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# **Explaining cross-national variations in the informalisation of employment: some lessons from Central and Eastern Europe**

## **Abstract**

The aim of this paper is to better understand cross-national variations in the informalisation of employment by evaluating critically three contrasting explanations which variously represent informal employment as more prevalent in: poorer under-developed economies (modernisation thesis); societies with high taxes, corruption and state interference in the free market (neo-liberal thesis) and societies with inadequate levels of state intervention to protect workers (political economy thesis). To evaluate these rival explanations, the relationship between the variable informalisation of employment in 10 Central and East European countries, measured using data from a 2007 Eurobarometer cross-national survey involving 5,769 face-to-face interviews, and their broader work and welfare regimes are analysed. The finding is that wealthier, less corrupt and more equal societies and those possessing higher levels of taxation, social protection and effective redistribution via social transfers are significantly more likely to have lower levels of informalisation. No evidence is thus found to support the neo-liberal tenets that the informalisation of employment results from high taxes and too much state interference in the free market but evidence is found to positively confirm the modernisation and political economy theses as explanations for the cross-national variations in the informalisation of employment. The paper concludes by discussing the tentative theoretical and policy implications of these findings and calling for further evaluation of their wider validity both longitudinally and across other global regions.

**Keywords:** informal sector; shadow economy; undeclared work; corruption; tax evasion; Central and Eastern Europe.

## **Introduction**

Given that 60 per cent of all jobs globally are in the informal economy (Jütting and Laiglesia 2009) and informal employment is expanding relative to formal employment in many global regions (ILO 2011; OECD 2012; Schneider 2008, 2011; Williams, 2014), it is important to understand and explain the informalisation of employment and how this varies across

populations. The aim of this paper is to begin to do so by seeking to explain the cross-national variations in the informalisation of employment in Central and Eastern Europe (CEE).

Until now, three contrasting explanations have been proposed for the cross-national variations in the informalisation of employment relations. During the twentieth century, informal employment was widely explained simply as a leftover from some pre-modern system of work organisation that was steadily disappearing as economies modernised and a formalisation of work occurred (Boeke 1942; Geertz 1963; Lewis 1959). Although scholars warned that this was not necessarily the case during the 1980s (Gershuny 1983; Handy 1984; Shankland and Turner 1988; Sparrow 1986), since the turn of the millennium the informalisation of employment has been more widely recognised resulting in the emergence of various contrasting explanations. On the one hand, a 'neo-liberal' thesis has proposed that its incidence directly results from high taxes, corruption and state interference in the free market and that the remedy is therefore to pursue tax reductions, deregulation and to minimize state interference in both the market and welfare provision (Becker 2004; De Soto 1989, 2001; London and Hart 2004; Nwabuzor 2005; Sauvy 1984; Small Business Council 2004). On the other hand, a political economy perspective has argued that its resurgence is a direct by-product of a deregulated global production system that uses informal employment as a key component in its new downsizing, sub-contracting and outsourcing arrangements and that the solution is therefore to pursue greater state intervention in both work and welfare arrangements so as to stem the growth of the informal economy (Davis 2006; Gallin 2001; Slavnic 2010). To evaluate these competing explanations for the cross-national variations in the informalisation of employment, the intention here is to compare the variable prevalence of this work practice across CEE countries.

To achieve this, the first section of this paper will briefly review the competing

modernisation, political economy and neo-liberal theses that have been previously used to explain the variable prevalence of informal employment across countries. To evaluate critically these rival explanations, the second section will then report evidence from a 2007 Eurobarometer survey on the cross-national variations in the informalisation of employment in CEE countries and how this varies across different work and welfare regimes. Revealing significant correlations between lower levels of informalisation and particular types of work and welfare arrangement, the concluding section will then discuss the implications of the findings both for theory and policy.

