POVERTY AND INFORMALITY IN SOUTH EAST EUROPE

by Alexandre Marc and Zeynep Kudatgobilik*

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Abstract

The informal sector is a critical component of many economies of Eastern Europe and the former Soviet Union. The economic, social, and political re-engineering, which characterize transition to a market economy and western-style democracy, creates many uncertainties as well as many opportunities. A large part of this re-engineering has actually happened outside of official channels through informal relations and activities. The purpose of this paper is to examine the significance of the link between "informality" and poverty in South East Europe. The paper argues that what is relevant for the poor is not so much the informal "sector" but the fact that "informality" is a way to cope and survive. Drawing on the empirical work carried out through social and poverty assessments by World Bank staff, the paper suggests that the underlying facts that lead the poor towards informality as a survival mechanism are linked to the failure of the formal system: lack of employment and inability of State institutions to provide adequate health care and education services, regulatory oversight, and public security. We will illustrate these connections through an examination of three aspects of informality: i) in access to social services; ii) in access to revenue and employment; and iii) in obtaining favors, justice, and security. This paper aims to contribute to the understanding of the dynamics of informality and to draw a portrait of the characteristics of informality and poverty. The paper also tries to explore the challenges of reducing poverty by building more inclusive policies in South East Europe, taking fully into account the importance of informality in the coping mechanisms of the poor.

I. INTRODUCTION

This paper looks at the informal economy from the perspective of the poor. The paper tries to identify some possible directions for dealing with the problem of informality as part of poverty reduction strategies. The empirical evidence is very patchy and the paper does not try in any way to be exhaustive. This paper bases its analysis on the empirical findings of qualitative and quantitative studies on poverty and social assessments carried out in South East Europe by the World Bank over the last six years. This paper focuses on the South East Europe (SEE) region, which in this report refers to Albania, Bosnia and Herzegovina, Croatia, the Federal Republic of Yugoslavia (FRY), the Yugoslav Republic of Macedonia (FYR), Bulgaria, and Romania. It argues that the coping mechanisms of the poor in most of the countries under review is informality. "Informality" is a way of coping with the many dimensions of poverty, beyond the common dimension of income. Using the concept of "informality" and not of "informal economy," we will argue that it is important to make more comprehensive recommendations related to the "informal sector" for policies that would reduce poverty. The poor have to deal with informality both in the economic sphere and for those concerns related to the access to social services, network of solidarity, security, etc. It is therefore important for policy-makers to look at coping mechanisms and not just economic activity, as an integral aspect of poverty.

Countries of South East Europe have experienced three transitions, from a socialist system to a market economy; from State control to democracy, and in many cases to democracies in new States; and, for a majority of these States, from war to peace. South East Europe is an extremely diverse region and the trends in economic changes have been very different. There are various reasons that are central to the disparate outcomes. One reason is the dissimilarities in historical legacies. Other factors include the substantial variations in the patterns of corruption and cronyism, and the considerable disparities in the development of civil society, political parties, and reform policies of the governments.

The countries also experienced a very rapid fall in GDP in the beginning of the 1990's due to the collapse of trading systems and war. Since the process of transition began, large sectors of the population were marginalized and their living standards fell abruptly. The country-specific poverty levels are very different but poverty increased everywhere in the early 90's.

Table 1. Growth in Real GDP in Selected South East European Countries

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002*
Albania	9.8	-10.0	-28.0	-7.2	9.6	8.3	13.3	9.1	-7.0	8.0	7.3	7.8	7.0	6.0
B-H	na	-23.2	-12.1	-30.0	-40.0	-40.0	20.8	86.0	37.0	10.0	10.0	5.0	5.0	5.0
Bulgaria	0.5	-9.1	-11.7	-7.3	-1.5	1.8	2.1	-10.9	-6.9	3.5	2.4	5.8	4.0	3.5
Croatia	-1.6	-7.1	-21.1	-11.7	-8.0	5.9	6.8	6.0	6.5	2.5	-0.4	3.7	3.8	3.0
FR Yugoslavia	1.3	-7.9	-11.6	-27.9	-30.8	2.5	6.1	7.8	10.1	1.9	-15.7	5.0	5.0	5.0
FYR Macedonia	0.9	-9.9	-7.0	-8.0	-9.1	-1.8	-1.2	1.2	1.4	2.9	2.7	5.1	-4.0	1.0
Romania	-5.8	-5.6	-12.9	-8.8	1.5	3.9	7.1	3.9	-6.1	-5.4	-3.2	1.6	4.0	3.5

Source: EBRD, 2001, Transition Report. (*EBRD forecast.)

Most Central East Europe (CEE) and South East Europe countries have seen a surge in informal activities, despite the fact that informality was already high under the socialist system, mostly to cope with the imperfection of the economic system. The changes in the legal framework, and the

superposition of new market oriented legislation over the old laws inherited from the socialist system, have created a "legislative" confusion that has favored the development of informal activities.

