

Engaging with Informal Sector for Inclusive Growth: Policy Perspectives*

The context of the discourse

Issues related to informality in the labour markets of developing countries have been attracting renewed attention in recent times, for several reasons: chronic persistence; heterogeneity; possible adverse implications for economic growth; difficulties involved in ensuring social compliance and labour rights; low efficiency, low productivity and the resultant low income originating from informality. A notable characteristic of informality in developing countries is that informal labour is not only a distinctive feature of the informal sector, it is also a common facet of the formal sector where it coexists with formal employment. There is no reason to treat informality merely as a corollary of underdevelopment. Addressing the multidimensionality of informality thus entails dealing with a diverse range of challenges across the entire policy spectrum.

Successive Labour Force Surveys (LFSs) and Household Income and Expenditure Surveys (HIESs) carried out in Bangladesh, and also industrial, sectoral and micro-level studies indicate that, in spite of the positive achievements in the economy, 'informality' continues to have predominant presence in Bangladesh's economic landscape, in terms of both employment (informal nature of employment) and sectoral features (informal enterprises).

More than four fifth (86.2% according to LFS 2015-16) of the total employed in Bangladesh were engaged in some type of informal employment. This calls for a deeper and insightful understanding of informality as a critically important aspect of the jobs agenda, and the broader inclusive growth agenda, in the Bangladesh context. Thus, it is important to take an indepth look at the various dimensions of informality in Bangladesh, from both the labour market and sectoral-enterprise perspectives.

Like many developing countries, Bangladesh is at present experiencing the so-called Lewis turning point – with labour moving from agriculture to rural non-farm and the urban sector, but mostly in the urban unorganised and informal manufacturing and services sector, and mostly in low-paying jobs, either in self-employment or in hired employment. The falling employment elasticity of GDP growth observed recently, with a decline from 0.55 during 2005-2010 to 0.45 during 2016-2020 also demands a closer scrutiny at the employment dynamics in Bangladesh.

Methodology and research questions

Insights gleaned from cross-country surveys and enterprise level experiences, analysis of data from the most recent six labour force surveys (between 1999-2000 and 2015-16) and deployment of various empirical tools¹ address the following questions:

What is the magnitude and what are the trends in informality in Bangladesh?

What is the nature of its heterogeneity?

What are the key characteristics and background of those in the informal labour market? How do wages and productivity vary between informal and formal employment?

Are the policies pursued adequate to safeguard the interests of informal employment?

What is the nature of complementarity between the formal and informal sectors within value and production chains?

* This policy brief is based on the study titled "The Role of the Informal Sector in Inclusive Growth: A State of Knowledge Study from a Policy Perspective" prepared by the CPD in collaboration with ODI. The authors of the study report are Mustafizur Rahman, Distinguished Fellow, CPD, Debapriya Bhattacharya, Distinguished Fellow, CPD and Md. Al-Hasan, Research Associate, CPD.

¹ These include discrete choice model, Oaxaca-Blinder (O-B) decomposition, quantile regression, and principal component analysis.

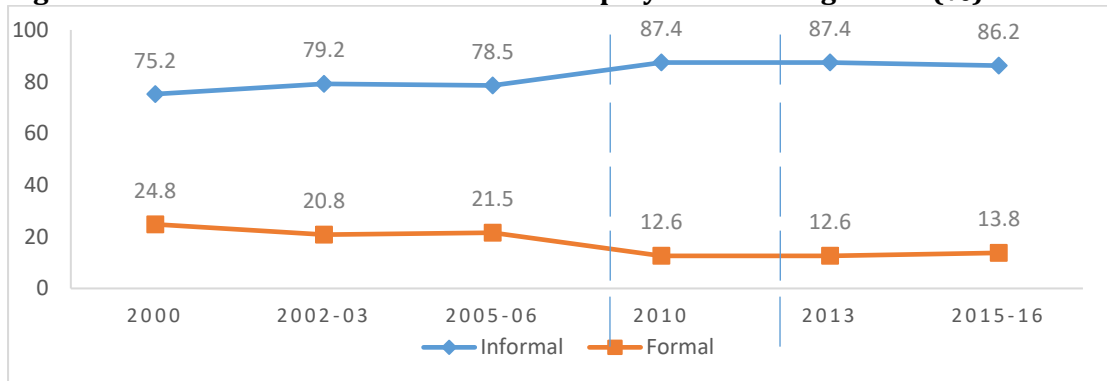
How does the informal–formal continuum operate on the ground?
 What policies need to be pursued to bring informality within the ambit of inclusive growth in Bangladesh?

