Contents

Foreword	1
Acknowledgments	
Abbreviations	
Overview: Informality: Exit and Exclusion	
The razón de ser of the informal sector: Adding exit to exclusion	
Workers: A mix of opting out and exclusion	
Firms: Little gain, high costs, or weak enforcement?	
Need for more effective and legitimate institutions	1.
Summing up: Policy implications of the report	1.
informancy and the development agenda	1 (
Note	10
References	19
Chapter 1: The Informal Sector: What Is It, Why Do We Care, and How Do We Measure It?	3.
Introduction: What is informality?	2.
Informality and the relationship between the individual and the state	21
Three margins of informality	25
Measuring the informal sector ,,,,,,,,	20
Correlations among measures and trends over time	29
Conclusions	2 -
Annex	20
Notes	39
References	40
Chapter 2: The Razón de Ser of the Informal Worker	42
Informal work: Adding exit to exclusion	12
The sectors of informal labor: Characteristics and dynamics	40
Motivations for participation in informal work	62
Conclusions	7/
Notes	7/
References	75
Chapter 3: Informality, Earnings, and Welfare	
Compensating differentials, comparative advantage, and informal work	79
The question of equal pay for equal work in the informal and formal sectors	80
Informality and self-rated welfare	വാ
Conclusions and policy implications	
Notes	00
References	99

Chapter 4: The Informal Labor Market in Motion: Dynamics, Cycles, and Trends	
Informality through the lens of gross labor force dynamics	
Drivers of the increase in informality	
Conclusion	125
Notes	
References	128
Chapter 5: Microfirm Dynamics and Informality	
Conceptual framework: Firm dynamics and institutional development	
Microfirm dynamics in Latin America	
Informality among microfirms	
Conclusions	
Notes	
References	154
Chapter 6: Informality, Productivity, and the Firm	127
Informality among registered firms	
Firm-level determinants of informality	
Impact of informality on firm productivity and economic growth	
Conclusions	
Notes	
References	177
Chapter 7: Informality, Social Protection, and Antipoverty Policies	179
Informality and social protection: Why policy makers should care	170
The state of social protection in Latin America and the Caribbean	
Private risk management and rationale for public social protection	
Challenges for social protection in the face of informality	193
Reengineering social protection to protect all citizens	
Potential costs of social protection reform: Financing essential cover	
Managing the transition from here to there	
Conclusion	
Notes	
References	
References	
Chapter 8: The Informal Sector and the State: Institutions, Inequality, and Social Norms	
Social norms, the state, and informality	217
The tax side of the social contract in Latin America	
Inequality, taxes, and transfers	235
Informality: A reflection of a broken social contract?	239
Conclusions	244
Notes	245
References	
Boxes	
Overview	
1 Informal workers in Latin America and the Caribbean: Their profile, motivations, earnings, and welfare	
2 Government failures in the design of social protection systems in Latin America and the Caribbean	8
Chapter 1	
1.1 The ILO definition of informality	27
1.2 Indirect methods of estimating informality	
1.3 Schneider and Enste in the new world: Checking MIMIC estimates against Mexican data	
•	
Chapter 2	
2.1 Home-based work: Exploitation or flexible work arrangement?	
2.2 Data from rotating panels in Argentina, Brazil, and Mexico	
2.3 Informal self-employment: Risky and informal, or risky because informal?	
2.4 Special informal employment surveys: What can we learn from them?	64

Chapter	4
4.1	Conceptual issues in gross worker flows
4,2	Simulated effects of labor market legislation on the size of the informal sector
	-
Chapter	
5.1	Patterns of entry and exit in industrialized countries
Chapter	7
7.1	
7.1	Social protection—strengthening people's abilities to manage risk and promoting long-term productivity,
7.0	growth, and development
7.2	
7.3	Extending health insurance coverage by correctly aligning risk-pooling instruments
7.4	Old-age protection in the new millennium: Chile's proposed pension reform
7.5	De-linking health coverage from employment status: Spain's shift to general-revenue financing of essential
	social insurance
Chapter	Q
8.1	
8.2	The extreme of informality and exclusion: Being undocumented
	Local taxation and social norms
8.3	Tax compliance, social norms, and trust in the state: The contrasting cases of Chile and Argentina in the
0.4	late 1990s
8.4	Earned income tax credits: Transfers that encourage formal employment
8.5	Expansion of private security services in Managua
8.6	Negotiating tax reform and the start of the social contract, Chile, 1990
Figure	es establishment of the second
Overviev	
1	Labor market informality and income per capita
2	Trends in informality, by various definitions
3	Probability of transition between formal salaried and self-employment in Mexico
4	Rate of urban employment across sectors, by age in Brazil, 2002
5	Informal workers across firm size
6	Male entry into and exit from self-employment
7	Advantages of formalization reported by IFC-surveyed firms
8	Underreporting of tax and social security contributions, by firm size
9	Economically active population contributing to the pension system
10	Informality versus inequality
11	Tax morale and state capture
12	Self-employment and quality of institutions (governance)
Chapter	
1.1	Margins of informality
1.2	Methods for measuring the informal sector
1.3	Sclected measures of informality
1.4	Informality and gender: women versus men (ages 25–64)
1.5	Informal salaried workers (legal definition) across firm size and time
1.6	Distribution of manufacturing sector firms according to worker registration in Mexico
1.7	Distribution of manufacturing sector firms according to tax compliance in Mexico
1.8	Global correlation of measures of informality with GDP
1.9	Trends in informality by various definitions
Ch1	
Chapter	
2.1	Relative sector sizes and wages under a nominal wage rigidity
2.2	Relative sector sizes and wages in the presence of a labor tax
2.3	Rate of urban employment across sectors, by age
2.4	Probabilities of transition among sectors of employment
2.5	Absolute mean duration of labor force status
2.6	Propensity to move to self-employment from different sectors
2.7	Transition between self-employment and out of labor force, by gender
2.8	Employment sector allocation by gender, marital status, and parental status in Mexico

