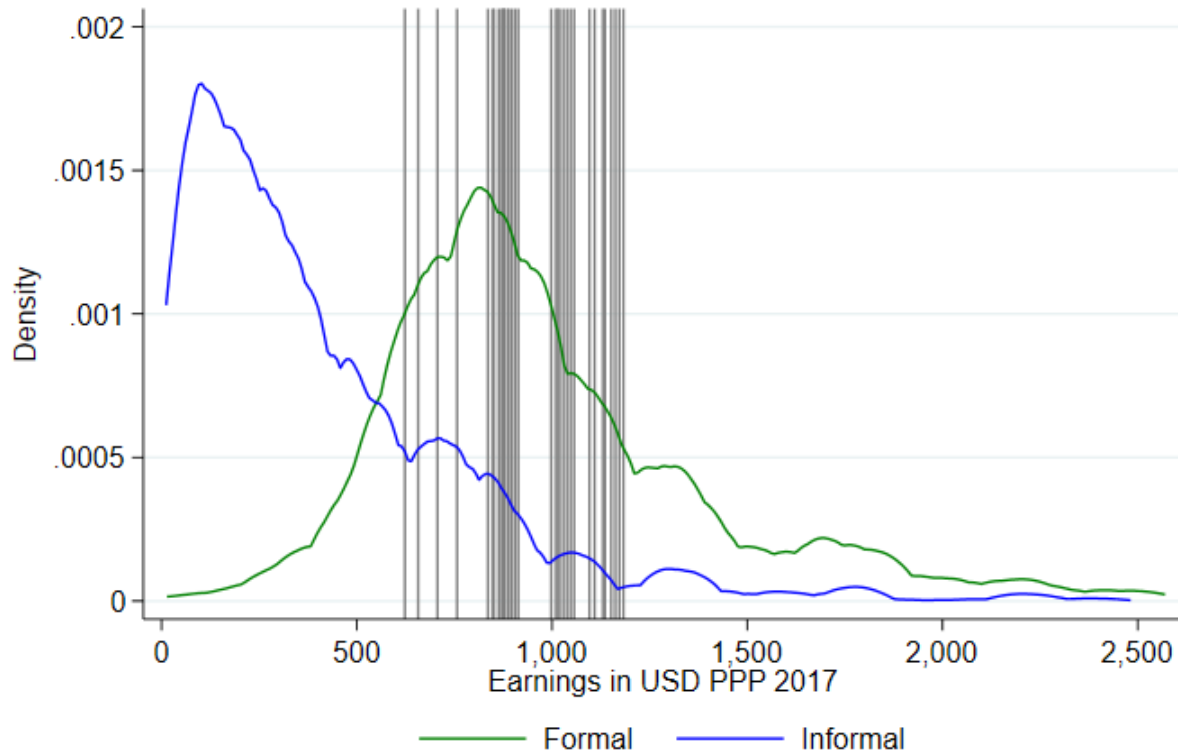
Source: *De jure* regulatory frameworks and author's calculations based on National Household Surveys.