At the outset, however, it is important to define informal employment. Although some 45 different adjectives have been used to describe this realm, including ‘atypical’, ‘cash-in-hand’, ‘hidden’, ‘non-visible’, ‘irregular’, ‘shadow’, ‘unregulated’, ‘underground’ and ‘undeclared’, all describe what is absent, insufficient or missing relative to formal employment. Reviewing the extensive literature, a strong consensus prevails regarding what is missing, absent or insufficient. Informal employment is widely defined as remunerated activity that is not declared to the state for tax, social security and labour law purposes as should be the case, but is legal in all other respects (European Commission 1998, 2007; OECD 2012; Pfau-Effinger 2009; Sepulveda and Syrett 2007; Williams 2006). In consequence, if an employment relationship possesses other absences or insufficiencies, such as that the goods and services provided are illegal or that the work is unpaid, these work practices are not defined as informal employment but instead as belonging to the ‘criminal’ or ‘unpaid’ spheres respectively. Blurred edges, nevertheless, remain such as when gifts are provided in lieu of money or in-kind labour is exchanged (White 2009; Williams 2006). In this paper, however, informal employment includes only exchanges involving monetary transactions between the employer/purchaser and employee/supplier.

This definition of informal employment covers diverse forms of employment relationship. On the one hand, it includes wholly undeclared employment, in the form of either waged work or self-employment, where the worker is not formally employed by the employer and the remunerated activity is not declared to the state for tax, social security and labour law purposes. On the other hand, and sometimes overlooked because it challenges the widely held notion that jobs are either formal or informal but cannot be concurrently both (Williams 2009), this definition also includes the employment relationship where a formal employee receives from their formal employer both a declared salary as well as an additional undeclared ('envelope') wage (Neef 2002; Sedlenieks 2003; Williams 2010; Woolfson 2007).

### **Explaining cross-national variations in the informalisation of employment**

To explain the variations in the informalisation of employment, three contrasting explanations have been proposed: the modernisation, neo-liberal and political theses. Each is here considered in turn.

#### **Modernisation thesis**

For much of the twentieth century, it was widely believed that the formal economy was steadily colonising every nook and cranny of the modern world and that the informal economy was merely a residue or remnant from some pre-modern era that was gradually fading from view as the modern formal sector took hold. The persistence of informal employment was consequently viewed as a sign of 'traditionalism', 'under-development' and 'backwardness' whilst the emerging modern formal economy was in contrast delineated as representing 'progress', 'advancement' and 'development' (Geertz 1963; Gilbert 1998; Lewis 1959). Viewed through this lens, informal employment thus constitutes a pre-modern traditional economic order that persists at the fringes of modern society and is fading from view with modernisation. Applying this to explaining the cross-national variations in the

prevalence of informal employment, it can be suggested that in less developed economies, measured in terms of GDP per capita, such employment will be higher. Therefore, the following hypothesis can be tested:

Modernisation hypothesis (H1): the informalisation of employment will be higher in less developed economies measured in terms of their GDP per capita.

### **Neo-liberal thesis**

For many commentators of a neo-liberal persuasion, the prevalence of informal employment is deemed a populist reaction to high taxes, a corrupt state system and too much interference in the free market, which leads to a rational economic decision to voluntarily exit the formal economy in order to avoid the costs, time and effort of formal registration (e.g., Becker 2004; De Soto 1989 2001; London and Hart 2004; Nwabuzor 2005; Sauvy 1984; Small Business Council 2004). From this neo-liberal perspective, therefore, informal workers are only breaking rules and regulations imposed by an excessively intrusive state and are seen as a political movement resisting state over-regulation so as to generate a rational competitive market economy. Here, in consequence, the prevalence of informal employment will be greater in economies with higher taxes and public sector corruption and greater state interference and the resultant solution is to reduce taxes, tackle public sector corruption, deregulation and minimal state intervention. To explore the validity of this neo-liberal theory, therefore, the following hypothesis can be tested:

Neo-liberal hypothesis (H2): the informalisation of employment will be higher in countries with higher tax rates, greater public sector corruption and higher levels of state interference in the free market.

