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Labour Statistics - Towards Enlargement. Labour Market Flexibility: The Role of the Informal Sector in the Context of EU Enlargement and the Need for a Systematic Statistical Base

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LABOUR STATISTICS – TOWARDS ENLARGEMENT

**LABOUR MARKET FLEXIBILITY: THE ROLE OF
THE INFORMAL SECTOR IN THE CONTEXT
OF EU ENLARGEMENT AND THE NEED FOR
A SYSTEMATIC STATISTICAL BASE**

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Labour market flexibility: the role of the informal sector in the context of EU-enlargement and the need for a systematic statistical base

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Abstract

Industrial restructuring and the relative expansion of the services sector is going hand in hand with a relative growth of production and employment in the informal sector. This development is associated with greater flexibility in the labour market generated by forces of supply – the changing pattern of family life – and demand – the flexibilisation of employment relationships under the pressure of globalisation. The elements of flexibility in the formal sector labour market are compatible with what prevails in the informal economy, thus facilitating the integration of informal work into formal sector production and employment along a continuum. The informal sector may be likened to a sponge, which can soak up labour from the formal sector as well as release labour into the formal sector, depending on the prevailing economic and social forces. Informal activities are neither a temporary nor a residual phenomenon.

The groups of workers and enterprises in the informal sector have diversified in the wake of globalisation and flexibilisation of labour markets. Currently some 10 to 20 percent of GDP is produced on average in the informal sector of EU member countries, and some 30 to 50 percent in the transition countries. It is not clear to the user of official statistics, to what extent output and employment trends are biased by economic activities missing from the various statistics. Lack of data on the extent and nature of interlinkage between the formal and informal activities may lead to wrong conclusions about changes in the wellbeing of the society, and thus to policy mistakes. A systematic statistical data base is needed, particularly in the context of Eastern European enlargement.

Currently, monetary contributions made to the EU budget are based on GDP (including an estimate of the informal sector) and financial contributions from the European Social and other EU-funds are based on formal sector employment/unemployment relationships and poverty. This is an inconsistent procedure. It understates the actual labour input in the production of GDP and thus

overstates labour productivity in countries with a high proportion of unrecorded employment. Greater formalisation of work may increase the recorded labour input and by that token slow down recorded productivity growth. The compositional change of formal-informal employment may lead to false policy conclusions – the recorded slowdown in productivity growth may not correspond to actual productivity growth, and the recorded employment growth may not correspond to the actual rise in real income flows. It will, however, increase employment security and welfare protection for a larger proportion of the workforce.

The paper outlines the reasons for the increasing proportion of informal activities in the EU countries on the one hand and transition countries on the other. It proposes the inclusion of pertinent questions in labour force surveys and household consumption and expenditure surveys as a first step in the provision of reliable data for policy guidance. In the medium term, the development of Social Accounting Matrices (SAM) should be envisaged. A SAM has the clear advantage over indicators derived from a single survey by providing harmonised and mutually consistent data as well as the linkage between national accounts on the one hand, and labour accounts on the other.

Labour market flexibility: the role of the informal sector in the context of EU-enlargement and the need for a systematic statistical base

GUDRUN BIFFL*

Introduction

Labour market behaviour is changing rapidly in developed and developing countries under the impact of globalisation, social change, technological innovations and knowledge-intensification of production. A by-product of these changes is a general trend towards informal sector production of goods and services and the creation of jobs and incomes in the non-observed economy, both in developing and developed countries (OECD, 2002, ILO, 2002). The ILO claims that the bulk of new employment in recent years, especially in developing and transition countries, has been in the informal sector. (ILO, 2002: 1) Currently some 10 percent to 20 percent of GDP is produced (and employment created) in the informal sector in EU member countries (Schneider – Enste, 2000, SAMLEG, 2002, Biffi, 2002), and some 30 to 50 percent in the transition countries (Musiolek, 2002), which are to join the EU by 2004 (EC, 2002a). Thus, informal sector production plays a significant role in employment creation, income generation and poverty reduction.

Table 1: The share of the informal sector in terms of GDP and employment

	Informal sector in percent of GDP				Informal sector in percent of employment Ø 1999
	Ø 1989-90	Ø 1990-93	Ø 1994-95	Ø 1999	
Austria*)		4.5		8.5	10.0
Bulgaria	24.2	26.3	32.7	33-35	33.1
Czech Republic	6.2	13.4	14.5		
Estonia	20.2	23.9	18.5		
Germany			15.0	18.0	
Hungary	28.2	30.7	28.4		
Latvia	13.2	24.3	34.8		
Lithuania	11.2	26.0	25.2		
Poland	18.2	20.3	13.9		
Romania	16.2	16.0	18.3		
Slovakia	7.2	14.2	10.2		

Source: Schneider — Enste (2000). Musiolek (2002). — *) Statistics Austria.

Reliable data on the size and characteristics of the informal sector and its contribution to GDP are necessary for policy making. Today, it is not clear to the user of official statistics, to what extent output and employment trends are biased by economic activities missing from the statistics. Informal sector activities may expand when the formal economy is contracting; lack of data on the

* I would like to thank Julia Bock-Schappelwein for her competent research assistance and Joe Isaac for helpful comments.

extent of interlinkage between formal and informal activities may lead to wrong conclusions about changes in the wellbeing of the society, and thus to policy mistakes.