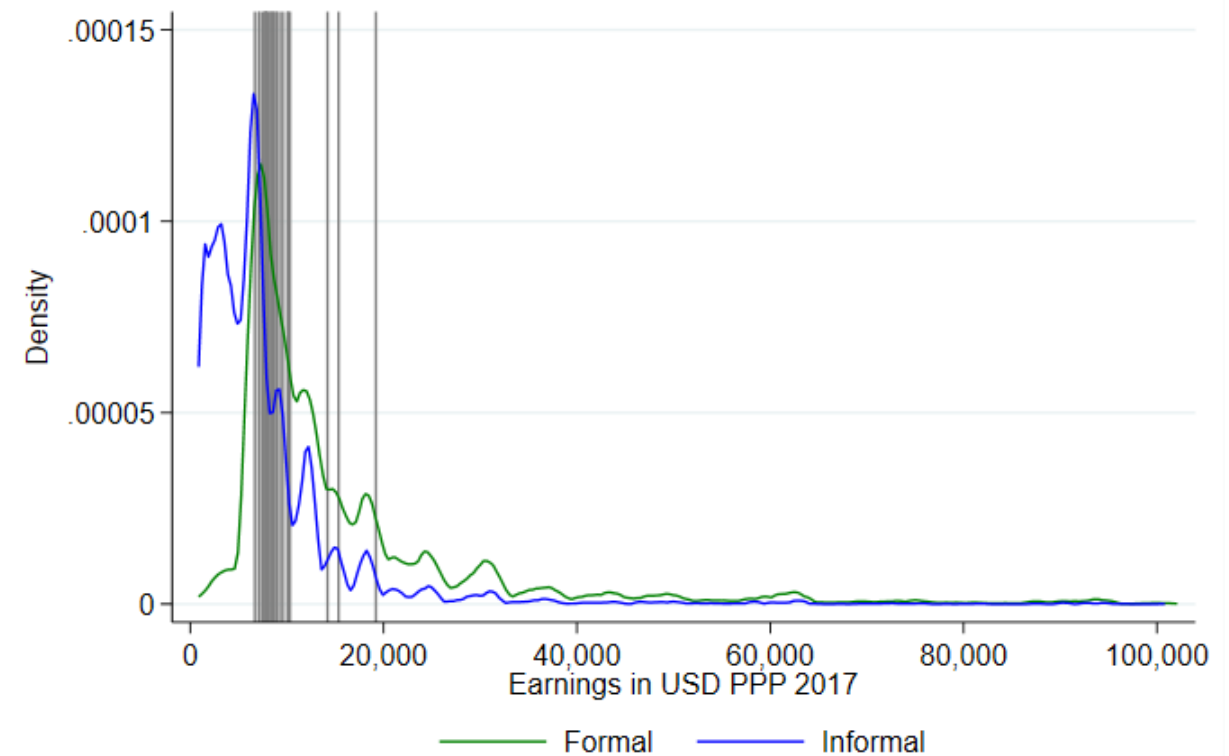
Source: *De jure* regulatory frameworks and author's calculations based on National Household Surveys.

Differential minimum wages are not solving the labor informality problem but may be contributing to “organize” earnings across categories.

