

# Does Informal Employment Improve Livelihood in the Long-Term?

written by Firuza Nahmadova Firuza Nahmadova

Much of the research on income inequality, and livelihood rely on government labor and wage statistics. In emerging economies, a lack of reliable data and the prevalence of informal employment are often noted as main limitations to the credibility of these studies' results. Azerbaijan is one such case where it is quasi-impossible to estimate an actual average income, for informal employment is over half of the entire economy due to, among other things, undeclared revenue, low-level bribery, and low formal income.

The term *informal* employment refers to economic activities that go undeclared and take place *under the radar* of government institutions. However, informal employment is complementary to the formal sector as it most often responds to unmet economic needs and creates economic opportunities, particularly in developing economies. Informal employment makes it difficult to estimate real income, undermining research on income inequality because the presence of the informal sector makes statistics on the formal sector by default incomplete. Hence, most assume that real income is in fact higher than that declared to the state. Does informal employment truly improve the livelihood of a household in the long-term, increasing its expendable income and sustaining a satisfactory way of life?

This paper investigates whether informal employment and undeclared (informal) income that citizens receive from related activities improve their livelihoods in the long term. The relationship between income inequality and informal employment will be discussed based on a comparative analysis

of three developing countries from three different regions, namely Southeast Asia, Central America, and Africa. Evidence from these developing economies suggests that informal income does not positively impact livelihoods. Instead, it often exacerbates income inequalities. Theory and evidence seem to concur on the positive correlation between informal employment and income inequality. When informal employment rates increase, income inequality follows the same trend. The paper ends with a discussion of the impact of informal employment in Azerbaijan using household income per capita statistics for 2020. The discussion suggests that the prevalence of informal employment does not improve the livelihood of the average household.

### **Informal employment in developing countries**

An estimated 60% of all employed people in the world are engaged in informal employment and that percentage is highest in developing countries (ILO 2018). While formal employment is the main source of income in developed countries, informal employment makes up most of all economic activities in the developing world. In this section, several case studies are put forward to show how informal employment negatively affects long-term livelihood and income inequality in these countries.

Southeast Asian countries have been the focus of research on the impact of informal employment on the long-term livelihood of workers. 68% of the region's workers are engaged in informal employment (ILO 2018). Informal employment in the region has received increased attention in the past two years because informally employed workers have been one of the most vulnerable people to changes in income generation mainly due to the pandemic. In fact, Southeast Asian workers at large were the most impacted by the pandemic of any group on the planet. The risk of falling further into poverty was much higher for this group of workers during the COVID19 lockdowns, partly due to their low level of savings. Yet again, most of these workers turned to informal employment due to the lack of

opportunities outside this sector. Because the region's lack of safety nets, social security, and access to finance, these workers were the first to suffer from the worldwide crisis. In Thailand, for example, over 55% of workers are employed by the informal sector down from 65% in 2016 (WIEGO 2021). Yet, income inequality levels have not budged by much as the gap between the top 10% and bottom 50% has slightly increased. This observation reinforces the idea that informal employment does not increase long-term livelihoods, financial safety, and independence of the workers in that sector.

Central America is no different regarding the positive relationship between income inequality and the size of the informal sector. The case of Mexico after the early 2000s-peso-devaluation crisis has been of particular interest to researchers (Binelli 2016, Villareal 2010). As a result of the macroeconomic crisis, levels of unemployment quickly rose, and in the absence of unemployment compensation, many workers turned to the informal sector as the only viable option to survive. Like in South East Asia, the choice to participate in informal employment is a survival tactic. Furthermore, this switch towards informal employment indicated that a more significant percentage of the working population accepted lower income to provide for their families. This situation also meant that these workers were at higher risk of losing the bare minimum lifestyle as no informal employment protection legislation exists. The increase in the informal sector thus led to even higher income inequalities (Binelli 2016).

As of 2014, the informal sector represents 60% of all workers in Mexico, twice more than in the early 2000s, although the overall unemployment rate has been relatively low at only 5% since the 2008 financial crisis. This suggests that since the early 2000s, informal employment has become more of an alternative to formal employment and less of a survival tactic. Workers turn towards it not always out of pure necessity but choose informal employment when entrepreneurial

conditions are more desirable. Some government programs target the formalization of these jobs with unemployment insurances and universal pensions. However, these efforts have not had direct results on alleviating the switch to informal employment after a loss of formal income, especially during the COVID19 pandemic (Reuters 2020).

Uganda is another such country in which the informal sector represents over 50% of the economy. Analysis of the 2020 business owners' survey shows that the main reasons for informal employment are not related to illegal activities. Instead, such businesses are created by those who could not integrate into the formal sector or those who had the entrepreneurial motivation to create business opportunities for themselves (Mugoda et al. 2020). This suggests that most turn to informal employment as a survival tactic because of the lack of other options. While the main objective of informal employment is to take advantage of otherwise absent economic opportunities, Ugandan informal employment does not help decrease income inequalities. Indeed, income inequality has increased from 2000 to 2016 reaching a Gini coefficient of 0.428 (World Bank 2016). Informal employment acts only as an income-generating activity that, in many cases, does not cover the workers' basic needs.