		Propensity to move to informal salaried status from different sectors	
	2.10	International comparison of desired and actual self-employment rates	6
	2.11	Earnings gain from voluntary movement to informality in Mexico	6
Ch	apter	3	
	3.1	Propensity to informal employment by firm size and economic sector, 2005-06	8
		Propensity to informal employment by education and tenure, 2005–06	8
	3.3	Propensity to informal employment by age, gender roles, and work preferences, 2005–06	Ŕ
		Distribution of hourly earnings for workers in urban areas of Argentina and Bolivia, 2005–06	0
		Earnings cost of informality in urban areas of Argentina, Bolivia, and the Dominican Republic	
	3.6	Fraction of workers who are income-poor and self-rated poor, by education and occupational group	
	3.7	Impact of informality on self-rated poverty	
	3.8	Direct impact of having access to social protection through a family member on self-rated poverty	9
	3.9	Differences between actual labor incomes and the level of income needed to avoid self-rating poverty	
		in Argentina	9
		·	
Çh	apter -	4	
	4.1	Formal share of the labor force and unemployment, Brazil and Mexico	.10
		Probability of transition between formal salaried and self-employment, Brazil and Mexico	
		Probability of transition between formal salaried and informal salaried, Brazil and Mexico	
		Involuntary transition to self-employment in Mexico	
	4.4	Searching while employed, Mexico	
		Decreased availability of formal sector jobs without segmentation	
	4.6		
		Probability of transition to unemployment (separation rate), Brazil and Mexico	
	4.7	Probability of transition from unemployment (job-finding rate), Brazil and Mexico	
		Informal employment reaction to the business cycle	
	4.9	Relative sector shares and earnings, real exchange rate	
		Variation of informality rate (social protection definition)	
		Variation of informality rate (productive definition)	
	4.11	Decomposition of changes in informality (social protection definition) for urban salaried workers	.11
	4.12a	Labor force participation, rate of formality, and unemployment, Brazil	.11
		Labor force participation, rate of formality, and unemployment, Colombia	
		Actual and predicted size of the industrial formal sector, Brazil	
		Informality rate for salaried workers in Greater Buenos Aires	
		Informal salaried versus formal salaried, Mexico, relative earnings and sector size	
	1.17	Evolution of informality across age groups	12
		Labor legislation and related variables, Peru	
	4.17	Labor registation and related variables, Peru	.12
۸1.	apter	-	
J11			
		Entry and exit into self-employment among men	
		Entry and exit into self-employment among women	
	5.3	Job creation and destruction in Colombia, 1977–82	
	5.4	Job creation and destruction by entering and exiting versus continuing firms in Colombia, 1977–82	
	5.5	Employment growth of microenterprises in Nicaragua	.14
	5.6	Size distribution of microenterprises in Mexico and Nicaragua	.14
	5.7	Informality among Mexican microenterprises by number of paid workers and time in business	.15
	5.8	Effect of doubling labor productivity on probability of being informal	
Ch	apter	6	
	6.1	Unreported sales and workers, by firm size	.15
	6.2	Effect of doubling employment size on underreporting rates	
	6.3	Effect of having started informally on underreporting rates	
	6.4		
		Effect of doubling labor productivity on underreporting rates	
	6.5	Advantages of formalization reported by IFC-surveyed firms	
	6.6	Disadvantages of formalization reported by IFC-surveyed firms	
	6.7	Impact of changes in costs and benefits of informality	.16
	6.8	Labor regulations described by firms as biggest obstacle to hiring workers	
	6.9	Estimated impact of informality on growth	
	6.10	Estimated impact of informality on labor productivity	.17