Honduras



Brazil

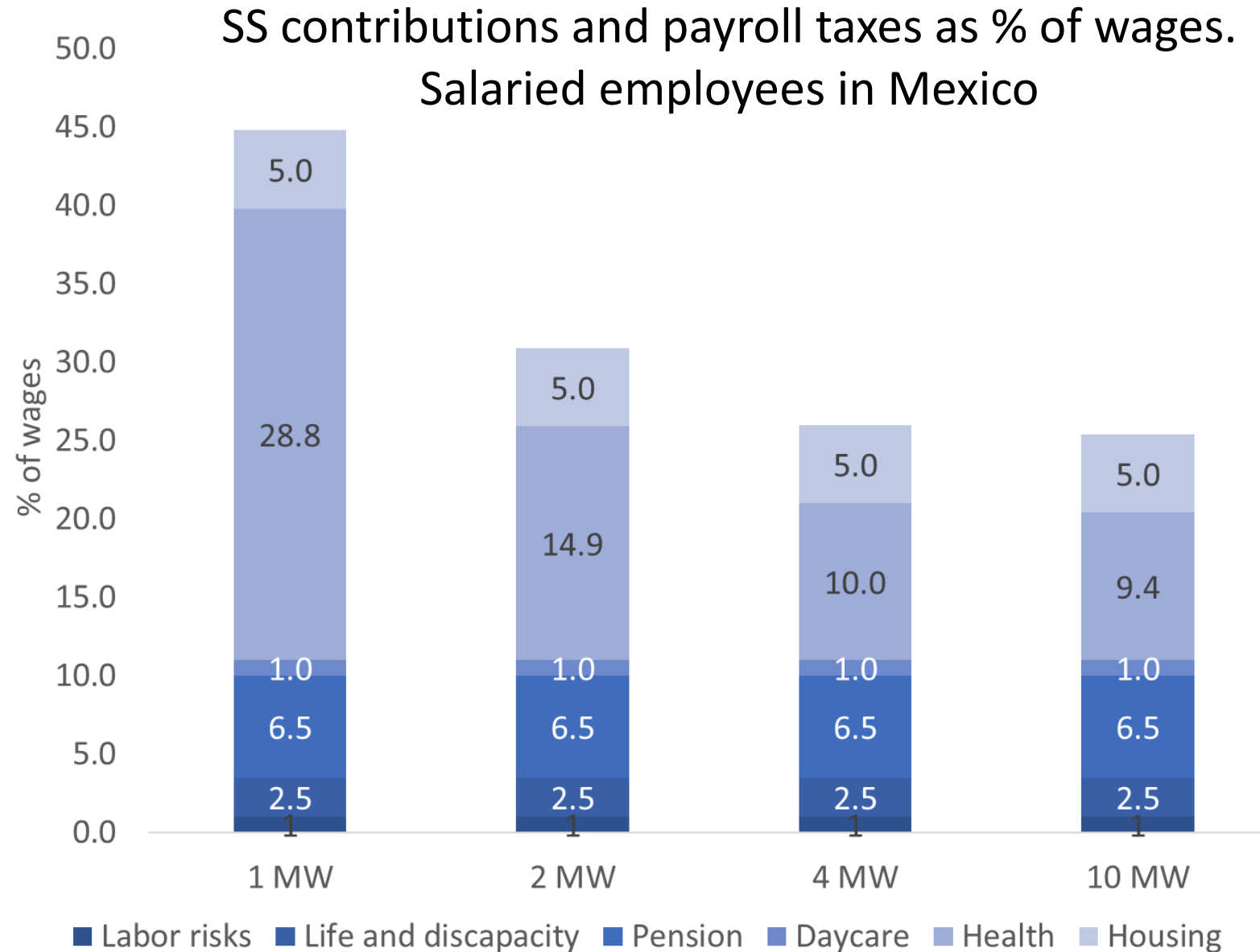


Source: *De jure* regulatory frameworks and author's calculations based on National Household Surveys.

Message 3: Mandatory contributions are often regressive and frequently **impossible to comply with.**