Empirical evidence from these three developing economies shows that informal employment does not have a positive effect on long-term livelihood and level of income. In all three of the case studies, informal employment represents a large percentage of all labor, and a significant portion of the working population is employed informally. What is more striking is that those who are working informally often do not have any acceptable choice other than to participate in informal employment despite the lower incomes it offers. Informal employment is used either to support their formal income or as their only source of income altogether. The downsides of informal employment were further revealed during the pandemic where informally employed people became even more

vulnerable without any social nets.

### **Informal employment and its impact in Azerbaijan**

If informal employment does not bring any long-term livelihood benefits to the worker and their household in other developing countries, is it the same in Azerbaijan? Does the existence of a high informal employment rate prove that the real livelihood level of Azerbaijanis is higher than stated by official statistics? Below, we test a number of hypotheses for these questions:

*HYPOTHESIS: If the state's average household revenue from formal employment is 707AZN alongside 923.8AZN of average monthly expenditures, the average household cannot meet their monthly expenditures. However, if we were to add in additional informal income from informal employment, one can assume the following:*

- the household would thus afford to pay all their monthly expenditures.*
- the household could save for the future.*
- informal employment can improve the livelihood of the average household in the long-term.*

A simple look at the formal average household income and expenditures statistics over the past few years shows that the average person's formal income does not suffice to afford the household's monthly expenditures (State Statistical Committee of Azerbaijan 2020). In turn, the household is incentivized to engage in informal employment to supplement the total income.

<b>Average household budget per person (AZN/month)</b>	<b>2019</b>	<b>2020</b>
Expenditures	298.41	297.78

Total income	292.64	291.36
Balance	-5.77	-6.42

The situation only worsens once the household increases in size, for example if it includes a couple and a child. As per official statistics, the average household size in 2020 was 4.12 people in 2020, putting average household expenditures at over 1230AZN per month, while average income is still at 707 AZN. The monthly household income per person is also much lower when comparing households with and without children: 260 versus 351AZN.

Some might also include their elderly parents who only receive pensions which do not cover their personal expenses, thus making them an additional financial burden to the household. As a result, the negative balance between total income and expenditures increases if we look at different household compositions.

<b>Average household of 4.12 people with child</b>	<b>Current situation</b>
Expenditures	1119
Total income	1071
Balance	-48

Even if the household were to generate enough informal income to cover their total expenditures, in the previous case an extra 48AZN, informality adds another set of issues related to instability. Compared to formal employment, informal employment usually generates uncertain income. Does it genuinely increase the long-term livelihood of a person or their household to have an uncertain informal income each month? There is always the risk of not making the same amount

each month which in turn pushes the household to find other complimentary sources of income, such as micro-credit (Mehralizadeh 2020).

Furthermore, when a household's informal income is higher than the amount required to pay off monthly expenditures, the additional amount might not always be expendable for other durable goods. Because the following month's informal income might be lower, the incentive is to save for the next month instead of investing into other goods or into leisure. The vulnerability that comes with informal or mixed employment does not enable long-term livelihood improvement as the household's expendable income does not increase. The inability of the workers to move from informal to formal employment could negatively affect their ability to improve the household's livelihood in the long-term.

As the average income and expenditure levels in Azerbaijan show a negative balance, a third point to discuss is the relationship between informal income and poverty. Research shows that a higher share of informal employment in the economy is associated with a higher level of poverty (OECD/ILO 2019). While this correlation does not mean causation, it still suggests the following inference: informal income does not help poor households' livelihood in the long term.

When looking at Azerbaijan's poverty levels and informal economy statistics, there is, at first, a discrepancy in the numbers. Estimates put the size of Azerbaijani informal employment at about 50% of GDP in 2017 (Medina and Schneider 2019), meaning that the equivalent of half of the current GDP is not declared and is generated by informal employment. This is to say that another 20 billion USD could have been generated on top of the official GDP in 2020, which would have translated into about 300AZN a month per person, that is without looking at disparities in the informal economy distribution (e.g., high-level corruption and bribery).

While this current 50% is a lower percentage than the 61% at the beginning of the 2000s (Guliyev 2015), it is still high enough to have a significant impact on the population's long-term livelihood. This high percentage suggests that a large percentage of the population turns to informal employment either as their only source of employment or as a source of supplementary income to their low formal income. As a result, it is reasonable to assume that this same population struggles with their basic needs every month even without looking at income and expenditures statistics. At the same time, the number of people under the official poverty line (194.9 AZN in 2020) is at only 6% versus 29% in 2005. While 6% is not a small amount, it is still much lower than the nearly 30% 15 years ago.

*Question: If informal employment negatively affects long-term livelihood, how is it that poverty has decreased?*

One possible explanation is data manipulation. If we presume the Azerbaijani official income statistics to be inflated, then those statistics are simply unreliable. It is then also plausible that the real difference between income and expenditures is higher than stated. That is, in fact, probably the safest assumption. Nevertheless, this is not the only explanation for the discrepancy.