European Union Accession of South East European Countries

The move to accession to the European Union is a key political priority in almost all countries of SEE. This motivation stems from political and economic ambitions as well as security concerns. The requirement to become an accession country relates to the progress of liberalization of trade, market, macro-economic policy, and the development and democratization of institutions. There are different trends in the progress in transition of SEE countries. At the Helsinki European Council in December 1999, accession negotiations with Bulgaria and Romania began. Due to various concerns, the EU was unwilling to open up prospects of accession negotiations with Albania, Bosnia-Herzegovina, Croatia, FR Yugoslavia, and FYR Macedonia. Thus as an alternative, the Stabilization and Association Process (SAP) became a way to move forward towards negotiations. In 2001, FYR Macedonia signed a Stabilization and Association Agreement (SAA) and was followed closely by Croatia and Albania. As EU accession prospects improved, structural reforms accelerated and in recent years FDI increased in Bulgaria and Romania while have lagged behind in the other SEE countries. Source: EBRD. 2001. Transition Report.

The social and economic dislocation of transition, along with the resulting drop in output, government revenues, and household incomes, accelerated the emergence of informality as a coping mechanism. This is mostly because the formal support system collapsed or was seriously weakened and could not cope with the increasing number of poor.

Table 2. Absolute Poverty Rates of Selected Transition Economies, 1995-1999

	Headcount index		
	Survey Year	2.15/day	4.30/day
Albania	1996	11.5	58.6
Romania	1998	6.8	44.5
Macedonia. FYR	1996	6.7	43.9
Bulgaria	1995	3.1	18.2
Croatia	1998	0.2	4

Source: World Bank. 2000. Making Transition Work for Everyone.

This paper will look at informality from three perspectives: informality in access to social services; informality in access to employment and revenues; and, informality in access to favors, security, and justice. This paper will look at some of the implications for policies to reduce poverty.

II. COPING WITH "INFORMALITY"

Looking at the various qualitative assessments undertaken by the World Bank and client countries in the region – assessments which registered the opinion of the people interviewed and in particular the poor – informality could exacerbate poverty, either directly or indirectly, through increasing inequality in access to services and opportunities, increased vulnerability, and human abuse. However it is also clear that informality is an important coping mechanism when formal systems have collapsed or are under immense stress. Households recognize that informality is harmful to the standard of living and to the distribution of income, but in most cases they have no choice because there are no viable formal alternatives. In some cases, however, there is a perception that through informal means it may be possible to get better deals

by playing on connections or just by appealing directly for the understanding of the service provider. Obtaining a job is another argument found in some of the interviews to justify the fact that informality is not so bad after all for the poor (whereas if it was formal the job would not have been created in the first place because of the high indirect costs). Indeed, in countries where formal cost recovery for services have been imposed to try and reduce under-the-table payment, it is not clear that the poor have been made better off.

In the poorer South East European countries informality as a coping mechanism is prevalent due to a number of very straightforward factors. *First, the lack of fiscal capacity of governments, which has many consequences.* For example, social benefits and pensions are too low to survive on, and in some cases they are lower than the poverty line. Health and education are insufficiently provided and staff working in social sectors is underpaid, both of which stimulate informal payments. Enforcement is very difficult because law enforcement personnel are underpaid.

Second, the lack of State institutional capability, where capacity to target benefits is low in part because of a large-scale informal sector but also because the capacity for outreach and support is limited. Consequently, it is very difficult for the State to target subsidies for the poor and to introduce users fees for the wealthy. Moreover, **non-governmental organizations** (NGOs) and civil society in the region are also weak and not sufficiently organized to carry out the sort of support and outreach that is increasingly their responsibility in the European Union countries.

Third, the lack of formal organizations to support trade and economic activity. Private sector activities are limited where the poor are numerous. This is both a cause and consequence of poverty. Regional imbalances have increased, particularly dramatically with the transition to a market economy, mostly because the high level subsidies supporting poor and isolated regions had been suppressed. Additionally, a high concentration of parastatal industries, which provided a livelihood to a whole region, often collapsed.

Small businesses, which have been so crucial for growth and employment in many countries, are still constrained in SEE by the lack of availability of formal credit for the poor. This is true for micro and small enterprises in general because the banking sector is very weak. Recently, micro-finance institutions have developed in the region as a way to support informal sector activities, but the scale of these institutions is not yet adequate to serve the majority of needs. Furthermore, there is an unclear legal and administrative framework for businesses. There is a prevalence of network connections to obtain favor from the pre-socialist time or war-time. Theses networks can be very negative; mafia, money laundering, and human trafficking are based on such networks. There is much evidence that these networks, especially when they are extending further than the limited community, are actually excluding the poor.

A. Informality in Access to Social Services

Health Systems

It is now quite clear that throughout Eastern Europe informal payments for health services are becoming critical to the issue of access to these services. "While there is hard evidence showing health outcomes for the poor are more negatively affected than the rest of the population, it is clear that access to health is becoming increasingly dependent on whether a household can afford the informal payments to doctors and others practicing in collapsed public institutions and that the poor have the least ability to pay."[1] Most social assessments show that loss of access to free health care is a growing concern to the poor and contributes to their sense of hopelessness and vulnerability.

