



City Research Online

City St George's, University of London

Citation: Acosta, P. & Montes-Rojas, G. (2014). Informal Jobs and Trade Liberalisation in Argentina. *Journal of Development Studies*, 50(8), pp. 1104-1118. doi: 10.1080/00220388.2014.919381

This is the unspecified version of the paper.

This version of the publication may differ from the final published version. To cite this item please consult the publisher's version.

Permanent repository link: <https://city-ref-test.eprints-hosting.org/id/eprint/3859/>

Link to published version: <https://doi.org/10.1080/00220388.2014.919381>

Copyright and Reuse: Copyright and Moral Rights remain with the author(s) and/or copyright holders. Copies of full items can be used for personal research or study, educational, or not-for-profit purposes without prior permission or charge, unless otherwise indicated, provided that the authors, title and full bibliographic details are credited, a hyperlink and/or URL is given for the original metadata page and the content is not changed in any way. For full details of reuse please refer to [City Research Online policy](#).

Informal Jobs and Trade Liberalisation in Argentina

Abstract

Rapid trade liberalisation can exert profound effects on labour markets. Domestic firms, to sustain competitiveness for survival, could react through cutting labour benefits to achieve cost reductions. Alternatively, trade liberalisation may alter the industry composition of firms changing the aggregate formality rates. This paper studies the relationship between trade liberalisation and informality in Argentina. Using manufacturing industry-level data for 1992-2003, the results confirm the hypothesis that trade increases informality in industries that experience sudden foreign competition. This explains about a third of the increase in informality. Sectors with higher investment ratios are able to neutralize and reverse this effect.

JEL classification: J31, F16, 033

Keywords: informality; trade liberalisation; Argentina

I. Introduction

Informal activity is a common feature in developing countries. Informality refers to the lack of compliance with taxation and regulation by employers, and the lack of protection and services that the government can provide to workers. Informality is a complex phenomenon: in the Harris and Todaro's (1970) view, the informal self-employment sector is a "parking lot" where aspirants to formal salaried employment bid time; however, recent evidence challenge this view and instead suggests that workers and firms may voluntarily choose to have "informal" contracts to avoid unwanted or undervalued benefits (Maloney, 1999, 2004).

Recent works studied the main determinants of labour informality, highlighting government interventions as playing a major role, through taxation and labour market regulations (Johnson, Kaufmann & Zoido-Lobaton, 1998; Friedman, Johnson, Kaufmann & Zoido-Lobaton, 2000; Fugazza & Jacques, 2004), or bureaucracy and corruption (Busato & Chiarini, 2004; Choi & Thum, 2005; Dabla-Norris, Gradstein & Inchauste, 2008), among other institutional and enforcement conditions. Income inequality has also been signalled as an important driver of informality (Chong & Gradstein, 2007). Other studies have argued that firms' heterogeneity and limited access to credit and capital markets are more relevant to explain the emergence of informal activities (Dessy & Pallage, 2003; Gordon & Li, 2005; Amaral & Quintin, 2006; Antunes & Cavalcanti, 2007).

Rapid trade liberalisation can exert profound effects on labour markets. Aside from the abundantly documented effects on employment levels and compensations, this paper looks at another potential determinant of labour informality: trade liberalisation in economies which are relatively closed to foreign competition in goods and services. Evidence for developing countries on the potential effect of trade exposure on the size of the informal sector is scant, and therefore,

empirical results on this issue are important. At a cross-country level and using alternative definitions and data sources for informal labour, Fiess and Fugazza (2008) do not find any conclusive association with trade liberalisation. Currie and Harrison (1997) find a positive relationship between trade liberalisation and informal jobs in Morocco. In Latin America, Goldberg and Pavcnik (2003) show results from Brazil and Colombia, finding no effect in Brazil, but a positive relationship in Colombia during the period preceding a major labour market reform. Bosch, Goñi-Pacchioni and Maloney (2012) do not find either a significant effect of trade reforms in the rise in informality for Brazil in the eighties and nineties, with rise in firing costs and union power being more important drivers. Finally, Aleman-Castilla (2006) finds that Mexican import tariffs are significantly related to reductions in the likelihood of informality in the tradable industries, but informality decreases less in industries with higher levels of import penetration, and more in industries that are relatively more export oriented.

This paper presents additional evidence on the relationship between trade liberalisation and informality in developing countries, using industry-level data for Argentina. Argentina is the Latin American country for which the speed and depth of economic reforms were among the largest in the region (Behrman, Birsdall & Szekely, 2007). Its government started in the early 1990s a program that included a massive privatisation, deregulation, as well as trade and financial liberalisation. However, the intensity of this process was not uniform across economic sectors, which allows an identification strategy by taking advantage of the variability in time and extent of trade exposure and tariff regimes across industries in Argentina's manufacturing sector.

The results in this paper suggest that informality has significantly increased in manufacturing Argentinean sectors in which trade liberalisation has been more intense, explaining around a third of the increase in informality between 1993 and 2003. Given that trade liberalisation had a

significant effect on reducing the cost of acquiring new technology, we also find that sectors with higher investment ratios were able to neutralize and reverse this effect. These results hold after controlling for other sector characteristics, such as the export/import orientation of the sector, size, and industry- and time-specific fixed-effects, as well as general macroeconomic shocks.

The paper is organized as follows. Section II discusses the effect of trade on formality. Section III presents recent trade exposure and informality trends in Argentina. Section IV shows results at the industry level of the link between trade liberalisation and industry informality differential. The paper concludes with some brief comments and interpretation of the results in section V.

II. Informality and Trade

The effect of trade on formality can be decomposed into a within-industry effect, which corresponds to the response of the firms in a given industry with respect to their workers' formality, and between-industry effect, in which workers move to other industries with more or less formality.

Regarding the between-industry effect, formal firms may respond to the intensified competition from abroad by laying off workers who subsequently seek employment in the informal sector. Depending on their qualifications, workers have different degree of between-industry mobility.

Regarding the within-industry effect, in developing countries, low enforcement of labour market regulations determines that firms have greater flexibility to adjust to trade exposure by self-selecting into different degrees of formality. Goldberg and Pavcnik (2003) argue that trade exposure increases pressure on firms "to try to reduce labour costs by cutting worker benefits,

replacing permanent workers with part-time labour, or subcontracting with establishments in the informal sector, including home-based and self-employed microentrepreneurs” (p. 464). In a similar vein, Revenga (1997) and Galiani and Porto (2010) argue that trade protection produce rents that are partially absorbed by workers in the form of wage premiums, namely unskilled unionized workers, and that the removal of those rents can affect their wages negatively and presumably reduce their job benefits.

There is also theoretical ground for the opposite effect, that is, trade liberalisation may increase formality via a composition effect. Trade models predict that trade exposure have a significant effect in the industry composition. Melitz (2003) argues that trade exposure induces more productive firms to enter, less productive firms to reallocate towards the domestic market and, simultaneously, force the least productive firms to exit. Thus, Aleman-Castilla (2006) suggests that import tariff elimination could increase job quality by making more profitable to some firms to enter the formal sector, forcing the less productive firms to exit the industry, and inducing the most productive ones to engage in foreign trade.

