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Labour Market Informality and Employment Security in Developing Economies

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Labour market informality remains one of the most persistent challenges confronting developing economies. Informal employment provides income-generating opportunities to millions of individuals who might otherwise remain unemployed, yet it frequently operates beyond the effective coverage of labour legislation, social insurance, written contracts and workplace protection. This article examines the relationship between labour market informality and employment security through a review of theoretical perspectives, international evidence and contemporary policy debates. It argues that informality should not be interpreted as a uniform condition. Some individuals enter informal self-employment voluntarily because it offers flexibility, independence or lower operating costs, while many others are pushed into informal work by poverty, limited formal-sector job creation, educational disadvantage, institutional exclusion and weak enforcement of employment standards. The analysis demonstrates that informal workers commonly experience insecurity in several interconnected dimensions, including unstable earnings, unpredictable working hours, arbitrary dismissal, inadequate occupational safety, limited bargaining power and exclusion from pensions, health insurance and unemployment protection. Women, young people, migrants, domestic workers, agricultural labourers and workers in microenterprises are particularly exposed to these disadvantages. Informality also has broader economic consequences because it can restrict productivity growth, weaken public revenue, reduce investment in worker skills and increase household vulnerability to economic, health and environmental shocks. The article concludes that compulsory registration and punitive enforcement alone cannot create sustainable formal employment. Effective formalization requires coordinated interventions that lower the cost of compliance, improve enterprise productivity, expand portable social protection, strengthen labour inspection, recognize diverse employment relationships and increase workers' collective representation.

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Introduction:

Labour markets in developing economies are characterized not only by unemployment but also by extensive employment outside formal regulatory and social-protection systems. Informal workers may include street vendors, agricultural laborers, domestic workers, home-based producers, casual construction workers, transport operators, unpaid contributing family workers, digital platform workers and employees of unregistered or partially registered enterprises. Informality may also exist inside legally registered companies when employees are hired without written contracts, social-security registration or legally required employment benefits. The International Labour Organization estimates that more than 60 per cent of the global workforce and approximately 80 per cent of enterprises operate within the informal economy. Informality is particularly concentrated in emerging and developing countries, where formal employment creation has not kept pace with labour-force growth. Informal employment therefore remains an essential source of income, but it is also associated with vulnerability, poor working conditions and inadequate protection against employment and income loss. Recent international assessments indicate that informality continues to absorb a considerable proportion of new labour-market entrants in low-income countries. Employment may increase without a corresponding improvement in job quality when structural transformation, labour productivity and formal enterprise growth remain weak. Consequently, improvements in employment numbers alone may conceal continued insecurity, low earnings and working poverty. Employment security refers to more than the probability of retaining a particular job. It includes predictable earnings, protection against arbitrary termination, continuity of work, access to social insurance, enforceable employment rights, safe working conditions and the ability to manage periods of unemployment, illness, maternity, disability or old age. Labour market informality weakens many of these protections because employment relationships remain undocumented or inadequately regulated. This review article examines five major dimensions of the relationship between informality and employment security: the conceptual foundations of informal employment, the structural causes of informality, and its consequences for workers' security, its distributional and macroeconomic effects, and the policy measures required for inclusive formalization.

Conceptual Foundations and Forms of Labour Market Informality:

Informal employment refers broadly to work arrangements that are not effectively covered by formal labour regulation, taxation, social insurance or employment-related legal protections. It is important to distinguish between the informal sector and informal employment. The informal sector generally consists of small or unregistered economic units, whereas informal employment includes unprotected jobs located in both informal and formal enterprises. An employee working for a registered company may therefore remain informally employed when the employer does not provide a written contract, register the employee for social insurance, comply with minimum-wage requirements or recognize legally mandated leave. Similarly, domestic workers, subcontracted workers and platform workers may perform economically important work while remaining outside conventional definitions of employment.

The literature provides several explanations of informality. The dualist perspective views informal work as a residual source of employment for workers who cannot obtain jobs in the modern formal economy. Under this interpretation, weak industrial development and insufficient formal job creation force people to generate their own survival-oriented employment. The structuralism perspective emphasizes the links between formal and informal production. Large firms may reduce costs by subcontracting production, transport, cleaning, security or home-based work to smaller units that provide lower wages and fewer protections. Informality is therefore not always separate from the formal economy; it may be integrated into formal supply chains through unequal commercial and employment relationships. The legalist perspective argues that costly registration procedures, complex taxation and excessive regulation encourage entrepreneurs to operate informally. From this viewpoint, simplified business registration and more proportionate regulation can increase formal participation. The voluntarism perspective similarly recognizes that some workers and entrepreneurs choose informality because they value flexibility, independence or the avoidance of taxes and administrative obligations. However, voluntary and involuntary motivations frequently overlap. A worker may value flexible hours while simultaneously lacking access to any secure formal employment. The World Bank's "exit and exclusion" framework captures this complexity by distinguishing individuals who voluntarily exit formal arrangements from those excluded from formal employment, public services and institutional protection. Informality should therefore be understood as a spectrum rather than a simple formal–informal division. Workers may possess some protections but lack others, while enterprises may comply with selected regulations and avoid others. This diversity requires differentiated policies instead of a single formalization strategy.

