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Tackling informal employment in developing and transition economies: a critical evaluation of the neo-liberal approach

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Abstract: This paper evaluates critically the argument of neo-liberals that informal employment is a result of high taxes, public sector corruption and too much state interference in the free market and that the consequent solution is to reduce taxes, public sector corruption and the regulatory burden via minimal state intervention. Comparing International Labour Organization data on the cross-national variations in the prevalence of informal employment with the variables levels of tax rates, corruption and state intervention across 41 developing and transition economies, little support is found for the neo-liberal approach. Instead, lower (not higher) levels of informal employment are found to be associated with higher levels of regulation and state intervention, resulting in a call for more, rather than less, regulation and state intervention to protect workers in developing and transition economies. The theoretical and policy implications are discussed.

Keywords: development economics; economic development; informal economy; shadow economy; underground sector; emerging economies.

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Biographical notes: Colin C. Williams is Professor of Public Policy in the Management School at the University of Sheffield in the UK. His research interests include the informal economy, work organisation and the future of work, subjects on which he has published some 20 monographs and over 300 journal articles over the past 25 years. His recent books include *Confronting the Shadow Economy* (2014, Edward Elgar), *The Shadow Economy* (2013, Institute of Economic Affairs) and *Informal Work in Developed Nations* (2010, Routledge).

1 Introduction

For much of the past century, the dominant view was that informal employment was a remnant from a pre-industrial mode of production and steadily disappearing with economic development and the advent of modern economies (Geertz, 1963; Lewis, 1959). During the past few decades, however, there has been growing recognition that

informal employment is extensive and even expanding in many global regions (Dana, 2010; ILO, 2012; Schneider, 2013; Schneider and Williams, 2013; Williams, 2007; Williams and Round, 2007, 2009). The outcome has been the emergence of new theories to explain the prevalence of employment that lacks basic social or legal protections or employment benefits (ILO, 2012, 2013). The aim of this paper is to evaluate critically the validity of a theory that has begun to gain widespread support, namely the neo-liberal perspective which views informal employment direct result from high taxes, public sector corruption and too much state interference and consequently calls for reductions in taxation and corruption along with de-regulation so as to minimise state interference in the market (Becker, 2004; De Soto, 1989, 2001; London and Hart, 2004; Nwabuzor, 2005). To evaluate critically the validity of this neo-liberal policy approach, the intention in this paper is to analyse whether the cross-national variations in the extent of informal employment across 41 developing and transition countries are correlated with the varying level of tax rates, corruption and state intervention across these countries.

To do this, the first section reviews the neo-liberal theoretical approach along with the other competing explanations for the prevalence and expansion of informal employment. Finding that although this neo-liberal perspective has become ever more popular, few critical evaluations have been undertaken of its validity, the second section then begins to fill this gap by outlining a methodology to do so. To evaluate whether the cross-national variations in the level of informal employment are associated with cross-national variations in tax rates, corruption and state interference across 41 developing and transition economies, this outlines how International Labour Office data on the level of informal employment is compared with World Bank development indicators on tax rates, corruption and state intervention. The third section then reports the results regarding the cross-national variations in the level of informal employment followed in the fourth section by a preliminary analysis of the validity of the neo-liberal explanation. The fifth and final section then draws some conclusions regarding the validity of the neo-liberal approach and discusses both the implications for theory and policy of the findings.

Before commencing, however, informal employment needs to be defined. All definitions denote such employment in terms of what is absent, lacking or missing relative to formal employment (Latouche, 1993; Williams, 2009, 2014), exemplified in the adjectives used (e.g., 'atypical', 'cash-in-hand', 'hidden', 'non-visible', 'irregular', 'shadow', 'unregulated', 'underground' and 'undeclared'). Despite this multitude of terms, however, a strong consensus exists regarding what is lacking. As the *17th International Conference of Labour Statisticians (ICLS)* in 2003 outlined, informal employment involves jobs lacking basic social or legal protections or employment benefits. Informal employment is thus employment which in law or in practice is not covered by national labour legislation, income taxation, social protection or entitlement to certain employment benefits (e.g., notice of dismissal, severance pay, paid annual or sick leave) (Husmanns, 2005; ILO, 2012, 2013).

2 Explaining the prevalence of informal employment: the neo-liberal perspective

During the 20th century, the predominant assumption was that there would be a natural and inevitable expansion of the formal economy and that informal employment was a leftover from a pre-modern mode of production and gradually waning (Boeke, 1942;

Geertz, 1963; Lewis, 1959). From this modernisation perspective, therefore, the level of informal employment would naturally reduce as economies modernise and develop. If informal employment is rife in an economy, in consequence, this signals its 'backwardness' and 'under-development'.

Over the past few decades, however, it has been recognised that some 60% of the global workforce are engaged in informal employment (Jütting and Laiglesia, 2009) and that informal employment is therefore extensive, persistent and even expanding relative to formal employment in many countries and global regions (Buehn and Schneider, 2012; Dana, 2013; Feld and Schneider, 2010; ILO, 2012, 2013; Jütting and Laiglesia, 2009; OECD, 2012; Rodgers and Williams, 2009; Schneider and Williams, 2013). The outcome has been to refute the view that there is a natural and inevitable trajectory towards modern formal economies and that informal employment is a residue from some pre-modern mode of production. Instead, the recognition is that the majority of workers globally engage in informal employment and that it is formal rather than informal employment which is the minority form of employment relationship. The result has been the emergence of new explanations for the ongoing persistence and prevalence of informal employment.

At first, it was a political economy perspective which predominantly replaced the modernisation perspective. From this standpoint, informal employment is a central facet of de-regulated global capitalism and integral component of the new sub-contracting, outsourcing and downsizing practices which provide a channel through which businesses can achieve flexible production, profit and cost reduction (Castells and Portes, 1989; Davis, 2006; Gallin, 2001; Sassen, 1996; Slavnic, 2010; Taiwo, 2013). As such, informal employment is seen as a survival practice to which marginalised populations turn out of necessity as a last resort when alternative means of livelihood are absent and as composed of 'sweatshop-like' dependent employment and/or 'false' self-employment (Ahmad, 2008; Geetz and O'Grady, 2002; Ghezzi, 2010). From a political economy perspective, therefore, the prevalence of informal employment in an economy is a product of a lack of state intervention to protect workers from poverty and the solution is therefore greater regulation and state intervention in work and welfare arrangements.

