



Working paper No. 4



Informal middle-class workers: the missing middle

Working paper series on the middle class

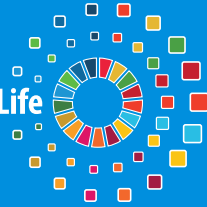


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Key messages

 Lower middle class **>x2**  Upper middle class

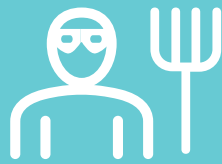
Informality in the **lower middle class** is more than twice as **prevalent** as in the **upper middle class**.

Microenterprises are **major employers** for middle-class **informal workers** in all five countries.



In agriculture

86%



are informal workers in Egypt, Jordan, Lebanon the State of Palestine and Tunisia.

High informality rates also occurs in



construction



trade

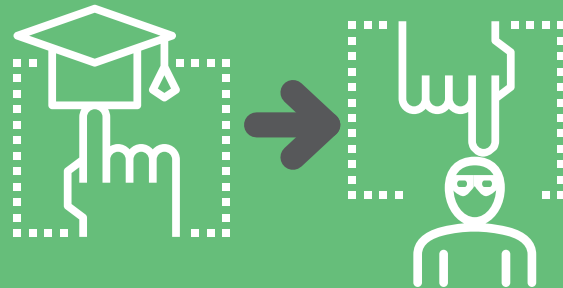


industry

Middle class informality is concentrated in agriculture.

An average of 86 per cent of agricultural workers in Egypt, Jordan, Lebanon, the State of Palestine, and Tunisia are informal.

High informality rates also occur in construction, followed by trade and industry.



There is a negative correlation between a lack of educational attainment and informality in Egypt, Jordan, Lebanon, the State of Palestine, and Tunisia.

However, the relationship between education and informality may not be causal and **improving education**, specifically by increasing educational access, **may be helpful to reduce informality**.

Introduction

Informal employment is a worldwide phenomenon that is often considered a factor for several vulnerabilities, including poverty, marginalization and indecent work conditions. Informality includes working individuals with no legal arrangements or formal contracts, as set out in the guidelines endorsed by the 17th International Conference of Labour Statisticians, held in 2003.¹ In reviewing those guidelines, Hussmanns states the following:²

“The basis used for distinguishing informal jobs is that they are outside the framework of regulations either because (a) the enterprises, in which the jobs are located, are too small and/or not registered, or (b) labour legislation does not specifically cover or is not applied to atypical jobs (such as casual, part-time, temporary or home-based jobs) or to subcontracting arrangements in production chains (such as industrial outwork), so that the jobs (and, therefore, their incumbents) are unprotected by labour legislation. In order for most labour law to be implemented, it is necessary to recognise the existence of an employment relationship between employer and employee. Informal jobs, however, include forms of employment for which there is no clear employer-employee relationship.”

Informal employment is characterized by absent or low levels of decent work conditions, low productivity and lower-skilled labour.³ Many scholars argue that political instability, weak economic governance and weak development within a State play key roles in increasing unregistered employment activities.⁴ Several determining factors that contribute to informal employment exist in the Arab labour market. Arab States have the world’s highest overall unemployment rate, one of the world’s highest youth unemployment rates (26 per cent) and are experiencing a deterioration in job quality, hence, the informal sector is expanding.⁵

