

# Growth and Informality: The Case of Bangladesh

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Are workers “locked” into informal employment?

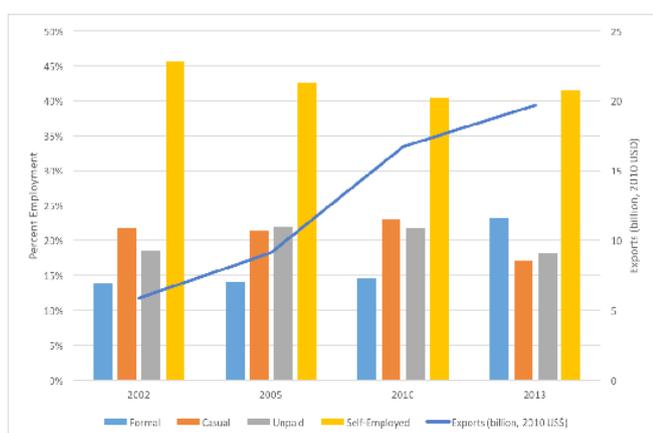
What aspects of formal jobs do workers value?

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## Topic at a Glance

The informal sector accounts for the majority of employment in many developing countries, yet its role in the process of economic growth, and its links with the formal sector, remain poorly understood. Looking at informality across countries suggests that as countries become richer, the share of informal employment falls. However, in recent years, a number of developing countries have experienced substantial growth with little change in the share of informal employment.

We examined the relationship between growth and informality in Bangladesh, with a view to shedding light on the nature of the informal sector, on whether workers tend to be “locked” into informality or can transition between different types of work, and on what aspects of formality workers value.



*Caption:* This figure shows the rapid growth in exports from Bangladesh between 2002 and 2013, as well as the shares of formal, casual, unpaid and self-employment. Sources: UN Comtrade and Bangladesh LFS.

## New Insights

Export-led growth not only increases formal employment but also increases various types of informal employment.

Despite rapid growth in exports, the share of formal employment in Bangladesh has remained stubbornly low. We examine the effects of export-induced demand on four types of employment: formal, casual, unpaid, and self-employment. At an aggregate level, export-induced demand increases the levels of all four types of employment. Turning to a district-level analysis, we construct a measure of trade exposure that relies on national, industry-level variation in exports, coupled with pre-existing, district-level shares of employment by industry. We find that the direct impact of trade is to increase labor force participation and formal employment. When we consider both the direct and indirect impacts of trade, including induced demand in other industries through supply chain linkages, we find a larger impact on labor force participation than the direct effects alone suggest. The results also show that trade triggers an immediate increase in both formal and casual employment, as well as a longer-run increase in self-employment.

A substantial share of informal, self-employment in Bangladesh appears to be voluntary.

We conducted a survey of approximately 2,000 workers in the urban and peri-urban areas of Dhaka and Chittagong. The survey asked workers – including those in regular paid employment, as well as casual employment, self-employment, and in household businesses – about their current jobs, as well as up to two previous jobs they had held over the past 15 years.

Using these job histories, we find that workers in our sample tend to stay in jobs for fairly long periods of time. Workers who do move between jobs often stay in the same type of employment; for example, nearly 60 percent of workers who leave jobs as private employees, take up similar jobs. However, there is a substantial amount of transition between different types of employment. Among workers who leave jobs as private employees, 30 percent move into self-employment, and this includes a number of work-

ers who report voluntarily giving up jobs that included a number of benefits such as contracts and paid leave. An important implication of these findings is that an important share of self-employment is driven by volition and entrepreneurship rather than necessity.

The benefits of formal jobs that workers value most are those related to job stability.

As part of the survey, we used a choice experiment to elicit workers' willingness to pay for specific benefits associated with formal employment. Respondents were presented with two hypothetical job offers, each with different levels of the following attributes: a written contract, termination notice, paid holidays, working hours, a retirement fund (Provident Fund), and monthly income. We asked them to assume that all other attributes were identical between the two jobs, and select which jobs they would prefer if given a choice. The workers were presented with a series of different choices in which the levels of each of these benefits varied, which allowed us to examine their willingness to substitute between these attributes. Examining the tradeoffs between monthly income and other job benefits allowed us to estimate workers' valuation of those benefits in monetary terms.

A key finding from the choice experiment is that workers place a high value on job stability. The average worker would be willing to give up 19 percent of monthly income for a 6-month contract (relative to no contract), 27 percent for 1-year contract and 44 percent for a long-term contract.

## Policy Recommendations

In the short to medium term, a large share of employment in many countries, including Bangladesh, is likely to remain informal in spite of growth. However, there is evidence that for a large share of workers, informality – particularly self-employment – may be a choice rather than a necessity. To the extent policymakers wish to extend the benefits of formal employment to informal workers, but are limited in their ability to do so, the greatest benefits may come from focusing on job attributes that provide stability to the workforce.

## Limitations

A limitation of this research is that the valuation of benefits is based on workers' responses regarding hypothetical job offers. This type of stated preference method is subject to the usual concern that individuals may not actually act as they claim they would. However, it offers the key benefit of allowing informal workers to express preferences about benefits that they would rarely be offered, and thus could not be measured through standard revealed preference methods.

A related limitation is that the findings on worker transitions are

based on workers' recollections of their previous three jobs. To the extent workers do not accurately recall the types of jobs they have held, the benefits available for each job, or the reasons they left or took up jobs, the findings may be biased.

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