Responses to the abovementioned questions were strengthened by case studies to generate relevant insights as regards informal employment on two important sub-sectors of the manufacturing sector of Bangladesh; viz. export-oriented readymade garments sector, and leather and the footwear sector.

Key findings

Women and those with low levels of education dominate the informal labour market in Bangladesh. While among those in informal employment, women constitute 33% of the total, their share is only 10% among the ones in formal employment. While 29% of those in the formal employment did not have education beyond the primary level, the corresponding figure for those in informal employment was found to be about 63%.

Figure 1: Trends in Informal and Formal Employment in Bangladesh (%)



Source: BBS, LFS (Various years).

The definition of informal-formal dichotomy has undergone a number changes in successive LFSs. Before 2010, informality was associated with informal enterprises, when four attributes were used to define workers in informal employment (i.e. unpaid family workers, irregular paid workers, day labourer in agriculture and non-agriculture, and domestic workers). In 2013, those not receiving pension and not contributing to a retirement fund were also added in the definition of informality.

Figure 1 indicates a change in the level of informality during the last decade and half (2000 – 2015/16). However, estimates according to consistent definition (as per 2013 LFS) can only be generated from LFS 2010 data (because of lack of required information). The figure shows that informality has remained at consistently high level of about 86% (51.3 million) among those in employment in the country.

While the national income gini coefficient has gone up between 2010 and 2016 from 0.45 to 0.48, gini coefficient for wage income has come down from 0.38 to 0.29 over the comparable period. It is reckoned that, creating (“decent”) jobs that pay good wages could prove to be an important way to reduce inequality and move towards inclusive growth in Bangladesh. On the other hand, the distribution of wage for those in formal and informal employment shows that, not only the average income of those in formal employment was higher compared to those in informal sector, percentile wise, the former earns higher income than the corresponding cohorts in the latter group.

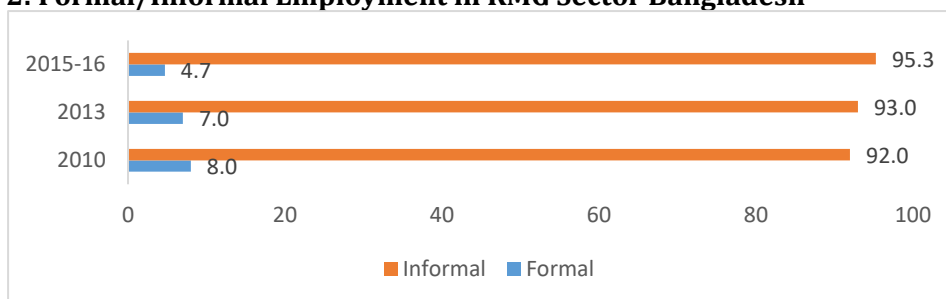
Data reveal male dominance in Bangladesh’s formal sector employment, and gender-based wage premium along all segments of the labour market. This is also true for the two sub-sectors selected for the case study. Formality and informality were found to coexist in the Bangladesh

labour market spectrum, both horizontally and vertically, which speaks of the complexity of the issues involved (see Box 1 and Box 2). This holds both for employment and at the level of enterprises. Thus, there is a case for moving gradually to formalisation, on both counts, through incremental and progressive steps.

Box 1: Informality in the RMG Sector

In the export-oriented RMG sector, less than 5% of total workforce belonged to the formal category while the remaining 95% was in informal employment (LFS 2015-16). More than 67% of the informally employed were of between 15 to 29 years; 46.5% did not have education beyond the primary level. While the shares of young and less educated labour in the formal RMG sector have fallen between 2013 and 2016, these same have gone up in the informal counterpart. Whether this is a consequence of the developments within the sector following the Rana Plaza tragedy (e.g. through greater practice of contractual jobs) is an issue that demands a more detailed examination.

Figure 2: Formal/Informal Employment in RMG Sector Bangladesh



In the vertical segment of employment in the RMG sector, the higher the job hierarchy with attendant higher income, the higher the percentage of those in formal employment. Thus, about 85% of the executives were in formal employment, whereas among the other categories of employment, between 93% and 98% belonged to the informal category.