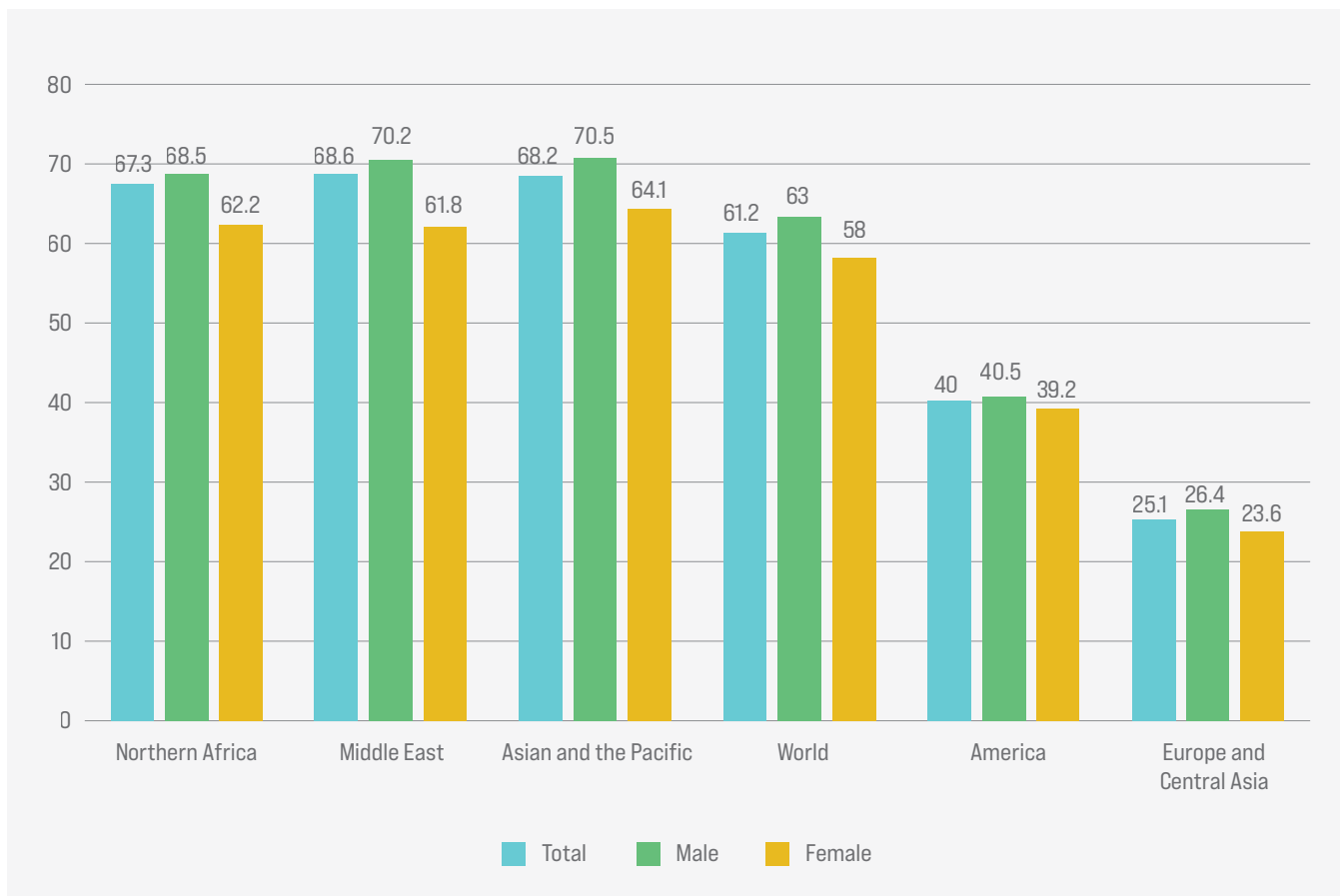
Informal employment has recently increased due to the COVID-19 pandemic, especially where vulnerable labour market conditions exist, including in markets with low economic growth and weak labour law enforcement. In addition to COVID-19-related factors, long-standing political instability in Iraq, Libya, the State of Palestine, the Syrian Arab Republic, and Yemen have forced more workers into the informal sector.⁶ In conflict-affected countries, workers often work in the informal sector or the war economy if they are able to find employment. Therefore, previously existing work skills tend to decline over time given the protracted nature of wars in the Arab region.⁷



Recent research indicates that 68 per cent of the labour force in most Arab countries works informally.⁸ As shown in figure 1 below, the Arab region has the highest level of informal employment among all regions globally, with a higher percentage of males than females engaged in informality. When each country in the Arab region is examined individually, countries with the lowest level of gross domestic product (GDP) per capita tend to have the highest levels of informality. Estimates suggest that one third of GDP in the region is produced through informal work.⁹

This paper seeks to provide detail on the degree of informality among middle-class workers in Arab countries and describe its characteristics. That analysis lays the foundation for a discussion of social protection schemes to support the marginalized middle class who has not received meaningful social protection coverage in the past, beyond defunct or substantially reduced general subsidy schemes.¹⁰ For the purposes of this paper, middle-class informal employees are referred to as the “missing middle”.