This political economy perspective, however, has begun to be challenged over the past few decades. This is because it has been increasingly recognised that the majority of informal employment is conducted on a self-employed basis and is undertaken out of choice rather than necessity (Cross, 2000; Cross and Morales, 2007; ILO, 2002; Neuwirth, 2011; Small Business Council, 2004; Snyder, 2004; Venkatesh, 2006; Williams, 2006; Williams and Martinez-Perez, 2014; Williams et al., 2012). The outcome of this recognition is the emergence of a neo-liberal explanation that reads informal employment to be a result of over-regulation rather than under-regulation (Becker, 2004; De Soto, 1989, 2001; London and Hart, 2004; Nwabuzor, 2005; Small Business Council, 2004).

For neo-liberal commentators, informal employment is a result of high tax rates, a corrupt state system and too much interference in the free market, meaning that workers make a rational economic decision to voluntarily exit the formal economy to avoid the time, costs and effort of working on a formal basis (e.g., Becker, 2004; De Soto, 1989, 2001; London and Hart, 2004; Nwabuzor, 2005; Sauvy, 1984; Small Business Council, 2004). Informal workers are therefore depicted as heroes directly challenging regulations imposed by intrusive governments and as voluntarily operating in the informal economy in order to cast off the constraints of state over-regulation (e.g., Sauvy, 1984; De Soto,

1989) As Nwabuzor (2005, p.126) puts it, 'informality is a response to burdensome controls and an attempt to circumvent them', or as Becker (2004, p.10) asserts, 'informal work arrangements are a rational response by micro-entrepreneurs to over-regulation by government bureaucracies'. From this neo-liberal perspective, therefore, the level of informal employment is greater in economies with higher taxes, more public sector corruption and greater state interference and the consequent policy approach is to reduce taxes, tackle public sector corruption, deregulation and minimal state intervention (De Soto, 1989, 2001; Perry and Maloney, 2007; Small Business Council, 2004).

In this neo-liberal approach, therefore, those engaged in informal employment are seen as participating in a form of popular protest and as constituting a political movement seeking to generate a rational competitive market economy (De Soto, 1989). Nevertheless, this does not mean that neo-liberals wish to promote informal employment. Rather, they seek to eradicate informal employment as much as the political economists but wish to do so by reducing taxes, public sector corruption and de-regulation so as to liberate the formal economy from the state interference that raise labour costs, prevent flexibility and increase the costs of formalisation. By diminishing the regulatory burden and state interference, the intention is to erase the distinction between the formal and informal economies by enabling all work to be conducted in the manner now termed 'informal', although this will be 'formal' because it will not be contravening any rules and regulations.

The neo-liberal policy approach, therefore, is to decrease tax rates, tackle public sector corruption and give the market free reign by reducing state interference in work and welfare arrangements. Akin to political economists, neo-liberals thus portray the economy and welfare state as adversaries. The difference between them is that political economists are supportive of the welfare state and depict free market capitalism as preventing advancement, whilst neo-liberals are supportive of the free market and view state intervention in work and welfare provision as interfering with the ability of the market to effectively and efficiently allocate resources. Although debates exist within neo-liberalism in relation to the degree to which social protection might be provided (see Williams, 2004), such commentators largely construe social protection as negative due to its deleterious effects on economic performance. Instead, competitive self-regulatory markets are seen as superior allocation mechanisms and government interference in allocation processes as producing crowding-out effects, maldistribution and inefficiency resulting in economies producing less aggregate wealth than if a *laissez-faire* approach is pursued (Lindbeck, 1981; Okun, 1975).

To evaluate critically the validity of this neo-liberal perspective, therefore, the following hypotheses can be evaluated:

- *taxation hypothesis (H1)*: informal employment is more prevalent in countries with higher tax rates
- *public sector corruption hypothesis (H2)*: informal employment is more prevalent in countries with higher levels of public sector corruption
- *state interference hypothesis (H3)*: informal employment is more prevalent in countries with greater state interference in the workings of the free market.

Until now, only one study has evaluated this neo-liberal explanation for the varying prevalence of informal employment across countries. Comparing the member states of the European Union, this finds no evidence to support the neo-liberal explanation and instead displays that there is some evidence to support both the modernisation and political economy explanations (Williams, 2013). No studies have so far evaluated the validity of this neo-liberal explanation beyond the European context. This paper fills that gap by examining the variable prevalence of informal employment across 41 developing and transition economies.

3 Methodology

To evaluate the validity of the neo-liberal explanation for the variations in the prevalence of informal employment across developing and transition economies, firstly, an International Labour Organization (ILO) dataset is used to report the cross-national variations in the prevalence of informal employment. This uses the same common broad definition of informal employment and the same survey methodology in each of the 41 countries. The Bureau of Statistics of the ILO sends a common questionnaire to all statistical offices requesting the completion of detailed tables on statistics regarding the prevalence of informal employment. This data is collected using either an ILO Department of Statistics questionnaire or existing national labour force or informal sector survey data is used (for further details, see ILO, 2012). In all countries, those with more than one job are classified by their self-reported main employment and only the non-agricultural workforce is surveyed. The result is the production of a cross-nationally comparable database on the proportion of the non-agricultural workforce whose main job is informal employment.

To test the three hypotheses that constitute the neo-liberal approach, relevant indicators are selected from the World Bank development indicators database for the same (or closest) year to the survey conducted of informal employment (World Bank, 2013). The only non-official indicator here used relates to public sector corruption, taken from Transparency International's corruption perceptions index (Transparency International, 2013).