Within the region, the growing pattern of informal payments to doctors, hospital administrators, nurses, and others connected with health-service delivery (where these payments are unaudited and unreported), has implications for governance, equity and access. Recent research on informal payments has provided convincing evidence that informal – and out-of-pocket payments more generally – constitute a substantial portion of health expenditures in many countries in Europe and Central Asia (ECA). The World Development Report of 1993 on health care estimated that 25 percent and 20 percent of expenditures on health in Romania and Hungary, respectively, were from out-of-pocket payments and gratuities. A survey of urban residents in Bulgaria, conducted in 1994, found that 43 percent of those respondents who had used health services in the previous two years reported having paid cash for officially free services in a State medical facility. (Delcheva et al., 1997) Along similar lines, a 1992 Bulgarian survey had found that 34 percent of respondents had used a "connection" to receive medical care[2].

Another extremely common form of informal payment comes in the form of in-kind gifts to physicians. Balabanova (1998) suggests in her recent study on Bulgaria that the bulk of informal payments are gifts and food products. In many cases, the value of the gifts is small – such as flowers, alcohol, or food. Other types of in-kind payments, however, may include car repair or other services. Such payments, she argues, are often expressions of gratitude – given after successful or complex treatment. They may also be given as a form of insurance in order to guarantee security and good will in case of future illness. This is actually a widespread phenomenon in rural areas in the European Union, and might not have such especially negative consequences.

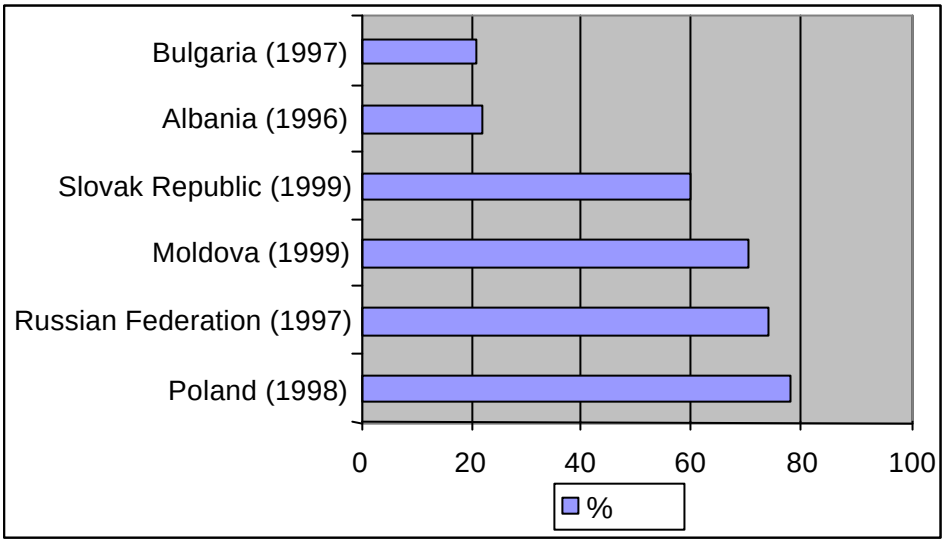
Recent research has identified a number of potentially negative impacts that informal payments have had on health care, including decreased access to health care for women and the poor. However these informal payments also allow for services that the State cannot fund to continue to operate. The problem once again is not the informal payment, but the under-funding of health services. The relationship between informal payments and access is complex. It may not make much difference to the poor whether high health fees are official or unofficial. Obstacles to

[1] World Bank. 2000. Making Transition Work for Everyone.Poverty and Inequality in Europe and Central Asia.] Washington, DC, p.9.

[2]

access would seem equal in both cases. Health indicators and anecdotal evidence suggest that the increase in out-of-pocket payment has substantially decreased utilization of health care facilities. People tend to utilize health facilities only when they are in acute need. (The evidence from the US on the effects of co-payments suggests that prices have a stronger effect on the decision to initiate treatment than on the amount of care obtained once treatment began. Manning et al. 1987). Moreover, many of the studies show that the poor have been forced to pay an increasingly larger percentage of their income on health care over the last six years. In addition, informal payments make it impossible for the government to modulate health fees in order to facilitate access by the poor.

Figure 1. Share of Patients Making Informal Payments in Selected ECA



Source: World Bank. 2000. Making Transition Work for Everyone.

On the other hand, the demand for informal payments may simply arise out of the need to survive. In many Eastern European countries, including Bulgaria and Ukraine, the salaries of medical personnel are below the average of public sector employees, very close to the poverty line.

As seen in Romania as well as many other countries in the region, the poor in the informal sector do not have formal "work contracts", so no contributions are made by the employer or the employee to the State for pensions or health benefits. The result is that individuals are not eligible for those services and that little money is actually paid into any health insurance.

Informality and Roma Minority

Many studies show that Roma have been more vulnerable to social impact of economic transition in the region than other groups. The Roma is by far the group for which informal coping mechanisms are the most widespread. This is partly due to cultural reasons but overwhelmingly because of poverty. Roma generally have lower levels of education and professional skills, and have thus had difficulty in competing for jobs. "Due to these reasons, along with discrimination in the labor market, they were the first to be laid off from State-owned enterprises, mines, and agricultural cooperatives during restructuring. Their access to social services in the transition period has been challenged by the new barriers at entry, such as informal and formal payments. Cultural prejudice and

discrimination had their toll also and in many countries these have increased with the social tension related to transition and war. They frequently live in isolated areas, and may lack necessary documentation for schooling, claiming social assistance or health benefits."[3] Moreover, the high prevalence of Roma in informal sector employment limits their access to insurance-based benefits, including health care and unemployment insurance.