Figure 1. Informal employment by region and sex, 2016 (Percentage)



Source: International Labour Organization.

High informality among the lower middle class

6



01

Informal employment is known as a characteristic of the working class. Prior studies have analysed social and economic factors that can explain the prevalence of informality. Some studies have argued that, if the State fails to promote the benefits of registration (if such benefits exist), and if the formal private sector has only a limited role in employment, those factors have a great effect on informality.¹¹ In addition, an increase in labour supply and the stagnation of labour demand have forced many of working age to seek any type of job rather than insist on finding employment with decent labour conditions.¹² Furthermore, institutions play a key role in formal sector growth. Correlations between corruption and the growth of a shadow economy have been shown¹³ as well as the links between the size of a government and the prevalence of informality.¹⁴ The conclusion is that informal employment is inversely related to the actual size of the government in developing countries.

The below table shows a high prevalence of informal employment among the working class, a class with the most precarious working conditions as compared to other classes. A point of note is that the owning class also has a significantly elevated level of informality. This could be because the owning class includes a large segment of business owners and high-income self-employed workers operating in

the informal sector. Working paper No. 2 in the present series discusses the fact that more than 65 per cent of the owning class works in microenterprises, which are characterized by high informality rates.¹⁵ Although middle-class workers have lower rates of informality compared to other social classes, informality rates among those in the lower middle class is more than double the rates of the upper middle class. This statistic is a strong indicator that lower middle-class workers are more vulnerable and therefore prone to falling below the poverty line unless adequate social protection programmes are put in place.

The State of Palestine records the highest informality rates in the region among its lower and upper middle-class workers, followed by Lebanon, Egypt, Jordan, and Tunisia. For the upper middle class, Lebanon has the highest informality rates compared with the other countries, indicating that a share of high-level professionals is contending with informal employment vulnerabilities. The relatively low informality among the owning and upper middle classes in Tunisia is an anomaly in the analysis. However, the small data set used to analyse the situation in Tunisia may cause some distortions and, unfortunately, occupation data limitations impede expanding the analysis to cover alternative data sources.

Middle-class informality rates in selected Arab countries

| Class | Egypt | Jordan | Lebanon | State of Palestine | Tunisia |
|--------------|-------|--------|---------|--------------------|---------|
| Owning | 65.2 | 74.7 | 50.9 | 82.3 | 38.4 |
| Middle | 49.7 | 37.6 | 51.1 | 49.0 | 36.2 |
| Upper middle | 19.9 | 16.1 | 32.8 | 22.9 | 8.9 |
| Lower middle | 54.3 | 43.7 | 55.6 | 56.5 | 39.9 |
| Working | 79.5 | 56.2 | 67.9 | 84.8 | 50.8 |
| Total (n) | 5 898 | 2 937 | 26 358 | 15 355 | 1 499 |

Source: ESCWA calculations, 2023.