6.11	Effects of a 10 percent increase in tax and social security evasion at the industry/region level	
	on individual firm productivity (pooled sample)	.74
	Productivity difference between tax-paying Mexican microfirms and informal firms with similar characteristics 1	.75
6.13	Productivity and paid employment effects of exogenous increase in formality driven by Brazil's	
	SIMPLES program	.75
Chapter	• 7	
7.1	Pension coverage rates in Latin America and the Caribbean	84
7.2	Social security coverage and GDP per capita	
	Coverage rates in Latin America and the Caribbean, mid-1990s to early/mid-2000s, by quintile of per	.0)
7.3		0.7
_ ,	capita income	
7.4	Pension coverage rates in Argentina, by quintile of per capita income	.87
7.5	Pension coverage among the elderly in Latin America and the Caribbean, contributory and	
	noncontributory programs	188
7.6	Coverage of two poverty-targeted assistance programs in Mexico: Oportunidades and Seguro	
	Popular (by decile, 2004)	188
7.7	Public social protection spending in Latin America and the Caribbean	189
7.8	Public spending on social insurance and social assistance in Latin America and the Caribbean, early 2000s	
7.9	Nonpoor population who fell below the national poverty line due to out-of-pocket health expenditures	
	Distribution of Mexican workers' years insured by IMSS, 1997–2005, for low- and high-wage	.,_
7,10	workers in IMSS in 1997	105
7 1 1		
	Density function for years of formal sector work among 60-year-olds in Uruguay (accumulated ages 18–60) 1	. אָנ
1.12	Cumulative distribution of years of formal sector service among 60-year-olds in Uruguay	
	(accumulated ages 18–60)	190
Chapter	• 8	
8.1	Informality and government effectiveness	220
8.2	Informality and corruption	
8.3	Share of firms confident that the judiciary will enforce contractual and property rights	
8.4	Share of firms that consider the court system fair, impartial, and uncorrupt	
8.5	Informality and state competence indicators	
8.6	Central government tax revenue and GDP per capita	
8.7	Tax revenue of Latin America and Caribbean countries	
8.8	Average tax rate of Latin America and Caribbean countries	
8.9	Average VAT and income tax productivity in Latin American countries	
8.10	VAT productivity and informality indicators	227
8.11	Tax morale, state capture, and perception that the government spends taxpayers' money wisely	228
8.12	Tax morale and informality indicators	
	Social spending and taxation by income quintiles	
	Informality and inequality	
0.1.		-,,
Table		
Iabic		
Chapter		
1.1	Correspondence of the "productive" and "legalistic" definitions of informality	.31
1.2	Correlations across measures of informality	.36
1A.1	Comparisons of ILO and Gasparini-Tornarolli measures of self-employment	
	• • • • • • • • • • • • • • • • • • • •	
Chapter		
2.1	Distribution of formal salaried, informal salaried (social protection/legal definition), and self-employed in	
	urban areas of Latin America (percent)	
2.2	Distribution of informal salaried, self-employed, and unpaid workers, by firm size (percent)	.50
2.3	Characteristics of informal salaried employees in Mexican microfirms	.51
2.4	Informal employment and work-life occupational history, Dominican Republic and Argentina (percent of workers)	.63
2.5	Preference for independent employment (percent of workers)	
2.6	Distribution of the motivations/reasons for being in the current job as an independent worker (percent)	
2.7	Reported reasons to be informal self-employed in Mexico (percent of workers)	
2.8	Reported reasons to be informal self-employed in Brazil (percent of workers)	
2.0		60

N f : N	,
2.10	Reported reasons to be informal salaried in Brazil (percent of workers)
	Principal reason for working without monetary compensation in the Dominican Republic (percent of workers)70
	Main reasons why the informal do not contribute to social security (percent of workers)
2.13	Main reasons why workers do not contribute to health insurance (percent of workers)
Chapter	· 3 • 3 • • • • • • • • • • • • • • • • •

2.12	Principal reason for working without monetary compensation in the Dominican Republic (percent of workers)
Chapter	•3
3.1 3.2 3.3 3.4 3.5 3.6	Unconditional hourly earnings gaps (percent difference in earnings) for formal employees, informal employees, and independent workers in urban areas in Argentina, Bolivia, and the Dominican Republic, 2005
Chapter	•4
4.1 4.2	Evolution of informality across firm size and time: Distribution of informal and self-employed workforce119 Subcontracting in Mexico, 1992–2002 (percent)
Chapter	• 5
5.1 5.2 5.3 5.4 5.5 5.6 5.7 5.8	Entry probabilities into Mexico's self-employment sector (percent)
Chapter	
6.1	Firm-level correlates of sales and employment underreporting
Chapter	
8.1	Long-run informality relationships
8.2	Indicators of informality and institutional indicators
8.3	Comparative perspective of tax burdens and structures (percent of GDP)
8.4	Tax structure by region, selected years, 1975–2002 (percentage of total tax revenue)
8.5 8.6	Tax exemptions in Latin America (percent of GDP)
9.0	Comparative enderency and corruption in tax administracion; ourvey evidence for 2007-00