The poverty line, or the minimum income deemed sufficient for living, is a good measure of how the economy is developing and how good the long-term livelihood is for most of the population. The less the number of people under the poverty line, the less income inequality there is in a country.

However, this measure does not show the complete picture. In the case of Azerbaijan, it is safe to assume that a large percentage of households is in the 'near poor' category, as demonstrated by the average total expenditure and income table above. The average household cannot afford their monthly expenditures and likely turns to informal employment to supplement their income. While this extra income is enough to



cover expenditures in most cases, the uncertainty that comes with it puts the average household on the brink of poverty. A household that is uncertain whether its total income will cover its expenditures is one that could fall into poverty at any time.

### **In lieu of a conclusion**

The existence of informal employment does not create an improvement in the livelihood of the average household. When considering the negative balance between income and expenditures per capita, and the overall instability engendered by informal income, informal employment does not appear to have any long-term positive effect on household savings and economic wellbeing. Instead, it might even push a household into an even more challenging situation, adding more instability into workers' lives.

### **References:**

Aghayev, R. (2020). The Threat of an Economic Crisis: Risks for Households. Baku Research Institute. Available online: <https://bakuresearchinstitute.org/en/iqtisadi-bohran-t%C9%99hluk%C9%99si-ev-t%C9%99s%C9%99rrufatlari-ucun-riskl%C9%99r/>

Aghayev, R. (2018) Statistics that can't hide the reality. Baku Research Institute. Available online: <https://bakuresearchinstitute.org/en/azerbaijan-gerc%C9%99kl%C9%99ri-gizl%C9%99d%C9%99-bilm%C9%99y%C9%99n-statistikamiz>

Binelli, C. (2016) Wage inequality and informality: evidence from Mexico. IZA Journal of Labor & Development, Issue 5:5.

Friedrich-Ebert-Stiftung Uganda, Akina Mama wa Afrika Kampala. (2020) From the Margins to the Centre: Discourses on the Impact of the COVID-19 Pandemic on Women in Uganda. Edited by Maria Alesi and Leah Eryenyu. Available online: <http://library.fes.de/pdf-files/bueros/uganda/17364.pdf>

Guliyev, F. (2015) The Informal Economy in Azerbaijan.

Caucasus Analytical Digest, n.7. Available online: <https://www.files.ethz.ch/isn/192445/CaucasusAnalyticalDigest75.pdf>

ILO. (2018) Women and men in the informal economy: A statistical picture. Available online: [https://www.ilo.org/global/publications/books/WCMS\\_626831/lang-en/index.htm](https://www.ilo.org/global/publications/books/WCMS_626831/lang-en/index.htm)

Medina, L., Schneider, F. (2019) Shedding Light on the Shadow Economy: A Global Database and the Interaction with the Official One. CESifo Working Papers.

Mehralizadeh, F. (2020) Why Are Consumer Loans on the Rise? Baku Research Institute. Available online: <https://bakuresearchinstitute.org/en/why-are-consumer-loans-on-the-rise/>

Mugoda, S., Esakun S., Nakimu, R. K., Bbaale, E. (2020) The portrait of Uganda's informal sector: What main obstacles do the sector face? Cogent Economics & Finance, 8:1.

Nahmadova, F. (2020) Housing and Wealth Inequality in Azerbaijan: A Statistical Analysis of Real Estate Prices in Baku. Baku Research Institute. Available online : <https://bakuresearchinstitute.org/en/housing-and-wealth-inequality-in-azerbaijan-a-statistical-analysis-of-real-estate-prices-in-baku/>

OECD/ILO. (2019) Chapter 3. Risks and vulnerabilities in the informal economy. Tackling vulnerability in the informal economy. Available online: <https://www.oecd-ilibrary.org/docserver/2cfd8904-en.pdf?expires=1633465504&id=id&accname=guest&checksum=453B71455549172E50E3FDB905300BDC>

Reuters. (2020) Mexico loses 12 million jobs, workers in informal sector grow. Available online: <https://www.reuters.com/article/us-mexico-unemployment-idUSKBN>

[24137C](#)

State Statistical Committee of Azerbaijan. (2020) Labour Market. Available online: <https://www.stat.gov.az/source/labour/?lang=en>

Villareal, A. M. (2010). The Mexican Economy After the Global Financial Crisis. CRS Report for Congress. Available online: <https://sgp.fas.org/crs/row/R41402.pdf>

WIEGO. (2021) COVID-19 Crisis and the Informal Economy: Informal Workers in Bangkok, Thailand. Available online: <https://www.wiego.org/publications/covid-19-crisis-and-informal-economy-informal-workers-bangkok-thailand>

World Bank. (2016) Gini index (World Bank estimate) – Uganda. Available online : <https://data.worldbank.org/indicator/SI.POV.GINI?end=2016&locations=UG&start=2015>