### **Political economy thesis**

In stark contrast to neo-liberals, political economists view the informalisation of employment to result from too little rather than too much state intervention in work and welfare arrangements. Informal employment is construed as an inherent component of the current production practices of late capitalism and a key facet of the new downsizing, sub-contracting and outsourcing arrangements emerging under deregulated global capitalism since informalisation provides businesses with a production channel to attain flexible production, profit and cost reduction (Castells and Portes 1989; Davis 2006; Gallin 2001; Hudson 2005; Sassen 1996; Slavnic 2010; Taiwo, 2013). In deregulated global capitalism, therefore, the full-employment/comprehensive formal welfare state regime that characterised the Fordist and socialist period is being replaced by a new post-Fordist and post-socialist regime of deregulation, liberalization and privatization (Castells and Portes 1989; Meagher 2010; Sassen 1996) which through subcontracting, outsourcing and diminishing state involvement in welfare and employment has enabled informal economic arrangements to move to the heart of contemporary economies.

Informal employment is thus viewed as unregulated, low paid and insecure work conducted under 'sweatshop-like' conditions by marginalised populations who undertake such work due to their exclusion from the formal economy and no other options being open to them (Ahmad 2008; Castells and Portes 1989; Davis 2006; Gallin 2001; Hudson 2005; Sassen 1996). As such, informal employment is a result of the under-regulation of work and welfare provision, including reduced social protection and social transfers, and the remedy is greater intervention in work and welfare arrangements (Davis 2006; Gallin, 2001; Slavnic 2010). Consequently, informalisation will be greater in countries with lower levels of state intervention to protect workers from poverty. To evaluate this, the following hypothesis can be tested:

Political economy hypothesis (H3): the informalisation of employment will be higher in countries with lower tax rates and less social protection to protect workers from poverty.

### **Previous evaluations of the rival explanations**

Conventionally, most scholars have explained the greater prevalence of informal employment in some populations rather than others by adopting one or other of these theses. For example, Yamada (1996) adopts the neo-liberal thesis whilst Slavnic (2010) adopts the political economy thesis.

Recently however, when examining the informalisation of employment at a national or local level, or amongst particular population groups, a more nuanced understanding has begun to emerge that combines these theories. For example, it has been contested that the political economy thesis is more relevant to explaining informal employment in relatively deprived population groups and neo-liberal theory to relatively affluent population groups (Evans et al. 2006; Williams and Round 2010; Williams et al. 2012), that neo-liberal exit rationales are more common in developed economies and political economy exclusion rationales in developing economies (Oviedo et al. 2009) and that women are driven more by political economy exclusion motives and men more by neo-liberal voluntary exit motives (Franck 2012; Grant 2013; Williams 2011).

Few if any studies, however, have yet evaluated critically the validity of these competing theses when explaining cross-national variations in the informalisation of employment. To begin filling this gap therefore, we here conduct an exploratory analysis of the validity of these theories when explaining the cross-national variations in the informalisation of employment in Central and Eastern Europe. The reason for selecting this European region is because over the past few decades, adherents to neo-liberal theory, or



what Kostera (1995) calls ‘market missionaries’, including the International Monetary Fund and World Bank, have imposed through structural adjustment programmes, neo-liberal remedies on this region. This paper therefore, evaluates critically the validity of such an approach for tackling the informalisation of employment in Central and Eastern Europe.

## **Cross-national variations in informal employment in Central and Eastern Europe**

### **Methodology**

#### Data

Most previous studies of informal employment in CEE nations are small-scale surveys of particular nations, population groups and/or types of informality (e.g., Centre for the Study of Democracy 2008; Ghinararu 2007; Loukanova and Bezlov 2007; Williams et al., 2013).

These however, cannot be aggregated together to analyse the varying prevalence of informal employment cross-nationally because they are not representative surveys and use varying definitions and measurement methods so the findings are not comparable.

Cross-national comparative measures of the prevalence of informal employment in CEE are of two kinds: indirect measures of its prevalence that use proxy indicators and/or statistical traces of such work found in data collected for other purposes (GHK and Fondazione Brodolini 2009; Ram and Williams 2008), and surveys that directly interview people about their participation in informal employment (European Commission 2007). Here, the latter is employed. Although advocates of indirect methods sometimes assert that interview methods underestimate the extent of informal employment because participants conceal their informal work, those who have conducted such surveys find that although participants hide this work from the authorities, they do not hide it from researchers and openly discuss this matter with them (MacDonald 1994; Pahl 1984).

