

# Entrepreneurship in the Informal Sector as a Form of Labour Market Adjustment – the Case study of Macedonia

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The past two decades Macedonia has gone through the process of transition which is still shaping the social, political and economic ambience in the country. The initial transitional recession has inter alia manifested salient effects on the labour market performance. Macedonia is among rare countries, where the unemployment rate during the whole period of transition hovers above 30%. Even though there is some criticism regarding the accuracy of the Macedonian unemployment rate estimated by the Labour Force Survey it is still evident that we are facing an odd phenomenon. By using the Keynesian terminology, the Macedonian labour market experiences a suboptimal equilibrium assumed as a state where significant part of resources are not utilised or underutilised. We argue that this suboptimal equilibrium to great extent is result of the alternative labour market adjustment mechanisms that mitigate the high and sustained unemployment. These mechanisms cushion the social implications of unemployment by absorbing a part of unemployed workforce and/or providing additional incomes for households that enables their basic subsistence. One form of adjustment mechanism among the unemployed workers is the employment in the informal sector that provides the necessary income support for the households. Generally, the informal sector in transition countries is marked by a number of peculiarities which make informality in transition distinct from that observed elsewhere. Although, the informal economy may take different forms and is difficult to measure it is characterised by strong entrepreneurial dynamism. In this paper we will make an attempt to identify the profile of the unemployed workers that undertake various forms of entrepreneurial activities in the informal sector. For this purpose we will use results from the survey carried on a representative sample of registered unemployed workers in Macedonia. Furthermore, we will estimate an econometric model that will assist in the process of identification of relevant factors that influence the entrepreneurial activities in the informal sector. Finally, we will formulate appropriate policy measures that will target the informal sector in order to provide the necessary conditions for transferring the informal businesses to the formal sector of the economy.

## **Keywords**

Labour market, entrepreneurship, informal sector

## 1. Introduction

The past two decades Macedonia has gone through the process of transition which is still shaping the social, political and economic ambience in the country. As a part of South-Eastern Europe, the Macedonian economic growth is constrained by the general regional predispositions, which amongst other things are determined by the political instability of the region. Hence, the economic performance of the South-Eastern European countries (SEECs) has not been strong enough compared to Central-Eastern Europe countries (CEECs), which already take part of the European Union. In this sense, Macedonia and other SEECs, are known as 'lagging reformers' with regard to completion of the reforms in all spheres of the society.

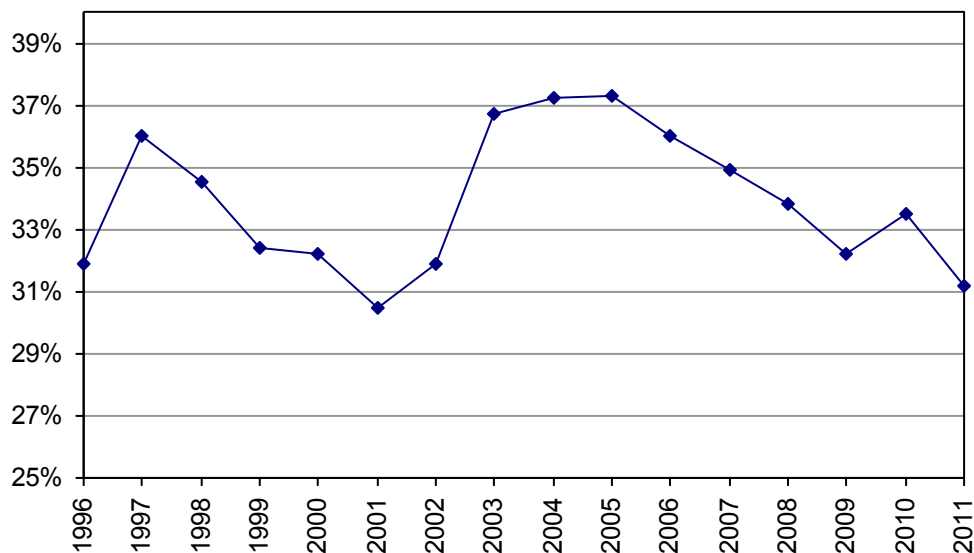
The transitional process as a multidimensional phenomenon has affected every domain of the political, economic, and social life in the country. In the economic sphere, transition has been characterised by a change in the ownership of capital, liberalisation of goods and capital markets, liberalisation of the foreign economic relations, radical change in the role of the state in the economy, and the creation of a less regulated labour market. In the sphere of social life, transition has led to rising poverty and income inequality, a weakening of the middle class and social exclusion of vulnerable social groups. Politically, the transition has been accompanied by the creation of a democratic society, differentiation of power into legislative, executive and judicial branches, the creation of a pluralistic political system and implementation of public and democratic elections [1].