Roma minority comprises a considerable part of population in many Central and Eastern Europe countries and in the former Yugoslavia. "They represent 6 to 10 percent of the population in Hungary, Romania, Slovakia, the former Yugoslav Republic of Macedonia and the Czech Republic. Roma have long been a marginalized group and they have entered the transition period with lower levels of welfare and access to social services than the non-Roma."[4] These gaps have widened during the transition. "Poverty data confirm that poverty rates for the Roma far exceed those of overall population. In Hungary, for example, the Roma are about eight times more likely to be in long term poverty than the general population."[5] Health status is affected by poor living conditions, and Roma housing is overcrowded and public services are inadequate. Access to clean water, sanitary facilities, and waste removal is lacking. Communicable diseases associated with poor living conditions are prevalent.

The recent qualitative poverty assessment for Albania has shown that the quality of health and access to health care is a serious issue in Albania. Some 41 percent of people surveyed believe that the health of households has worsened since 1990.[6] Principally, for those who are at the bottom of the socioeconomic ladder – those without access to key infrastructure, like water and sewage systems in rural areas – health and health care conditions are worse. The quality of health care delivery has declined in cities, villages, and rural areas. Many doctors and nurses are leaving the profession due to low incomes. Without enough staff and sufficient funds, health care delivery in many rural and village areas has been reduced or stopped. As a result many of the medical staff work out of their houses informally and charge informal fees for their services. Most of the poor cannot afford to pay fees for medical help. All of these factors contribute to declining health in the country. [7]

Education Systems

The education sector also suffers in many poorer countries due to the under-funding and low wages for teachers, especially in primary education, with pre-school having practically disappeared from whole areas in the region. Informal payments are now widespread, as well as formal fees.

Informal payments are made to support classroom maintenance, payment for heating or energy, and to purchase basic instruction materials in the poorer region. This is a practice that also exists in the EU. In poor countries in transition informal payments are not just to ensure commitments by parents but really to allow for basic functioning of the schools. Tension arises between those who can pay and those who cannot pay, thus creating an impression among the poor that they

[3] Ringold, Dena. 2000. *Roma and the Transition in Central and Eastern Europe: Trends and Challenges*. The World Bank, p.viii.
[4] Ibid.

[5] World Bank. 2000. Making Transition Work for Everyone. The World Bank. p.? .
[6] World Bank. 2001. *A Qualitative Assessment of Poverty in 10 Areas of Albania*. The World Bank..p. 63. Footnote is hidden… needs p.60-68.

[7] Ibid, 60-68.

cannot contribute, and a consequent sense of exclusion. This appears in a number of qualitative interviews.

Informal payments to teachers are another very important aspect of informality. It most cases it takes the form of tutorials and evening classes. In itself it is not negative with the exception that some teachers provide much more attention to these evening classes than to the normal day classes. More cause for concern is the direct payment to teachers, or in some cases bribes, to pass exams or advance from class to class. These various issues, related to informality penetrating the classroom, contribute greatly in the access to quality education for the poor.

According to the recent qualitative poverty assessment for Albania, most people feel that the quality of education has declined over the past ten years. Overall decline in educational quality and education levels has created some very worrying trends such as cases of illiteracy emerging in some rural and newly formed urban settlements. There are certain causes for the decline, including economic hardship and physical and social insecurity. To cope with poverty, there is evidence that some people withdraw their children from school when they are at an age to work.

Also, the decline in funding for educational materials, teachers' wages, heat, and maintenance for some schools, contributes to a decline in the quality of schooling in most of the South East European countries.

Social Protection

Informality and social protection raises two very different issues. First, the poor tend to rely on informal mechanisms in the traditional areas of social protection, including help to the elderly, the large family the handicapped, and to those in extreme poverty. As discussed earlier, the difficulty that the State has to target benefits to the ones in need, and the low level of public funds available in many of the countries under review, have limited the effectiveness of social protection systems. Consequently, many elderly, large families, handicapped, or others have been left with no other means than their own or family support. The second issue is that the large level of informal activities considerably limits the financing available for formal social protection, especially for countries where payroll tax constitutes the largest source of funds for pensions and still, in many cases, for other support like unemployment benefits and, even in some cases, social assistance.

The study on local level institutions in Bosnia and Herzegovina[8] identify a wide range of informal support between neighbors and keen: "the main forms of material assistance are monetary assistance, donation of food and commodities, sharing of collective charges, cooperation in building and repair of houses, and cooperation in maintenance of apartment buildings. Monetary assistance is most frequently related to traumatic events such as fire, illness, accident, or death. Donations of food and commodities are closely linked to the impoverishment of the post-war period." The study also shows that this type of solidarity varies according to regions and also how long the communities have been together. This type of support is more widespread in countries that have undergone major stress like war but it is also string common in

[8] World Bank. 2002. *B &H: Local Level Institutions and Social Capital Study*. The World Bank.

rural villages in Albania and it is particularly strong among some ethnic communities like the Roma.