In 2005, recognising the lack of cross-national comparative data on the informalisation of employment relations, the European Commission funded the design of a survey. This paper's author was part of the team employed to design the survey. The resultant survey was then implemented as Special Eurobarometer No. 284, conducted as part of wave 67.3 of the 2007 Eurobarometer survey (European Commission 2007). Here, the findings of this survey in ten CEE countries are reported, namely Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia, Slovakia and Romania. In total, face-to-face interviews were conducted with 5,769 participants in these 10 countries ranging from some 500 interviews in smaller nations to 1,500+ interviews in larger countries conducted in a manner that provides a representative sample of the population in each country. In each country, the standard multi-stage random (probability) sampling method was used as in other Eurobarometer surveys (see European Commission 2007).

## Methods

To gather evidence, a face-to-face structured interview schedule was used which adopted a gradual approach to the more sensitive research questions. Participants were firstly asked for their opinions and attitudes regarding informal employment and having established some rapport, questions were asked regarding their purchase of goods and services on an undeclared basis in the last 12 months, whether they received envelope wage payments, and finally, about their participation in wholly undeclared work.

Given how advocates of indirect methods often argue that participants hide their informal work from interviewers, it is here useful to briefly mention the validity of this survey method. The finding is that in 88 per cent of the interviews conducted, the interviewers reported good or excellent cooperation from the participant. Cooperation was asserted to be bad in only 2 per cent of cases.

## Measures

To measure the prevalence of informal employment in these CEE countries, firstly, the number of the full sample of 5,769 participants who had undertaken wholly undeclared employment in the last 12 months was surveyed and secondly, the 2,355 participants who were in formal employment were asked about whether they had received envelope wages from their formal employer in the last 12 months. Here, those who had participated in wholly undeclared work in the form of one-off jobs conducted for kin, friends, neighbours and acquaintances for reasons related to redistributing money or help to somebody in need are excluded from the analysis since such 'paid favours' are more akin to unpaid community exchange than formal employment in terms of the social relations and motives involved. However, all other forms of wholly undeclared employment are included from permanent full-time informal jobs conducted either as an employee or on a self-employed basis, through to all part-time, temporary or short-term work regardless of its duration, just as is the case when analysing the findings regarding participation in formal employment. The outcome of identifying the number of participants in formal employment, the number of these who were paid envelope wages and the number holding wholly undeclared jobs, was that the proportion of all jobs that are informal was calculated.

To identify participants conducting undeclared work and receiving envelope wages, explicit definitions were used. Undeclared work was described as 'activities which were not or not fully reported to the tax or social security authorities and where the person who acquired the good or service was aware of this', whilst envelope wages were described as being when 'employers prefer to pay all or part of the regular salary or the remuneration for extra work or overtime hours cash-in-hand and without declaring it to tax or social security authorities' (European Commission 2007). Although this reduces the likelihood of participants reporting other economic practices such as criminal activities, it is worth noting

that blurred edges remain and there will be variation both across individuals and countries in whether an activity and what activity is reported as informal, not least due to national variations in legislation regarding what is informal and what is not (see, for example, Portet 2005).

To generate statistical indicators and data on the characteristics each theorisation suggests has an influence on the prevalence of informal employment, official data sources of the European Commission have been used and data collated for 2007, the same year as the Eurobarometer survey of informal employment (European Commission 2011, Eurostat 2007, 2010, 2013a,b,c). The only indicator and data taken from a non-official source is on perceptions of public sector corruption, extracted from Transparency International's corruption perceptions index for 2007 (Transparency International 2013).

To evaluate the modernisation thesis, three indicators are employed that have previously been used (ILO 2012; Yamada 1996), namely:

- GDP per capita (European Commission 2011, Table 3). and
- purchasing power standards (PPS) (Eurostat, 2013a)
- Human Development Index (HDI) - this is a composite of life expectancy, education, and income indices intended to shift the focus of development from national income accounting to people-centred policies (United Nations Development Programme, 2014).