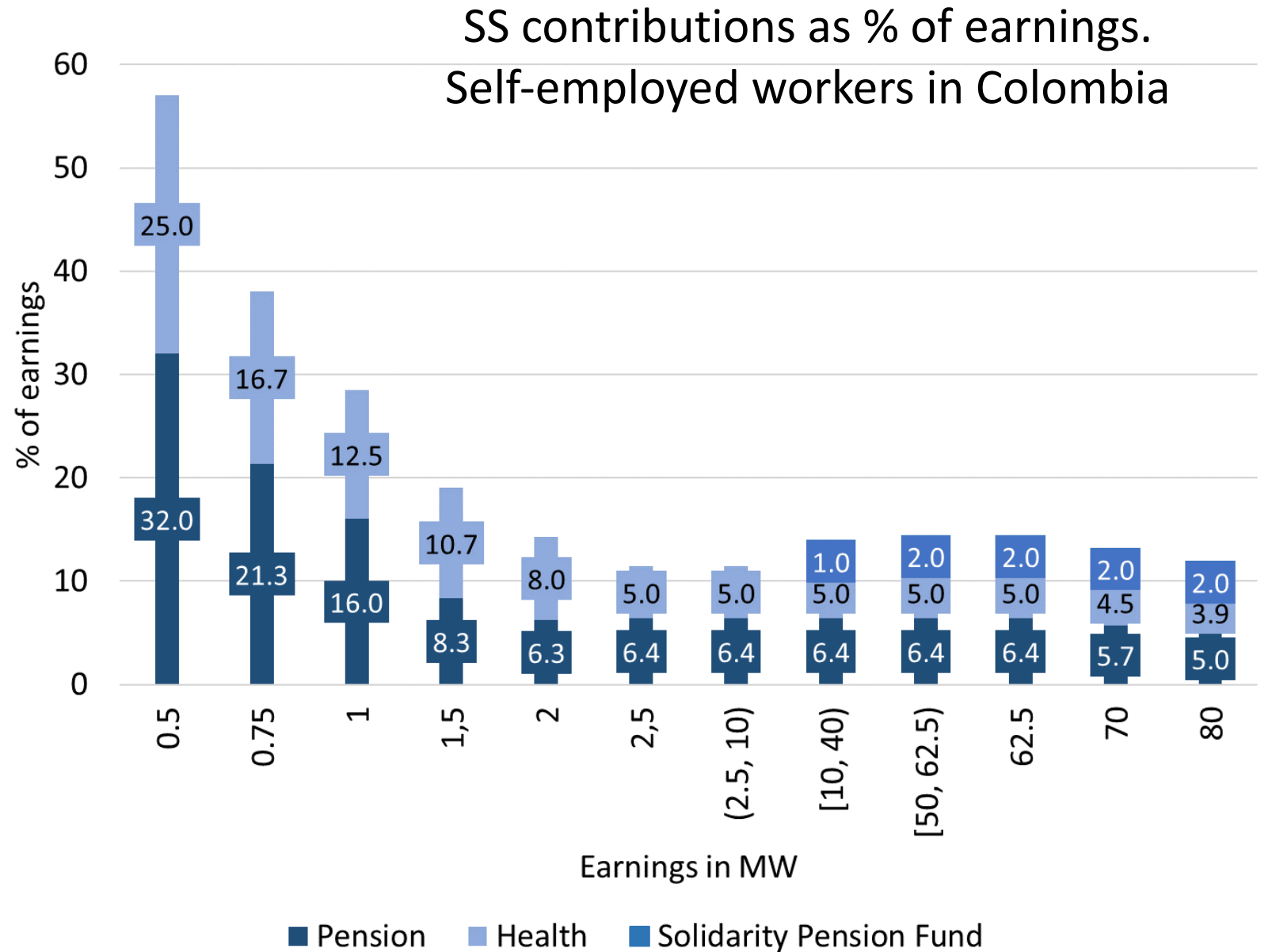
Salaried workers earning 1 MW in Mexico are required to contribute more as % of their income than workers with higher earnings.



Source: Correa, A., García de Alba, M., Martínez, A., Martínez, C., and Sulmont, A. (2021). UNDP LAC Working Paper No. 23.

Self-employed workers in Colombia must pay SS contributions over earnings of 1 MW or more.