To evaluate the neo-liberal taxation hypothesis (H1), the following World Bank (2013) country-level indicators on taxation rates are used:

- Taxes on goods and services as a percentage of revenue. This includes general sales and turnover as well as value added taxes, excise duties on goods, taxes on services, taxes on the use of goods or property, taxes on extraction and the production of minerals and the profits of fiscal monopolies.
- Taxes on income, profits and capital gains as a percentage of revenue. This covers taxes on the actual or presumptive net income of individuals, the profits of businesses and capital gains on land, securities and other assets.
- Taxes on revenue (excluding grants) as a percentage of GDP. Revenue covers cash receipts from taxes, social contributions and other revenues (e.g., fines, fees, rent and income from property or sales).

- Tax revenue as a percentage of GDP. Tax revenue includes compulsory transfers to central government for public purposes including fines and penalties. Most social security contributions are excluded. Refunds of wrongly collected tax revenue are treated as negative revenue.
- Total tax rate as percentage of commercial profits. This includes all taxes and mandatory contributions payable by organisations after allowable deductions and exemptions, as a share of commercial profits. Taxes withheld (e.g., personal income tax) or paid to tax authorities (e.g., value added taxes, sales taxes or goods and service taxes) are not included.

The neo-liberal public sector corruption hypothesis (H2), meanwhile, is evaluated using the following three country-level indicators on public sector corruption:

- Transparency international's corruption perceptions index (CPI), which is a composite index of perceptions of public sector corruption from 14 expert opinion surveys. It scores nations on a 0–10 scale, with zero indicating high levels and ten low levels of perceived public sector corruption (Transparency International, 2013).
- The percentage of firms making informal payments to public officials
- The percentage of firms expected to give gifts in meetings with tax officials.

Finally, the neo-liberal state interference hypothesis (H3) is evaluated using the following seven World Bank development indicators that compare the administrative burden, level of regulation and state intervention across countries:

- Time required to obtain an operating license.
- The time required (in days) to start a business.
- The time spent dealing with tax officials as a share of total management time.
- The 'ease of doing business' ranking of each country in the World Bank doing business surveys, which is a proxy indicator of the relative regulatory burden across countries
- Social contributions as a % of revenue. This includes social security contributions by employees, employers and self-employed individuals and other contributions whose source cannot be determined, as well as actual or imputed contributions to social insurance schemes operated by governments.
- The expense of government as a share of GDP, which covers cash payments for the operating activities of the government in terms of providing goods and services. It covers compensation of employees (e.g., salaries), interest and subsidies, grants, social benefits and expenses such as rent and dividends.

To analyse the relationship between cross-national variations in the prevalence of informal employment and the cross-national variations in the above indicators and given the small sample size (i.e., 41 cases) and lack of necessary controls to include in a multivariate regression analysis, only bivariate regression analyses can be here undertaken. Given the non-parametric nature of the data, Spearman's rank correlation coefficient (r_s) is employed to do this. As will become apparent, nevertheless, some meaningful findings are produced regarding the validity of the neo-liberal approach.

4 Results

Analysing the prevalence of informal employment across the 41 developing and transition economies for which data is available, the simple unweighted average is that the majority (53.9%) of non-agricultural workers are in informal employment as their main job. Given that the size of the workforce varies across these countries, this needs to be taken into account by producing a weighted average. The finding is that across all 41 countries, 44.4% of the non-agricultural workforce is in informal employment as their main job. Informal employment, therefore, is not some minor remnant. It is a sizeable sphere employing a significant proportion of the workforce in these developing and transition economies.

However, the share of the workforce in informal employment varies markedly across global regions. Dividing these 41 countries into six global regions using the World Bank (2013) classification (see Table 1), the weighted average findings are that 83% of the working population are in informal employment as their main job in South Asia, 53% in Sub-Saharan Africa, 52% in the Middle East and North Africa, 51% in Latin America and the Caribbean, 44% in East Asia and the Pacific and 27% in Europe and Central Asia. The share of the workforce in informal employment as their main job is thus not evenly distributed across the globe.

Table 1 Share of non-agricultural workforce in informal employment, 41 countries

<i>Country</i>	<i>Year</i>	<i>Global region (World Bank classification)</i>	<i>% of jobs in informal employment</i>	<i>% of informal employment which is self-employment</i>	<i>Type of economy</i>
India	2009/10	South Asia	83.6	47.2	Dominantly informal
Mali	2004	Sub-Saharan Africa	81.8	88.1	Dominantly informal
Pakistan	2009/10	South Asia	78.4	53.0	Largely informal
Tanzania	2005/6	Sub-Saharan Africa	76.2	73.2	Largely informal
Bolivia	2006	Latin America and Caribbean	75.1	53.6	Largely informal
Honduras	2009	Latin America and Caribbean	73.9	60.2	Largely informal
Madagascar	2005	Sub-Saharan Africa	73.6	57.7	Largely informal
Indonesia	2009	East Asia and Pacific	72.5	49.2	Largely informal
Paraguay	2009	Latin America and Caribbean	70.7	40.2	Largely informal
Philippines	2008	East Asia and Pacific	70.1	47.2	Largely informal
Peru	2009	Latin America and Caribbean	69.9	59.0	Mostly informal

Source: Derived from ILO (2012)

Table 1 Share of non-agricultural workforce in informal employment, 41 countries (continued)