To evaluate the neo-liberal thesis that the prevalence of informal employment is a result of high taxes, corruption and state interference in the free market, meanwhile, indicators are analysed previously used by Eurofound (2013) and the European Commission (2013) when evaluating the assumptions of neo-liberal thought:

- the implicit tax rates (ITR) on labour, which is a summary measure of the average effective tax burden on the income of employed labour. This is the sum of all direct and

indirect taxes and employees' and employers' social contributions levied on employed labour income divided by the total compensation of employees (Eurostat 2010);

- total tax revenue (excluding social contributions) as a percentage of GDP. Total tax revenue here includes: all taxes on production and imports (e.g., taxes enterprises incur such as for professional licenses, taxes on land and building and payroll taxes), all current taxes on income and wealth (including both direct and indirect taxes) and all capital taxes (Eurostat, 2007), and
- Transparency International's 2007 Corruption Perceptions Index (CPI) is used (Transparency International 2013). This is a composite index of perceptions of public sector corruption that draws on 14 expert opinion surveys and scores nations on a 0-10 scale, with zero indicating high levels and 10 low levels of perceived public sector corruption.

To analyse both the neo-liberal thesis that state interference leads to greater levels of informal employment, as well as the political economy thesis that informalisation is a direct by-product of a deregulatory regime and inadequate levels of state intervention, five indicators are analysed previously used by the European Commission (2013) and Eurofound (2013) when evaluating the assumptions of neo-liberal and political economy thought:

- levels of state social protection expenditure (excluding old age benefits) as a proportion of GDP;
- the percentage of the total population at risk of poverty, defined here as persons with an equivalised disposable income below the risk-of-poverty threshold, which is set at 60 per cent of the national median equivalised disposable income, after social transfers (Eurostat 2013b);
- the effectiveness of state redistribution via social transfers. Here, the poverty level is again defined as the proportion of the population with an income below 60 percent of the

national median income, and then the reduction in percentage points of poverty after social transfers is calculated to determine the effectiveness of state redistribution (European Commission 2011, Table 3);

- the inequalities in the distribution of income (Eurostat 2013c), measured by evaluating the ratio of total income (by which is meant equivalised disposable income) received by the 20 per cent of the population with the highest income (top quintile) to that received by the 20 per cent of the population with the lowest income (lowest quintile), and
- the level of equality in a society, as measured by the gini-coefficient (European Commission 2011).

### Analysis

To analyse the relationship between the informalisation of employment and the various characteristics of work and welfare regimes which these competing theorisations deem influential, and given the small sample size of just 10 countries and lack of necessary controls to include in a multivariate regression analysis, it is only possible here to conduct bivariate regression analyses of the relationship between the informalisation of employment and different individual characteristics of the wider regulatory environment. To do this, Spearman's rank correlation coefficient ( $r_s$ ) is used due to the non-parametric nature of the data. Nevertheless, and as will be shown, despite being limited to bivariate regression analysis, some meaningful findings are produced regarding the validity of the different theoretical perspectives.

### Findings

Across the ten CEE countries surveyed, 20.1 per cent of all reported employment conducted during the 12 months prior to the survey was informal employment in that some or all of the remunerated activity was not declared to the state for tax, social security and labour law

purposes when it should have been, but the activity is legal in all other respects (see Figure 1). There are, however, variations in the prevalence of informal employment across this region ranging from the Czech Republic and Slovenia (where 7 per cent and 8.2 per cent of employment is informal respectively) to Romania where 35.7 per cent of all reported employment is informal employment.

INSERT FIGURE 1 ABOUT HERE

How, therefore, can these cross-national variations in the informalisation of employment be explained? Firstly, and to evaluate the modernisation thesis that ‘developed’ wealthier economies have lower levels of informalisation and ‘less developed’ economies higher levels of informalisation, the relationship between the prevalence of informal employment and the level of development across these CEE countries in 2007 is analysed (see Table A1). A strong significant relationship is identified between the extent of informal employment and the levels of GDP per capita at the 0.01 level ( $r_s = -.879^{**}$ ). Countries with higher levels of GDP per capita have more formalised employment relations systems. This is similarly the case when purchasing power standards (PPS) is investigated, which unlike GDP per capita, takes into account the differences in the cost of living between countries. Again, there is a strong correlation between the prevalence of informal employment and the level of PPS at the 0.01 level ( $r_s = -.915^{**}$ ). This is also the case when a wider definition of ‘development’ is taken in the form of the Human Development Index (HDI). A strong correlation is identified between the prevalence of informal employment and the HDI ( $r_s = -.867^{**}$ ). Informalisation is lower in more developed countries. Indeed, previous studies reveal that this relationship remains valid when extrapolated beyond these CEE countries (ILO, 2012; Yamada, 1996). Akin to this study however, the directionality of the correlation in terms of a cause-effect

relationship cannot be established. This, therefore, is a limitation of both the current and previous studies.