The estimates of the extent and value of the output produced in the informal sector depend on the definitions and methods used. In order to be able to make meaningful cross-country comparisons, a more systematic statistical data base is needed in order to formulate a coherent policy for dealing with the informal sector. This is particularly important in the context of Eastern European Enlargement, when monetary contributions made to the EU budget are based on GDP, and when financial contributions from the European Social Fund or other EU-funds to the new member countries, are based on formal sector poverty and employment/unemployment relationships.

What is the informal sector?

To begin with, it is necessary to be clear on the concept and the function of the 'informal sector' in the economy and on its definition. There is a growing convergence on the view of what constitutes the informal sector. The dualist model, which was proposed in the early 1970s by the ILO (1972), is losing ground against the formal-informal continuum model (MacGaffey, 1991, Kurkchian, 2000). According to the first model, the informal sector is associated with unregistered and unregulated small-scale activities at the margin of the economy which generates income for the poor. The second model takes a more comprehensive view. It sees formal and informal activities not as separate and independent segments of the market but as interdependent activities, one feeding into the other, i.e., informal work is subordinate and dependent on developments in the formal sector work. The ILO has now moved to this model and has adopted the view that 'formal and informal enterprises and workers coexist along a continuum' (ILO, 2002:4) Thus, the informal sector may be likened to a sponge, which can soak up labour from the formal sector as well as release labour into the formal sector, depending on the prevailing economic and social forces. It is neither a temporary nor a residual phenomenon and the group of workers and enterprises in that sector have diversified in the wake of internationalisation and flexibilisation of labour markets. It consists of employers, workers on own-account and wage workers. But unlike their counterparts in the formal sector, they are not subject to the legal and social protection, the workers are not unionised and are more likely to be exploited, and their work and income are unrecorded.

In order to formulate appropriate policy in relation to the growth of informal activities, it is important to understand the formal-informal employment relationship. To discover the extent of value added/income generated by informal activities, so far, no standard calculation technique has been established. Depending on the method employed, the estimate of the contribution of the informal sector to GDP may range from 4 percent to 22 percent of GDP for USA in 1976 (Frey – Pommerehne, 1982). In the case of Austria the estimates range from 8.5 percent of GDP (Statistics Austria, 1999) to 15.5 percent (Schneider, 2000) in the mid to late 1990s. Therefore, the OECD proposes, in its Handbook on the Non-Observed Economy (2002), a set of definitions and calculation procedures which should ensure comparisons across countries and over time.

At the outset, the OECD suggests to conceptualise the informal economy as an element of a larger set of economic activities, namely the Non-Observed Economy (NOE). The latter encompasses underground, illegal, and informal sector activities as well as household work for own consumption. The OECD proceeds with the definition of informal sector production which was agreed upon by the United Nations, OECD, ILO and Eurostat (*SNA*, 1993, *OECD*, 2002:12), saying that it comprises "those productive (economic) activities conducted by unincorporated enterprises in the household sector that are unregistered and/or are less than a specified size in terms of employment, and that have some market production". This definition is narrow and does not include the production of legal goods and services in medium to larger enterprises which are deliberately concealed from the authorities to avoid payment of taxes or complying with regulations — the latter being part of the underground economy¹.

Reasonably reliable statistical information on the magnitude of all elements of the NOE is necessary for policy guidance. However, to be realistic, we could not expect complete accuracy for such information from this source any more than could be expected from the informal sector. For our purposes of understanding the driving forces for the rising share of informal labour in employment creation, we focus on the activities as defined by the OECD (2002, Chapter 10), which is essentially the ILO definition agreed upon at the 15th International Conference of Labour Statisticians in January 1993 (*ICLS*, 1993). Under this definition, the core element of the informal sector is the unincorporated enterprise, where one is working either on one's own account or as small scale employer. From a legal standpoint one may distinguish between registered and non-registered own-account enterprises and registered and non-registered enterprises of small scale employers (with at least one continuously employed person). From the point of view of social protection, i.e., the vulnerability of the persons working in that sector, and from the point of view of the role that sector plays in the production of goods and services, the registered and unregistered sector often share the same characteristics.

As to the availability of data, it is unsatisfactory, given that small enterprises, employing 15 or fewer persons, are not or not fully covered in employer surveys. Because of the limited information available on the informal sector, the OECD suggests supplementary questions to labour force surveys and household income and expenditure surveys, i.e., by data in the discretionary power of the EU (Eurostat guidelines). Questions may be addressed to all respondents, irrespective of their status, on hours worked by type of enterprise (government agency, public enterprise, private enterprise, own account, paid and unpaid family help etc, for main job and secondary jobs, declared and undeclared. In order to find out, if children work in the informal sector, the age limit in surveys of the economically active population should be lowered. Since informal work may be very volatile in the course of the year, quarterly (or monthly) surveys would have to be envisaged.

¹ The dividing line between the underground and informal economy is not clear-cut and self-evident at times.

As to the household income and expenditure survey, questions on expenditure by point of purchase (supermarket, formal shop, street stalls etc.) could be included, thus providing information about the final consumption expenditure on informal sector products.

The link between formal and informal labour

Industrial restructuring and the relative expansion of the services sector in the formal economy, is linked to the growing practice of outsourcing and subcontracting to smaller enterprises, many belonging to the informal sector. But this is not the complete picture. The rising share of informal labour in total employment has been associated with other elements of greater flexibility in the formal labour market generated by the forces of demand and supply (*Standing, 1999, OECD, 1994, ILO, 2002*). These flexibility elements are compatible with what already prevails in the informal economy – workers employed by informal enterprises, domestic workers, outworkers, homeworkers, part-time and casual workers – and thus facilitate the movement from one economy to the other.