The initial transitional recession has inter alia manifested salient effects on the labour market performance. Generally, the transitional reforms initially had negative effects on labour markets, which were manifested in declining participation rates and in persistent high unemployment. The processes of ownership restructuring and sectoral reallocation assumed a large-scale transformation of state owned firms into privatised ones and, a reallocation of a substantial part of the labour force from the manufacturing and agricultural sectors towards the expanding service sector [2]. The experience in almost all transition countries, including Macedonia shows that the creation of new jobs in the emerging private sector was not initially strong enough to absorb the mass of workers laid-off from the restructured state-owned firms. At the same time, the mismatch between the skill requirements of newly created jobs and effective skills owned by the workers has become a substantial problem [3]. Consequently, the labour markets in early transition became less dynamic with a relatively stagnant unemployment pool leading to increases in unemployment and especially long-term unemployment [4]. The initial 'transitional unemployment' differed in several aspects from other types of unemployment in that it was characterised by pronounced labour market segmentation, long average duration of unemployment and a low probability of exiting unemployment into employment [5].

The aim of this paper is to assess the entrepreneurship in the informal sector as a labour market adjustment mechanism in transition countries and particularly to investigate the case of Macedonia. For this purpose we will use the empirical results from a survey of registered unemployed workers. To our knowledge this is the first study addressing this issue in Macedonia that will shed light on the role that entrepreneurship in the informal sector plays on the Macedonian labour market. In this context, in section 2 we first present the general labour market trends in Macedonia. Next, in section 3 we will define the concept of entrepreneurship in the informal sector as a form of labour market adjustment mechanism. The empirical assessment of the entrepreneurship in the informal sector in Macedonia will be subject in section 4. Finally, in section 5 we will conclude and formulate suitable labour market policies that target the unemployed population involved in various forms of informal entrepreneurial activities.

## 2. Macedonian Labour Market Performance

In order to investigate the features of the Macedonian labour market during transition, it is appropriate to divide the transitional period into two sub-periods. The first period encompasses the transformational recession from 1990 to 1995, with the second period starting immediately thereafter and lasting until the present. The changes of the unemployment rate in relative terms during the business cycle are rather small, which reflects the depressed characteristics of the Macedonian labour market [6]. The dynamics of the unemployment rate in Macedonia for the period 1996-2011 is shown on Figure 1.



**Figure 1** The unemployment rate in Macedonia 1996-2011

*Source: Macedonian Statistical Office, Labour Force Survey*

The first Labour Force Survey (LFS) in Macedonia was conducted in 1996, and since then we have detailed data concerning labour market trends. During the period 1996-2003, the Macedonian LFS was conducted on a yearly basis, whereas since 2004 it is conducted as a continuous survey throughout the year with quarterly processing of data. For the period prior to 1996 we can explore labour market trends based on the number of registered unemployed workers. According to both sources of data we can generally distinguish several features of Macedonian labour market presented as follows.

First, during the initial phase of transition, the labour force participation and employment rates fell for most of this period, while the unemployment rate steadily increased. These trends are in line with the normal labour market patterns found in the CEECs i.e. declining employment under the initial shock of recession and subsequent persistence of sluggish demand for labour.

Second, the mature phase of transition is characterised by broad stability in all three rates. However, we can observe recessions in 2001 (primarily caused by the already mentioned political instability) and in 2009 due to the global economic crisis. The downward trend in the unemployment rate was broken and unexpectedly remained high for several years due to the lack of job creation in the formal part of the economy [7]. Only recently, there are some positive signs of a slow recovery and the possibility of renewed decreases in unemployment.

Third, the Macedonian labour market is affected by strong segmentation, meaning that certain social groups such as youths, less skilled workers, and women, face a higher risk of unemployment and inactivity than the rest of the labour force. As a consequence, the high Macedonian unemployment rate has enormous social implications such as rising poverty, income inequality and social exclusion of deprived social segments [8].

Fourth, long-term unemployment prevails over the short-term unemployment implying likelihood of possible 'discouraged workers' phenomenon. For instance, long-term unemployment accounts for almost 80 percent of total unemployment [9]. Long-term unemployment has significantly contributed to an erosion of skills and motivation of unemployed workers, making them less employable over time [10]. The deterioration of skills further reduces the attractiveness of the labour force and contributes to a blurring of the difference between the states of unemployment and inactivity. After remaining unemployed for a long period of time, a considerable part of unemployed workers stops looking for jobs and quits the labour force.

