

## ECONOMIC AND SOCIAL ASPECTS OF THE INFORMAL EMPLOYMENT

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### Executive Summary

Informal employment remains a major structural problem of Turkish economy, while there seems to be a recent rise in the number of workers being registered with the social security system. Informality is one of the most important reasons behind the unfair competition, low productivity, tax evasion and ineffective social policies. The number of informally employed who are not registered social security significantly increased after the 2001 crisis in non-agriculture, while showing a tendency to decline in the last year. Nevertheless, informal employment is rising among self-employed. Also, it is pervasively widespread among the young and those over middle-age. Informality decreases as the level of schooling increases for self-employed and as the firm scale increases for the wage earners.

### Different dynamics for different groups

9.7 million out of 21.6 million employed, including 4.7 out of 15.9 million in the non-agriculture are not registered with none of the social security institutions according to the TurkStat 2008 April data.

The great majority of the self-employed in the non-agriculture (84 percent) consists of wage earners and self-employed. So the reasons behind the informality should be discussed separately for these two groups.

In 2008 April, 2 out of 11.2 million wage earners and 1.2 out of 2.1 million self-employed were informal. These two groups form 68 percent of 4.7 million informally employed. (Figure 1)

### Informal employment declines among the wage earners

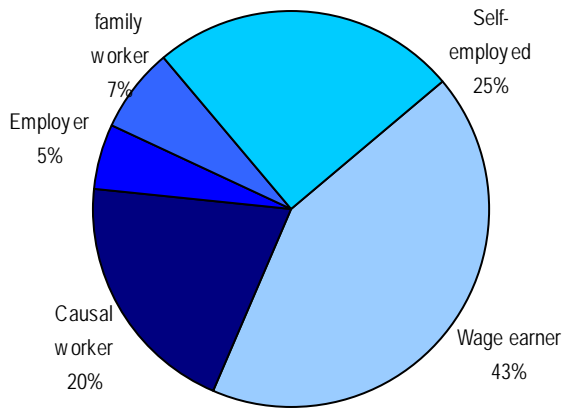
The share of wage earners in the labor market has been constantly increasing since 2000. The number of wage earners was 8.2 million in 2000, while it reached to 11.2 million in May of 2008. This is not surprising since family enterprises and petty traders have been eliminated in the fierce competition.

While, the rate of informality among the wage earners was 15 percent (11 millions), it attained 23 percent (2 million) in 2006. (Figure 2)

Figure 1: Informality with respect to work type in the non-agricultural sector

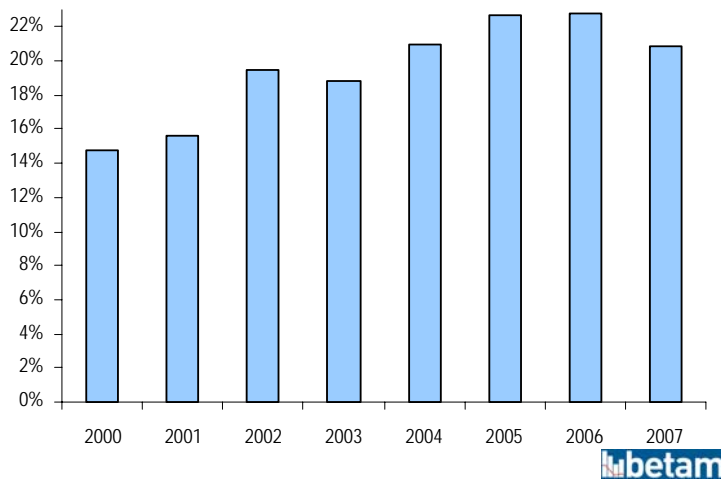
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Source: TurkStat Household Labor Force Survey, April 2008

Figure 2: Change of informality over time among wage earners



Source: TurkStat, Household Labor Force Survey (2000-2007)

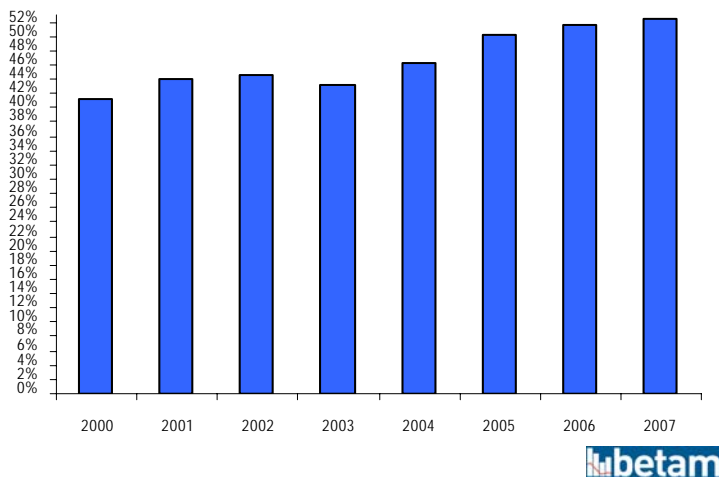
The leading reason behind this increase was the 2001 economic crisis as particularly the small and middle scale enterprises hired the informal labor as a way of minimizing the labor costs. Besides, the rise of subcontracting bolstered the informal economy for the same reason, namely by lowering the labor costs.