Acosta and Gasparini (2007) argue that trade liberalisation also reduces the cost of acquiring new technology through the reduction in the cost of imported capital goods. Using an efficiency wage argument, if firms can upgrade to a better technology, they may be able to offer better job conditions to its labour force in order to maintain the best workers, thus increasing formality.

Between-industry analysis requires a longitudinal labour database that follows individuals for subsequent waves. Unfortunately, Argentina’s household survey is a pooled cross-section and not a panel. Thus, this paper only studies the within-industry effects by analyzing the industry trends and by establishing potential causality with trade. We focus on the manufacturing sector, where

we can focus on the direct within-industry effect of trade, in order to test for direction of the within effect. We evaluate the effect of trade using the empirical model of Goldberg and Pavcnik (2003) described in detail in Section IV.a. This model is extended to evaluate the potential effect of reducing the cost of acquiring capital goods developed in Acosta and Gasparini (2007).

III. Trade Liberalisation and Informality Trends in Argentina

Argentina was a country relatively closed to international trade since the end of the Second World War until the 1990s. This period was characterized by an import substitution process, conceived for promoting industrialization based in national production. But the country witnessed an important trade liberalisation process during the 1990s, mainly through customs tariff reduction. Reforms included the end of sector-specific subsidies with protectionist goals, and a commercial agreement with neighbour countries (Brazil, Paraguay, and Uruguay, called MERCOSUR). The largest import tariff reductions agreed at the MERCOSUR level were implemented in wood, paper, printing, chemical and petrochemical, machinery, and electrical/electronic equipment. Average ad valorem manufacturing import tariffs declined from an average of 21 per cent in 1992, to 17 per cent in 1995, and 14 per cent in 2003 (Figure 1). As a result, trade openness (as measured by imports plus exports as a share GDP) increased from 14 per cent in 1992, to 24 per cent in 1997, and to 39 per cent in 2003.

Contemporaneously with trade liberalisation, the 1990s was a period of economic growth, deindustrialization, and labour market deregulation in Argentina. Macroeconomic stability, an ambitious privatisation program, and reduction of state intervention, resulted in a GDP growth of around 50 per cent during the decade until 2002, when Argentina suffered a severe economic collapse.

¹ Economic growth was not even across sectors: manufacturing industry, as a share of value added, declined from 22 per cent in 1980, to 18 per cent in 1990, and to 15 per cent in 2002.

Although labour costs only decreased slightly in Argentina in the 1990s (Galiani, 2002), there is evidence that government enforcement of labour regulations relaxed during this period (Ronconi, 2010). Informality rates, defined in this paper as “absence of social security and other labour benefits,” increased considerably in the 1990s.² While labour informality in the manufacturing sector was in the order of 17 per cent in 1992, by 2003 this figure was around 30 per cent. Sectors where informality increased the most in this period include food and beverages (34% of workers in the informal sector in 2003), textiles (30%), clothing (52%), and leather and footwear (60%) (Table 1). These are typical “unskilled” sectors in Argentina, with two-third of the workers without a secondary school degree, when on average half of the workers in the manufacturing sector have completed secondary education (Acosta & Montes-Rojas, 2008). These sectors experienced between 1992 and 2003 a tariff protection rate reduction of two to seven percentage points (Figure 2).

Other sectors experienced more drastic reductions in tariff protection: electrical and electronic equipment, machinery and equipment, paper, wood and cork, and publishing and printing. In these sectors, tariffs declined between 9 and 13 percentage points over the period 1992-2003. But informality rates did not increase as much in comparison with other sectors, and as of 2003 less than one-third of the workers in the sector were informal. With the exception of wood and cork, these sectors are relatively “high-skilled”, with more than half of the workers with completed secondary education. Wood and cork, and paper, are also among the sectors that have been exposed to important technological change, through the acquisition of foreign machinery and equipment (Acosta & Gasparini, 2007).

While previous evidence for Argentina has suggested that this trade liberalisation episode had an effect in the labour market through an increase in the relative wages of high-skilled workers with respect to less-skilled counterparts (Galiani & Sanguinetti, 2003; Galiani & Porto, 2010), this paper explores instead a causal link between trade liberalisation and informality, by exploiting variability in tariff reductions across sectors. A priori, simple correlation of tariff reductions and informality surge seems to suggest a link among both episodes (Figure 3). But since manufacturing sectors differ in terms of typical workers' skills, size, as well as the exposure to technological change among other dimensions, it is important to control for observed and unobserved characteristics of sectors to avoid imputing spurious causality effects. The next section presents a two-step methodology to isolate the effect of trade protection from other confounding effects that operate simultaneously with trade liberalisation.

IV. Industry Informality Differentials and Trade Liberalisation

IV.a. Empirical Methodology

This paper follows a two-step methodology originally proposed in Goldberg and Pavcnik (2003), which is the standard methodology in empirical trade and labour market studies.³ In the first stage, industry level informality propensity indicators are estimated using labour and household survey data.

Let Inf_{ijt} be an indicator variable for whether the worker i is informal (see section III.b for a definition of informality) in industry $j = 1, \dots, J$, and time $t = 1, \dots, T$. Arguably, Inf_{ijt} is the result of a bargaining process between the hiring firm, the worker, and (potentially) the Government. The multidimensional nature of informality determines that several factors may affect the probability of being a formal worker. Eventually, this outcome would depend on the observable attributes of

the individual, H_{it} , containing age, age squared, education, gender, and geographic location, unobservable attributes ε_{ijt} , and the industry F_{jt} . A reduced-form relationship will imply:

$$Inf_{ijt} = \sum_{t=1}^T H_{it} \alpha_t + \sum_{j=1}^J F_{jt} \beta_{jt} + \varepsilon_{ijt} \quad (1).$$

The set of coefficients $\{\beta_{jt}\}$ captures the variation in the informal employment that cannot be explained by worker characteristics, but rather is attached to industry affiliation. These coefficients represent the industry-specific propensity to informality, which by construction are orthogonal to individual characteristics.

To evaluate the effect of trade on the industry-specific propensities towards creating informal jobs, a reduced-form specification at the industry level is proposed. Let $Tariff_{jt}$, M_{jt} , and X_{jt} be the average tariff level, imports and exports by industry, respectively, where the latter two are normalized by the gross value of production (GVP) in each industry and year. Each variable has a different interpretation and captures different potential effects of trade. Tariff is a proxy for the actual level of protection; M measures the foreign penetration in a particular industry, that is, it shows the actual effect of competition from abroad in a particular industry; and X measures the industry competitiveness abroad. Note that Tariff and M captures different effects. For instance, there could be an industry with low tariffs but low imports penetration if the country has a clear comparative advantage in this industry vis-à-vis the rest of the world; eventually this may or may not be reflected in X_{jt} . Note that given that we use a fixed-effects specification, we are already controlling for industry-specific comparative advantages.