The Bulgaria poverty assessment raises some serious concern about the bind in which social protection systems are finding themselves. With the exception of guaranteed employment, Bulgaria's pre-transition social protection system – consisting of pensions, short-term benefits for illness and maternity, family allowances, and in-kind social assistance programs and institutions – still remains intact. Since the transition, government policies involving early retirement options for laid-off workers and the benefits made available under new programs, have meant that the numbers of people receiving income support through State social protection programs has increased. However, cumulative social insurance payroll tax rates are higher today than before. The rates were increased by policymakers in an effort to cover rising expenditures and compensate for shrinking contributions – in turn, the result was raising unemployment, payment of arrears by State enterprises, and non-compliance by the growing private sector.[9] Inconsistently, the high payroll taxes are themselves a disincentive for both work and formal job creation, instead contributing to the informalization of the economy. A pensioner in Sofia said, "There is security, stability, when you have a job and stable pay. But not in a private company, because they don't provide social insurance. Before 1989 life was better, there was greater security because the prices of foods and medicines were low and stable."[10]

B. Informality in Access to Revenue and Employment

Informal Economy and Unemployment

Unemployment has become a feature of transition economies of South East Europe. However, unemployment figures do not account for the many people who now work in the informal sector. Accounts of informal employment in social assessment and other qualitative studies have emphasized the insecurity, hard work, often-unsociable hours, exploitative wage rates, and sometimes-dangerous conditions attached to it. The unemployed rarely choose to become involved in informality, preferring the security of formal employment. However, lack of formal employment, coupled with an inability to meet household needs in the absence of welfare benefits or because of the inadequacy of the assistance available, encourages some to turn to informal economy as a way of responding and coping.

Table 3. Unemployment (Annual Average, %)

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Albania	24.8	16.1	13.9	9.3	14.9	17.8	18.0	16.8	na
B-H	na	na	na	na	37.0	38.0	40.0	40.1	na
Bulgaria	16.4	12.8	11.1	12.5	13.7	12.2	16.0	17.9	na
Croatia	14.8	14.5	14.5	10.0	9.9	11.4	13.6	16.1	na
FR Yugoslavia	23.1	23.1	24.6	25.8	25.8	25.1	26.5	27.3	na
FYR Macedonia	28.3	31.4	37.7	31.9	36.0	34.5	32.0	32.1	na
Romania	10.4	10.9	9.5	6.6	8.9	10.3	11.8	10.5	na

Source. EBRD. 2001. Transition Report

[9] World Bank. 1999. *Bulgaria, Poverty during the Transition*, p. 48. not in bibliography
[10] World Bank. 1999. *Consultations With the Poor*. National Synthesis Report, Bulgaria.

Likewise, MacDonald sees the informal employment strategies of the unemployed as a part of a survival strategy through which some individuals are able to develop alternative ways of working in the face of restricted opportunities and the failure of system and welfare benefits.[11] Informality enables the unemployed poor to earn some basic revenues, but even more importantly it may help them to maintain a sense of pride in themselves.

Enterprise restructuring and the privatization process led to painful worker layoffs in Romania. Even though data on the size of the economy is questionable, Romania has a considerably large informal economy estimated at 40 percent of GDP by the US Treasury. In the qualitative research done by the World Bank staff, it was estimated that maybe up to 80 percent of the unemployed worked in the informal sector, either as their main source of income or supplemental incomes. According to the qualitative and quantitative research done in December 2000, most informal sector work is in agriculture, construction, trade, and in some service sectors.[12]

Most individuals work in the informal sector only if they have to, or if they can supplement their informal sector earnings with their unemployment benefits and the social services, such as health care, that are available with these benefits. First of all, for the vast majority, informal sector wages are very low. Research showed that average monthly informal sector wages range from ROL 300,000 to ROL 750,000 ($16.70 to $41.65) per month for full-time work, which is only about half of the average monthly formal sector wage. [13] The more illegal the work, the higher the wages, as well as the higher risks and fines if caught. Secondly, informal sector employment is often irregular and uncertain. Employees claim that employers will only hire someone for a maximum of three months or less. In the qualitative research, "many unemployed workers claimed they could only find about five days of work per month."[14]

A Bulgaria social assessment on poverty shows that the changing situation of the labor market creates an acceptance for illegal activities. The actual loss of jobs in the public sector and the collapse of "State-guaranteed" job security have led to public acceptance of not simply illegal acts but also of criminal activities as a form of employment for survival. These include burglaries, pick pocketing, muggings, and theft as well as prostitution and drug dealing. Some people argue that in the case of Varna, where in 1999, 80 percent of the working population were unemployed, this was compensated by a very large involvement in informal economy. [15] For example, women in this community were all unemployed and all were engaged in informal and criminal activities because they did not have a choice. Moonlighting is another strategy for private households or businesses to hire mostly Roma, off the books.