In 2007, the percentage of informal employment among the wage earners seems to have declined by 10 percent signaling a new tendency, from 2 millions and 330 thousands in 2006 to 2 millions and 232 thousands in 2007. This decline needs to be accounted for. It can be tentatively argued that the strict controls over firms and the fact that Turkey has got over 2001 crisis by now played a substantial role.

### Deepening informality among the self-employed

In the non-agriculture, 55 percent of the self-employed are informal (Figure 3). Unlike the downward trend in informality among the wage earners, there seems to be a remarkable upswing among the self-employed. In 2000, the number of the unregistered among the self-employed in the non-agriculture was 845 thousand out of 2 million. In 2007, the number of the self-employed reached to 2.1 million by a 10 percent increase while the number of the unregistered became 1.1 million by 5 percent increase.

Figure 3: Change of informality over time among self-employed



Source: TurkStat, Household Labor Force Survey (2000-2007)

For the wage earners, the decision of informality is basically up to the employers, apart from the “green card” effect, which will be discussed later. However, the self-employed people make their own decisions about social security. In this sense, the income losses and the high costs of social security may have discouraged small traders and craftsmen to augment the informal economy in effect. Another explanatory factor for the high rate of informality may be the fact that the green card holders (15 million at the moment) benefit from the health services for free. We think that the majority of the informal among the self-employed are green card holders. However, the formal employment brings two benefits: The access to the health services and the retirement benefits. Thus, the green card holders give up the retirement benefits avoiding health costs.

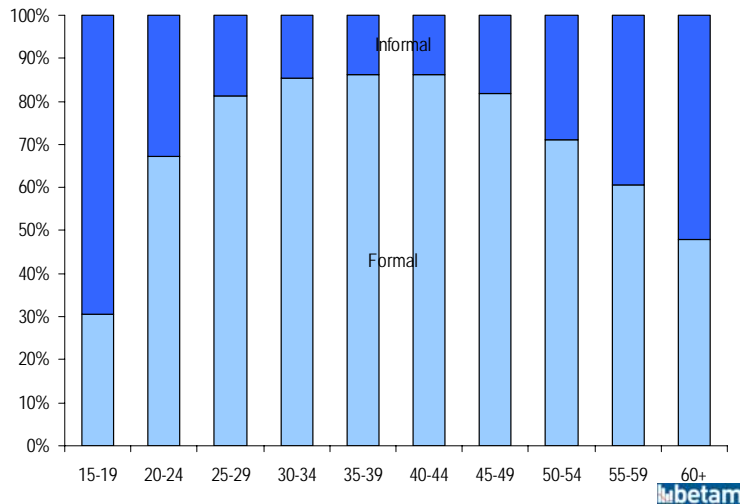
### The young and retired work informally

Data shows that the informality is more common among the young and retired.

513 of 740 thousand young wage earners (70 percent) of age between 15 and 19 are employed informally. Particularly the young wage earners are forced into informal employment prior to the military service. The percentage of informality among the young in the age group 15-19 reaches its highest point, 71 percent, 381 out of 535 thousand. The ratio goes down to 34 percent for the age group 20-24, i.e. after the military service. Considering only the unskilled male labor who are primary or secondary school graduates, the informality rate decreases from 77 percent in the age group 15-19 to 45 percent in the age group 20-24.

The lowest informality ratio of 13 percent appears to be in the age group 40-44. The informality among those who are older than 45 increases and it attains 52 percent for those who are above the age of 60, due in part to the fact that the people who retire at an early age participates again in the labor market informally (Figure 4).

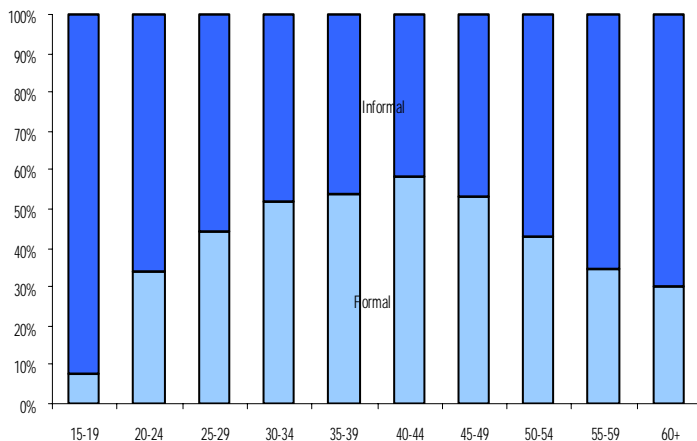
Figure 4: Informality with respect to age among wage earners



Source: TurkStat, Household Labor Force Survey, 2006

The situation for the self-employed seems more striking. 92 percent of the self-employed of the age between 15 and 19 seems informal (Figure 5). That ratio decreases for the higher age groups as it does among wage earners and hits to the bottom with 41 percent, for the age group 40-44. After that point, it increases up to 70 percent for those older than 60.