Fifth, the sectoral reallocation of labour has been characterised by a significant increase of subsistence agriculture and other non-standard forms of employment at the expense of rapid shrink of employment in industry. These trends in employment by sectors indicate that in Macedonia new jobs are not predominantly created in the more productive industries and service sector, but rather in agriculture and low productivity services. The increase in the share of employment in agriculture suggests that this sector has become a buffer for some people who have lost their jobs in the state-owned industrial enterprises [6].

Finally, given the rigidities in the standard adjustment through employment and wages, less traditional (in the western context) labour market adjustment mechanisms may play a more significant role. Among the alternative labour market adjustment mechanisms in SEEC we particularly distinguish the non-participation, emigration and employment in the informal sector of the economy.

### **3. The Entrepreneurship in the Informal Sector as a Form of Labour Market Adjustment**

Having in mind the multitude of different approaches, defining the informal economy is not a simple task. There are various terms that are used in order to denote the informal sector such as: informal, hidden, underground, parallel, black, unofficial, unrecorded, shadow, grey, dual, and so forth. Despite existing nuances in the meaning of the above terms, we will assume that more or less they concern the same issue. However, in this analysis, for convenience we adopt the term 'informal' as the most appropriate and frequently used in the case of transition economies, because it indicates its specific nature in providing employment and alleviating poverty [11].

Generally, there are two distinct approaches to the formulation of the informal sector. The first is called 'definitional' and considers the informal economy as unrecorded economic activity. The second approach, called 'behavioural', considers the informal economy as an explicit change in the behaviour of economic agents in response to institutional constraints. According to the most commonly used definition, the informal economy encompasses all unregistered economic activities that contribute to officially calculated or observed Gross National Product [12]. In this context, the informal entrepreneurship is defined as involving somebody in starting a business or is the owner/manager of a business who participate in the paid production and sale of goods and services that are legitimate in all respects besides the fact that they are unregistered by, or hidden from the state for tax and/or benefit purposes [13].

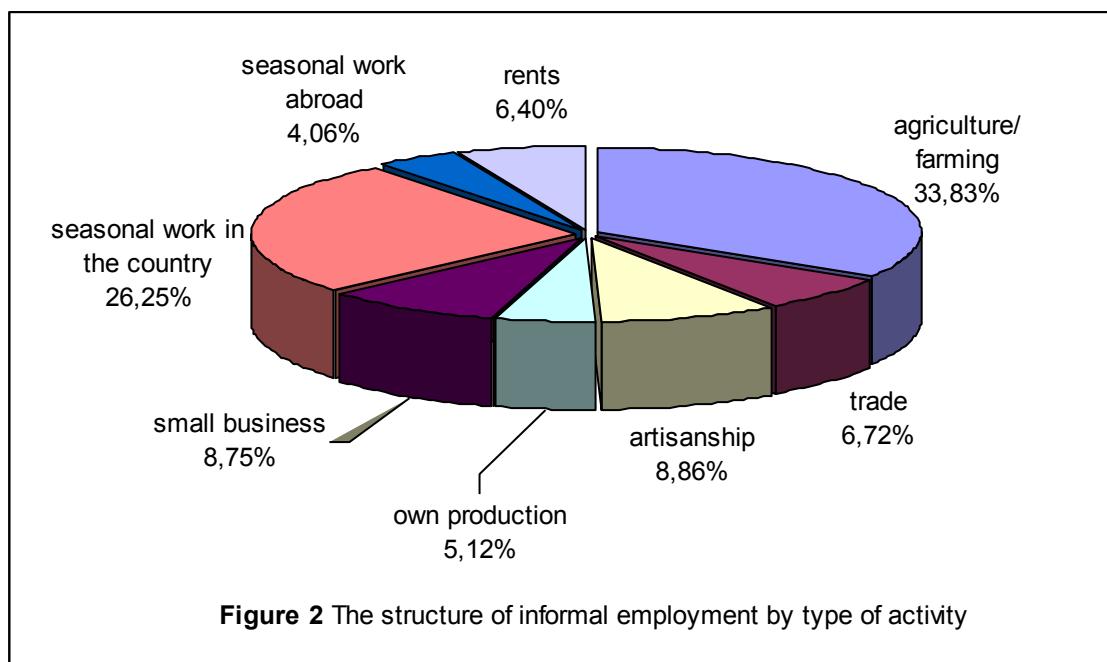
Research on the informal economy has identified a number of factors that influence the size and structure of the informal sector. As summarised by Schneider and Enste [14], the main cause of a flourishing informal economy is the burden of tax and social security contributions, intensity of regulation, and the disincentive effects of social transfers. All these factors create a tax wedge, which consist of the difference between the total cost of labour and after tax earnings. The greater is this difference, the higher will be incentives to operate in the informal sector. Moreover, in developing and transition countries there exist peculiar factors that can cause a large informal economy such as poverty and social exclusion. In these countries,