<i>Country</i>	<i>Year</i>	<i>Global region (World Bank classification)</i>	<i>% of jobs in informal employment</i>	<i>% of informal employment which is self-employment</i>	<i>Type of economy</i>
Zambia	2008	Sub-Saharan Africa	69.5	64.7	Mostly informal
Uganda	2010	Sub-Saharan Africa	69.4	65.2	Mostly informal
Vietnam	2009	East Asia and Pacific	68.2	59.8	Mostly informal
El Salvador	2009	Latin America and Caribbean	66.4	57.6	Mostly informal
Nicaragua	2009	Latin America and Caribbean	65.7	58.4	Mostly informal
Sri Lanka	2009	South Asia	62.1	49.7	Mostly informal
Ecuador	2009	Latin America and Caribbean	60.9	47.5	Mostly informal
Liberia	2010	Sub-Saharan Africa	60.0	82.5	Mostly informal
Colombia	2010	Latin America and Caribbean	59.6	70.1	Semi-informal
West Bank and Gaza	2010	Middle East and North Africa	58.5	23.5	Semi-informal
Mexico	2009	Latin America and Caribbean	53.7	44.6	Semi-informal
Zimbabwe	2004	Sub-Saharan Africa	51.6	N.A.	Semi-informal
Egypt	2009	Middle East and North Africa	51.2	N.A.	Semi-informal
Argentina	2009	Latin America and Caribbean	49.7	45.7	Semi-formal
Dominican rep	2009	Latin America and Caribbean	48.5	57.9	Semi-formal
Venezuela	2009	Latin America and Caribbean	47.5	65.7	Semi-formal
Namibia	2008	Sub-Saharan Africa	43.9	26.1	Semi-formal
Panama	2009	Latin America and Caribbean	43.8	60.3	Semi-formal
Costa Rica	2009	Latin America and Caribbean	43.8	56.1	Semi-formal
Thailand	2010	East Asia and Pacific	42.3	N.A.	Semi-formal
Brazil	2009	Latin America and Caribbean	42.2	46.3	Semi-formal
Uruguay	2009	Latin America and Caribbean	39.8	65.7	Mostly formal
Lesotho	2008	Sub-Saharan Africa	34.9	10.1	Mostly formal
South Africa	2010	Sub-Saharan Africa	32.7	35.5	Mostly formal

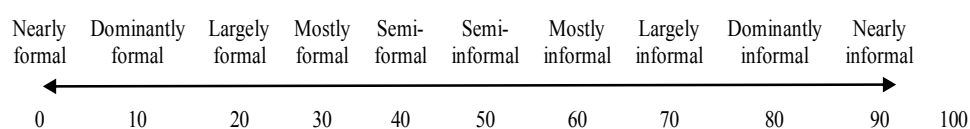
Source: Derived from ILO (2012)

Table 1 Share of non-agricultural workforce in informal employment, 41 countries (continued)

Country	Year	Global region (World Bank classification)	% of jobs in informal employment	% of informal employment which is self-employment	Type of economy
China	2010	East Asia and Pacific	32.6	59.8	Mostly formal
Turkey	2009	Europe and Central Asia	30.6	N.A.	Mostly formal
Armenia	2009	Europe and Central Asia	19.8	33.1	Dominantly formal
Moldova	2009	Europe and Central Asia	15.9	44.3	Dominantly formal
Macedonia	2010	Europe and Central Asia	12.6	40.0	Dominantly formal
Serbia	2010	Europe and Central Asia	6.1	46.6	Nearly formal

Source: Derived from ILO (2012)

There are also marked cross-national variations in the prevalence of informal employment. As Table 1 displays, the proportion of the non-agricultural workforce that is in informal employment ranges from 83.6% of the non-agricultural workforce in India to 6.1% in Serbia. As indicated earlier, the growing recognition that much informal employment is conducted on a self-employed basis is reflected in Table 1, ranging from 82.5% in Liberia to 10.1% in Lesotho. The proportion of the non-agricultural workforce employed in informal employment, moreover, is significantly correlated with the proportion that is self-employed at a 0.01 level. Using Spearman's rank correlation coefficient (r_s) due to the non-parametric nature of the data, the finding is that the greater is the prevalence of informal employment, the lower is the proportion of the informal workforce in informal self-employment ($r_s = -.413^{**}$).

Figure 1 Type of economy: by level of informal employment

To chart the relative importance of informal employment in these developing and transition economies, Figure 1 provides a spectrum along which countries can be located by the share of the non-agricultural working population whose main job is informal employment. As the final column of Table 1 reveals, none of these economies are 'nearly informal' economies, 5% are 'dominantly informal' economies, 20% are 'largely formal' economies, 22% are 'mostly informal' economies, 12% are 'semi-formal' economies, 20% are 'semi-formal' economies, 12% 'mostly formal' economies, 7% are 'dominantly formal' economies and 2% nearly formal economies. These developing and transition economies, therefore, are largely clustered towards the centre of the continuum but skewed towards the informal side of the spectrum.

Given these findings concerning the cross-national variations in the proportion of the non-agricultural workforce in informal employment, the validity of the neo-liberal perspective as an explanation for these cross-national variations is now evaluated.

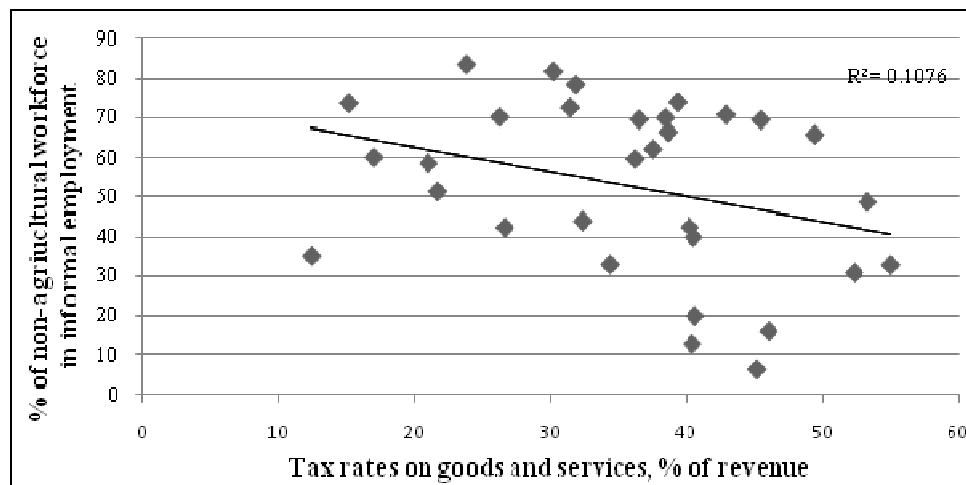
5 Analysis: evaluating the neo-liberal policy approach

To evaluate the neo-liberal explanation for the cross-national variations in the level of informal employment, an exploratory analysis of the validity of each neo-liberal hypothesis is here conducted.

