

CALL FOR PROPOSALS: UNDERSTANDING LABOR MARKET INFORMALITY IN DEVELOPING COUNTRIES

Within the framework of the Multi-donor Trust Fund (MDTF), “**Labor Markets, Job Creation, and Economic Growth: Scaling up Research, Capacity Building, and Action on the Ground,**” the World Bank's Social Protection & Labor Unit intends to solicit proposals from qualified research institutions, firms, including universities, NGOs, or other institutions on the topic of “**Understanding Labor Market Informality in Developing Countries.**”

1. Background

Regardless of the level of development, labor markets of all countries include diverse types of employment in terms of “formal” jobs, “informal” jobs, and variations in between. In many developing and transition countries, the share of informal employment is large – and, moreover, in recent decades the informal employment has been growing more rapidly than formal employment. This has raised many questions for labor market analysis and also for policymaking.

The concept of informality itself is unclear. The World Bank’s flagship report on informality (World Bank, 2007, p. 1) states, “The mere fact that we need to employ multiple measures of informality capturing distinct approaches to the sector suggests that we are not clear on exactly what it is and what we should be studying. In all likelihood, we are dealing with several distinct phenomena under this convenient, but arguably unhelpful, umbrella term.” Although there is no agreed-upon unique definition (or statistical measure) of informal economy, **the concept of the informal labor market usually relates to the non-participation in tax and social security systems, and to the failure to meet regulatory requirements.** Thus the informal sector is typically seen to include the following types of workers: (i) micro-entrepreneurs, (ii) self-employed, (iii) salaried workers of informal sector firms, and (iv) salaried workers of formal sector firms who are not covered by social protection arrangements.

What are the driving forces of informality? According to the traditional view, informal sector workers, unable to find formal jobs, are forced to undertake jobs of low productivity so as to earn for their subsistence while searching for something better (the exclusion dimension of informality). Segmentation produced by restrictive labor market legislation, onerous entry regulations, and excessive taxes and costs of doing business are among the factors often seen responsible for such exclusion. But evidence also shows that many workers and firms choose to opt out from formal institutions (the exit dimension of informality). For these workers and firms, the costs of joining the formal sector exceed the benefits of doing so – a testimony of both the meager value of services provided or facilitated by the government as well as of the weak enforcement capacity of the government.

Regardless of what forces contribute to it, informality is connected with two important socially suboptimal outcomes. First, informal sector workers are vulnerable to various risks, key among them being dangerous health and safety work conditions, loss of earnings due to unemployment and ill-health, and old-age poverty. Moreover, specific groups of workers – above all, youth and women – seem particularly likely to be included among informal sector workers. Second, informality is associated with important efficiency costs due to lower productivity of informal firms.

While informality is intrinsically a multidimensional phenomenon, **for the purpose at hand the following two manifestations of informality are particularly important:**

- **Informality in African countries:** these are low income economies with vastly predominant informal share. Informality is there to stay and is strongly connected with the move from rural to urban areas.
- **Informality in transition countries:** these are predominantly middle-income countries where informal sector is about as large as the formal one or smaller. An important component of informality in these countries includes workers in the formal firms who do not have a formal contract and/or whose social security contributions are not paid.

2. Research Objectives

The objective of the this research is to articulate sound, well-substantiated **policy options for developing and transition countries** that will help create more and better jobs in both formal and informal sectors and thus help these countries to move to a higher-level growth path. Specific questions to be answered by the research are as follows:

- **How to reform labor market policies and institutions to increase formal sector job creation and productivity?** In particular, under what conditions is it desirable to reduce (direct and indirect) labor costs imposed by employment protection legislation, minimum wages or institutional wage bargaining set-up?
- **How to remove or reduce binding constraints on entry and growth of formal sector firms?** Reducing taxes and/or the costs of administrative red tape connected with business start-ups may be part of the answer, but other measures may include improving skills of the workforce or improving access to credit and insurance. In the last area (credit and insurance), are there innovative schemes and approaches – for example, public-private partnerships – which developing countries can replicate?
- **How to encourage the creation and boost productivity of informal, household enterprises?** In particular, which policies and programs (including entrepreneurship and vocational training, provision of business services, enhancing access to credit, providing micro-insurance) are effective and efficient in supporting such enterprises?

- **How to bring social protection to informal workers?** While informal jobs may constitute a form of safety net, this is likely to be an imperfect or inefficient risk management strategy. What are the most efficient and cost-effective ways to improve the risk management strategies of vulnerable workers? What policies and interventions can be applied in the context of low-income countries with low capacity and limited fiscal resources? It may also be important to improve benefits from formal social insurance schemes so as to improve incentives for formalization.
- **How to strengthen the enforcement and compliance with regulations?** For example, tax administration may need to be strengthened by improved registration of businesses, audit, and tax collection. But simply improving enforcement of regulations may backfire, and the incentives for compliance may also be improved.