The implications of this trend for the wellbeing of societies are not straightforward. While labour market flexibility may increase competitive power and thus economic and employment growth at a macro level, for many countries, it has been associated with a reduction in employment security for a rising portion of the working population, and a widening in the distribution of income and earnings. Informal sector work may also be a 'survival tool', e.g., in the form of subsistence farming for laidoff workers in some CEECs; or a means of additional income for persons, who are well covered by social security arrangements – e.g., early retirement and disability pensioners in Austria.

Informal activities differ from formal sector jobs both in terms of supply and demand. This has important implications for policy. One question to be answered is to what extent the driving forces for informal sector work differ between old and new EU member countries; another question relates to the probability of a transfer of informal sector work (through migration) and products (petty trade) from new to old Member States. Further, we also need to know what drives the movement of labour between the formal and informal sectors. In order to answer these questions and to better understand the underlying processes, we need standardised concepts and norms in the definition and collation of data on the informal sector.

Comparable data on the pattern of and the driving forces behind informal activities, will enable us to judge the potential impact of EU enlargement on product and labour markets in the enlarged EU. A better understanding of the functional mechanisms at work will facilitate the extension of co-ordinated employment policy to the new member countries (*Biffli, 2001*), in particular, the objective of increased socio-economic inclusion of the people of working age and the fight against poverty. Since the prospective member countries have adopted institutions similar to those in the EU, such co-ordination should not be hampered by enlargement. However, this raises the question of the

extent to which institutional arrangements may affect employment and unemployment levels, their composition and their inherent dynamics.

One point to be followed up is the potential impact of increased formalisation of work in the prospective Eastern European member countries on visible employment and unemployment. It may well be that both will rise. Further, the current practice of including an estimate of the informal sector production in the System of National Accounts (ESA95), i.e., in GDP, without including clandestine or informal labour in the official labour accounts/statistics, understates the actual labour input into the production of GDP and thus overstates labour productivity in countries with a high share of unrecorded labour. Thus, greater formalisation of work may increase the recorded labour input and show a reduced productivity growth. This compositional change may lead to false policy conclusions. A slow-down in recorded productivity growth may not correspond to the actual productivity growth while the increase in recorded employment numbers may not involve a corresponding rise in real income flows. The declining proportion of the informal economy may, however, increase taxes and thus the social dividend and, by the token, increase employment security and welfare protection of the workforce.

In what follows, the reasons for the growth in informal labour in developed countries and countries in transition, the implications for institutional change and the need for specific data, will be considered. The implications of developments in the formal labour market on the informal sector will also be noted.

Socio-economic changes which have boosted informal work in the developed world

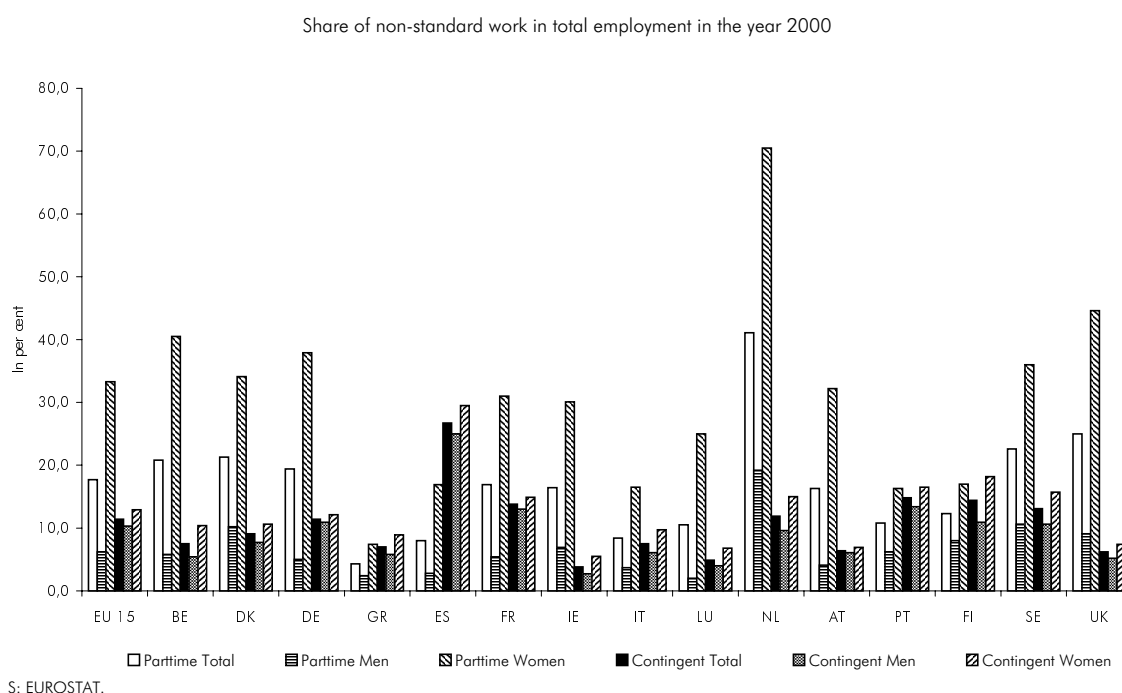
More flexible work patterns as well as the changing pattern of family life are contributing to increased informal work in developed countries (Sorrentino, 1990).