Figure 5: Informality with respect to age among self-employed



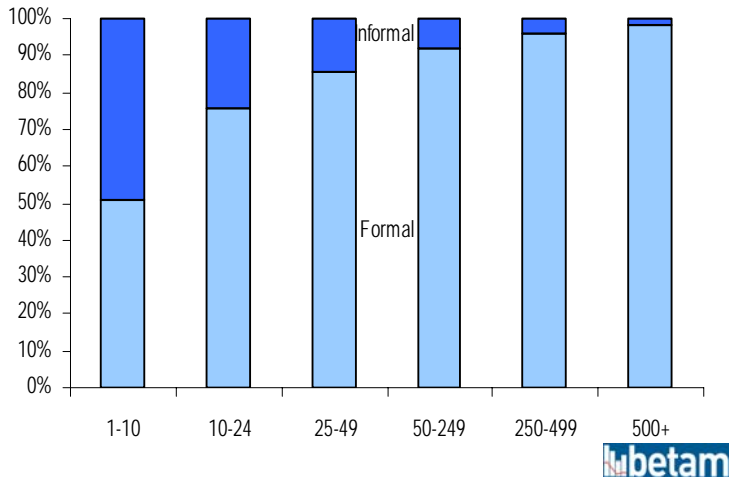
Source: TurkStat, Household Labor Force Survey, 2006

### Low informality in the large firms

The firm size seems to be an important variable in explaining informal employment among the wage earners. In small firms employing less than 10 workers, half of the employed has no social security, while the fraction is around 2 percent in the firms employing more than 500 workers (Figure 6). This clearly indicates a negative correlation between informality and institutionalization.

For the small firms, informality seems to result from low productivity coupled with tax burden on the employment. The larger the firm, the easier they cope with the employment tax benefiting from factors such as advanced technology, higher productivity, ability of affecting the price level and higher profitability.

Figure 6: Informality with respect to firm size among wage earners

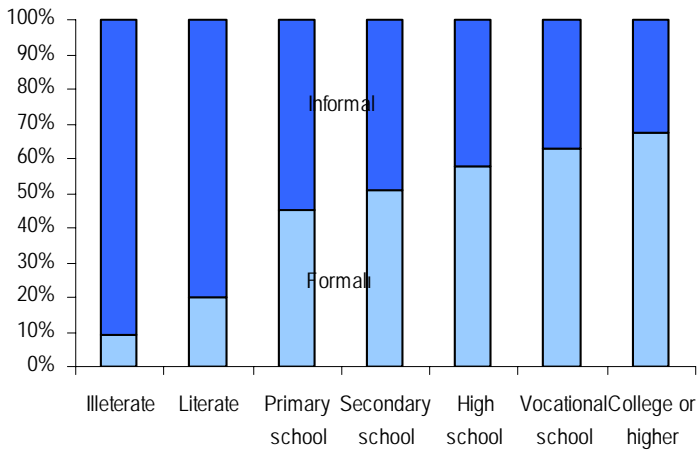


Source: TurkStat, Household Labor Force Survey, 2006

### More schooling, less informality

Given the strong positive relationship between income and schooling, the fact that the more educated self employed people are more likely to have social security is consistent with rational behavior. However it is indeed remarkable that one third of the self employed college graduates prefer to be informally employed. We observe a negative relationship between informality and schooling among the self-employed. 90 percent of those with no schooling, 80 percent of the primary school graduates and 32 percent of college graduates are informally employed.

Figure 7: Informality with respect to schooling among self-employed



Source: TurkStat, Household Labor Force Survey, 2006

### Need for a multi-dimensional struggle against informality

There is no doubt that strict controls over employment should be introduced particularly to prevent informality among wage earners. But one should take into account its side-effects. Small firms are likely to go bankruptcy or fire workers when faced some enforcement, because formal employment means high tax costs. Thus it is not a coincidence that informality is so widespread among the self employed

and wage earners. In this regard, the combined strategy of 5 percent discount in tax contributions, stricter controls, and generally decreasing labor costs seems to be the optimal one.

The green card has the effect of encouraging informality among wage earners as well as the self employed. Even though there is not enough data, anecdotal evidence indicates that many wage earners benefiting from the green card abstain from becoming formally employed with the fear of losing their green cards.

Informality among those who have not completed the military service requires particular measures. A significant discount in the tax contributions for the age group 15-19 as well as the undertaking of the social security costs by the government should be discussed as alternative policies. It is indeed a big step forward that Social Security Institution employee contributions have been discounted by 100 percent in the first year of employment and by 20 points for each year afterwards for the age group 18-29. However, a more comprehensive and further discount seems to be required for this young people.