Moreover, let Y_t be year dummies and F_j industry dummies. The effect of trade on informality can be measured by a regression of the industry-specific informality indicators on tariffs levels, exports, imports and other controls:

$$\beta_{jt} = \text{Tariff}_{jt}\theta + X_{jt-1}\varphi + M_{jt-1}\gamma + \sum_{j=1}^J F_j\eta_j + \sum_{t=1}^T Y_t\mu_t + \xi_{jt} \quad (2).$$

Following this methodology, the coefficients on Tariff, X and M would not be capturing industry differences in worker composition correlated with trade indicators because in order to obtain the industry-specific informality indicators, equation (1) already controlled for workers characteristics. Similarly, as suggested in Pavcnik et al. (2004), because worker characteristics are allowed to differ year by year in the computation of the informality industry indicators, all of the economy-wide changes in the propensity to become informal associated with changes in labour supply over time are already taken into account. Moreover, the time dummies also capture other important effects, such as changes in the real exchange rate and changes in GDP. Note that the joint inclusion of time and industry dummies made the latter redundant. Equation (2) is estimated by fixed-effects least-squares accounting for general forms of heteroscedasticity in the error term using Huber-White standard errors clustered by industry and year.

As argued in Section II, if trade liberalisation also has the effect of reducing the cost of acquiring capital goods, sectors that update their technologies should be able to face foreign competition in better shape. In this case, we expect that sectors that invest the most may have smaller effects in terms of formality. Thus we also consider in some specifications the addition of the ratio of imports of capital goods by sector standardized by GVP.

The exports variable intends to capture how foreign competition affects firms' behaviour, since it may lead them to reduce the burden of non-wage benefits to remain competitive. However, this should not be associated with firms' productivity, which may also be related with informality (less productive firms could only remain in the market by becoming informal). To

explore this productivity channel, the GVP of the industry of reference divided by the number of workers employed (a proxy for labour productivity) is also included.

IV.b. Data

Labour market data to calculate informality rates by sector come from Encuesta Permanente de Hogares (EPH), the only nationally representative household survey of Argentina. For the period 1992–2003, repeated cross-sectional data are available, covering 28 urban areas that account for nearly two-thirds of the total country’s population.⁴ We employed the October round of each household survey. The analysis is restricted to 16 manufacturing sectors, grouped according with survey statistical representation with the ISIC Rev. 3 classification (Table 1 shows the sector classification employed). Workers considered are male and female between 18 and 65 years old with positive earnings. Education is measured as completed years of schooling: workers are classified into those with (i) no high school degree, (ii) at most a high school degree, and (iii) a university degree.⁵

Workers are classified as “informal” if they lack social security (pension and health insurance) and other labour benefits (paid holidays and yearly bonuses). In case the worker receives any of these benefits, he/she is classified as “formal”. Unfortunately, we are not able to identify individuals who become voluntary to avoid changes in the burden of formality, from those who negotiate with their employers to avoid losing their jobs, and from those who lose a formal job and find a new informal one. The interpretation of the results below should then take into account that we are estimating the effect of trade on both voluntary and involuntary informal workers without making this distinction.

Trade data is from the Institute for the Integration of Latin America and the Caribbean's database of the Inter-American Development Bank. Sectors originally classified according to the two-digit International Standard Industrial Classification (ISIC) classification were matched to correspond to the 16 sectors considered. Data on machinery and equipment gross investment by manufacturing sector (at current prices) comes from Centro de Estudios de la Producción, Ministry of Economy. Gross value added (at current prices) by manufacturing sector is available at the National Institute for Statistics and Census.

Finally, the average ad valorem import tariffs by manufacturing sector come from Galiani and Porto (2010). These originally come from official tariff schedules, which specify the tariff rate levied on each item of the Harmonized System (HS). Each heading in the HS is matched with its closest equivalent in the ISIC. Galiani and Porto (2010) explains with additional details this matching process. To aggregate at each industry sector level, the median is taken from the item belonging to each sector.

IV.c. Results

Table 2 shows for a subsample of the years considered (1994, 1997, and 2001) the main results from equation (1) that correlates informality status with individual characteristics, including sector of employment.^{6,7} As expected males, older, and more educated workers have less likelihood to be informally employed. Also married individuals have a lower propensity to work in the informal sector, while being the household head increases it. In terms of sector of employment, the degree of significance varies from year to year, though not the sign of the relationship with informality. Sectors such as metallic products, machinery and equipment, and

transportation vehicles are consistently employing less informal workers with respect to food and beverages (the base category in the regression), presumably due to higher unionization rates.

Table 3 in turn shows the set of industry-specific informality indicators (β_{jt}) for the period 1992-2003 as calculated following the regression specification in (1), but this time setting the omitted industry category (food and beverages) to zero, and expressing all other sectors as deviations from the employment-weighted average informality rate (Krueger & Summers, 1988). As in Table 2, it confirms the existence of substantial differences in informality levels and evolution across manufacturing sectors in Argentina, even after accounting for differences in the composition of the workforce (age, gender, and education).

The main econometric results appear on Table 4. For comparison purposes when using dynamic panel estimation (we lose one year of lag), the analysis is concentrated on 1993-2003 (1992 is the first period lag). We first consider a regression of the estimated normalized industry-specific informality coefficients (β_{jt}) on tariffs rates by industry, controlling for industry and year fixed-effects (column 1). Tariffs induce a statistically significant negative effect on informality, implying that a reduction of average tariffs by one per cent produces an increment in informality rates by 0.55 per cent. Column 2 excludes 2002 and 2003 from the analysis for robustness given the inclusion of two severe crisis years where informality grew substantially. The effect of tariffs increases in magnitude and statistical significance. The rest of the analysis continues with those years included.

In columns 3 and 4 we add exports and imports (standardized by the value of production) as additional covariates. While imports and exports per se are not statistically significant, the effect of tariffs on informality is robust to the inclusion of these variables, implying that a similar reduction in tariffs would produce an increment in informality of 0.6 per cent. Exports and

imports show opposite signs, implying the manufacturing sectors with high export ratios have less informality, while high import ratios increase informality. This implies that the sector performance on international markets affects the formality rates of its labour force. These results are consistent with the hypothesis that trade openness make firms to reduce job formality in order to cope with international competition. However, this can be seen as a partial equilibrium effect, which does not account for the full (general or global) effect of trade openness and there might be potential endogeneity bias in our estimates.

First, governments might reduce tariffs in those industries where organized labour was weaker (and hence informality larger). This does not generate bias as long as the fixed-effects by industry capture the nature of labour organization, which is the case in Argentina where historical labour unions are attached to different industries. Moreover, these political economy considerations for tariff settings are less of a concern since tariff levels in Argentina are actually not determined at the sole discretion of the country, but at the MERCOSUR level (in agreement with governments from neighbouring countries participant in the trade bloc). Thus, we are confident that tariffs can be used to identify exogenous changes to trade policy that are not affected by informality

Second, tariff reductions (and presumably other measures that affected labour informality) might have been compensated by the government by increasing industry-specific subsidies or non-tariff trade barriers. This would determine that the estimated effect of tariffs on informality would be biased upwards, and therefore, tariffs might have induced a larger (negative) effect. We were not able to construct a panel of government subsidies and non-tariff barriers by industry, and therefore, our estimates should be considered as a lower bound (in absolute value), with potentially larger effects. Nevertheless it should be emphasized that much of the trade

liberalisation policy in the 1990's was accompanied with other policies of general liberalisation in the economy with overall reduction in state subsidies across all sectors.