The traditional norm of jobs as being full-time and life-time, is gradually waning in the wake of globalisation, technological innovation, macroeconomic restructuring, global relocation of production (Van Liemt, 1992), and micro-economic reforms.

Financial considerations are the major driving force behind outsourcing of services from the highly unionised industrial sector to the less organised services sector. Outsourcing is not only cost-efficient as a result of economies of scale of service providers, but also because of large wage differences between industries. The latter may in some cases be the result of institutionalised wage bargaining (unionised versus non-unionised sectors), in others, the result of differing market power or technical progress. While technological development has a dynamic of its own (endogenous technological progress), its implementation in work processes is also driven by financial considerations. As a consequence, standardised tasks are taken over by automation and computers, resulting in the total productive system undergoing change and renewal.

The implementation of a production system of flexible specialisation has resulted in the introduction of measures to increase the flexibility of labour markets. Comparable forms of labour market flexibility have occurred in most industrial societies despite different labour market institutions and traditional methods of employment regulation. Thus, for instance, since the 1980s, there has been a growth in contingent labour on temporary contracts and temporary work, and in the dispersion of earnings and incomes (Atkinson *et al*, 1995), accompanied by declining job security in the highly regulated and formalised Austrian labour market as well as in the labour markets of the Anglo-Saxon countries which are less formal and less regulated. In the competitive world, the need for flexibility is generally unquestioned (OECD, 1999); it is merely a matter of the extent to which the various labour market flexibility processes are applied (Graph 1). But there are wide variations between the countries. While in Ireland less than 5 percent of all work is on a contingent basis, 27 percent of workers have a contingent job in Spain. Netherlands, on the other hand, uses part-time work to a larger extent than any other EU country to satisfy its labour needs.

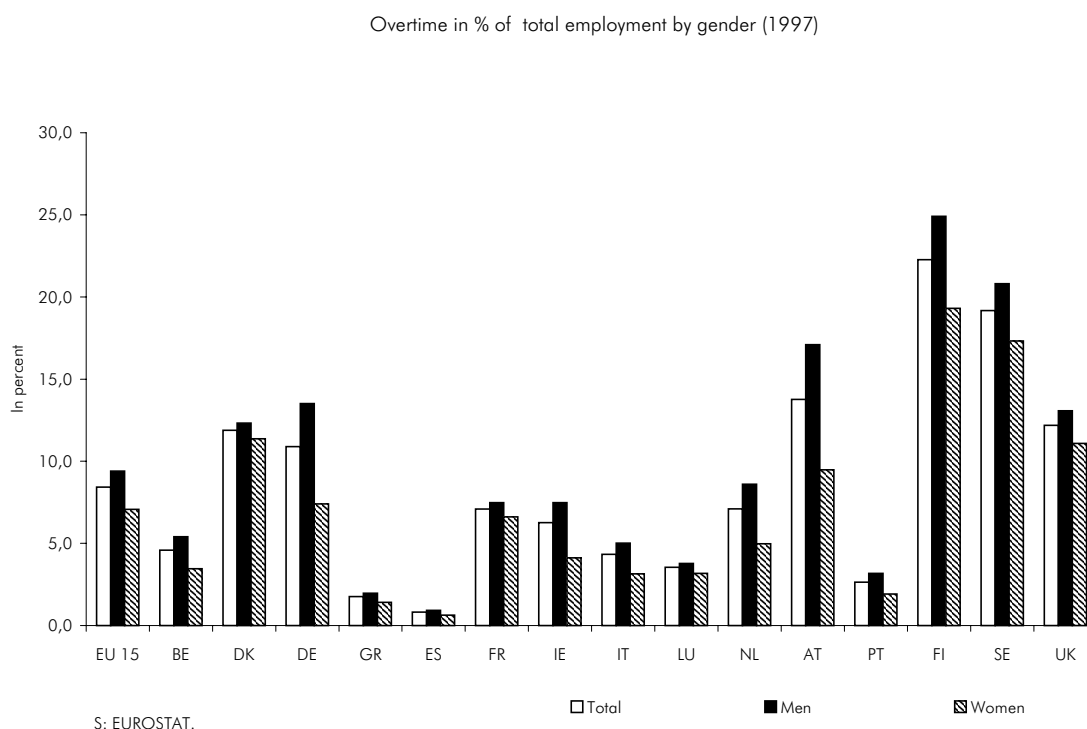
Graph 1: Share of non-standard employment in total employment in the EU (2000)



The choice of flexibility measures depends on many factors, e.g., industry, size and locality of the enterprise, relative wage rates, and the regulatory mechanisms of the labour market. Thus internal (to the firm) and external forces impact on the type and degree of flexibility measure used. Strong corporatism and an effectively structured system of industrial relations, as in the case of Austria, tends to favour working hours flexibility. The relatively large amount of overtime in Austria indicates that fixed labour and recruitment costs, i.e., transaction costs, are high and tend to be a barrier to

entry into the formal sector of the labour market (Biffi, 2000). In the year 1997, for example, 14 percent of all employees were working overtime in Austria (men: 17 percent, women 9 percent), while only 8 percent (men: 9 percent, women: 7 percent) did so in the EU 15 on average. In contrast, countries with a larger proportion of flexible employment relationships (contingent work), e.g., Spain (ES in graph 2), do not resort to this source of flexibility to the same extent.