5.1 Evaluation of the taxation hypothesis (H1)

To evaluate the neo-liberal taxation hypothesis that the level of informal employment is greater in countries with higher tax rates, five different taxation measures are here used to examine the association between cross-national variations in taxation levels and cross-national variations in the level of informal employment across these 41 developing and transition economies.

Figure 2 Relationship between informal employment and tax rates on goods and services



Starting with the level of taxes on goods and services as a share of revenue and using Spearman's rank correlation coefficient, the finding is that there is a statistically significant relationship at the 0.01 level ($r_s = -.400^{**}$). As Figure 2 displays, this association is not in the direction suggested by neo-liberal discourse. As tax rates on goods and services rise, the share of the non-agricultural workforce in informal employment falls, perhaps displaying how countries with greater social transfers have lower levels of informal employment because their populations are less dependent on the informal economy as a survival tactic.

Figure 3 Relationship between informal employment and revenue as % of GDP

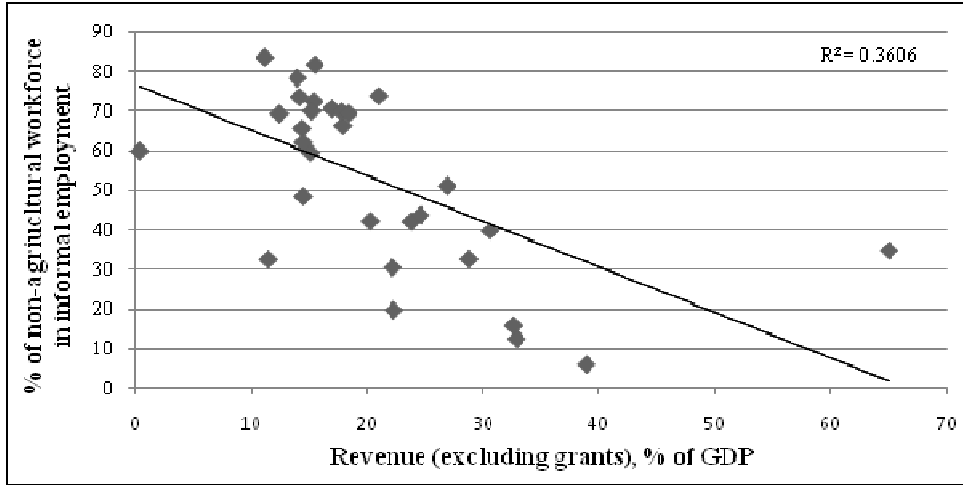
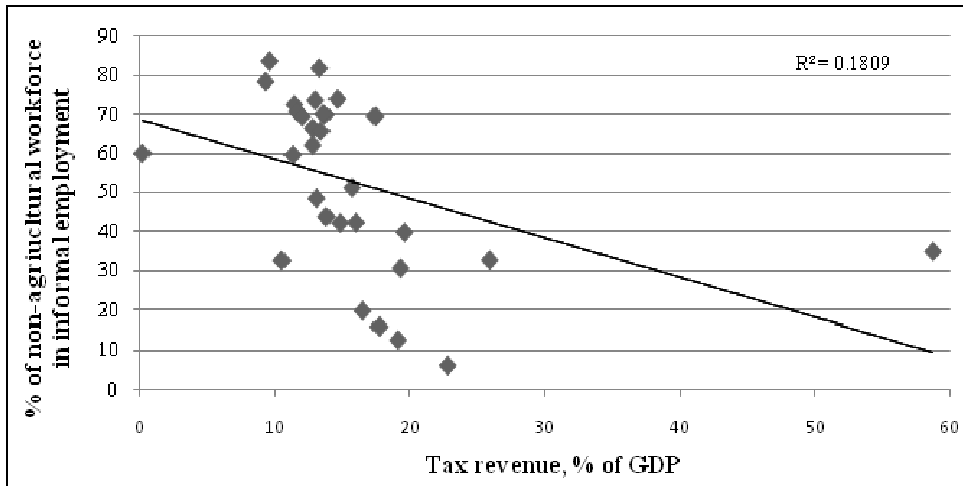


Figure 4 Relationship between informal employment and tax revenue as % of GDP



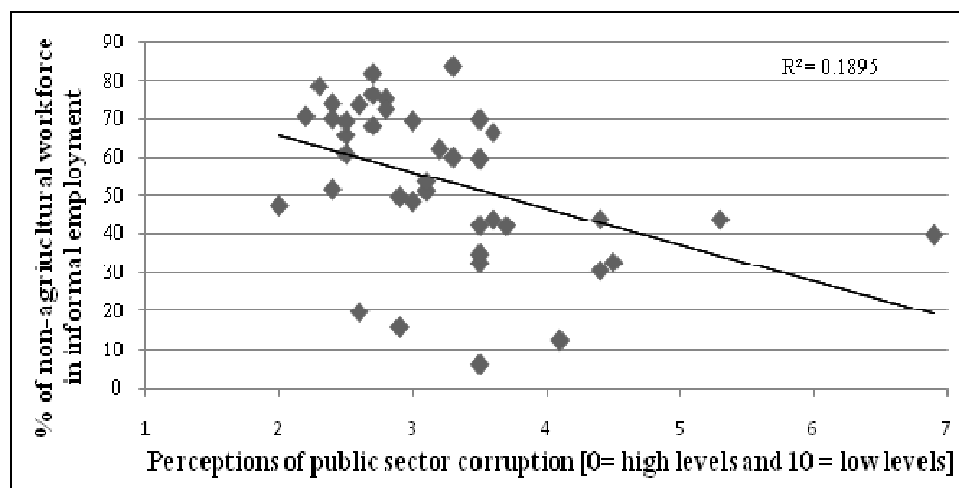
Is this similarly the case when other measures of taxation are analysed? Although no significant association is identified between the level of informal employment and either the level of taxes on income, profits and capital gains as a share of revenue ($r_s = .310$) or total tax rate ($r_s = .216$), a statistically significant correlation at the 0.01 level is identified when the cross-national variations in the revenue (excluding grants) as a share of GDP ($r_s = -.626^{**}$) and tax revenue as a percentage of GDP ($r_s = -.637^{**}$) are analysed (see Figures 3 and 4 respectively). In both cases, the direction of the association is again not in the direction suggested by neo-liberal discourse. As the level of revenue as a share of GDP rises and also tax revenue as a share of GDP rises, the proportion of the non-agricultural workforce in informal employment falls.