Third, tariff elimination could make more profitable to enter and less profitable firms to exit the industry, and promote export oriented firms (Acosta & Montes-Rojas, 2008). Our own estimates on the effect of exports on informality (column 3) suggest this hypothesis. Thus, the change in the industry composition after trade opening can exert an effect on the sector's informality levels. We test this hypothesis by including the ratio of GVP to employment in each industry, a proxy for labour productivity, but we do not find evidence that less productive firms are associated with higher informality levels (column 5).

Fourth, trade liberalisation also reduces the cost of acquiring new technology through the reduction in the cost of imported capital goods, as argued for Argentina in Acosta and Gasparini (2007). Using an efficiency wage argument, if firms can upgrade to a better technology, they may be able to offer better job conditions to its labour force in order to maintain the best workers. We test for this hypothesis by including the ratio of investment to gross value of production in the regression, as well as its interaction with the tariffs variable. This last variable is thus intended to identify simultaneous effects of trade liberalisation on the industry, and in particular, changes in the technology. The results in column 6 show that, as expected, sectors that invest more have a lower incidence of informality. And that they also have a lower impact of tariffs reduction on informality. For instance, a sector with no investment would have an increment of 0.85 percent in informality after a 1 per cent reduction in tariffs. However, a sector with an average investment rate of 10 per cent would have an impact of only 0.28 per cent ($= 0.85 - 5.72 \times 0.1$). Further, a sector with an investment ratio above 15 per cent would have a positive effect of tariff reduction on informality.

As a robustness check of the previous results, we also introduce the lags of the considered covariates, together with the lag of the dependent variable. The results in column 7 confirm that there is a negative relation between trade liberalisation and informality, again with an average elasticity close to 0.6 in absolute terms. In fact, the results show that only the contemporaneous effect is significant. This determines that the sectors adjust relatively fast to trade openness. The lagged dependent variable appears as non-statistically significant in both specifications and therefore, the fixed-effects model does not require a dynamic specification (with the consequent use of instruments for eliminating potential dynamic panel bias). Further analysis reveals that the inclusion of the year dummies produces this lack of significance, which means that many sectors behave similarly across periods and that they are affected by common shocks. The interaction of investment and tariffs produces similar effects.

As mentioned before, the dependent variable in Table 4 corresponds to the set of industry-specific informality indicators (β_{it}) that net out individual characteristics. But as an additional robustness check, Table 5 reports estimates using as dependent variable the raw (unadjusted) informality ratios by industry as the dependent variable, already presented in Table 1. As seen, the main conclusions with respect to the role of tariffs, exports, and imports in explaining informality are unaffected when we use informality rates (though statistical significant levels vary). But given that this alternative variable omits individual factors not related to industry effects, we prefer to use the corrected measure proposed by Goldberg and Pavcnik (2003) for the rest of the analysis.

Finally, following Bosch et al. (2012), to overcome remaining concerns that tariffs could be an endogenous variable for the impact of trade liberalisation on informality, we also consider the dynamic panel GMM estimator model of Arellano and Bond (1991). We use first differences

and lags of the dependent variable, together with X and M , as instruments for solving the potential dynamic panel data bias and endogeneity. All the variables are treated as potentially endogenous, including Tariff, to which the same set of instruments is applied. Results for this specification are presented in Table 6. Note that the results are very close to those in Table 4, which we keep as the preferred specification.

Figure 4 shows the actual evolution of informality rates and its predicted evolution using our preferred elasticity of 0.6 per cent, starting with the 1992 average tariff level. Our results suggest that trade liberalisation in the form of tariff reductions can explain around a third (32%) of the observed increase in informality in Argentina between 1992 and 2003. This impact is large compared with those for Colombia reported in Goldberg and Pavcnik (2003), of the order of 10-15 per cent. Moreover, they contrast to those for Brazil in Goldberg and Pavcnik (2003) and Bosch et al. (2012) who both find no relationship between informality and trade, as well as Aleman-Castilla (2006), who shows a negative relationship for Mexico.

V. Conclusion

This paper tests for the effect of trade liberalisation on informality using industry-level data for Argentina. The results in this paper suggest that informality has significantly increased in those manufacturing sectors in which trade liberalisation has been more intense. The econometric results show that a reduction of average tariffs by one per cent produces an increment in informality rates by 0.6 per cent. However, sectors with higher investment ratios were able to neutralize and reverse this effect. These results are robust to trade variables capturing the export/import orientation of the sector.

These estimated impacts could actually be a lower bound of the full effect of trade liberalisation on informality. This is because workers who lost their formal manufacturing jobs due to trade liberalisation might end working in an informal job in the non-manufacturing sector. During the 1990s in Argentina there was an increment in the number of informal jobs in the service sector and a reduction in the number of formal jobs in the manufacturing sector suggesting that this could have been an important channel of adjustment of the labour market to trade liberalisation. Further research is needed to understand the trade effects on overall labour markets that include the service sector. Finally, because workers can move across sectors, a tariff reduction in manufacturing sector j may not only affect the informality rate in j but can also affect the informality rate in other manufacturing sectors. This problem is also likely to bias the estimates downwards.

¹ A thorough description of the 2002 Argentinean crisis and its effects in labor markets can be found in McKenzie (2004).

² We use this strict definition of labor informality because pension contributions, basic health insurance, paid vacations, and yearly bonuses are all legally-mandated social security benefits in Argentina, so non-compliance with any of them would entail a violation of the labor laws. As the literature has suggested, alternative definitions of labor informality may include the self-employed and workers in micro-firms.

³ To mention a few studies applying this procedure: Attanasio, Goldberg and Pavcnik (2004), Pavcnik et al. (2004), and Acosta and Gasparini (2007).

⁴ Urban areas considered are: Buenos Aires City, Gran Buenos Aires, Bahía Blanca, Catamarca, Comodoro Rivadavia, Córdoba, Corrientes, Formosa, Jujuy, La Plata, La Rioja, Mar del Plata, Mendoza, Neuquén, Paraná, Posadas, Resistencia, Rio Cuarto, Rio Gallegos, Rosario, Salta, San Juan, San Luis, Santa Fe, Santa Rosa, Santiago del Estero, Tierra del Fuego, and Tucumán. These areas account for nearly two-thirds of the country's population.

⁵ Primary education in Argentina consists of 7 years of schooling, while secondary education comprises 5 years of schooling.

⁶ Results for other years do not differ much from those reported, and are available upon request.

⁷ Following the standard methodology in the literature we use a linear probability model. The range of predicted values shows that the linear model performs well for this sample. Results using logit or probit model are similar to those of the linear probability model.