Formal micro businesses and self-employment, which have been a very fast growing sector in recent years in the European Union, face very large constraints in South East Europe. The

[11] MacDonald. 1994. "Fiddly Jobs, Undeclared Working and the Something for Nothing Society." *Work, Employment and Society*. vol.8, no.4, p.507-30.
[12] World Bank. 2000. *Social Assessment: Unemployment in Romania*. ECA. Social Development Unit.
[13] World Bank. 2001. *A Qualitative Assessment of Poverty in 10 Areas of Albania*. The World Bank. ECA Social Development Unit.
[14] ibid, p. 98.
[15] World Bank. 1999. *Consultations With the Poor*. National Synthesis Report, Bulgaria.

underdeveloped market environment as well as poor legal framework, petty corruption among law enforcement authorities and bureaucrats, and lack of credit does not help the situation of the poor, except the recent emergence of micro-finance for a small percentage of the poor. All this leads to a vicious circle: Informal economy – dodging taxes and social contributions while taking advantage of public goods and services – increases the budget deficit and is an immediate cause for raising taxes and social contributions which are a heavy burden on lawful activities."[16] In turn, high taxes depress economic activity and income stabilization, which brings us back to square one, making "informality" a mechanism of survival and coping, especially for the poor.

In a poverty assessment of FYR Macedonia, carried out in the framework of the preparation of the poverty reduction strategy, most interviewed households claimed that it was not possible for them to obtain loans to start a small business, especially because they cannot obtain a mortgage at affordable rates given the condition of the poor. Most unemployed have a lot of ideas and interest in what they would do (e.g. open cattle breeding farms or craft workshops, or market products) if they could get credits in favorable terms. With no access to financing and credit, and unbearable unemployment, most households are led to engage in illegal or semi-legal trade to survive. Others, with a small amount of capital (savings from "better times", loans from relatives), deal in smuggling goods. They buy goods, food, textile products, jewelry, alcohol or cigarettes from duty-free shops from Bulgaria and Turkey and sell them in the markets or on the streets, the so-called "suitcase trade".

Informality and Women in the Former Yugoslav Republic of Macedonia

Recent qualitative assessment in FYR Macedonia suggests that women's involvement in the informal sector is likely to exceed that of men. Emerging new barriers to women's participation in the formal economy often creates conditions for their involvement in informality. Many end up in the informal sector out of necessity rather than choice. Some of the opportunities available to women in the informal economy include the time flexibility it can offer to allow them to reduce the conflict between work and household life.

Recent trends in the newly developing private sector show that women earn less than men in the private sector, though at similar levels of education, experience, occupation and industry, particularly in rural areas. The gender wage gap is purely explained by discrimination, as women have on average much more industry, occupation and other factors. The lack of contract enforcement in the private sector, increasing informalization of the economy, the higher cost of hiring women (generous maternity benefits, etc.), and other discriminatory behavior towards women workers, are some reasons for the lower wages of women compared to men.

A small number of interviewed women were engaged in skilled work, knitting sweaters, weaving, or in making traditional garments (mostly in the western region) at home. Some women work in the informal sector as seamstresses. Women in urban areas most often work as cleaning ladies in buildings and apartments. In many households from the urban areas, prostitution was mentioned as a way of survival. In rural areas, poor people work as day laborers on other people's land (cutting, digging, sawing and similar) or mind cattle, mainly during the summer months. The informal work described in household interviews is arduous, seasonal or occasional in nature, requiring a long search period, and is often available only during the summer months. Women selling traditional garments also cited reduced demand for their work as a result of increased competition from workers in Albania. Many women said that it was easier to find work a few years ago. They related that even seasonal work opportunities, for example, the extraction of sugar turnip; picking apples, sour cherries and other fruit in orchards; or work at hotels, are now few."[17]
Source: World Bank. 1999. Former Yugoslav Republic of Macedonia, Focusing on the Poor.

[16] World Bank. 1999. *Consultations With the Poor*. National Synthesis Report, Bulgaria, p.52.
[17] World Bank. 1999. Former Yugoslav Republic of Macedonia Focusing on the Poor, p.27.

C. Informality in Obtaining Favors, Justice, and Security

World Bank poverty assessments in South East Europe have many references to "informality" as an important way to obtain essential administrative documents, pressure the judicial system, and obtain the collaboration of law enforcement personnel. Many poor see the lack of fair access to the legal system and the lack of security as major components of poverty.

The lack of trust in the legal system and in the possibility for people to influence in a non-transparent way is a major issue. It is very difficult to get precise information in this area but it is obvious that petty corruption of law enforcement officials is widespread in the poorer countries of South East Europe.

In Albania the qualitative poverty assessment has shown that the traditional form of justice is administered through the "fis" clan, based on a council of elders and the Canun system (a traditional legal system) and is now widespread in the poorer northeastern part of the country. This mechanism tends to provide some form of stability inside clans but is not effective at dealing with problems between clans, and it encourages blood feuds and revenge. In some areas such as Skhodra and northern Kukes, families reportedly are confined to their own homes to protect themselves during a feud, not even being able to access their land. These are quite extreme cases for South East Europe but they indicate how broadly informality has expanded to areas such as justice and security.

III. LESSONS FOR POLICY

The difficulty of the transition and the post-war reconstruction in most of the South East European countries have pushed many social actors, individuals and firms, and even public institutions to operate in the informal sector. This has been overwhelmingly the case for the poor. The complete elimination of the informal economy is unrealistic as European Union governments themselves realize. No significant reduction of the informal sector will occur unless there is improvement in the general economic situation and in the policies supporting those who are seeking survival within the informal sector.