Consequently, no evidence is found to validate the neo-liberal taxation hypothesis that the level of informal employment is greater in countries with higher tax rates and that informal employment can therefore be tackled by reducing the level of taxation. Indeed, these results in developing and transition economies reinforce the findings in Europe which similarly identify no association between cross-national variations in tax rates and cross-national variations in the prevalence of informal employment (Vanderseypen et al., 2013; Williams, 2013).

5.2 Evaluation of the public sector corruption hypothesis (H2)

To evaluate the neo-liberal public sector corruption hypothesis which asserts that the level of informal employment is greater in countries with higher public sector corruption levels, three different measures of such corruption can be analysed.

Figure 5 Relationship between informal employment and public sector corruption



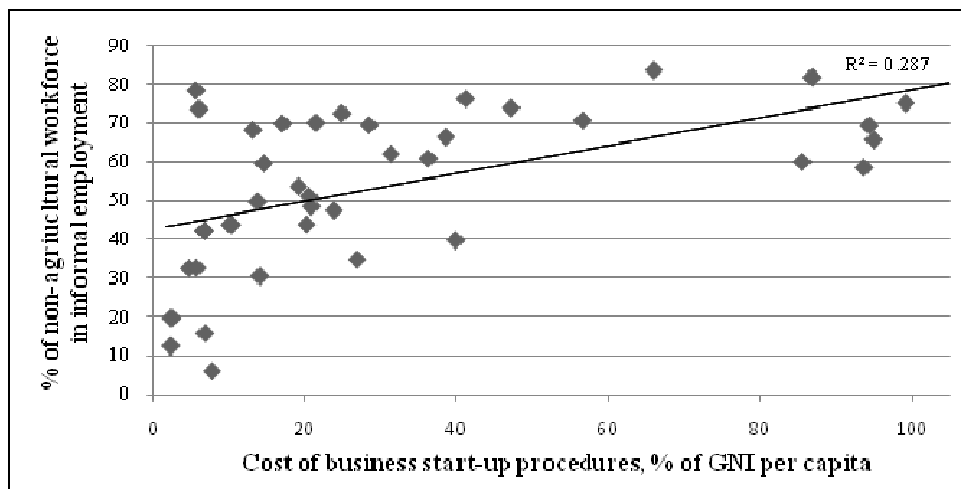
Examining Transparency International's perceptions of public sector corruption index, a significant association at the 0.01 level is identified between cross-national variations in the level of informal employment and levels of public sector corruption ($r_s = -.564^{**}$). As Figure 5 reveals, the direction of this relationship is that the greater is the perceived level of public sector corruption in a country, the higher is the level of informal employment. This, therefore, validates the neo-liberal public sector corruption hypothesis. However, this is not the case when two measures of actual public sector corruption are examined. When the cross-national variations in the percentage of firms who make informal payments to public officials is compared with the cross-national variations in the level of informal employment, no significant correlation is identified ($r_s = .219$). Neither is any statistically significant association identified between cross-national variations in the percentage of firms who state that they are expected to give gifts in meetings with tax officials and cross-national variations in the level of informal employment ($r_s = .247$). Although one composite indicator of perceptions of public sector corruption thus provides some evidence to support the neo-liberal public

sector corruption hypothesis, more direct indicators that ask businesses about whether they have suffered such corruption do not find any significant correlation.

5.3 Evaluation of the state interference hypothesis (H3)

To evaluate the state interference hypothesis which asserts that the level of informal employment is greater in countries with higher levels of state interference in the workings of the free market, various measures of state intervention in work and welfare arrangements are here examined.

Figure 6 Relationship between informal employment and cost of starting-up a business



Comparing the cross-national variations in the level of informal employment and cross-national variations in the time required in days to start a business, which signals whether there is a burdensome regulatory environment for start-ups, no significant association is identified ($r_s = .088$). Neither is a significant correlation identified between cross-national variations in the level of informal employment and cross-national variations in the time required to obtain an operating license ($r_s = -.135$). However and as Figure 6 displays, there is a strong statistically significant association between cross-national variations in the level of informal employment and cross-national variations in the cost of business start-up procedures, expressed as a percentage of GNI per capita ($r_s = .551^{**}$). In countries where the cost of business start-up procedures is relatively high, informal employment tends to be more prevalent, thus supporting the neo-liberal approach.

If the cost of business start-ups validates the neo-liberal state interference hypothesis, it is important not to extrapolate from this to all forms of state intervention. Examining whether state interference in welfare arrangements increases the level of informal employment as neo-liberals argue or decreases its size as political economists assert, the relationship between cross-national variations in the level of informal employment and the level of social contributions as a percentage of revenue can be evaluated. The finding is that there is a significant association ($r_s = -.560^{**}$). As Figure 7 displays, the direction

of this association is that informal employment is more prevalent in countries which spend a smaller proportion of revenue on social contributions. This, therefore, refutes the neo-liberal state interference hypothesis and supports the political economy argument that greater state intervention to protect citizens from poverty reduces the prevalence of informal employment.