Graph 2: Overtime as a means to gain flexibility

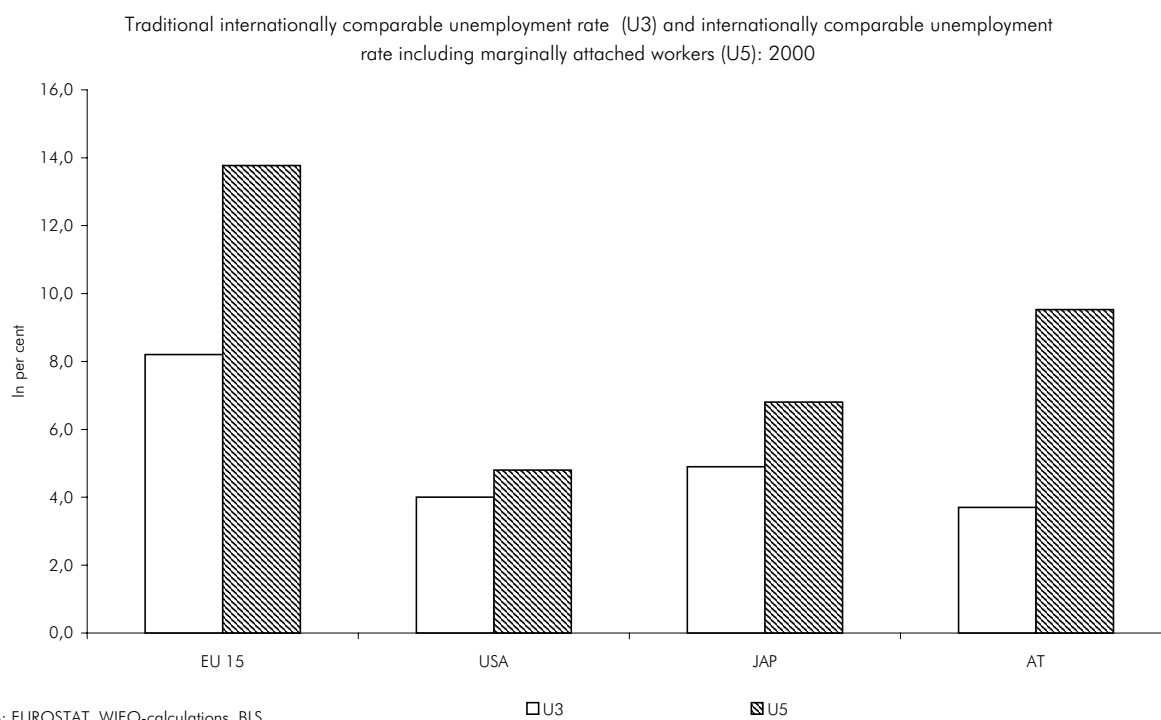


The changing labour market requirements result in a departure from standard age-status transitions. People frequently move from school into work, then into training, re-training or further education, back into work with intermittent phases of unemployment and informal sector work. Thus, lines of economic dependence may be reversed between men and women and even between young and old as non-traditional employment relationships, which often carry no or only limited social security coverage, become more prominent. As a result of increased labour turnover, the proportion of marginally attached persons to the labour market increases, and a rising number of people is not covered by the traditional social safety nets.

The strong increase in employment turnover is not adequately captured in the traditional unemployment rate (U3). U3 is based on the belief that there is a duality in the sense that a person is either employed or unemployed. The rest of the population are considered to be out of the labour force and covered by some sort of social insurance or assistance programme. The greater

fluidity between the different statuses implies, however, that there are many people in the assumed non-active population who access the labour market on a more or less temporary basis to increase their income, at times on the formal and at others on the informal segment of a continuum of labour markets. This is to say that U3 takes a very narrow view of unemployment. Anybody who works for one hour or more per week is counted as employed. Apart from the fact that this definition is most likely to understate the magnitude of involuntary unemployment, no distinction is made in the survey whether the type of work undertaken is in the formal or informal sector of the economy. The relatively large number of people working very short hours may reflect their wish to remain in contact with the labour market; they may accept less than their normal desired working hours, even casual work, and hope to find more and better jobs at some later stage. Moreover, anybody who has given up searching for a job, i.e., who is not actively searching in the survey week – because of an economic downturn in which one does not expect to find an adequate job (discouraged workers) — may temporarily turn to unpaid work in the household sector (care for sick or elderly) or to informal work. The latter is the more probable and makes up the larger proportion of the informal sector output in GDP.