References

- Acosta, P., & Gasparini, L. (2007). Capital accumulation, trade liberalization, and rising wage inequality: The case of Argentina. *Economic Development and Cultural Change*, 55, 793-812.
- Acosta, P., & Montes-Rojas, G. (2008). Trade reform and inequality: The case of Mexico and Argentina in the 1990s. *World Economy*, 31, 763-780.
- Aleman-Castilla, B. (2006). The effect of trade liberalization on informality and wages: Evidence from Mexico. London School of Economics, CEP Discussion Paper 763, London, UK.
- Amaral, P., & Quintín, E. (2006). A competitive model of the informal sector. *Journal of Monetary Economics*, 53, 1541-1553.
- Antunes, A., & Cavalcanti, T. (2007). Start up costs, limited enforcement, and the hidden economy. *European Economic Review*, 51, 203-224.
- Arellano, M., & Bond, S. (1991). Some tests of specification for panel data: Monte Carlo evidence and an application to employment equations. *Review of Economics Studies*, 58, 277-297.
- Attanasio, O., Goldberg, P., & Pavcnik, N. (2004). Trade reforms and wage inequality in Colombia. *Journal of Development Economics*, 74, 331-366.
- Banerji, A., & Jain, S. (2007). Quality dualism. *Journal of Development Economics*, 84, 234-250.
- Behrman, J., Birsdall, N., & Szekely, M. (2007). Economic policy changes and wage differentials in Latin America. *Economic Development and Cultural Change*, 56, 57-98.

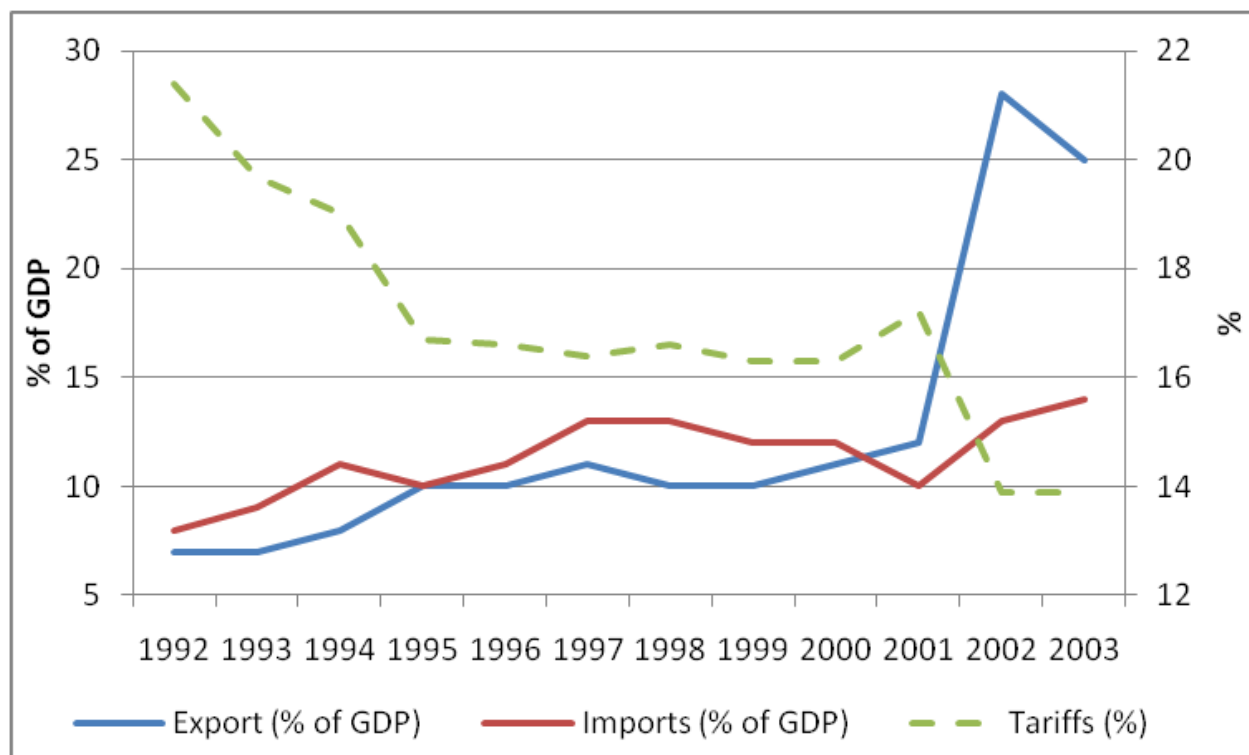
- Bosch, M., Goñi-Pacchioni, E. & Maloney, W. (2012). Trade liberalization, labor reforms and formal-informal employment dynamics. *Labour Economics*, 19, 653-667.
- Busato, F., & Chiarini, B. (2004). Market and underground activities in a two-sector dynamic equilibrium model. *Economic Theory*, 23, 831-861.
- Choi, J., & Thum, M. (2005). Corruption and the shadow economy. *International Economic Review*, 46, 817-836.
- Chong, A., & Gradstein, M. (2007). Inequality and informality. *Journal of Public Economics*, 91, 159-179.
- Currie, J., & Harrison, A.E. (1997). Sharing the costs: The impact of trade reform on capital and labor in Morocco. *Journal of Labor Economics*, 15(3), pp. 44-71.
- Dabla-Norris, E., Gradstein, M., & Inchauste, G. (2008). What causes firms to hide output? The determinants of informality. *Journal of Development Economics*, 85, 1-27.
- Dessy, S., & Pallage, S. (2003). Taxes, inequality and the size of the informal sector. *Journal of Development Economics*, 70, 225-233.
- Fiess, N., & Fugazza, M. (2008). Trade liberalisation and informality: New stylized facts. University of Glasgow, Department of Economics, Working Paper 2008-34, Glasgow, UK.
- Friedman, E., Johnson, S., Kaufmann, D., & Zoido-Lobaton, P. (2000). Dodging the grabbing hand: The determinants of unofficial activity in 69 countries. *Journal of Public Economics*, 76, 459-493.
- Fugazza, M., & Jacques, J. (2004). Labor market institutions, taxation and the underground economy. *Journal of Public Economics*, 88, 395-418.

- Galiani, S. (2002). Labor market reform in Argentina: Where do we stand? Stanford Center for International Development Working Paper 133, Stanford, USA.
- Galiani, S., & Porto, G. (2010). Trends in tariff reforms and in the structure of wages. *Review of Economics and Statistics*, 92, 482-494.
- Galiani, S., & Sanguinetti, P. (2003). The impact of trade liberalization on wage inequality: Evidence from Argentina. *Journal of Development Economics*, 72, 497–513.
- Goldberg, P., & Pavcnik, N. (2003). The response of the informal sector to trade liberalization. *Journal of Development Economics*, 72, 463-496.
- Harris, J., & Todaro, M. (1970). Migration, unemployment, and development: A two-sector analysis. *American Economic Review*, 60, 126-142.
- Johnson, S., Kaufmann, D., & Zoido-Lobaton, P. (1998). Regulatory discretion and the unofficial economy. *American Economic Review*, 88, 387-392.
- Krueger, A., & Summers, L. (1988). Efficiency wages and the interindustry wage structure. *Econometrica*, 56, 259–293.
- Maloney, W. (1999). Does informality imply segmentation in urban labor markets? Evidence from sectoral transitions in Mexico. *World Bank Economic Review*, 13, 275-302.
- Maloney, W. (2004). Informality revisited. *World Development*, 32, 1159-1178.
- McKenzie, D. (2004). Aggregate shocks and urban labor market responses: Evidence from Argentina's financial crisis. *Economic Development and Cultural Change*, 52, 719-758.
- Melitz, M. (2003). The impact of trade on intra-industry reallocations and aggregate industry productivity. *Econometrica*, 71, 1695-1725.