Figure 7 Relationship between informal employment and social contributions

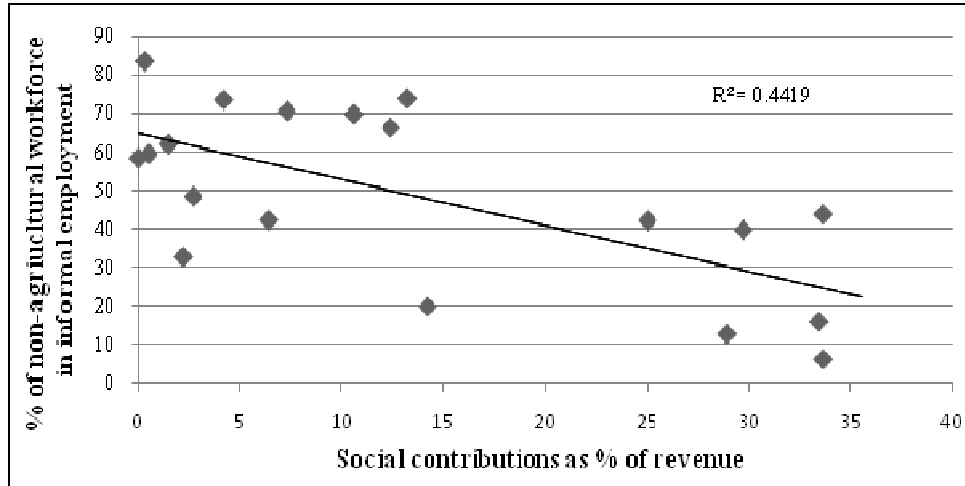
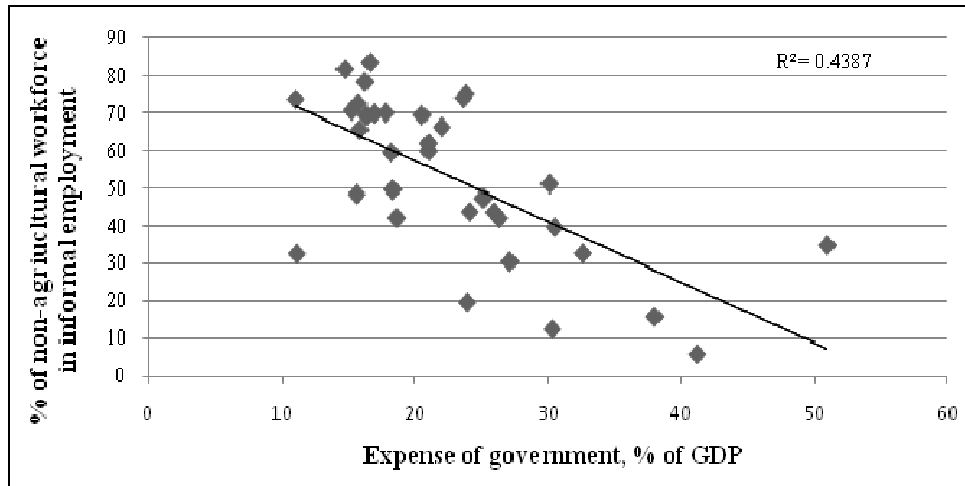


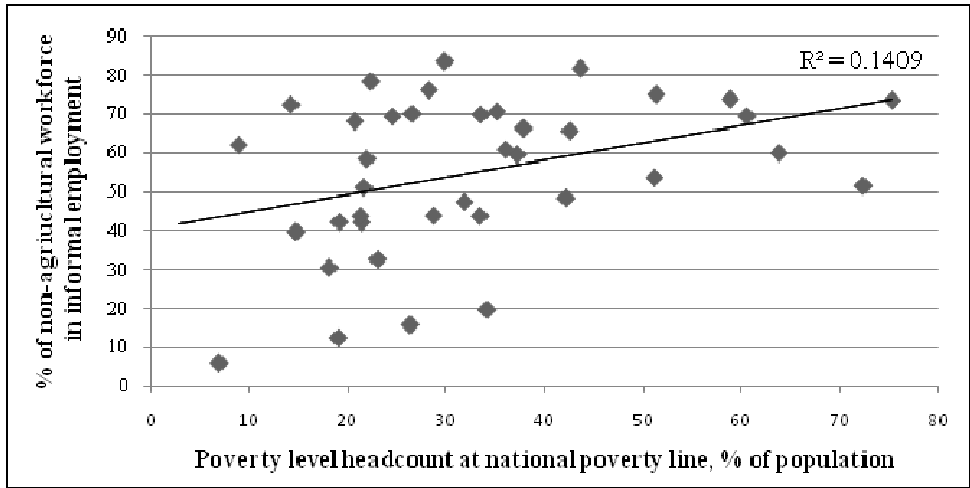
Figure 8 Relationship between informal employment and size of government



This is further reinforced when analysing the association between the expense of government as a share of GDP, which is a proxy of the degree to which governments intervene in work and welfare arrangements and the level of informal employment. Again and as Figure 8 reveals, a statistically significant association is found ($r_s = -.668^{**}$). This again refutes the neo-liberal state interference hypothesis. Instead, it

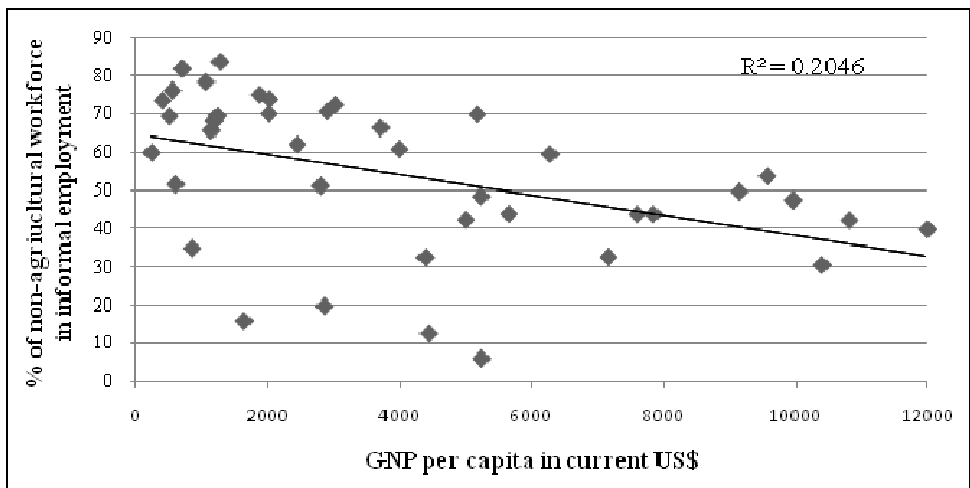
provides support for the political economy explanation that bigger government reduces, rather than increases, the prevalence of informal employment.