Graph 3: Unemployment rates including the marginally attached workers, selected countries/regions (2000)

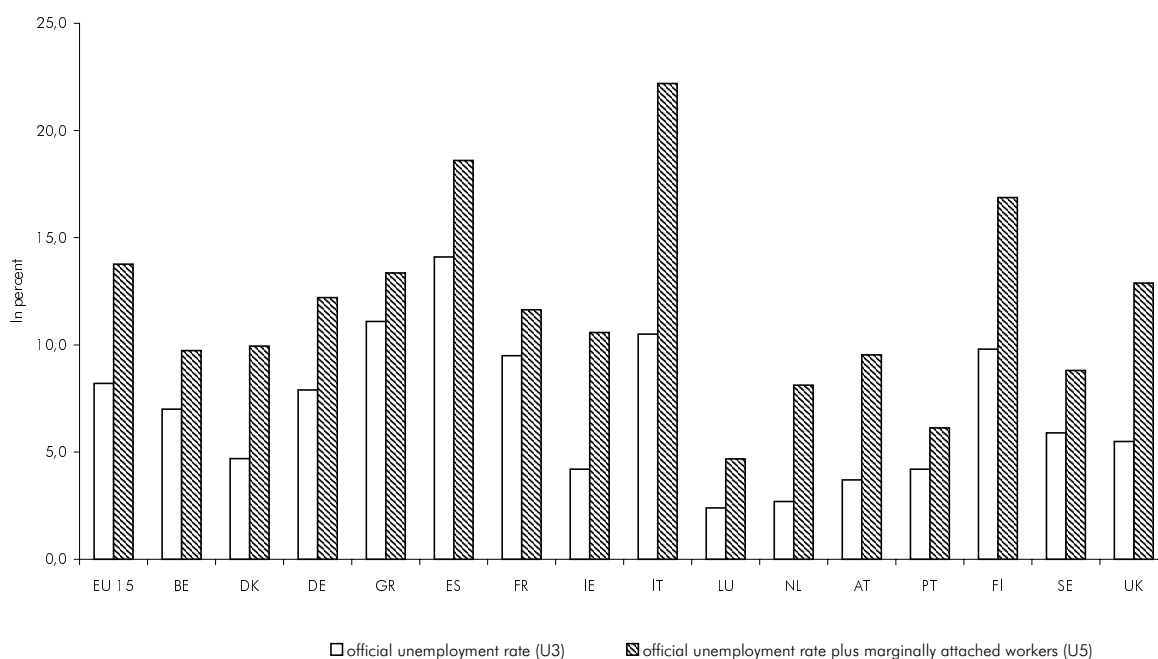


If we include the marginally attached workers, who say that they would like to work but are not currently searching actively for work because they are discouraged from doing so, among the unemployed (U5), we get a broader and more complete measure of unemployment and maybe

some insight into the formal-informal employment link (Bregger – Haugen, 1995, Castillo, 1995, Sorrentino, 1995, 2000). In the case of Austria, U5 is more than double U3 – 9.5 percent versus 3.7 percent in 2000. This result would confirm the earlier point that, judging by the high propensity for overtime work, entry into the formal sector labour market is rather difficult in Austria. U5 does not only convey a better picture of the extent of unused labour resources than U3, it is also a more reliable indicator of changes in disposable income and thus of pending poverty.

In the EU 15, there are pronounced differences between the degree of integration of the unemployed as measured by U3 and U5. While Austria scores number three – behind Luxembourg and the Netherlands – in the case of U3, it is only number 5 – behind Portugal and Sweden – if the marginally attached work force is also taken into account. On the U5 measure, the unemployment rate in the EU 15 is 13.8 percent, i.e., the unemployment rate is not twice as high than in the United States but almost three times as high (4.8 percent in USA).

Graph 4: Unemployment rates including the marginally attached workers in the EU 15



S: EUROSTAT, WIFO.

To sum up, it can be said that two sets of forces driving flexibilisation, have gained prominence under the competitive pressures of globalisation in harness with technological and social changes. One is the growing practice of sub-contracting and outsourcing of services of the rapidly expanding services sector, to small enterprises and to workers in the informal economy. The other enables enterprises to keep a portfolio of different types of employment (contract labour, temporary

workers, flexworkers, homeworkers, casuals, consultants, core workers) some of whom may be in the informal sector, in order to spread risks and increase flexibility, analogous to a firm or an individual holding a portfolio of different types of assets. The wage system becomes complex and spans from the 'capitalist' top level management, who get paid in stock options, to the consultant, who has performance related pay components, and the worker, who gets paid piece rates or an hourly wage with or without social security coverage. These circumstances provide the basis for movements of labour between the formal and informal sectors.

Socio-economic factors affecting informal work in transition countries

The informal economy is not new to transition countries. Numerous studies recount the different types of legal and illegal elements of an economy parallel to the formal economy (the 'second economy' according to *Los, 1990*) consisting of private, unregistered and untaxed activities (*Braithwaite, 1994, Grossman – Trebl, 1987, Los, 1990, Shelly, 1990, Kurkchiyan, 2000*). However, the breakdown of the command economies has brought about a different extent and structure of the informal sector. On the one hand, privatisation of state enterprises in the course of the 1990s introduced flexible employment relationships into the formal sector, which reduced not only job security but also workers rights and social protection compared to the old order². On the other hand, 'second economy' enterprises (in particular services) entered the arena of the formal sector, thus recording elements of former informal employment and income, and thereby increasing the number of workers with social protection of the market economy type. These processes, i.e., flexibilisation of work in the former formal sector and legalisation of former informal enterprises, are responsible for the development of similar formal-informal sector interlinkages as in the EU 15.

