

# Trade and Informality

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# Informality at a Glance

- General definition:
  - Informal firms do not comply with government regulations and are unregistered
  - However, informal activities can be conducted by registered firms (share of production hidden from fiscal authorities)
- Main characteristics of informal (unregistered) firms:
  - Small size (less than 5 employees, large share of self employment)
  - Low productivity compared to their registered counterparts
  - Limited access to finance and public goods
  - Do not export (self-employed produce essentially non tradables)
  - Participation can be voluntary
- More informality is not a good sign whatever the view we have of the role of unofficial firms in development

# Informality and Trade

- What is the role of informal firms in the production of exported goods?
  - At best they produce inputs but sounds like an exception
- What is the impact of trade liberalization on informal firms and informal activity?
  - The conventional view poses that trade liberalisation would cause a rise in informality
  - However recent theoretical developments and empirical evidence have challenged this view

# Informality and Trade Liberalisation: Empirical Evidence (micro)

- Empirical evidence on the relationship between trade liberalisation and informality is limited and generally country specific (micro data)
- Most of the evidence relates to Brazil, Colombia and Mexico for which rich, relevant and reliable micro datasets are available
- Empirical studies suggest that informality can respond to trade liberalisation either positively or negatively, depending on country and industry characteristics (economic and institutional)

# Informality and Trade Liberalisation: Empirical Evidence (macro)

- Less restricted trade is associated with a larger share of informal output
- Less restricted trade is associated with a lower share of informal labor
- Results are obtained in a dynamic panel set-up and are robust to a series of changes in specification, controls and reference sample
- Results can suggest that unregistered activity has fallen with trade liberalisation but underground activity in registered firms has increased

# Research Agenda I: Theory

- No existing theoretical framework is able to replicate macro empirical findings: the sign of the relationship is the same for any dimension of informality in all models
- The real (modeling) issue seems to be undeclared production (/employment) in registered firms:
  - Lower informal employment (ILO definition) may be seen as a good news if workers move to formality (higher labour productivity)
  - However, the overall incidence of precarity may have remained the same or even worsened

# Research Agenda II: Empirics

- More needs to be known about the relationship between informal firms and the external sector: increase the country coverage of World Bank's Micro and Informal surveys (and perhaps adapt the questionnaires)
- Establishment of a reference database based on macro (indirect) estimated measures of informal activity across countries

# Research Agenda III: Policy

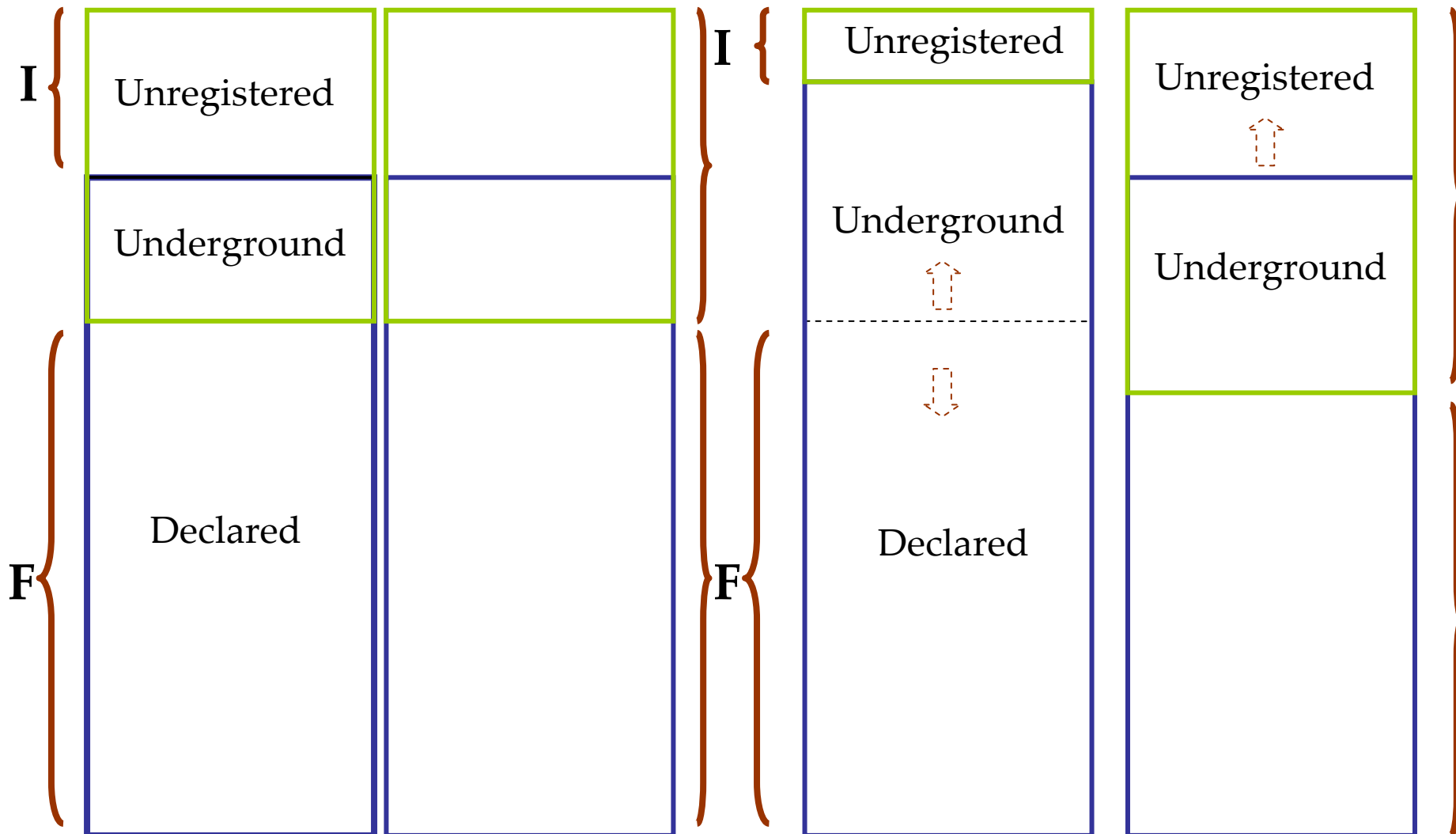
- En vogue: “Formalization” of informal firms
- However, formal entrepreneurs are better skilled than informal ones => main constraint to formalization
- The best way to formalize may be to promote and support job creation in the formal sector especially in times of policy reform like trade liberalization

Employment

Production

Employment

Production



Trade Liberalization →