Decreased informality in the Egyptian middle class

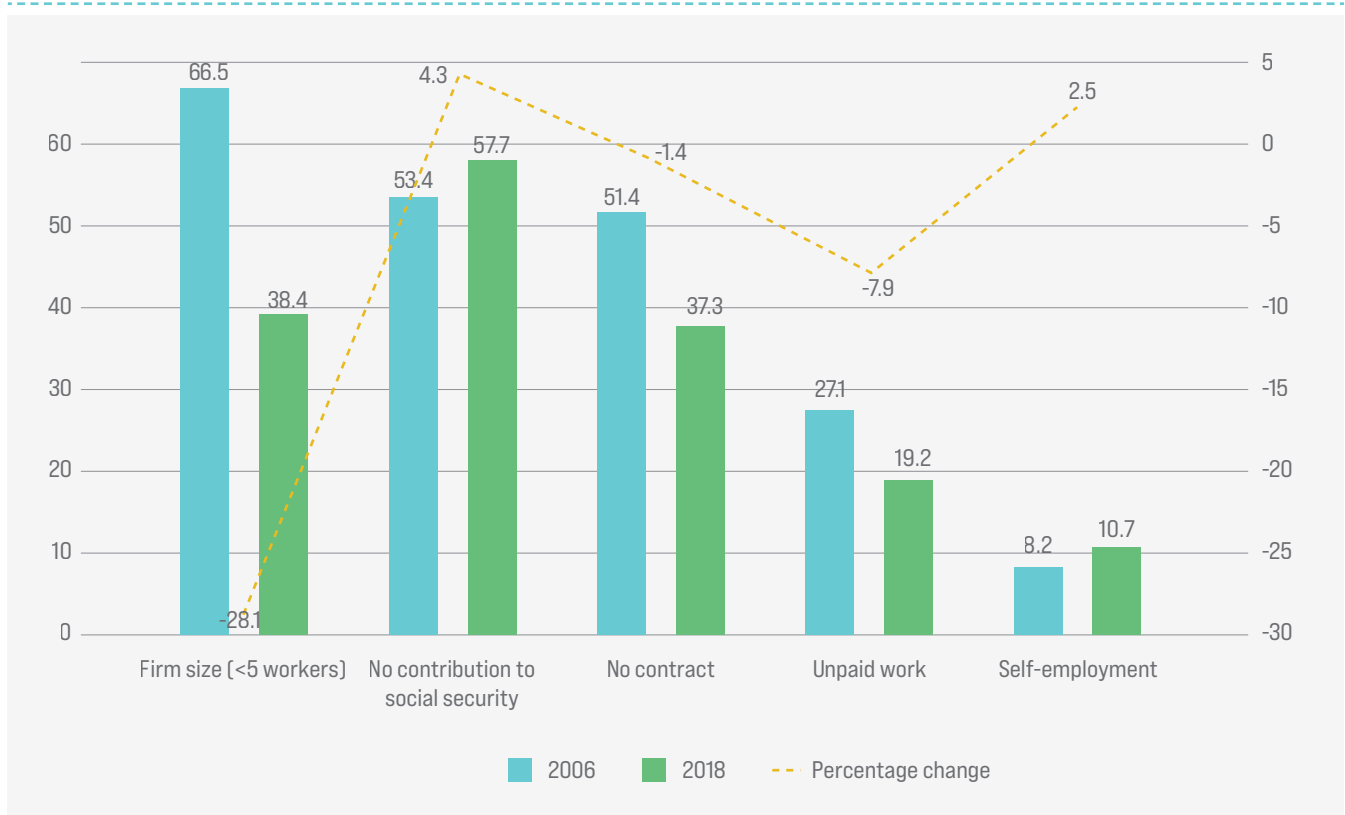
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02

Figure 2 shows the percentage change in informality indicators using Labor Market Panel Survey (LMPS) data from Egypt for the years 2006 and 2018. Generally speaking, the Egyptian middle class experienced decreased rates of informality between 2006 and 2018. However, certain informality indicators, including not contributing to social security, rose by 4.3 per cent, and the share of self-employed middle-class workers increased by around 2.5 per cent in the time period between surveys. Those two

observations indicate increased vulnerability during shocks, which, in fact, occurred during the COVID-19 pandemic. Although the percentage of middle-class workers who are employed without a formal work contract has decreased over the past few years, it is still very possible that many workers are on temporary assignments that include verbal agreements rather than legally binding contracts that secure their rights and ensure they are not subject to precarious working conditions.

Figure 2. Change in middle-class informality rates in Egypt between 2006 and 2018 (Percentage)



Source: ESCWA calculations, 2023.