For instance, the Romanian government attempted to reduce the size of the informal economy, but the emphasis has been on punishment rather than on prevention through the use of incentives. Laws and institutions were created to control and "fight" against the black market and tax evasion. These policies have not really been effective and the informal economy continues to expand in this country. The business environment has not improved, and the country has not become more attractive for foreign investors.

What is the most important is to try to differentiate between the informal economy that helps the poor to cope, and the informal economy that has large negative externalities on the economy as a whole and on the welfare and basic rights of the poor. This differentiation is especially important in situations when the State cannot really take its full responsibility for social support and human

development because of shortages of funds and weak capacity. In this case trying to reduce informal support and services would have a strong risk of excluding the poor.

Improving Access to Social Services

Incentives for promoting self-help among the poor are needed. Finding mechanisms that allow for flexible "officialisation" of the informal coping mechanisms that have a positive impact on the poor should be part of the strategies to deal with informality. For example, give responsibility to parent-teacher associations for some part of school maintenance and teaching materials, but with the creation of school funds that include mechanisms to have the poor exempted. Encourage national NGOs to support school maintenance in particularly poor regions. Have community-based targeting systems that allow municipalities to exempt some households for payment for services but in a transparent and informed way. Encourage local associations to set-up food distribution and other programs.

Reforming Regulatory and Legal Frameworks

For these programs to work it is essential to reduce to the minimum the administrative requirement of registration, reporting, licensing, etc. The mechanisms, however, need to be very clear, well defined, and well publicized. Very often for this to work the government needs to take action at the national level. The laws on associations and the non for profit [non-profit or not-for-profit?] sector are very important. They need to provide for flexibility and ease for registration, but they also need to protect the right of the members and avoid abuse. In some countries, things can get quite complicated, especially if theses associations are supposed to enter into partnership with central or local governments and use public funds.

On the other side, law enforcement and prevention activities need to be strengthened in the area of drug and human trafficking as well as larger informal activities benefiting mafias. This is a very urgent issue in South East Europe where international support is definitively required.

Employment Creation

Sustainable poverty reduction for South East Europe is also dependant on positive economic growth, based on a vibrant private sector. The private sector not only provides the necessary employment creation and higher incomes, but also the tax base for sustainable funding of public health care, education, social safety nets, agricultural research, and other critical expenditures, which impact positively on the poor. Improvement of the conditions for the poor, who are surviving via informality, will only occur in a favorable business and investment environment. The lack of an effective legal and regulatory framework remains a major impediment to successful private sector development.

In the employment-creation and revenue-generating area, micro-credit has an important role to play. Many promising experiences should be better assessed to see the potential for replicability. In Croatia, Catholic Relief Services (CRS) have very interesting credit and saving schemes. The World Bank is supporting a very successful program of micro-credit in Albania, which promotes credit and saving systems for village associations. The area of micro-credit offers very

interesting potential for development and is certainly a way to compete with the informal credit system in a way that benefits the poor. Technical support is important for micro-enterprises. There again the legislative framework is very important. Croatia has been preparing a law for the last two years that would allow non-Bank institutions to do some micro-lending and to expend some of the pilots, which have been started by NGOs and others. The development of the region's micro-, small- and medium-sized enterprises is severely constrained by the poor business climate, lack of finance, and inadequate infrastructure. The legal and regulatory environment impacts differently on different enterprises, entrepreneurs, and households. It can have a particularly negative effect on micro-enterprises, where excessively bureaucratic procedures and practices have an important disincentive effect on the creation and growth of enterprises. Programs to support SMEs and micro-enterprises are often thought of as key interventions to support the poor. Small enterprise, and in particular micro-enterprise development, is certainly an important way to increase employment, create a more regionally balanced development, and empower people in general.

In the area of trade, legislation needs to be adapted in order not to criminalize people for doing small trade for survival. There is quite a rich experience in the EU in this area. [Legislation needs to be adapted to simplify the tax and registration systems for small traders. [Additionally, legislation should be enacted to reduce the level of tax and provide clear rules of the game in order to reduce petty corruption from law enforcement officials, which can be a major source of difficulties for the poor.

Furthermore, for small businesses the intractable problem of corruption must be addressed through a mix of internal and external efforts that involve the state, the private sector, and civil society. The donors could make substantial investments in civic monitoring efforts and in the creation of business coalitions that promote good government, transparency in financial transactions, deregulation and the simplification of registration, taxation, and inspection procedures.

Improving Public-Private Partnerships

It is important to give a stronger voice to communities in order to fight petty corruption and to devise mechanisms that would require local civil servants or municipal employees to be more accountable to the poor. This is an area where quite a lot could be done. In Tirana, the mayor is setting up a report card system on delivery of basic services by the municipality. The mechanisms will get feedback from citizens on the quality of services through regular surveys and focus groups. Additionally, in Albania, a mechanism of participatory monitoring and evaluation for health services is under preparation, involving users of health services to provide feedback on the quality of services.