Turning to the neo-liberal thesis, the correlation between the prevalence of informal employment and high taxes, corruption and state interference needs to be analysed. Examining the tax rates tenet, the first finding is that there is a strong statistically significant correlation between the implicit tax rate (ITR) on labour and the prevalence of informal employment across countries ( $r_s = -.855^{**}$ ), but not in the direction assumed by neo-liberal theory. Instead, the higher is the average effective tax burden on employed labour, the less prevalent is informal employment. Moreover, taking another measure of tax rates, namely total tax revenue (excluding social contributions) as a percentage of GDP, no relationship is identified with informal employment ( $r_s = .091$ ). Contrary to neo-liberal discourse therefore, no evidence is found that the prevalence of informal employment is greater in nations with higher tax rates.

Turning to the neo-liberal assertion that informal employment is more prevalent where there is greater public sector corruption since this leads citizens to exit the formal economy in order to pursue means of livelihood beyond the reach of a corrupt public sector, a strong correlation is found between the level of public sector corruption and the degree of informalisation ( $r_s = -.815^{**}$ ); the higher is the perceived level of public sector corruption, the greater is the prevalence of informal employment.

Is it also the case, therefore, that higher levels of state interference in the free market leads to higher levels of informalisation, as neo-liberals suggest? Or is it the case, as political economists assert, that the prevalence of informal employment reduces with greater intervention in work and welfare regimes?

Examining the correlation between the prevalence of informal employment and the levels of state social protection expenditure (excluding old age benefits) as a proportion of



GDP, a strong statistically significant correlation is identified; the greater the level of social protection expenditure, the lower is the level of informalisation ( $r_s = -.790^{**}$ ). This therefore supports the political economy rather than neo-liberal explanation. In regulatory environments in which there is greater social protection of citizens, informal employment is less prevalent.

Is there also a relationship between state intervention to reduce the proportion of the population at risk of poverty, using social transfers, and the prevalence of informal employment? Examining the relationship between the prevalence of informal employment cross-nationally and the percentage of the total population at risk of poverty, a strong correlation is identified ( $r_s = .915^{**}$ ). The higher the proportion of the population at risk of poverty, the higher is the prevalence of informal employment.

However, is the level of informal employment lower in countries in which there is greater state intervention to reduce the proportion of the population at risk of poverty using social transfers? The finding is a strong statistically significant correlation: the more effective is state redistribution via social transfers in reducing poverty, the lower is the prevalence of informal employment ( $r_s = -0.782^{**}$ ). This further supports the political economy explanation that greater state intervention reduces the prevalence of informal employment.

Indeed, analysing the inequalities in the distribution of income (Eurostat 2013c), a strong correlation is identified with the prevalence of informal employment ( $r_s = .906^{**}$ ). The more equal is the society in terms of the distribution of income, the lower is the prevalence of informal employment. This is reinforced when the correlation between the gini-coefficient (European Commission 2011) is analysed. There is a strong correlation; the more equal the society the lower is the prevalence of informal employment ( $r_s = .766^{**}$ ).

In sum, these bivariate regression analyses reveal that in wealthier and more equal CEE societies, CEE countries with less public sector corruption, with higher levels of

taxation, social protection and more effective redistribution via social transfers, are significantly correlated with a lower prevalence of informal employment. Indeed, this perhaps explains the higher prevalence of informal employment in Romania, Latvia and Bulgaria which are generally less wealthy and less equal societies with higher rates of public sector corruption and lower levels of taxation, social protection and state redistribution via social transfers compared with countries such as the Czech Republic, Slovenia and Slovakia.

