

# Informal Employment and Labor Market Segmentation in Ukraine

Formal employment is by far the most favored destination for workers

Hartmut Lehmann, Norberto Pignatti

Ukraine has found itself in a prolonged transition recession for most of the 1990s. Reform efforts have been inconsistent and incoherent, making Ukraine one of the "laggards" among the transition countries. Only towards the end of the period did reform efforts by the government lead to positive growth of GDP.

Using the Ukrainian Longitudinal Monitoring Survey (ULMS), a nationally representative survey of the Ukrainian working age population, we investigate to what extent the informal sector plays a role in labor market adjustment in a transition economy. We define informal employment or informal economic activity of the self-employed as employees without a formal contract and self-employed activity that is not registered. Workers in formal employment relations are treated as formally employed salaried workers, even if they might receive part of their wages in an informal fashion, as undeclared "envelope payments".

From the data, we observe that the employment structure has significantly changed between 1991 and 2004 (see Table). The agricultural and industrial sectors lost employment shares (even if agricultural employment was still relatively large compared to many transition economies) while the services sector grew. However, the "laggard" status of the Ukrainian economy is clearly reflected in the low share of employment in privatized and new private firms. For com-

parison, in Central European countries, by 1997, the average employment share in the private sector was 65%. Very striking is also the low share — in international perspective — of the self-employed: 4% compared with 13% in both the Czech Republic and Hungary, 16% in Poland and 6% in Russia.

While in a centrally planned economy much of production took place in large conglomerates, the employment share of workers in relatively small firms was accelerating in Ukraine between 1997 and 2004. By 2004, nearly half the workforce was employed in firms with less than 50 employees.

## A Segmented Labor Market

According to conventional wisdom growth in an economy translates into the expansion above all of formal employment relations. However, the strong growth of the Ukrainian economy between 2003 and 2004, which brought with it a substantial fall in the unemployment rate, did not result in an expansion of formal employment. Instead, the fall in unemployment was entirely driven by growing informal employment relations.

The analysis undertaken with the help of transition matrices, however, points to the existence of a segmented labor market in Ukraine. Our findings indicate that most workers try to enter

formal employment and seem to use unemployment as well as informal dependent employment as waiting stages for entry into formal dependent employment. The flow analysis also demonstrates that at all ages workers line up for dependent formal employment, which is by far the most favored destination. At the same time, some workers are forced to take up informal salaried jobs, while a minority engage in informal jobs of their free will.

Our wage analysis further confirms labor market segmentation. In particular, our analysis points to a segmented labor market for dependent workers. This segmentation includes formal jobs, "upper tier" informal jobs that are well remunerated but have restricted access, and a majority of informal jobs that workers are forced to take up but bring no gain when workers move into them. Whenever possible, workers move from these latter jobs to formal employment relations.

There is less segmentation in urban self-employment, as returns to both formal and informal self-employment are of the same magnitude. The difference-in-differences analysis that compares earnings outcomes of stayers and movers also confirms our contention that informal self-employment in urban areas is voluntary since movement into this type of employment is associated with large gains in earnings. In rural areas, informal self-employment is above all linked to subsistence agriculture with the extremely low returns inherent in this type of economic activity.

### Employment Changes by Sector, Ownership and Size, 1991–2004

	Sector (% share)*			Ownership (% share)**			Size (% share)	
	Agri-culture	Industry	Services	Privat-ized	New Private	Non-Agricultural Self-Employed	Firms with over 100 employees	Firms with less than 50 employees
<b>1991</b>	15.98	32.01	47.21	1.59	1.26	0.33	33.77	23.54
<b>1997</b>	16.30	26.21	52.89	11.73	8.33	2.02	41.36	30.13
<b>2004</b>	13.59	23.07	59.18	19.59	20.09	4.36	53.98	43.52

Notes: \* Excluding public administration share. \*\* Including public administration employees.  
Source: ULMS.

Hartmut Lehmann is a Professor of Economic Policy at the University of Bologna and Program Director of the IZA research area "Labor Markets in Emerging and Transition Countries". Norberto Pignatti is a Research Fellow at the Department of Economic Sciences of the University of Bologna. The study can be accessed at <http://ftp.iza.org/dp3269.pdf> (IZA Discussion Paper No. 3269). **BT**