- Pavcnik, N., Blom, A., Goldberg, P., & Schady, N. (2004). Trade liberalization and industry wage structure: Evidence from Brazil. *World Bank Economic Review*, 18, 319-344.
- Rauch, J. (1991). Modelling the informal sector formally. *Journal of Development Economics*, 35, 33-47.
- Revenge, A. (1997). Employment and wage effects of trade liberalization: The case of Mexican manufacturing. *Journal of Labor Economics*, 15, 520-543.
- Ronconi, L. (2010). Enforcement and compliance with labor regulations. *Industrial and Labor Relations Review*, 63, 719-736.
- Straub, S. (2005). Informal sector: The credit market channel. *Journal of Development Economics*, 78, 299-321.

Figure 1

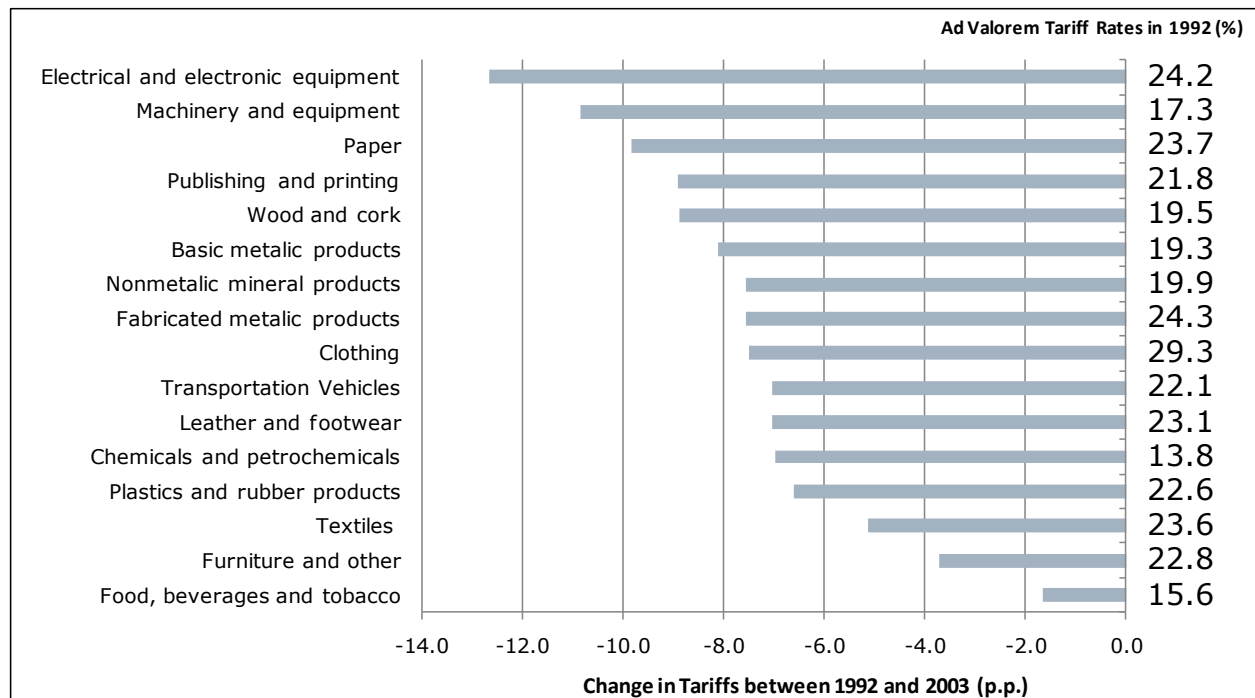
**Trade Openness (Exports and Imports, as a share of GDP) and Average Ad Valorem Tariff
Evolution**



Source: World Development Indicators (2009) and Galiani and Porto (2010)

Figure 2

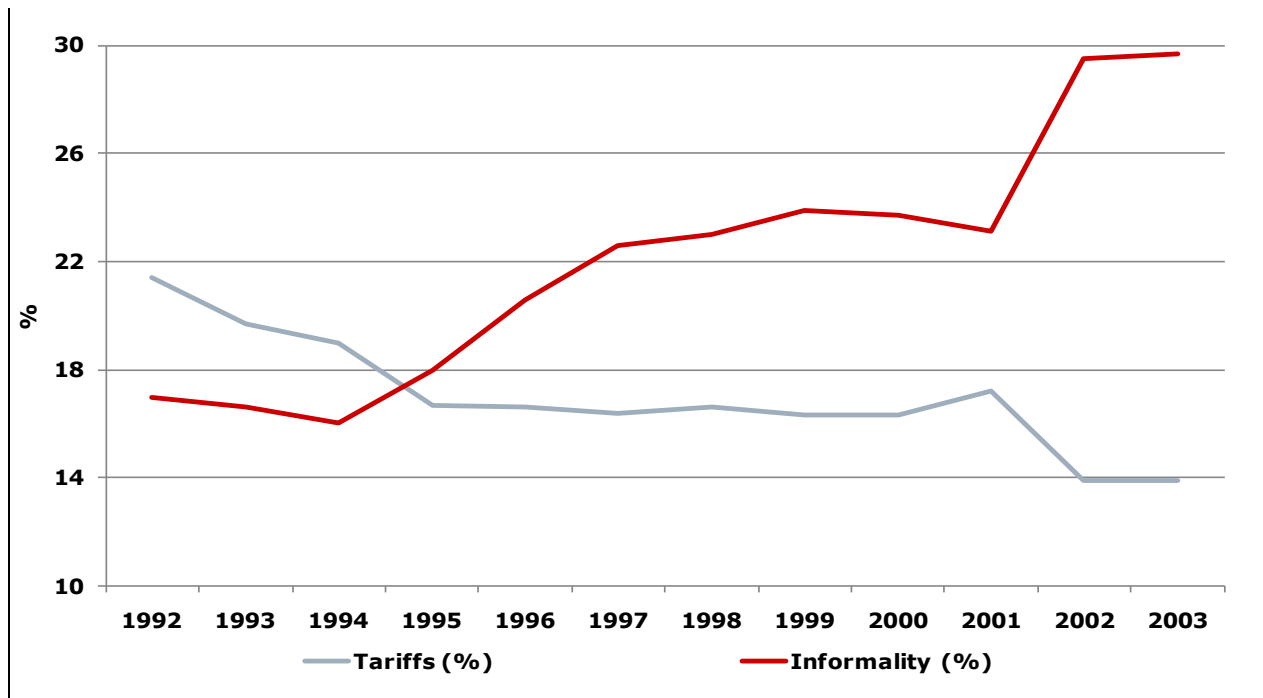
Average Ad Valorem Import Tariffs by Manufacturing Sector



Source: Authors' calculations based on Galiani and Porto (2010).