3. Scope of Work

Despite a voluminous and ever growing literature on informality, we still know too little about informality, what drives it, what its consequences are, and, above all, how to formulate sound policies and programs addressing informality. The proposed research will contribute to fill this gap by addressing the questions below. In doing so, the proposals should clarify what concept of informality they are using, and what their geographical focus is (African vs. transition countries). The process of research may involve piloting of specific policies and/or conducting consultation and dissemination workshops in selected countries.¹

- **What are the efficiency costs associated by various types of informality?** These costs may arise because informal firms fail to take advantage of economies of scope. Similarly, informal firms face heavy restrictions in their access to credit and other markets which is again likely to restrict their productivity. Moreover, the existence of inefficient informal firms may create an environment that puts less pressure on formal firms to engage in innovations and pursue technological progress. And there may be other costs associated with non-compliance with health and safety standards, for example.
- **What are the long-term consequences of informality for human capital enhancement and poverty, and which groups are most vulnerable?** To what extent, and for which workers, is informality a launching pad for career advancement, and for which others is it the only option available? In particular, do certain workers (e.g., parents of young children, youth, etc.) pursue informal jobs in

¹ The Multi-Donor Trust Fund will also sponsor two projects (to be concluded by March 2009) that could provide useful inputs for the research to be implemented in Round 2 (see the proposed timing below): (i) taking stock of the literature on informality – producing a review of literature on informality (both of conceptual/theoretical approaches and models as well as of empirical studies, including evaluation of programs seeking to improve productivity and labor market outcomes of informal sector workers), and (ii) compiling datasets (household and labor force surveys on developing and transition countries) useful to study informality. A separate Call for Papers will be submitted by the World Bank in mid/end June 2008.

order to combine work with other activities, or alternatively, do they do so because these are the only jobs available? Is informal employment the safety net of the poor and if so, how effective a safety net is it?

- **What are the determinants of informality and, in particular, how do labor regulations and social protection programs affect the incidence of informality?** What are possible incentives – costs and benefits – for informal sector employers to register, pay taxes, and contribute to social security system? Are there any examples of countries that have successfully integrated informal sector into the formal sector, and if so, which ones? To what extent is informal employment motivated by inappropriate regulations and costly social protection mechanisms? Do informal firms choose to remain small and unregistered to avoid regulations, payroll taxes, and payment of bribes? Does this behavior bring important aggregate costs in foregone productivity? And what, if any, regulations and social protection programs are most important in this decision process?
- **How to help the informal sector to become more productive and to create more and better jobs?** For many countries with large informal sectors, particularly African, formal sector jobs are a viable alternative only for few workers – informality is a fact of life. Hence assisting household enterprises to become more productive and grow is essential. This task requires addressing the following questions: What personal and family factors determine the incidence, longevity, and the success of household enterprises? What are the livelihood patterns associated with having an informal non-agriculture business? What public interventions have proven effective to enhance performance of such enterprises and what factors account for their success? Can technology of informal firms be improved to boost efficiency, productivity and growth of such firms? Providing examples of successful programs, in Africa in particular, would be instructive.
- **What are the linkages between urban and rural households through the informal urban income-earner?** Do such households reduce their vulnerability to income shocks? Relatedly, **how do formal and informal economies interact?** In particular, what is the role of the informal economy in mitigating the consequences of an uneven growth path of the formal economy?

Expected outputs. The proposed research will produce (a subset of) the following outputs:

- Conceptualization/theoretical models of explaining informality.

² Proposals for a separate world-wide inventory of data sources on informality will be solicited by mid/end June with delivery for mid-2009. The inventory will be accessible through the web.

³ There exist a plethora of different approaches in modeling informality. Some recent examples are Gutierrez-Romero, R (2007), “The Effects of Inequality on the Dynamics of the Informal Economy”, paper presented at the IZA/WB Conference in May, Bonn; Galiani, S. and Federico Weinschelbaum (2007), “Modeling Informality Formally: Households and Firms”, CEDLAS Working Paper No. 47, and Bennett, J. and Saul Estrin (2007), “Modelling Interactions between the Formal and Informal Sectors in a Developing Economy”, CEDI Working Paper No. 07-11.

- Empirical findings, including estimates of the impact of policies and programs.
- Proposals of statistical improvements of measuring informality (to be developed and piloted under the project²).
- Policy pilots – experiments that provoke behavioral change.
- Publications describing the above outputs and generally the research undertaken in: (i) policy primers (short notes written in easily comprehensible language addressing certain issues of direct interest to policymakers) summarizing the main policy-relevant findings of the project, and (ii) papers and reports, including flagship reports, presenting in depth the undertaken research according to the highest scientific standards and rigor.
- Dissemination events (workshops, conferences) and websites.