The large proportion of informal work in GDP and in total employment is not only the result of a legacy of informal work practices and a lack of experience with a whole set of new institutions typical for market economies (for example, managerial capacity), but also of the massive impoverishment of large segments of the population in the wake of transition to a market economy. Transition from a command to a market economy went hand in hand with substantial output declines in manufacturing, mining and agriculture and with an increase in services. The reallocation of labour was associated with a rise in unemployment and an corresponding loss of benefits traditionally provided by enterprises. A feature of the communist system of full and life-time employment was to top up wages by generous universal benefits, e.g., family allowance, pensions, subsidised food, housing and heating. The welfare system was thus linked to employment in the formal sector. The loss of formal sector jobs and the slow implementation of western style welfare institutions, like unemployment benefit systems, retirement pay, health provision, often made work in the informal sector a survival strategy.

² *Musiolek (2002)* points out that the CEECs have high standards of labour rights by the letter of the law, from the times of the command economy, the enforcement of these rights and the decent work concept is, however, limited.

In the CEECs, one may discern two types of labour adjustment patterns following the breakdown of the command economy; in the first case a strategy of rapid transition to a market economy, in the second, a strategy of slow transition to a market economy (Musiolek, 2002). In the first case, employment declined sharply as productive output collapsed, leading to both open and disguised unemployment, e.g., the case of Bulgaria, Poland and Hungary. According to this strategy, it was necessary to set labour free in the declining sectors before it could move to more dynamic industries. At times, open unemployment subsequently declined rather quickly, not as a consequence of employment uptake in the growing sectors but largely as a result of early retirement schemes and/or the expiry of unemployment benefits, which led to the withdrawal from the formal labour market, i.e., decline in labour force participation, in particular of women and older workers.

Graph 5: GDP growth and unemployment in countries with a rapid transition strategy (Poland, Bulgaria) and a soft transition strategy (Czech Republic)



In the second case, employment remained relatively unaffected by output declines in the early stages of transition, e.g., the Czech Republic or Russia; workers remained with their employer, even without work and wages, in order to continue to enjoy enterprise benefits, in the main benefits in kind like food and heating material. The latter strategy of underemployment mitigated

impoverishment in the face of a slow process of implementation of a new welfare system (Graph 5).

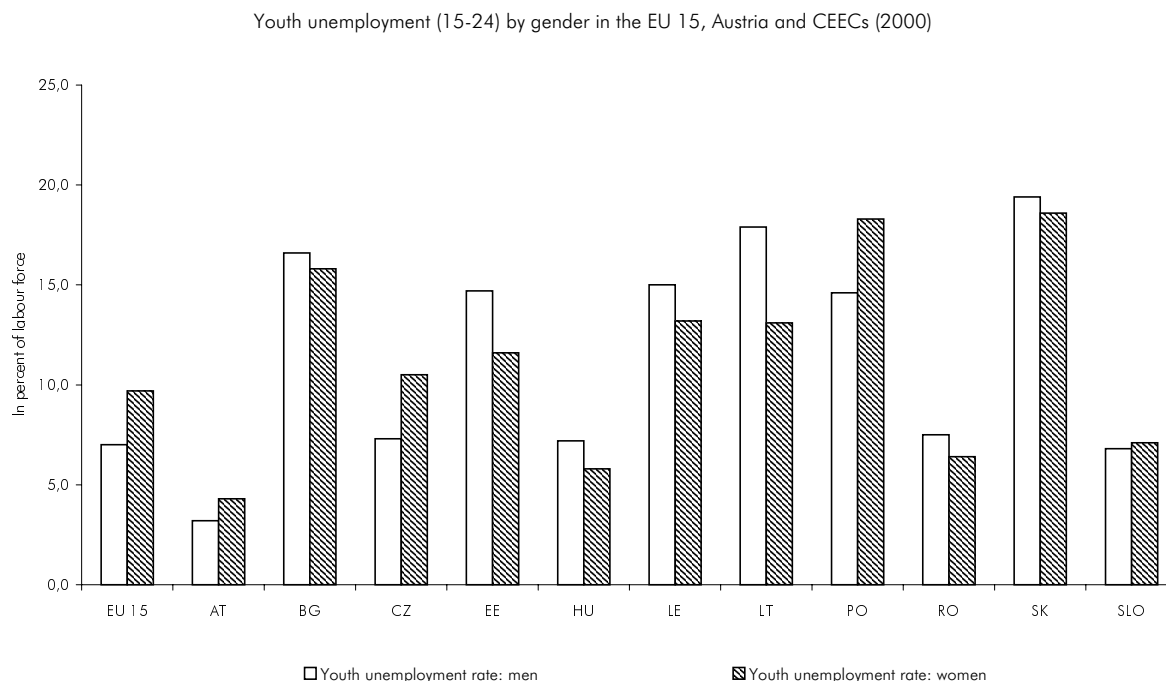
Informal sector work supplemented household income in the case of underemployment and open unemployment alike (Boeri *et al*, 1998, OECD, 1997)³.

Informal sector work may be a rational coping strategy in a world of scarce formal sector jobs. However, there is a risk of permanent deskilling of workers that are effectively excluded from formal employment. This may seriously impair the productive potential of a country. Therefore, in order to devise effective employment policies, it is important to learn about the structure of informal work – the demand side, – and about the characteristics of the workers in the informal sector – the supply side. In the current state of affairs of statistics, high youth unemployment could serve as an indicator of barriers to formal sector jobs of newcomers. We do not know, if and to what extent young people are working in the informal sector; nor do we have systematic and comparable information on the type of jobs in the informal sector. Graph 6 shows that youth unemployment rates are substantially higher in most CEECs than in the EU 15. The danger of deskilling of youth due to their high underutilisation in the formal labour market, is particularly pronounced in Slovakia, Poland, Bulgaria, and the Baltic States.