due to the low level of wages and social protection such as unemployment benefits and pensions, informal and household production can arise as potential survival strategies for marginalised and socially excluded segments [15]. Besides this, the informal sector can be viewed as an opportunity for undertaking various forms of entrepreneurial activities [13], [16].

#### 4. Empirical Assessment of the Entrepreneurship in the Informal Sector

To our knowledge, in Macedonia there is a lack of consistent cross-section data about the entrepreneurship in the informal sector as a form of labour market adjustment mechanism. In order to estimate to what extent the unemployed workers are prone toward the employment in the informal sector we have designed and carried out a survey based on a representative sample of registered unemployed. The survey was conducted during a reference period from mid October to mid November 2011. The sample size is 2300 unemployed workers selected randomly in each of 30 centres of the Employment State Agency (ESA) all over the country. Moreover, the geographical distribution was maintained by selecting from each centre a proportional number of respondents with respect to the total number of registered unemployed workers in that centre.

In our empirical analysis 38,3% of the surveyed unemployed workers declared that earn income from various types of additional activities that are informal by nature, while half of them declared that other household members also perform such types of activities. With respect to this, we argue that in depressed labour markets which lack job creation in the formal sector, informal employment helps people to enter the workforce by offering an alternative to unemployment or inactivity and, prevents a further decline in living standards. The structure of employment by type of informal activity is shown on Figure 2.



From Figure 2 it is evident that majority of the unemployed workers are engaged in subsistence activities such as agriculture, farming and seasonal work in the country that together represent about 60%. On the other hand, the entrepreneurial activities such as running own business, artisanship or own production and trade are represented to lesser extent. Therefore, we can conclude that most of the unemployed workers that operate in the informal sector are usually low skilled or unskilled and perform labour-intensive operations. The above argument is in line with the sectoral reallocation in Macedonia during transition,

according to which the share of employment in subsistence agriculture demonstrated a significant rise. Nevertheless, this should not be a general conclusion for the productivity in the informal sector, since in this case we do not include the informal activities performed as a second job by those who are otherwise formally employed.

The income gained from informal activities for these households on average is 34,2% of their total household incomes, which represents significant financial contribution. However, expressed in absolute terms the average monthly income from informal activities is moderate since one third of the respondents declared to earn less than 100 euros and another third declared between 100 and 200 euros. As a consequence we can argue that unemployed workers primarily are involved in informal businesses that usually operate on a small-scale basis either in the form of self-employment or as micro or small enterprises.

In order to assess the factors that influence the informal entrepreneurial activities among registered unemployed in Macedonia furthermore we estimate a Logit model, where the dependent variable takes value zero if the person declared that does not earn income from additional activities in the informal sector. In the opposite case where the unemployed worker declared that undertake and therefore earn income from such activities, the dependent variable takes value one. We divide the possible determinants in four groups: Personal traits, household characteristics, services from the ESA and the alternative labour market adjustment mechanisms. The results from the estimated Logit model are presented in Appendix 1.

According to the obtained results, most of the personal traits of the unemployed worker are statistically significant determinants of the employment in the informal sector. In this context, male unemployed are about 56.5% more likely to engage in informal activities than female. Married unemployed are about 31% less likely to perform various form of informal employment activities, whereas those who live in urban areas are 43.6% less likely to engage in informal employment compared to those who live in rural areas. The coefficient of the age variable is positive and statistically significant meaning that among informally employed prevail more experienced workers.

Considering the household characteristics, the number of employed members and having another unemployed member in the household significantly influence the respondents' decision to undertake informal economic activities. Hence, an unemployed worker on average will be 40.5% less likely to engage in informal employment for any additional employed member in the household. On the other hand, having an additional unemployed member in the household on average will decrease the probability for undertaking informal economic activities for about 21.9%. These results are somewhat expected since an increase of employed members in the household is often associated with increase of the income, which in turn renders the employment in the informal sector to be less attractive.

