

# Mobility, poverty and well-being among the informally employed in Bosnia and Herzegovina

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## Abstract

We analyse informal sector employment in Bosnia and Herzegovina (BH), using panel data from the living standards measurement studies. We derive four main conclusions. First, there is significant labour market mobility in BH. Second, those in informal jobs are much more likely to suffer from poverty than formally employed people are. Third, earnings inequality is more pronounced in the informal sector than elsewhere. Fourth, the informally employed report lower levels of life satisfaction compared to most other labour market states. We conclude that, while the informal sector helps people cope, the formal sector provides better prospects for prosperity and well-being.

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## 1. Introduction

Economic activity in Bosnia and Herzegovina (BH) has risen steadily since the end of the war in late-1995. According to IMF estimates, real GDP trebled over the period 1996–2004, with most of this growth concentrated in the early post-war years.<sup>1</sup> But there is still great uncertainty about the current size of the Bosnian economy and about basic macroeconomic aggregates such as GDP growth, unemployment and the balance of payments. The main reason for this uncertainty is that official statistics fail to take account of informal activities. There is general

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<sup>1</sup> See IMF (2005a).

agreement that informal activities are widespread throughout the country, as they are in many other transition countries. Yet there has been very limited analysis to date of this phenomenon in BH. This makes it more difficult to come up with concrete suggestions to improve the functioning of the labour market and bring informal activities into the formal sector.

This paper attempts to enrich our understanding of the informal sector in BH through a detailed analysis of panel data from several waves of the Living Standard Measurement Study (LSMS) household surveys between 2001 and 2004. We do *not* try to estimate the size of informal activities relative to “official” GDP. (Some previous attempts by other researchers to do this are discussed below.) Instead, we use our individual-level data to show two main things. First, we analyse the degree of flexibility in the labour market and demonstrate that there is substantial movement between formal and informal jobs. And second, we show the superiority of formal over informal activities for reducing poverty and inequality and enhancing life satisfaction. These issues highlight the importance of reducing barriers to doing business, a topic that we return to in the conclusion.

The structure of the paper is as follows. Section 2 provides relevant background information, both on the structure of the BH economy inherited from socialism and the war years and on the concept of “informal” activity. It also summarises briefly the state of existing knowledge about informal or non-observed activities in BH, highlighting the wide range of existing estimates and the difficulties that previous researchers have had in coming up with concrete results.

Section 3 presents summary statistics from the LSMS. Several points are noted. First, the size of the informal sector as a percentage of total employment appears to have fallen between 2001 and 2004, although this result is sensitive to the definition of “informal” employment. Second, both the employment and the unemployment rate have risen over this period, on account of a near 10% point increase in the labour force participation rate. Third, a breakdown of informal employment shows a concentration in agricultural activity, and a corresponding majority in non-wage employment, compared to about 8% of the formally employed. Fourth, monthly earnings in the formal sector are on average about 30% higher than those in the informal sector.

Section 4 contains the main analytical results. We show first that the degree of movement, even in 1 year, from one category of labour force to another is surprisingly high when compared to a selection of other transition countries. Those who make the move from informal to formal jobs typically gain significantly in terms of earnings increase, with average monthly earnings for this group rising by 26% (in nominal terms) over a 3-year period.<sup>2</sup> We then establish that informal employment helps to reduce poverty but by much less than formal employment does; more than two-thirds 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 (controlling for other characteristics) and saw lower consumption increases than formal workers. Finally, we show that the informal sector is associated with both higher inequality and (based on evidence from the most recent wave of the survey in 2004) lower life satisfaction relative to other employment categories.

Section 5 concludes the paper with some policy implications. There are several conclusions that we draw from our work. First, it would be useful to use these data and others to try to derive at least rough estimates of the “true” size of the economy. Otherwise, policy-makers will continue to operate in the dark and may propose misguided policies based on faulty data. Second, notwithstanding the considerable mobility in the labour force, a large number of highly educated

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<sup>2</sup> Inflation in BH has been in low single-digit levels since 2001 so there is little difference between large nominal and real changes over this period.

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