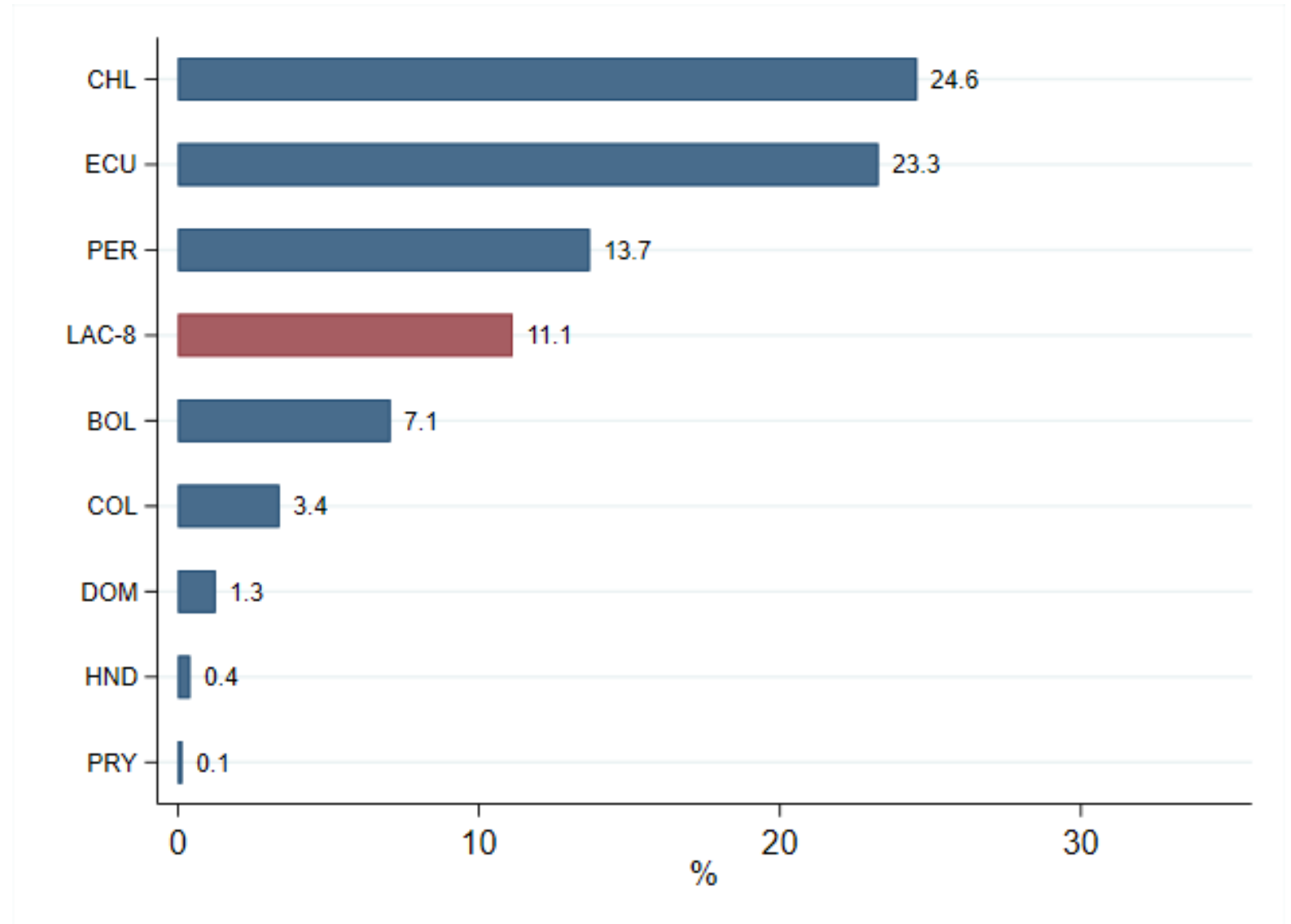
Workers with lower earnings may contribute, but...



Source: Meléndez, M., Alvarado, F., and Pantoja, M. (2021). UNDP LAC Working Paper, No. 14.