Figure 9 Relationship between informal employment and share of population living in poverty



Indeed, the neo-liberal state interference hypothesis is further refuted when the cross-national variations in the level of informal employment and cross-national variations in the proportion of the population living below the national poverty line is analysed. As Figure 9 reveals, there is a strong statistically significant relationship at the 0.01 level ($r_s = .416^{**}$). The greater is the share of the population living below the national poverty line, the higher is the level of informal employment. This supports the political economy argument that informal employment is more an activity of last resort turned to by populations in the absence of alternative sources of livelihood, rather than a voluntarily chosen endeavour as asserted by the neo-liberal approach.

Figure 10 Relationship between informal employment and GNP per capita



Indeed, it is not solely support for the political economy perspective which is found. The conventional modernisation perspective which argues that the level of informal employment is lower in 'developed' wealthier economies and higher in 'less developed' economies is also supported. As Figure 10 displays, a strong statistically significant association is identified between cross-national variations in the level of informal employment and cross-national variations in GNP per capita ($r_s = -.560^{**}$). The direction of this relationship is that the share of the non-agricultural workforce employed in informal employment is higher in economies with lower levels of GNP per capita, thus supporting the modernisation perspective.

6 Conclusions

Reporting ILO data on the cross-national variations in the level of informal employment across 41 developing and transition economies, this paper has revealed that 44.4% of non-agricultural workers are in informal employment as their main job. This brings informal employment out of the shadows. Such workers are not a small segment of the workforce of limited importance. Nevertheless, marked cross-national variations exist. To explain this, this paper has evaluated critically the neo-liberal approach which views countries with higher taxes, corruption and state interference to have higher levels of informal employment and therefore advocates tax reductions, tackling corruption and minimal state intervention as the required policy approach for tackling informal employment.

Evaluating the validity of this neo-liberal approach in relation to these developing and transition economies, the finding is that the prevalence of informal employment does not reduce when tax rates are lower (H1) and is only associated with the level of corruption (H2) when perceptions of public sector corruption are evaluated, not when actual corruption behaviour is analysed. Analysing the association between the cross-national variations in the level of informal employment and the degree of state interference in work and welfare arrangements (H3), beyond the cost of business start-up procedures, there is no evidence found that supports the neo-liberal argument that the level of informal employment is higher in economies with higher levels of state interference. Whichever tenet of the neo-liberal approach is evaluated, in consequence, little evidence is found to support the view that higher levels of informal employment are prevalent in countries with higher taxes, corruption and state interference and that the solution is therefore tax reductions, tackling corruption and pursuing minimal state intervention.

Nevertheless, support is found for the political economy approach which argues that higher levels of informal employment are found in economies with less state intervention to protect workers from poverty. Not only has it been shown that cross-national variations in the level of informal employment are strongly correlated with the level of poverty, but also that higher levels of social protection and bigger government result in lower levels of informal employment, doubtless because this diminishes the need for marginalised populations to turn to informal employment as a survival practice. This study of the cross-national variations in the level of informal employment does not only provide support for the political economy approach but also the modernisation perspective since it shows that the level of informal employment is lower in more developed modern economies as measured by GNP per capita.

These findings have implications for both theorising informal employment and policy. Beginning with the implications for theory, serious concerns are raised regarding whether higher levels of informal employment are due to higher tax rates, corruption and state interference. Instead, these findings tentatively support both the modernisation explanation which views higher levels of informal employment as associated with economic under-development and the political economy explanation which argues that higher levels of informal employment results from an under-regulation (not over-regulation) of economies and a lack of state intervention to protect workers from poverty. Consequently, if cross-national variations in the level of informal employment are to be explained, a synthesis of the modernisation and political economy approaches is required which explains lower levels of informal employment to be associated with economic development, smaller shares of the population in poverty and greater levels of social protection. The validity of this new 'neo-modernisation' explanation now needs to be evaluated in other global regions and when time-series data is analysed for individual nations. It might also be useful to explore a wider range of economic and social conditions regarding state intervention in and regulation of, work and welfare provision (e.g., the quality of state governance, labour market policy interventions to protect vulnerable groups, regulations on temporary employment) in order to further develop this neo-modernisation perspective in a more nuanced manner regarding what state interventions reduce informal employment and which do not.

The findings of this paper also have implications for policy. Over the past few decades, a shift has taken place away from eradicating informal employment and towards facilitating its formalisation as it has been recognised that the intention in tackling informal employment is to address the growth of the formal economy, decent work, fuller employment and increasing tax revenue to support wider societal objectives (Chen, 2012; Williams and Lansky, 2013). To achieve this, the vast majority of the policy debate has revolved around whether targeted repressive measures and/or targeted incentives are most effective at facilitating formalisation (Dibben and Williams, 2012; Eurofound, 2013; Feld and Larsen, 2012; OECD, 2012; Williams and Lansky, 2013; Williams and Nadin, 2012a, 2012b, 2014). This paper, however and in contrast to this conventional policy debate, reveals that broader economic and social policy measures are also important. Not only has it shown that the overarching modernisation of economies, reducing poverty and social protection are all closely associated with the level of informal employment but it has also shown that a more nuanced approach needs to be developed towards which forms of state intervention in work and welfare reduce informal employment and which measures increase it. Tackling informal employment, therefore, seemingly requires not only a mix of targeted policy measures but also the introduction of broader economic and social policies. Whether this policy implication is confirmed when time-series data is examined for individual countries needs to be evaluated in future research.

In sum, this paper raises questions regarding the validity of the neo-liberal approach that advocates tax reductions, tackling corruption, de-regulation and minimal state intervention when tackling informal employment. If these results thus stimulate further critical evaluation of this neo-liberal approach, then it will have fulfilled one of its intentions. If it also leads to a rethinking of whether certain forms of state intervention to protect workers from poverty might be the way forward in tackling informal employment, then it will have fulfilled all of its objectives.

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