

Informal Employment in Bosnia and Herzegovina

Highly educated people, stuck in low-skill informal jobs, run the risk that their skills will be eroded

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According to IMF estimates, real GDP in Bosnia and Herzegovina (BH) trebled over the period 1996-2004. However, there is still great uncertainty about the size of the Bosnian economy, GDP growth, unemployment, etc. as official statistics fail to take account of informal activities, which are generally believed to be widespread throughout the country.

We study the degree of flexibility in the labor market and the role of formal versus informal activities for reducing poverty and inequality and enhancing life satisfaction in BH. Our analysis is based on panel data from the Livings Standards Measurement Studies taken between 2001 and 2004.

Perhaps the most remarkable observation from the data is the dramatic increase, by nearly ten percentage points, in the labor force participation rate between 2001 and 2004. The data also show how significant the informal sector remains — representing nearly 43% of total employment in 2004, although its size as a percentage of total employment has fallen between 2001 and 2004. Compared to the formal sector, monthly earnings in the informal sector are on average about 30% lower.

Mobility is Surprisingly High

We find that the degree of movement, even in one year, from one category of the labor force to another is surprisingly high when compared to other transition countries. The informal sector is a significant source of labor mobility, providing more job opportunities for the unemployed and inactive but also having more job destruction than the formal sector. For example, almost two-thirds of those who lost or left a job between the two surveys had a job in the informal sector in 2001.

More educated people are the most likely to move from informal to formal employment. For instance, workers who completed college (in 2001) were 30% more likely to move from informal to formal employment, relative to those with secondary education. Across sec-

tors, workers in the service sector were most likely to move from informal to formal employment; and those in agriculture least likely.

Formal Employment is Better at Reducing Poverty

Our findings indicate that informal employment helps to reduce poverty but by much less than formal employment. Transitions to formal employment were associated with a higher probability of escaping poverty relative to staying in informal employment. More than 65% of workers who moved out of poverty between 2001 and 2004 remained or became employed in the formal sector. Informal workers were less likely to escape poverty over this period relative to formal workers and saw lower consumption increases than formal workers. In fact, it is the formally self-employed who faced the lowest poverty incidence, suggesting that formal self-employment may be an important route out of poverty.

Those who made the move from informal to formal jobs gained significantly in terms of increase in earnings, with average monthly earnings for this group rising by 26% (in nominal terms) over a three-year period.

Higher Inequality

Using various inequality measures we establish that, firstly, earnings in formal employment were higher than in informal employment in 2001 and 2004, and the ratio between the two increased slightly over that time. Secondly, inequality in both sectors declined over time. Thirdly, inequality was higher in both periods in the informal sector relative to the formal sector, possibly due to the relatively high minimum wage, which is enforced in the formal but not in the informal sector.

The Least Happy

Looking at how subjective estimates of well-being are correlated with differ-

ent labor market positions in 2004, we find that workers in formal employment showed higher levels of satisfaction than informal employees. The formal self-employed reported the highest levels of satisfaction. With the sole exception of the unemployed, informal employees were the least happy among the working-age population, even when controlling for differences in income.

Conclusions

Should we care about the large size of the informal sector, and if so, what can be done about it? Even though the informal sector represents an important safety net for many individuals and families, there are good reasons for the authorities in BH to try to bring these people into the formal economy. The main reason is that informal economic activities often act as unfair competition for those who play by the rules, and they also represent a loss of tax revenues to the state, implying a higher burden for others. An additional benefit of bringing people into formal employment is that this may lead to an improvement in the accuracy of BH's (up to now) notoriously unreliable real economy data.

Our results on self-employment suggest the need for further efforts to promote entrepreneurship and the creation of micro-enterprises. Many highly educated people are stuck in low-skill informal jobs and run the risk that their skills will be eroded over time and therefore options to move to better-quality jobs in the formal sector will be reduced. A much better option for some is to open their own businesses.

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