Informal middle class mostly operates in microenterprises

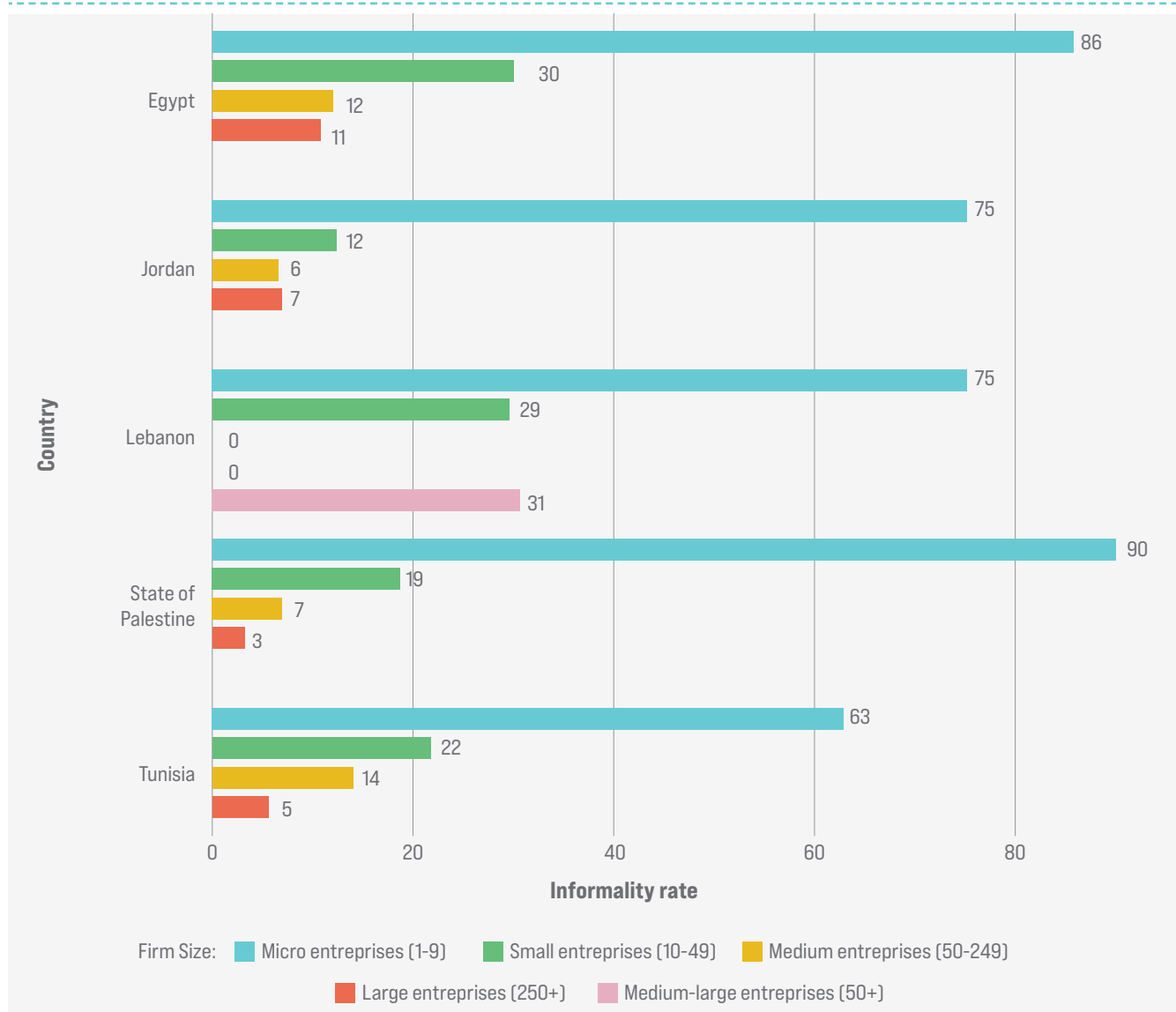
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03

Generally, Governments are primarily focused on reducing poverty rates through social assistance programmes. However, policymakers assume that the so-called “missing middle” workers who are informally employed are not necessarily poor and usually work in jobs that provide security and stability for themselves and their families. The assumption is a level of security equivalent to most formal employees. Informally employed middle-class workers are involved in private and public businesses across all economic sectors and at all firm sizes. However, they are heavily concentrated in private microenterprises, including those with fewer than

ten employees, as shown in figure 3. Figure 3 shows a clear informality bias by enterprise size, with large enterprises showing low rates and microenterprises showing high rates across all countries. Those results accentuate the vulnerability of the members of the middle class working informally, particularly as microenterprises were hard hit during the COVID-19 pandemic and had minimal access to Government support. In fact, small and microenterprises in Egypt, Jordan, Morocco, and Tunisia have had to address adverse conditions resulting from the pandemic, including high shutdown rates, reduced working hours, and a loss of revenue.¹⁶

Figure 3. Middle-class informality rates by enterprise size (Percentage)



Source: ESCWA calculations, 2023.