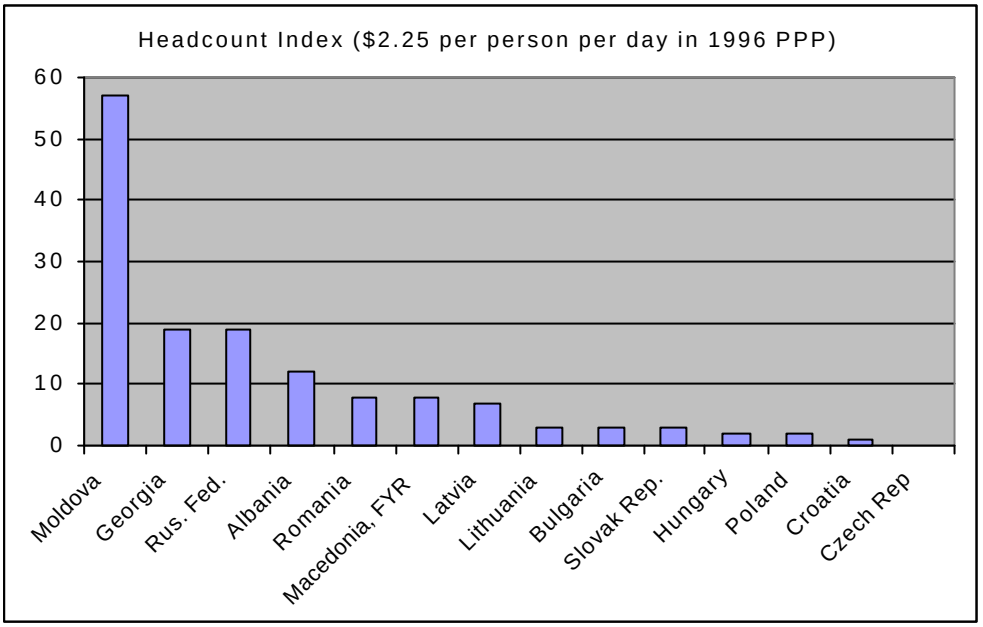
We have tried to demonstrate that in the poorer EU accession countries, the poor cope mostly through informality. The governments are not capable of providing the adequate safety net that would allow the poor to survive without informal relationships. It is therefore important to ensure that whatever measures are taken towards the informal sector it does not contribute to worsening the situation of the poor. In this paper we tried to indicate some possible ways for governments to reduce the negative impact of a large informal sector with pro-poor policies.

More understanding is needed on these informal relationships to identify adequate policy measures. This is the reason the World Bank is launching a number of studies in the region, on local-level institutions and social capital, which will hopefully improve our understanding of some of these issues.

ANNEX 1

OTHER RELATED TABLES AND FIGURES

Figure 1. Percentage of Population Living in Absolute Poverty in Various ECA Countries



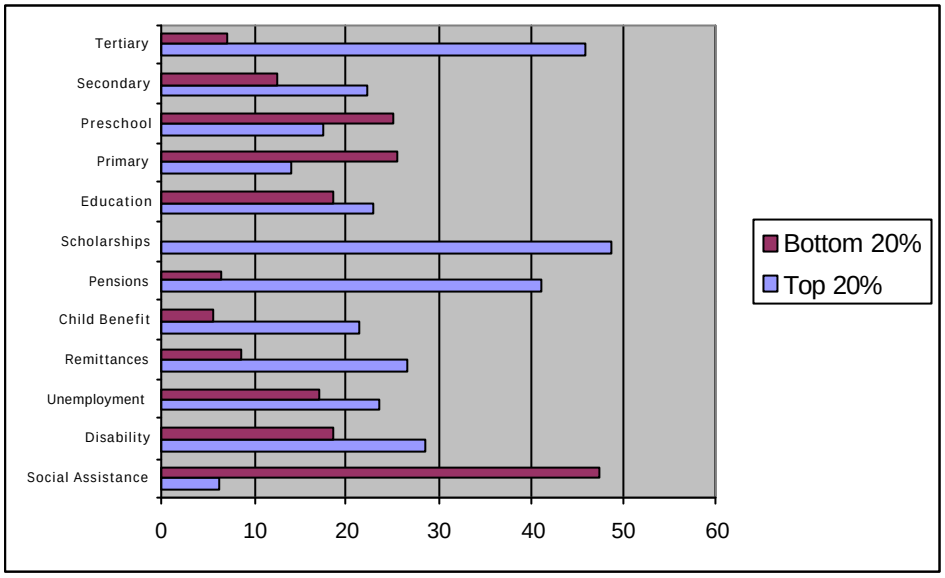
Source: World Bank. 2000. Making Transition Work for Everyone.

Table 1. Incidence of Public Expenditures on Education in Selected Countries

Country	Preschool	Primary	Secondary	Tertiary
Romania (1997)				
Bottom 20%	-	21	26	10
Top 20%	-	10	12	24
Bulgaria (1997)				
Bottom 20%	23	21	16	11
Top 20%	-	-	-	-
FYR Macedonia (1996)				
Bottom 20%	24.9	25.4	12.6	7.1
Top 20%	17.5	14	22.3	46
Albania (1996)				
Bottom 20%	-	27	7.2	7.5
Top 20%	-	11.8	32.3	31.6

Source: World Bank. 2000. Making Transition Work for Everyone.

Figure 2. Former Yugoslav Republic of Macedonia, Comparative Efficiency of Targeting: Share of Total Public Spending Received by the Poor



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