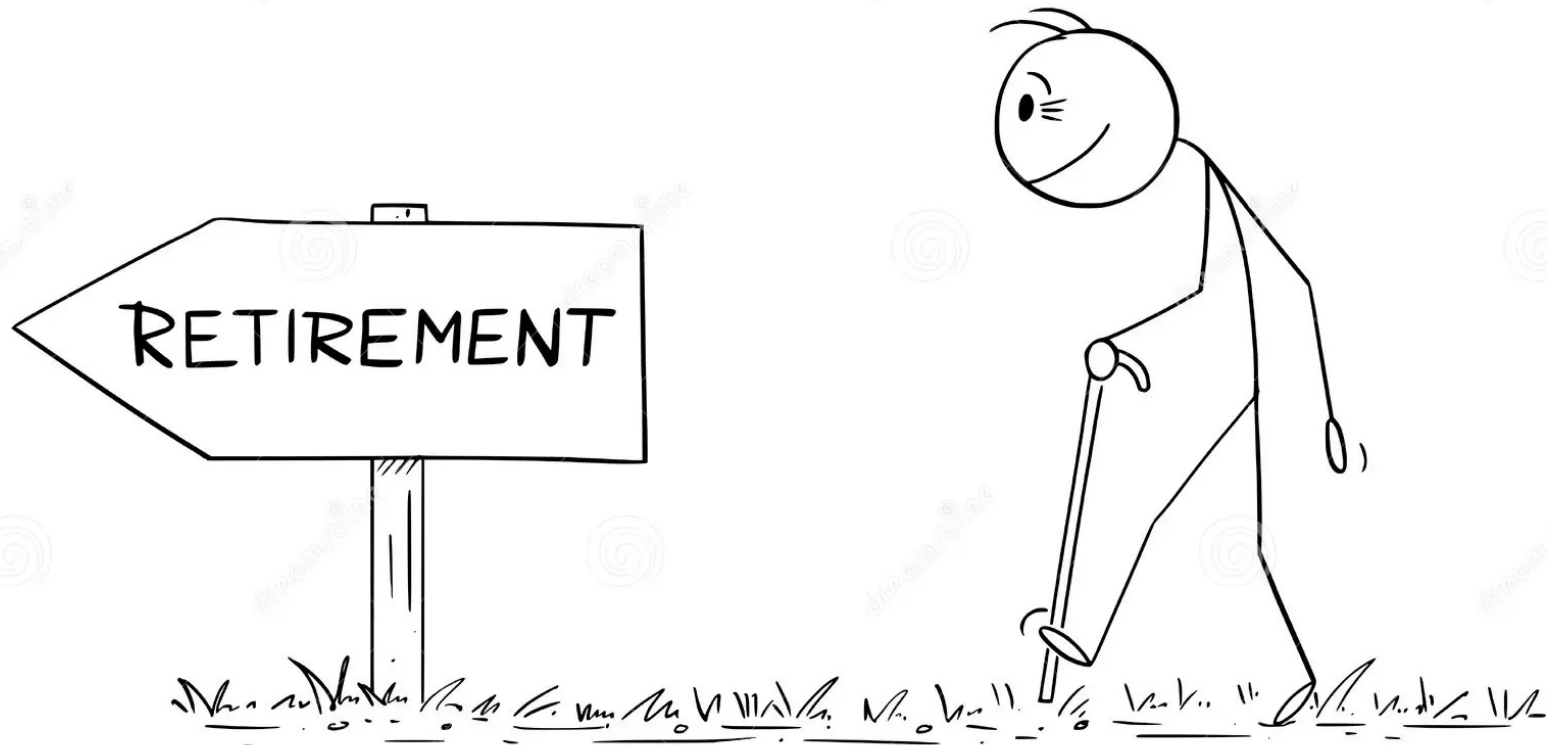
Not-obliged workers making voluntary contributions (%)

Only a **small share** of the not obliged makes **voluntary SS contributions**.



Source: *De jure* regulatory frameworks and author's calculations based on National Household Surveys.

Message 4: Frequent **transits between formality and informality** imply that many exit Contributory SS systems with no pension.



Message 5: Non-contributory SS programs compensate (some) informal workers for the absence of protection. But their co-existence with contributory SS programs shifts the cost-benefit balance against it maintaining the formal-informal labor market divide.

Final remarks

- Formalization programs won't work.
- Transit to non-contributory or semi-contributory SS systems will solve part of the problem.
- The real challenge for welfare and productivity is the emergence of a segment of small, medium and large businesses that can absorb workers in self-employment and tiny firms. More focus on education systems and less entrepreneurship programs please!

Thank you!