There is a growing consensus that increasing flexibility in the western style formal economy, together with the legacy of a second economy in the transition countries provide strong incentives for a large informal sector production in CEECs (Kurkchyan, 2000, Thomas, 1992, Sik, 1992). By drawing these countries into the EU, the expansion of informal sector activities will be reinforced – at least for the period of time in which free labour movement is not allowed between the EU 15 and the new member countries. Labour movement will be restricted to regulated cross-border labour movement and labour migration. In that situation it can be expected that migrants and cross-border workers from CEECs will be pulled into the formal-informal continuum of labour markets as we know it today. EU countries bordering on accession states may expect an increased supply of informal sector labour as a result of migration on the one hand and through petty trade with informal sector products from CEECs, given the large differences in wages and consumption possibilities. In the long run, i.e., when free mobility of labour will be extended to the Eastern EU member countries, integration into the formal sector will be facilitated thus reducing the incentives for and the extent of informal work.

³ It cannot be said that unemployment was an efficient way to promote restructuring. As Jackman has said (1998, p. 152): "Unemployment is not the route by which workers move from the declining state sector to the private sector. Unemployed workers are less attractive recruits for private firms than the workers in state firms, and a policy leading to higher unemployment may thus have restrained rather than encouraged the growth of the private sector."

Graph 6: Youth unemployment rates (15 to 24) in the EU 15, Austria and CEECs (2000)



S: EUROSTAT.

Data requirements and suggestions for further steps

As has been pointed out previously, lack of coverage of economic activities causes imbalances in the internal consistency of the national accounts. E.g., household consumption may include expenditures on goods and services produced in the informal sector, i.e., of goods and services which are neither adequately accounted for in the production accounts nor in the employment statistics. In order to provide consistency between national accounts (European System of Accounts – ESA95) and labour market statistics, an extension of ESA95 by labour accounts (Biffi, 1986) should be envisaged and developed into Social Accounting Matrices (SAMs). The SAM would provide the statistical framework for a comprehensive analysis of the formal-informal sector linkages⁴. An extended system of ESA95 has a clear advantage over indicators derived from a single survey, as the indicators are harmonised and mutually consistent, as they ensure full coverage and provide the linkage between supply and use tables on the one hand and employment on the other. A SAM combines detailed labour accounts (employment in the formal and informal sector) with labour income by type of labour and household. It clarifies that production of goods and services creates value added which is to be distributed among the

⁴ The Handbook on Social Accounting Matrices and Labour Accounts (SAMLEG, 2002:1) defines the SAM as "the linkage between the (mainly) macro-statistics of national accounts with the (mainly) micro-statistics of the labour markets and households".

workforce, unemployed, retired and the marginally attached and non-active population. Thus the analytical framework of the SAM allows a comprehensive analysis of the link between labour markets, the distribution of income and macroeconomic issues like GDP and productivity growth, the inflation rate, the budget deficit and the balance of payments⁵. It clarifies the interdependence between production, distribution, factor endowment and use thus increasing the transparency of economic and social processes in an economy.

Such an objective is probably rather ambitious and unrealistic in the immediate future; but it is one which should be aimed at and progressively refined as an important aid to policy.

Concluding observations

This paper has attempted to sketch in outline the complexity of labour market developments in recent years. In particular, the changing nature of work and its skill requirements, the flexibility of employment contracts, working hours and pay systems, and the practice of outsourcing and relocation of work, all driven by technological developments and competitive pressures on the demand side; and on the supply side, the changing characteristics of workers arising from social changes and their greater mobility within the EU, have a profound effect on interaction between the formal and informal economies. Further, the workforce must be considered as a flexible entity which should include those who are marginally attached to it, as well as those in the informal sector.

It is to be expected that EU enlargement consisting of countries with relatively larger informal economies, will be phased into the context of these changes. The *ILO (2002:5)* sees the desirable policy strategy as one which promotes the movement of labour from the informal economy with its decent work deficits, into the formal economy where such labour could be expected to enjoy the potential of a higher standard of living. But whatever the strategy, to ensure that appropriate economic and social policy may be formulated for all the countries involved, the existing EU as well as the new EU Member States, a reasonably precise knowledge is required, not only about the forces which affect the movement of labour between the formal and informal economies, but also about the numbers involved and their impact on the production process and on social welfare. The numbers involved require a systematic statistical base, covering both the formal and informal economy, which at present is inadequate. The complexity of the labour market and its changes will obviously need to be reflected in such a data base. The OECD and the ILO have provided guidelines for the collection of standardised and comparable data between the countries. However, this may not be sufficient: the integration of labour accounts into a system of national

⁵ As a second step in the development of statistics one may envisage the extension of a SAM into a SESAME (System of economic and social accounting matrices and extensions). The extension may detail the accounts expressed in money values (particularly labour income) with non-monetary information, e.g., poverty indicators and indicators of socio-economic exclusion.

accounts (a SAM) may be necessary. It would provide the statistical and analytical framework for a systematic analysis of the changes of socio-economic processes currently underway.

To sum up: in the context of EU enlargement, sustainable economic growth, increased social inclusion and the fight against poverty may be facilitated by the explicit inclusion of informal sector activities, their market production and their role in the creation and distribution of income. Such an outcome would be greatly assisted by a data base established through a comprehensive statistical framework like the SAM.

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