Cohabitation of formality and informality in employment along the production chain is clearly discernible if the various stages of production in the RMG/textile sector are considered. Thus, in the textile/RMG value chain formality and informality coexist in the labour market, both horizontally, in the various subcomponents of the value chain, and vertically, in various stages of production where employees with higher qualifications and skills tend to be more in formal employment. Since in most formal enterprises pensions/contributory funds are not applicable for non-salaried workers (as per the 2013 LFS definition), whether skilled or not, almost all workers remain in informal employment. In contrast, a majority of executives enjoy those benefits which qualify them to be considered as formally employed.

Box 2: Formal-Informal Continuum in the Leather and Leather Goods Sector

The leather and leather goods sub-sector is a predominantly sole proprietorship-partnership based industry (89%), with only a small share being private and public limited enterprises (11%). LFS data indicate that, similar to the common trend in Bangladesh, informality is overwhelmingly present in this sector with about 85.3% of the employment belonging to this category.

Table 1: Formal-Informal Divide along Value Chain (Ratio)

Value Chain	Tanning	Manufacturing of luggage	Manufacturing of footwear	Total
Formal-Informal Divide	1:100	1:2.5	1:6	1:5

Source: Extracted from BBS (2017)

Here also, (conditional) wage gap was found to be significant, between average wages for male and female employees, to the tune of 18.1%.

Informality is extensively present along the production chain in the leather-footwear sector. All employment in the tanning segment is of an informal nature, while share of formality tends to rise in the manufacturing segments.

Sectoral analysis reveals that the move from informality to formality in Bangladesh is a continuum. With increasing move to formality, both profitability and productivity of enterprises tend to increase significantly. This indicates that a (gradual) move towards formality will align well with the strategy of inclusive growth in Bangladesh.

Policy suggestions

The Seventh Five Year Plan (7FYP) of the Bangladesh government defines inclusive growth as ‘growth that is both sustainable, broad-based in terms of employment opportunities and reaches out to people on the margin’. In fact, one of the indicators related to the targets in Goal 8 of the United Nations 2030 Agenda pertaining to decent work (Target 8.3) refers to ‘reduction in the share of informal employment in the labour force’. Arguably, consideration of ‘informality’ issues within the broad rubric of overall labour market dynamics, thus, requires addressing wide ranging policy challenges through targeted interventions.

Three issues need to be addressed while dealing with informality in Bangladesh context. First, measuring and monitoring the dynamics of informality in the labour markets and enterprises. Second, pursuing policies to expand formality in terms of both enterprises and employment. Third, taking targeted steps to safeguard the interests of workers in informal employment as part of attaining the aspiration of decent jobs in light of SDG 8.



Streamlining definition and data need

There is serious dearth of relevant data on informality in Bangladesh. The definition of formal employment, vis-à-vis informal employment, has evolved over time, with the current definition of formal employment having been set in 2013. In the earlier definition there was a concordance between informal-formal enterprise, and informal-formal employment. All jobs in the informal (unregistered) sector were treated as being informal while all jobs in formal (registered) enterprises were considered as formal employment. However, the current definition of informal employment includes those who do not have pensions or do not contribute to retirement funds,

even though they may work in formal enterprises. As was pointed out, this would mean that an overwhelming proportion of workers in formal enterprises are actually in informal employment (as the two sub-sector studies also indicate). Evidently, the current definition of formal/informal employment is in tune with what is evolving as standard practice in many countries. The paper argues that Bangladesh's labour force surveys should be geared to generating more detailed information on informality, both in terms of employment and at enterprise levels, to generate adequate data to have broader and more in-depth understanding about informality.