Figure 3

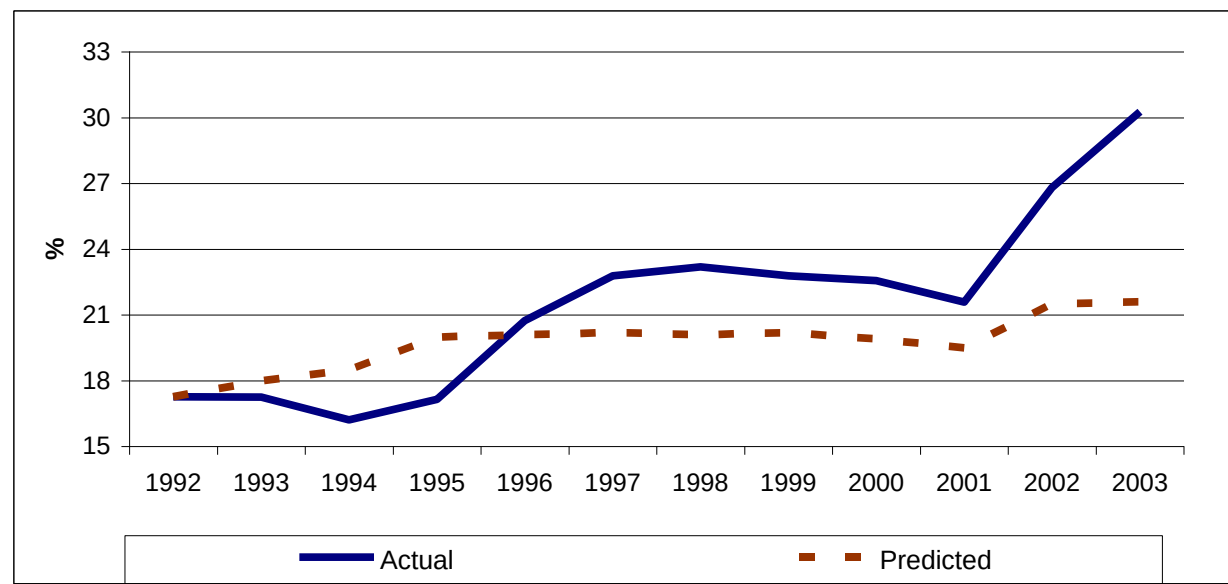
Change in Informality Rates and Ad Valorem Tariffs in the Manufacturing Sector



Source: Authors' calculations based on EPH, October issues, and Galiani and Porto (2010).

Figure 4

Actual and Predicted Changes in Informality Rates in the Manufacturing Sector



Source: Authors' calculations based on the estimated 0.6 elasticity starting at the 1992 average tariff level.

Table 1**Informality Rates (“Absence of Social Security Benefits”) by Manufacturing Sector**

Argentina, 1992-2003

Sector	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Food, beverages and tobacco	12.5	16.0	14.7	18.2	19.7	23.1	23.3	22.1	26.5	22.0	27.1	33.5
Textiles	5.7	13.1	17.5	14.0	15.2	8.2	20.7	21.3	19.2	16.6	25.2	30.3
Clothing	21.5	37.3	29.4	32.1	42.6	48.8	41.3	39.0	39.1	28.8	51.1	51.5
Leather and footwear	41.1	38.3	38.7	31.5	30.9	43.5	38.7	32.7	29.7	52.3	47.9	60.3
Wood and cork	31.7	24.9	29.6	19.4	34.1	31.6	33.8	36.5	26.8	35.1	49.1	38.2
Paper	15.3	6.8	15.6	20.2	15.3	6.8	12.7	48.1	16.0	26.6	7.8	6.1
Publishing and printing	12.9	11.8	13.8	13.4	23.4	31.2	25.8	31.4	23.2	25.3	8.1	22.7
Chemicals and petrochemicals	10.0	10.2	14.7	11.7	11.2	18.8	14.8	16.2	10.0	15.0	19.9	17.6
Plastics and rubber products	18.2	12.4	16.3	16.4	12.4	13.1	19.4	11.5	5.5	12.1	22.4	5.1
Nonmetallic mineral products	21.0	19.6	11.4	13.8	17.0	20.9	24.1	27.3	17.0	17.6	40.6	27.5
Basic metallic products	7.6	9.4	2.2	6.1	3.8	9.1	6.0	4.9	9.3	7.1	9.1	4.0
Fabricated metallic products	15.8	11.6	14.3	16.4	15.8	14.9	25.8	18.7	17.9	18.7	24.7	26.5
Machinery and equipment	14.9	13.6	10.5	8.6	11.6	16.2	8.9	13.9	18.7	17.2	10.9	20.1
Electrical and electronic equipment	17.0	6.2	3.6	17.3	12.5	20.8	17.3	18.2	22.1	28.3	21.3	15.4
Transportation Vehicles	11.0	13.2	4.1	9.3	19.2	8.3	6.5	10.5	15.2	6.3	6.0	23.5
Furniture and other	26.7	25.6	23.5	17.4	35.6	29.7	33.9	30.5	34.5	19.1	31.4	29.8
Manufacturing Sector	17.3	17.2	16.2	17.1	20.7	22.8	23.2	22.8	22.6	21.6	26.8	30.3
All Sectors	17.0	16.6	16.0	18.0	20.6	22.6	23.0	23.9	23.7	23.1	29.5	29.7

Notes: Authors' calculations based on EPH, October issues. Sample considers full-time (more than 20 hours worked) paid workers, between 18 and 65 years old.

Table 2**Determinants of Informality Status (“Absence of Social Security Benefits”)**

Argentina, 1994, 1997, and 2001

	1994		1997		2001
Age	-0.025 *** (0.001)		-0.028 *** (0.001)		-0.029 *** (0.002)
Age Squared*100	0.026 *** (0.002)		0.029 *** (0.002)		0.029 *** (0.002)
Male	0.002 (0.005)		-0.016 *** (0.005)		-0.050 *** (0.006)
Household Head	0.005 *** (0.001)		0.013 *** (0.002)		0.009 *** (0.002)
Married	-0.043 *** (0.005)		-0.070 *** (0.005)		-0.075 *** (0.006)
Primary Complete	-0.030 *** (0.006)		-0.034 *** (0.007)		-0.047 *** (0.008)
Secondary Incomplete	-0.128 *** (0.006)		-0.117 *** (0.007)		-0.151 *** (0.008)
Secondary Complete	-0.133 *** (0.008)		-0.165 *** (0.008)		-0.174 *** (0.009)
Tertiary Education	-0.145 *** (0.007)		-0.189 *** (0.008)		-0.218 *** (0.009)
Textiles	-0.026 (0.022)		-0.173 *** (0.025)		-0.100 *** (0.041)
Clothing	0.097 *** (0.019)		0.200 *** (0.019)		0.021 (0.025)
Leather and footwear	0.154 *** (0.021)		0.156 *** (0.025)		0.180 *** (0.034)
Wood and cork	0.115 *** (0.036)		0.034 (0.040)		0.093 * (0.051)
Paper	-0.042 (0.038)		-0.222 *** (0.039)		0.022 (0.044)
Publishing and printing	-0.011 (0.019)		0.070 *** (0.024)		0.011 (0.027)
Chemicals and petrochemicals	0.007 (0.020)		-0.014 (0.021)		-0.048 *** (0.024)
Plastics and rubber products	-0.032 (0.022)		-0.087 *** (0.026)		-0.124 *** (0.033)
Non-metallic mineral products	-0.068 *** (0.027)		-0.059 * (0.032)		-0.066 (0.044)