### **Discussion and conclusions**

This paper has sought to better understand the cross-national variations in the informalisation of employment by evaluating critically three competing explanations: the ‘modernisation’ thesis which simply purports that the informal economy decreases as economies develop; the ‘neo-liberal’ thesis that informalisation is a direct result of high taxes, corruption and state interference in the free market and the ‘political economy’ thesis that informalisation is the outcome of deregulation that results in inadequate levels of state intervention to protect citizens. Examining their validity when explaining cross-national variations in the prevalence of informal employment in Central and Eastern Europe, the finding is that wealthier nations, less corrupt states and more equal societies, and those possessing higher levels of taxation, social protection and effective redistribution via social transfers, have lower levels of informalisation. This, as will now be discussed, has both theoretical and policy implications.

In theoretical terms, the neo-liberal thesis (H2) is negatively confirmed.

Informalisation is not a product of high taxes and too much state interference. Instead, quite the opposite is found. Positively confirming the political economy thesis (H3), the prevalence of informal employment appears to be a direct by-product of under-regulation and it is in nations where there are higher levels of taxation, social protection and effective redistribution via social transfers that the prevalence of informal employment is lower. However, and as the

modernisation thesis (H1) asserts, wealthier economies measured in terms of GDP per capita and more developed economies measured using the Human Development Index, have lower levels of informalisation, as do nations in which perceptions are that public sector corruption is lower, as the neo-liberal thesis intimates. The tentative conclusion, therefore, is that the tenets of the political economy thesis are valid but there is a need to incorporate the mainly neo-liberal notion regarding public sector corruption and the modernisation thesis that wealthier more developed societies have lower levels of informalisation. If these facets are integrated into the political economy perspective, it becomes apparent that the prevalence of informal employment is closely tied to the extent to which economies have undergone a modernisation of work and welfare arrangements along the lines of the European social model (European Commission 2011). In other words, wealthier more equal societies, those with less public sector corruption and those pursuing higher tax rates, greater levels of social protection and more effective redistribution via social transfers, have lower levels of informal employment. What is now required is to evaluate whether this holds both when a wider range of nations and other global regions are evaluated as well as when time-series data is analysed for individual countries.

These findings have clear practical policy implications. Over the past two decades, the policy debate has involved evaluating whether targeted repressive measures and/or targeted incentives are the most effective means for moving employment into the formal economy (Dibben and Williams 2012; Eurofound 2013; Feld and Larsen 2012; OECD 2012; Williams and Lansky 2013; Williams and Nadin 2012; Williams et al. 2012). This paper, in stark contrast, strongly intimates that broader economic and social policy measures are important. The pursuit of lower taxes and deregulation, as advocated by neo-liberals, is not associated with reductions in informal employment. Instead, reducing informality is found to be associated with reducing public sector corruption, higher taxation, higher expenditure on

social protection, effective redistribution via social transfers and more equal societies. As such, it shows that broader policies associated with the wider modernisation of work and welfare arrangements are important.

Again, whether the same finding emerges regarding the changes required when a wider range of countries and global regions are investigated, as well as whether it remains valid when time-series data is investigated for individual countries, requires further research. If a wider range of nations are analysed using for instance the International Labour Organisation's database (ILO 2012), then multivariate regression analysis could also be used to correlate how important each characteristic is to the final outcome whilst controlling for other characteristics. This would overcome a major limitation of the current paper based on an analysis of just 10 nations. It would also help overcome the problems of reverse causality that apply to the correlations identified in this paper and also the fact that there may be third confounding variables influencing the correlations identified. Such further research is thus required to exclude these issues of confounders and reverse causality.

In sum, this paper has revealed the strong correlation between reducing the prevalence of informal employment and the modernisation of work and welfare arrangements. What is now required is for this to be applied longitudinally within countries as well as to a broader range of countries and global regions, using more refined multivariate regression analysis, so as to evaluate whether the relationships hold as well as which characteristics are most significantly correlated with lower levels of informalisation. If this paper stimulates such further research and also recognition and investigation of the broader policy changes required in work and welfare arrangements to reduce informal employment, then it will have achieved its objective.