Structural Causes of Informality in Developing Economies:

Limited formal-sector employment creation:

The most important driver of informality is the inability of formal enterprises and public institutions to generate sufficient productive employment. Developing economies often experience rapid population growth, rural-to-urban migration and increasing numbers of educated young people entering the labour force. When investment and industrial expansion remain inadequate, the formal sector cannot absorb all available workers. Informal activities then function as an employment buffer. Entry barriers are generally low because workers can begin trading, providing services, producing goods at home or performing casual labour with limited capital. This accessibility explains why informal employment persists even when earnings and working conditions are poor.

Low productivity and enterprise constraints:

Many informal enterprises operate with limited capital, outdated technology, inadequate infrastructure and restricted access to finance. Low productivity makes it difficult for them to pay formal wages, taxes and social-insurance contributions. At the same time, remaining informal can restrict access to institutional credit, government procurement, legal dispute resolution and larger commercial markets. This produces a circular relationship. Low productivity encourages informality, while informality limits the opportunities required to improve productivity. Research indicates that informal firms are generally smaller and less capital-intensive than formal enterprises, although substantial diversity exists within the informal economy.

Regulatory and administrative burdens:

Complicated registration systems, high compliance costs and fragmented government procedures can discourage small enterprises from formalizing. Business owners may be required to interact with several authorities responsible for taxation, municipal licensing, labour registration, environmental approval and social insurance. When the costs of compliance are immediate but the benefits of formalization are uncertain, enterprises may rationally remain outside official systems. Weak governance and inconsistent enforcement may further encourage selective compliance, particularly when regulations are applied unevenly. However, deregulation alone cannot eliminate informality. Enterprises will not necessarily become productive or create secure jobs merely because registration becomes easier. Simplification must therefore be accompanied by access to finance, infrastructure, technology, training and markets.

Educational and skills inequalities:

Workers with limited education or occupational skills are less able to compete for formal jobs. They frequently enter low-paid activities in agriculture, construction, domestic service, transport, retail trade and small-scale manufacturing. Informal workers may subsequently receive little employer-supported training, reinforcing their low productivity and preventing upward occupational mobility.

Economic crises and labour-market shocks:

Recessions, inflation, conflict, pandemics and climate-related disasters can destroy formal employment and push households towards informal activities. Workers without savings or unemployment insurance cannot afford lengthy job searches and must accept immediately available work. Informal employment therefore becomes a household survival strategy during crises. Nevertheless, it does not provide complete protection against economic shocks. Informal enterprises depend heavily on local demand and may experience severe income losses during recessions. Informal workers generally lack severance pay, income replacement and enforceable claims against employers.

Informality and Employment Security:

Job continuity and dismissal protection:

Informal workers commonly lack written contracts establishing their duties, wages, working hours and termination conditions. Employers may dismiss employees without notice or compensation because workers cannot easily demonstrate the existence or duration of the employment relationship. Casual and daily-wage workers face particularly high uncertainty. Their employment depends on daily demand, seasonal production or the decisions of labour contractors. Even when they work for the same employer over extended periods, they may continue to be treated as temporary workers.

Income security:

Informal earnings are generally more volatile than formal wages. Self-employed workers face changing demand, unstable prices and business interruption, while casual employees may not know how many days they will work during a particular week or month. Income insecurity affects household nutrition, education, housing and health expenditure. Families may borrow at high interest rates, sell productive assets or withdraw children from education when earnings decline. Thus, labour-market insecurity can be transmitted across generations.

Social-protection exclusion:

Most contributory social-insurance systems were originally designed for workers in stable employer–employee relationships. Contributions are normally deducted from regular wages and matched by employers. This model is difficult to apply to workers with irregular income, multiple employers or self-employment. Informal workers are therefore frequently excluded from pensions, unemployment insurance, employment-injury compensation, maternity protection and employer-supported healthcare. The World Bank describes many such workers as the “missed middle”: they may not qualify for poverty-targeted assistance but cannot access conventional employment-based social insurance.

Occupational safety and health:

Informal workers may operate in unsafe buildings, public spaces, private homes, farms, mines, factories and construction sites. They often lack protective equipment, safety training and effective mechanisms for reporting hazards. Occupational injuries can produce both health and income crises because workers may receive neither paid medical leave nor compensation.