5. Selection & Eligibility Criteria

The proposals will be selected based on the following criteria (presented in the order of importance):

- Policy relevance.
- Innovation.
- Exploiting existing knowledge.
- Technical quality.
- Capacity for delivery (quality of the core team, partnerships and alliances)
- Realism of budget and timeline.
- Comprehensiveness of approach/the scope of issues addressed by the proposed research.
- Proposals involving North-South collaboration of research institutions are specifically encouraged to apply.

Geographic Focus

Up to four proposals focusing on African countries (low income economies), and one on transition countries (middle income economies), will be selected. Possible synergies with existing projects on the given topic of donors should be exploited.

Eligible Participants: Research Proposals can be submitted by individuals, as well as firms including universities and research institutions, NGOs, or other institutions. World Bank Standard Procurement Rules apply (see World Bank Procurement guidelines at <http://go.worldbank.org/5GOU2GVSZ0>).

In line with the donors' request to reach out to the global research community, we will not be accepting proposals from Bank staff.

Funding Restrictions

The proposal process will be comprised of two rounds. Details are provided in the section on Proposal Process. All contracting will be subject to standard World Bank

procurement policies.

1. Round 1 is the submission of proposal Concept Note (5-page outline). Proponents will not receive funding for this stage of the process. From all submitted Concept Notes, 10 will be selected to move to the proposal development stage. Work to develop the Concept Note to a more comprehensive research study (approximately 40 pages) will be contracted at up to US\$30,000 per proposal.
2. Round 2 is the selection of the best 4-5 proposals from Round 1 to be allocated up to US\$ 500,000 for implementation of research proposals including conducting theoretical and/or empirical analysis as outlined in their proposals.

6. Selection Process & Timing

Proposal Process

The above research agenda will be approached by the following two-round implementation process:

Round 1: Soliciting expressions of interest and full-scale, substantive proposals to be implemented in the second round. The first round will consist of two stages. In the first stage, short concept notes of up to five pages will be solicited from a wide circle of potential consultants, and firms i.e. universities, research institutes, etc. Among these expressions of interest, up to 10 will be selected and invited to develop their research proposals into comprehensive proposals of approximately 40 pages within a year. These substantive research proposals will be financed by the multi-donor trust fund with an amount of up to US \$30,000 for each selected research paper. The papers will be presented at the 4th IZA-World Bank Employment and Development Conference in spring 2009 that is scheduled to take place in Bonn, Germany on May 5-6, 2009; travel expenses for presenters to participate at the conference will be covered. The substantive proposals will include the conceptualization of the problem – what explains labor market outcomes in countries with large informal markets, the formulation of theoretical modeling of informality, as well as presentation of empirical approaches to be used (including the description of data sources).³

Proposals produced under 2nd Stage in Round 1 should include implementation plans and descriptions of team compositions and consortiums formed.

Round 2: Implementation of full-scale, substantive research proposals by the winning authors. The best 4-5 proposals from Round 1 (selected in consultation with donors) will corroborate their hypotheses and implement their research agenda by conducting theoretical and/or empirical analysis as outlined in their proposals (financed by the multi-donor trust fund). The selected institutions will be asked to provide a detailed research and implementation plan, including a budget breakdown. A budget of up to US\$ 500,000 will be allocated to each selected proposal. Standard World Bank

procurement policies will apply.

Timing

Round 1 will begin with the call for “expressions of interest” in early June 2008. The winning proposals (up to 10) will be selected in July/August 2008, and the substantive research proposals (around 40 pages) will be completed by April 2009. The papers will be presented at the May 2009 4th IZA-World Bank annual conference on Employment and Development and disseminated via the trust fund’s website and other channels.

Round 2 implementation of the winning research proposals will start in May 2009 and will conclude by June 2011 (including dissemination). The dissemination will include print and website, as well as presentations at workshops and conferences.

Key Dates:

1. **Application Deadline: July 18, 2008**
2. Selection and Review Board Meeting: August, 2008
3. Winners of first round (up to 10) will be informed: September 2008
4. Submission of substantive research proposals: April 2009
5. Presentation of Papers at 4th IZA-WB-Employment and Development Conference: May 2009
6. Selection of Review Meeting of Round 2 papers: May 2009
7. Winners of round 2 will be informed and awarded: May 2009
8. Start implementation of research proposals: June 2009
9. Reporting, Workshops and Dissemination of first results: 2010
10. Conclusion and final dissemination: May/June 2011

7. Contacts & Submissions

The qualified firm and/or individual will be selected based on the quality of the submitted research. Interested firms or individuals should submit proposals by email to Sowmya Srinivasan at ssrinivasan4@worldbank.org, copying Friederike Rother (frother@worldbank.org) and Milan Vodopivec (mvodopivec@worldbank.org). **Proposals should be submitted no later than July 18, 2008.**

The World Bank reserves the right to issue a Request for Proposal to qualified firms, whether or not an Expression of Interest received.