Reforming the labour laws

Labour laws and labour market reforms play an important role in addressing the challenges faced by informality in terms of both income (e.g. minimum wage provisions) and rights (e.g. enforcement of trade union rights, safety and security of work, better compliance). As pointed out in the paper, successive labour force surveys in Bangladesh have defined formality in a progressive manner, with the 2013 LFS defining that only those who enjoy pension or contribute to a retirement fund will be considered to be in formal employment. On the other hand, the Amended Labour Law (2013) does not make a distinction between formal and informal labour. Manufacturing units of certain specified attributes (having more than 100 workers or Tk. 10 million investment etc.) are required by the Labour Law to contribute 5% of profits to welfare funds to be distributed according to certain proportions among the three designated funds (Workers' Participation Fund, Workers' Welfare Fund, and Workers' Welfare Foundation with respective ratios of 80:10:10). The Labour Law does not mention about issues of pensions or establishment of retirement funds. Policymakers may consider amending the Labour Law to distinguish between formal and informal enterprises by making a further differentiation among firms, perhaps by creating an upper threshold in the criteria mentioned above. This will also ensure alignment between the definition of formality in LFS and the Labour Law.

Encouraging formality in formal enterprises

Informality runs across the formal-informal divide at the enterprise level. With regard to formal enterprises (those registered under the Companies Act), policies should be geared to encourage formality of employment through specific criteria, in accordance with the definition of formality in the labour force survey. Incentives may also be considered (e.g. tax breaks) to encourage formal (registered) enterprises to have increasing numbers of employees in formal employment (with pension/contributions to retirement funds). This would ensure enhancement of benefits and employment security for workers in the formal sector.

New VAT law as an opportunity towards formalization

Informality-formality runs in a continuum in many production and value chains in Bangladesh. The nature of employment in export-oriented RMG and leather and leather goods sectors, which was investigated as part of the present study, corroborates this observation. While front-end production units tend to be more formalised, back-end production continues to be dominated by informal enterprises. While such enterprises have TIN/VAT etc. registration (stipulated by law), the majority remains outside the purview of fiscal authorities. These enterprises also remain outside the formal financial system and face difficulty in accessing bank credit and other support measures. The scope for scaling up and technological upgradation and attaining higher productivity remains severely limited under such circumstances. As a result, the willingness and ability to pay better wages to workers is significantly constrained.

Implementation of the proposed VAT Act can be seen as an opportunity to bring the entire value chain in the production of goods and services within the ambit of the fiscal purview. The law, when implemented (gradually), will bring business/production entities within the legal framework, from the fiscal perspective (encouraging business units to register and get tax credit). What is proposed here is that, the implementation of the VAT law be taken advantage of to trace

and track labour market dynamics along the informal–formal enterprise nexus and the informal–formal employment continuum along the horizontal and vertical value chains. This will help design policies to address the needs of those in informal employment, by taking supportive measures both, for the informally employed and for informal enterprises.

Policy support for those in informal employment

Informality in Bangladesh, as is the case in many other developing countries, has close correlation with age, sex and education. With age (used as a proxy for experience) and education, employability in the formal sectors significantly rises. In view of this, opportunities for skills development through on-the-job training and apprenticeships and creating scope for workers to move up the skills/employment ladder assume heightened importance. While these may be considered as part of general labour market policy in the Bangladesh context, there is a danger that many of the challenges originating from ‘informality’ may not be adequately addressed if a ‘generalised’ approach is pursued. If growth is to be of an inclusive nature, the particular problems faced by those in informal employment and informal sectors will need to be addressed with focused initiatives. A vast number of informal workers are in micro and home-based enterprises where the vicious cycle of ‘low-productivity – low-income’ is pervasive and persistent. Many informal workers are involved in low-earning self-employment activities. A large number of informally employed are also involved in various hazardous activities. From an inclusive growth perspective, there is thus an urgent need to address the particular challenges faced by informality. National policies such as the National Social Security Strategy (2015) may need to be revisited from this vantage point.

Macroeconomic management

The objective of achieving increasingly lower levels of informality should be seen as an integral part of Bangladesh’s overall inclusive growth strategy. However, this should be done in a manner that is not counter-productive and drives firms willing to become formalised underground. The study has identified some of the key determinants of formality-informality in the Bangladesh labour market and posits that the strategy of move towards formality should be a gradualist one. From a macroeconomic management perspective, reduction in informality will hinge critically on rise in productivity, higher human resource endowment and the resultant higher wages and income. Ensuring inclusive growth, from formality-informality perspective, would mean investing in development of skills to enhance employability in more dynamic sectors and in segments within sectors which offer higher wages and income. This will also depend on conducive investment environment and supportive fiscal-financial-institutional policies.

Hopefully, the analytical issues raised and the policy reforms proposed in the foregoing paragraphs will find space in the ongoing discourse on inclusive growth in Bangladesh.