Voice, representation and access to justice:

Employment security is also influenced by workers’ ability to negotiate and enforce their rights. Informal workers are difficult to organize because they are dispersed across small enterprises, households, streets and temporary worksites. Some may not be legally recognized as employees and may therefore be excluded from collective-bargaining institutions.

Fear of dismissal, deportation, harassment or loss of work can discourage workers from filing complaints. Labour-inspection authorities may also lack the staff, resources or legal mandate needed to reach private households, small farms and remote workplaces.

Distributional and Macroeconomic Consequences:

Gender inequality:

Women are frequently concentrated in informal occupations such as domestic work, home-based production, agricultural labour, street vending and unpaid family work. Household care responsibilities can restrict women’s ability to accept fixed-hour formal employment or travel long distances to workplaces. Informal work may offer flexibility, but it can also reproduce gender inequalities. Women may earn less than men, possess fewer productive assets, face harassment in public workplaces and remain excluded from maternity protection. Home-based workers are particularly difficult to identify in official statistics and may possess limited negotiating power within supply chains.

Youth employment insecurity:

Young workers often begin their careers through apprenticeships, casual jobs, family businesses and digital platforms. These opportunities can provide experience, but prolonged informal employment may prevent young people from developing recognized employment histories and contributing to pension systems. Young workers who repeatedly move between unemployment and informal employment may become trapped in low-productivity occupations. The absence of contracts and formal training also reduces the transferability of their skills.

Migrants and displaced workers:

Internal migrants, refugees and international migrant workers are vulnerable to informality because they may lack documentation, local social networks or knowledge of labour rights. Employers can exploit these disadvantages through wage deductions, excessive hours, unsafe accommodation or threats of dismissal.

Productivity and economic growth:

High informality can reduce aggregate productivity when workers and firms remain concentrated in small-scale activities with limited technology and capital. Informal enterprises may avoid investment because they cannot access finance or enforce contracts. Governments also collect less revenue, limiting their ability to fund education, infrastructure, social protection and labour administration. However, treating all informal activity as economically unproductive would be inaccurate. Informal enterprises provide essential goods, transport, food, recycling, care services and employment. Many also demonstrate considerable adaptability and entrepreneurial capacity. The policy objective should therefore be to improve productivity and protection rather than eliminate informal livelihoods through indiscriminate enforcement.

Public finance and social cohesion:

A narrow tax and contribution base makes it difficult to finance comprehensive social insurance. Formal workers and enterprises may carry a disproportionate share of financing, creating incentives to evade contributions. At the same time, informal workers may perceive public institutions as irrelevant when they receive few visible benefits. Persistent insecurity can weaken trust in governments, increase inequality and intensify social conflict. Employment security should therefore be treated as an element of inclusive development rather than only a matter of labour-law compliance.

Policy Pathways towards Formalization and Secure Employment:

Simplifying registration and compliance:

Governments should introduce integrated registration systems through which small enterprises can complete business, tax, municipal and social-security requirements. Digital registration, mobile payment systems and simplified tax schedules can reduce the time and cost of compliance. Simplification should not result in weaker labour rights. Proportionate regulation means adapting procedures and contribution schedules to enterprise capacity while maintaining fundamental protections against forced labour, discrimination, unsafe work and wage abuse.

Extending portable social protection:

Social-protection entitlements should increasingly be attached to individuals rather than a single long-term employer. Portable accounts can allow workers to accumulate pension, health and employment-injury protection across multiple jobs and periods of self-employment. Contribution schedules should accommodate irregular and seasonal earnings. Workers might contribute weekly, monthly or when income is available, while governments subsidize contributions for low-income groups. Digital systems can reduce administrative costs, although offline access must remain available for workers with limited digital literacy.