With respect to the labour market policies, we have considered the health insurance, unemployment benefit and participation in active labour market programmes. The signs of the estimated coefficients confirm the theoretical assumptions that passive labour market policies create disincentive effects, whereas the participation in active programmes goes hand in hand with the employment in the informal sector. However, we have not found statistically significant effect of those policies upon the engagement in the informal employment.

Finally, according to our estimated model we find out that among the alternative adjustment mechanisms only social assistance beneficiaries are significantly more likely to undertake informal economic activities. In fact, this category of unemployed are the most deprived on the labour market and, consequently they are about 64.7% more likely to engage in the informal employment as an alternative source of income for their households.

## 5. Conclusions

In this paper we develop the concept of entrepreneurship in the informal sector as a form of labour market adjustment in the Macedonian labour market. Namely, the Macedonian labour market during the past two decades of transition has been characterised by high and persistent unemployment coupled with alternative forms of adjustment such as inactivity, emigration and employment in the informal sector. The conventional forms of labour market adjustment are characteristic for the employed workers, whereas non-standard forms are mainly alternatives for the unemployed workers.

As informal economic activities we consider only those who are legal in nature but not officially registered. With respect to this, we attempt to identify their capacity to absorb part of the unemployed workforce and cushion the economic and social consequences of persistent unemployment. To our knowledge, in Macedonia there is a lack of consistent cross-section data about the role that entrepreneurship in the informal sector play as a form of labour market adjustment mechanism. In order to estimate to what extent the unemployed workers are prone toward the employment in the informal sector we have designed and carried out a survey based on a representative sample of registered unemployed.

According to the results from our empirical analysis, a considerable number of unemployed workers are engaged in various forms of employment in the informal sector. Furthermore, we found that income earned from additional informal activities represents more than one third of the total income for their households. Hence, employment in the informal sector alongside other forms of labour market adjustment significantly contributes to the wellbeing of the unemployed workers. However, most of the informal arrangements of the unemployed workers are low-productivity and small-scale predominantly in the agricultural and farming sector. With respect to the determinants of the employment in the informal sector we revealed that male, mature and those who live in rural areas are more inclined toward the informal sector. Regarding the labour market policies we have not found any significant impact on the respondents decision about participation in the informal sector. On the other hand, those who receive social assistance, who represent the poorest and the most marginalised segment of the population are significantly more involved in the informal arrangements.

Having in mind the characteristics of the employment in the informal sector as an adjustment mechanism for unemployed workers we can draw several conclusions and policy implications. First, the informal economic activities of unemployed workers in Macedonia mostly represent a strategy of last resort rather than opportunities for entrepreneurship. Second, the agriculture and farming represent the most common source of income for unemployed workers, whereas small businesses, own production and artisanship are represented to lesser extent. Third, the policy measures should target the most vulnerable segments of the unemployed population in order to provide appropriate employment opportunities in the formal sector.

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## Appendix 1

Estimated Logit model for the informal activities of registered unemployed

Variable	Coefficient	Standard error	t-value
Intercept	- 3.904221889	1.0497092002	- 3.71933***
Personal traits			
Male	0.447800262	0.1567525856	2.85673***
Age	0.185857540	0.0553166871	3.35988***
Age square	- 0.002107078	0.0006927936	- 3.04142***
Married	- 0.372126675	0.2101287032	- 1.77094*
Urban	- 0.572056576	0.1837637456	- 3.11300***
Long-term unemployed	0.207808458	0.2150794902	0.96619
Household characteristics			
Total number of members	0.074032639	0.0998112538	0.74172
Number of members at working age	0.140424789	0.0987348415	1.42224
Number of employed members	- 0.519439650	0.1096765291	- 4.73610***
Another unemployed member	- 0.246761809	0.1014281714	- 2.43287**
Services from the ESA			
Health insurance beneficiary	- 0.076563156	0.1732241995	- 0.44198
Unemployment benefit	- 0.201085680	0.3176740980	- 0.63299
Participation in active programmes	0.080994776	0.2472235676	0.32761
Alternative adjustment mechanisms			
Have retired member(s)	0.057112170	0.1841800829	0.31008
Social assistance beneficiary	0.498694808	0.2658019372	1.87618*
Have emigrated member(s)	0.254076750	0.2307808600	1.10094
Intention to emigrate	0.067665852	0.1683236838	0.40199
Search for job	0.228974879	0.2100193360	1.09025

Note: \*, \*\* and \*\*\* represent statistical significance at the 10%, 5% and 1% levels respectively.