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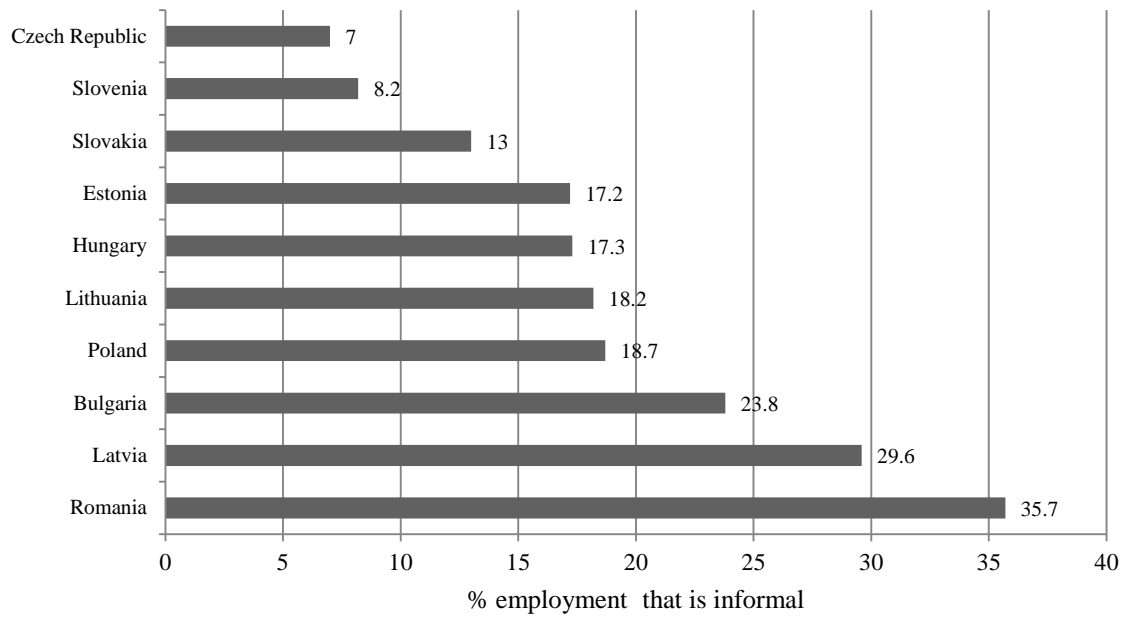
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Figure 1 Prevalence of informal employment in East-Central Europe:  
% of employment that is informal



## APPENDIX

Table A1 Informalisation of employment and broader measures of economic and social development: by country

Country	% of employment that is informal	GDP per capita	GDP per capita in PPS	Human Development Index	Implicit tax rate on labour	Total tax revenue (exc. Social contributions), as % of GDP	Corruption Perceptions Index	Social protection benefits (exc. Old age), % of GDP	% of popn at risk of poverty	Impact of state redistribution via social transfers	Income distribution inequality	Gini-coefficient
Czech Republic	7.0	13100	80	0.856	39.2	19.9	5.2	10.6	15.8	52.0	3.5	25.1
Slovenia	8.2	17300	88	0.871	35.9	23.3	6.6	12.9	22.3	48.6	3.3	22.7
Slovakia	13.0	11600	68	0.824	33.1	17.2	4.9	9.7	21.3	35.7	3.5	24.8
Estonia	17.2	10300	69	0.832	33.7	20.4	6.5	8.6	22.0	23.9	5.5	31.4
Hungary	17.3	9300	62	0.814	42.1	26.6	5.3	13.5	29.4	57.1	3.7	24.7
Lithuania	18.2	7900	59	0.827	32.7	21.3	4.8	9.3	28.7	39.9	5.9	35.5
Poland	18.7	8100	54	0.817	32.6	23.0	4.2	9.3	34.4	27.5	5.3	31.4
Bulgaria	23.8	4600	40	0.766	27.4	25.2	4.1	8.2	60.7	17.4	7.0	33.4
Latvia	29.6	8200	56	0.813	28.5	20.7	4.8	7.0	36.0	15.2	6.3	37.4
Romania	35.7	5500	42	0.781	27.3	18.7	3.7	7.6	45.9	23.0	7.8	34.9