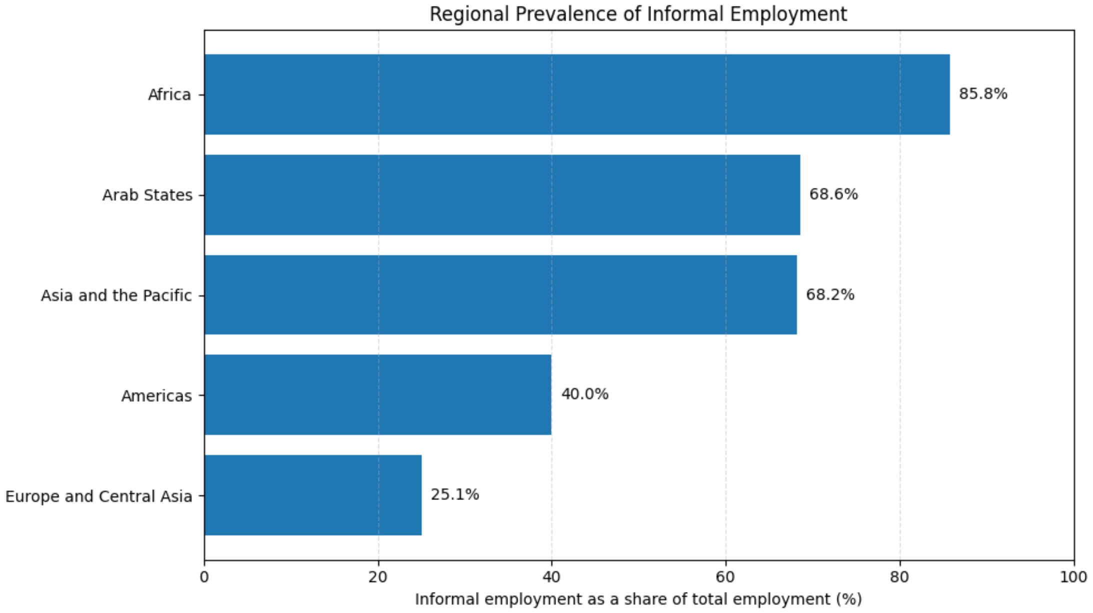
Raising enterprise productivity:

Formalization becomes more sustainable when it produces visible economic benefits. Small enterprises require access to credit, training, technology, infrastructure, legal services and market information. Governments can create incentives by reserving portions of public procurement for registered microenterprises and connecting them with formal supply chains. The World Bank's recent review recommends prioritizing worker protection and productivity rather than pursuing formal registration as an isolated objective. The appropriate policy combination depends on the characteristics of workers, enterprises and national institutions.

Strengthening labour inspection:
Inspection systems should adopt risk-based and advisory approaches. Punitive inspections alone may cause vulnerable enterprises to close or move further underground. Initial inspections can provide information, compliance plans and reasonable adjustment periods, while deliberate exploitation and severe safety violations should attract stronger sanctions. Labour authorities must also identify informal employment within formal enterprises. Subcontracting and worker misclassification should not permit companies to transfer employment responsibilities to vulnerable workers.

Supporting worker organizations:
Informal workers should be able to establish associations, cooperatives and trade-union structures. Collective organization can improve bargaining power, facilitate access to social insurance and create channels for dialogue with municipal and national governments. Street vendors may organize around licensing and public-space regulation, domestic workers around minimum standards, and platform workers around algorithmic transparency and employment classification. Representation is necessary because policies designed without workers' participation may unintentionally damage their livelihoods.

Coordinating formalization policies:
Informality is connected to education, taxation, industrial development, urban planning, transport, gender policy, social insurance and access to finance. Isolated interventions are therefore unlikely to succeed. ILO Recommendation No. 204 calls for an integrated transition that preserves and improves livelihoods while extending legal and social protection. It emphasizes the creation of decent formal jobs, the formalization of existing employment and the prevention of further in formalization. Governments should establish measurable formalization strategies with indicators covering registration, social-protection coverage, contract use, wage compliance, occupational safety and worker representation. Progress should be evaluated according to improvements in workers' lives rather than registration numbers alone.



Source: International Labour Organization, Women and Men in the Informal Economy (2018).

Summary:
Labour market informality is a central feature of employment in developing economies. It provides immediate livelihoods where formal-sector opportunities are insufficient, but it commonly exposes workers to unstable earnings, arbitrary dismissal, unsafe conditions and exclusion from social insurance. Informality is not a single or uniform category. It includes survival-oriented self-employment, unpaid family work, casual labour, informal employment inside registered enterprises and flexible entrepreneurial activity. The persistence of informality reflects structural conditions such as low productivity, limited industrial development, rapid labour-force growth, educational inequalities,

complicated regulation, weak enforcement and insufficient social-protection coverage. Consequently, compulsory registration cannot by itself produce secure employment. Employment security requires a comprehensive approach that protects workers during the transition towards formality. This includes written or digitally verifiable employment arrangements, access to portable social insurance, occupational safety, predictable payment, protection against unjust dismissal and effective worker representation. Policies must also improve the productivity and viability of small enterprises. Registration becomes attractive when it provides access to credit, markets, public procurement, infrastructure and legal protection. At the same time, labour inspection must prevent registered firms from using subcontracting or worker misclassification to avoid employment responsibilities. The central policy lesson is that formalization should be treated as a gradual process of extending rights, protection and productive opportunities. Developing economies should avoid strategies that destroy existing livelihoods without creating alternatives. The most sustainable pathway combines simplified regulation, inclusive social insurance, enterprise development, effective enforcement and participation by informal workers themselves.

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