Basic metallic products	-0.126 *** (0.037)	-0.092 *** (0.045)	-0.174 *** (0.052)
Fabricated metallic products	-0.041 *** (0.014)	-0.092 *** (0.019)	-0.049 *** (0.023)
Machinery and equipment	-0.046 *** (0.020)	-0.044 *** (0.023)	-0.069 *** (0.030)
Electrical and electronic equipment	-0.101 *** (0.026)	-0.015 (0.022)	0.112 *** (0.041)
Transportation vehicles	-0.136 *** (0.017)	-0.138 *** (0.020)	-0.158 *** (0.033)
Furniture and other	0.030 * (0.018)	0.041 * (0.023)	-0.058 *** (0.030)
Regional Indicators	Yes	Yes	Yes
Observations (unweighted)	26,627	29,686	20,581
Adjusted R2	0.094	0.110	0.118

Notes: Author's calculations based on EPH, October issues. Sample considers full time (more than 20 hours worked) paid workers, between 18 and 65 years old. Survey's population weights considered. *** Significant at 1% level. ** Significant at 5% level. * Significant at 10% level.

Table 3**Normalized Industry Informality Differentials**

Argentina, 1992-2003

Sector	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Food, beverages and tobacco	-0.057	-0.023	-0.028	-0.007	-0.020	-0.013	-0.011	-0.034	0.010	-0.024	-0.024	-0.003
Textiles	-0.132	-0.056	-0.001	-0.035	-0.054	-0.137	-0.024	-0.045	-0.055	-0.053	-0.011	0.013
Clothing	0.021	0.179	0.103	0.108	0.195	0.233	0.124	0.112	0.137	0.062	0.217	0.124
Leather and footwear	0.208	0.188	0.180	0.137	0.049	0.194	0.135	0.088	0.041	0.237	0.159	0.244
Wood and cork	0.154	0.058	0.145	0.044	0.139	0.071	0.117	0.138	0.071	0.137	0.128	0.067
Paper	-0.023	-0.093	-0.028	-0.023	-0.045	-0.184	-0.103	0.235	-0.085	0.066	-0.248	-0.333
Publishing and printing	-0.036	-0.060	0.003	-0.067	0.037	0.074	0.012	0.094	0.024	0.031	-0.136	-0.023
Chemicals and petrochemicals	-0.071	-0.035	0.028	-0.026	-0.071	-0.019	-0.050	-0.048	-0.077	-0.033	-0.016	-0.103
Plastics and rubber products	0.038	-0.035	-0.010	0.000	-0.106	-0.065	-0.029	-0.107	-0.163	-0.078	-0.024	-0.193
Nonmetallic mineral products	0.045	0.016	-0.046	-0.014	-0.030	-0.024	0.026	0.060	-0.026	-0.034	0.108	-0.043
Basic metallic products	-0.046	-0.075	-0.104	-0.071	-0.162	-0.106	-0.136	-0.111	-0.125	-0.158	-0.093	-0.213
Fabricated metallic products	0.012	-0.044	-0.018	0.024	-0.045	-0.061	0.038	-0.028	-0.035	-0.010	-0.034	0.033
Machinery and equipment	-0.019	-0.019	-0.019	-0.050	-0.059	-0.038	-0.143	-0.036	0.023	-0.031	-0.083	0.013
Electrical and electronic equipment	0.029	-0.093	-0.080	0.007	-0.040	-0.010	-0.010	0.000	0.039	0.146	0.013	-0.083
Transportation Vehicles	-0.056	-0.026	-0.112	-0.039	0.011	-0.142	-0.131	-0.101	-0.036	-0.126	-0.170	-0.053
Furniture and other	0.085	0.063	0.052	-0.023	0.135	0.061	0.102	0.061	0.074	-0.017	0.026	-0.013

Notes: Author's calculations based on EPH (October issues). Survey's population weights considered. Informality differentials by industry are calculated by regressing an informality indicator on age, age squared, gender, household head indicator, education indicators, marital status, geographic location, and a set of industry indicators. Reported industry informality differentials are calculated as deviations of coefficients on industry indicators with respect to the employment-weighted average industry differential.

Table 4

Determinants of Labour Informality: Industry-Level Fixed-effects

Dependent Variable:	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Industry Informality							
Differentials (β_{jt})							
Tariffs	-.554* (.319)	-.698** (.313)		-.596* (.349)	-.592* (.334)	-.851** (.342)	-1.030** (.401)
Exports (% of GVP)			-.067 (.028)	-.052* (.028)	-.091* (.049)	-.079*** (.026)	-.036 (.082)
Imports (% of GVP)			.083 (.053)	.083 (.053)	.079 (.062)	.081 (.066)	.045 (.086)
Labor Productivity (GVP/L)					-.024 (.062)		
Investment (% of GVP)						-.761** (.333)	-1.300* (.670)
Investment (% of GVP) * Tariffs						5.720** (2.390)	8.980** (4.310)
<i>Lagged one period</i>							
Tariffs							-.016 (.090)
Exports (% of GVP)							.362 (.405)
Imports (% of GVP)							-.068 (.083)
Investment (% of GVP) * Tariffs							.075 (.078)
Investment (% of GVP)							-6.930 (4.270)
Observations	176	144	176	176	171	171	169

Notes: All specifications include industry and year fixed-effects. Column (2) excludes year 2002 and 2003. Robust standard errors adjusted for industrial clusters. Tariffs: average tariffs by industry. *** Significant at 1% level. ** Significant at 5% level. * Significant at 10% level.

Table 5
Determinants of Labour Informality: Industry-Level Fixed-effects

Dependent Variable:	Industry Informality Differentials (β_{jt})	Non-adjusted Industry Informality Rates	Industry Informality Differentials (β_{jt})	Non-adjusted Industry Informality Rates
Tariffs	-.554* (.319)	-.550* (.315)	-.596* (.349)	-.534 (.356)
Exports (% of GVP)			-.052* (.028)	-.048** (.022)
Imports (% of GVP)			.083 (.053)	.038 (.058)
Observations	176	176	176	176

Notes: All specifications include industry and year fixed-effects. Robust standard errors adjusted for industrial clusters. Tariffs: average tariffs by industry. *** Significant at 1% level. ** Significant at 5% level. * Significant at 10% level.

Table 6**Determinants of Labour Informality: Arellano-Bond GMM Estimator**

Dependent Variable: Informality	(1)	(2)
Tariffs	-.657** (.331)	-.902** (.306)
Exports (% of GVP)	-.058* (.030)	- .082*** (.024)
Imports (% of GVP)	.082 (.051)	.088 (.069)
Investment (% of GVP) * Tariffs		5.740** (2.320)
Investment (% of GVP)		-.757** (.324)
<i>Lagged one period</i>		
Informality	-.035 (.049)	-.045 (.046)
AR(2) Test, p-value	.575	.453
Hansen Test, p-value	1.000	1.000
Observations	160	153

Notes: All specifications include industry and year fixed-effects. Robust standard errors adjusted for industrial clusters. Tariffs: average tariffs by industry. *** Significant at 1% level. ** Significant at 5% level. * Significant at 10% level.