Agriculture, trade
and transportation
hubs for informal
middle-class
workers

12

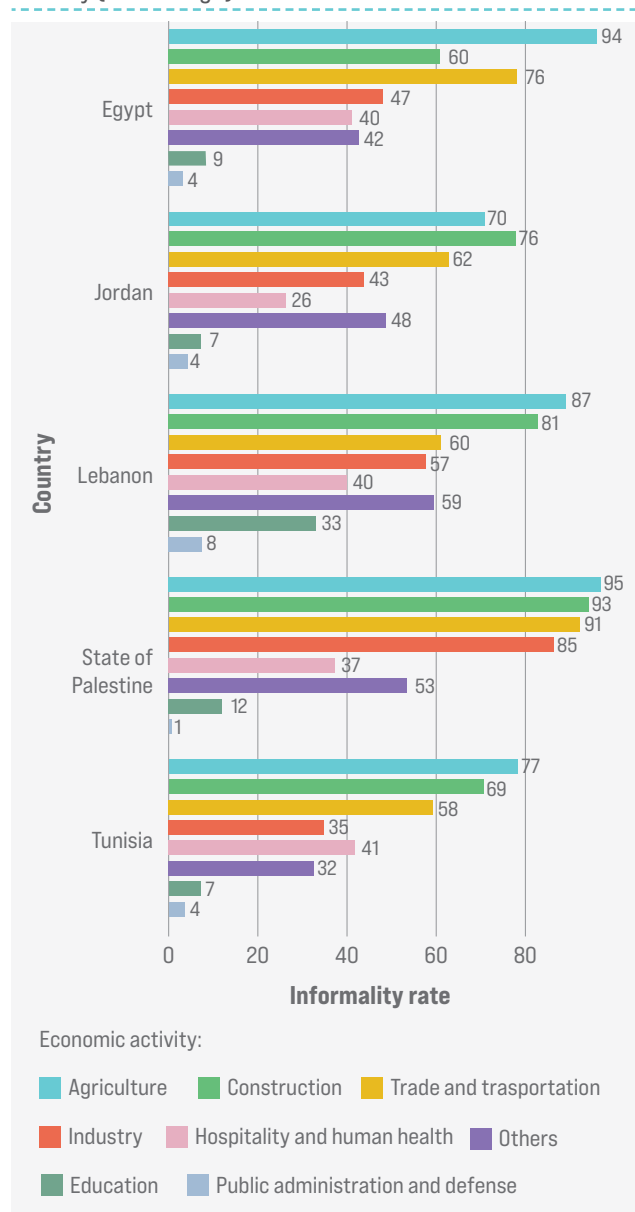
04

Using labour force surveys, figure 4 highlights the informality of middle-class workers in different economic sectors. The agriculture, trade and transportation sectors have the highest levels of informal employment in all countries except for Jordan. Formally employed middle-class workers in agriculture make up less than 10 per cent of the total in Egypt and the State of Palestine, and this share does not exceed 30 per cent in the other countries. The percentage of formally employed trade and transport workers is also quite small, and figure 4 shows that informal employment among the middle class in trade and transport ranges from 58 to 91 per cent of total employment. Employment in industry is nearly an even split between formal and informal work. Not surprisingly perhaps, public administration, defence, health, and education are the areas with the highest levels of formal employment, as most of these services in the Arab world are in the public sector. Nonetheless, the education sector in Lebanon employs a high number of middle-class workers informally, at 33 per cent, as compared to an average of 9 per cent in the other countries. The informal work arrangements can be attributed to an abundance of contracted teachers and workers with temporary, non-fixed-term contracts. In 2016, according to ANND, more than two fifths of Lebanese workers with informal contracts worked in the education sector.



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Figure 4. Middle-class informality by economic activity and country (Percentage)



Source: ESCWA calculations, 2023.

Formally employed middle-class workers in agriculture make up less than 10 per cent of the total in Egypt and the State of Palestine, and this share does not exceed 30 per cent in the other countries.

Less education, more informality

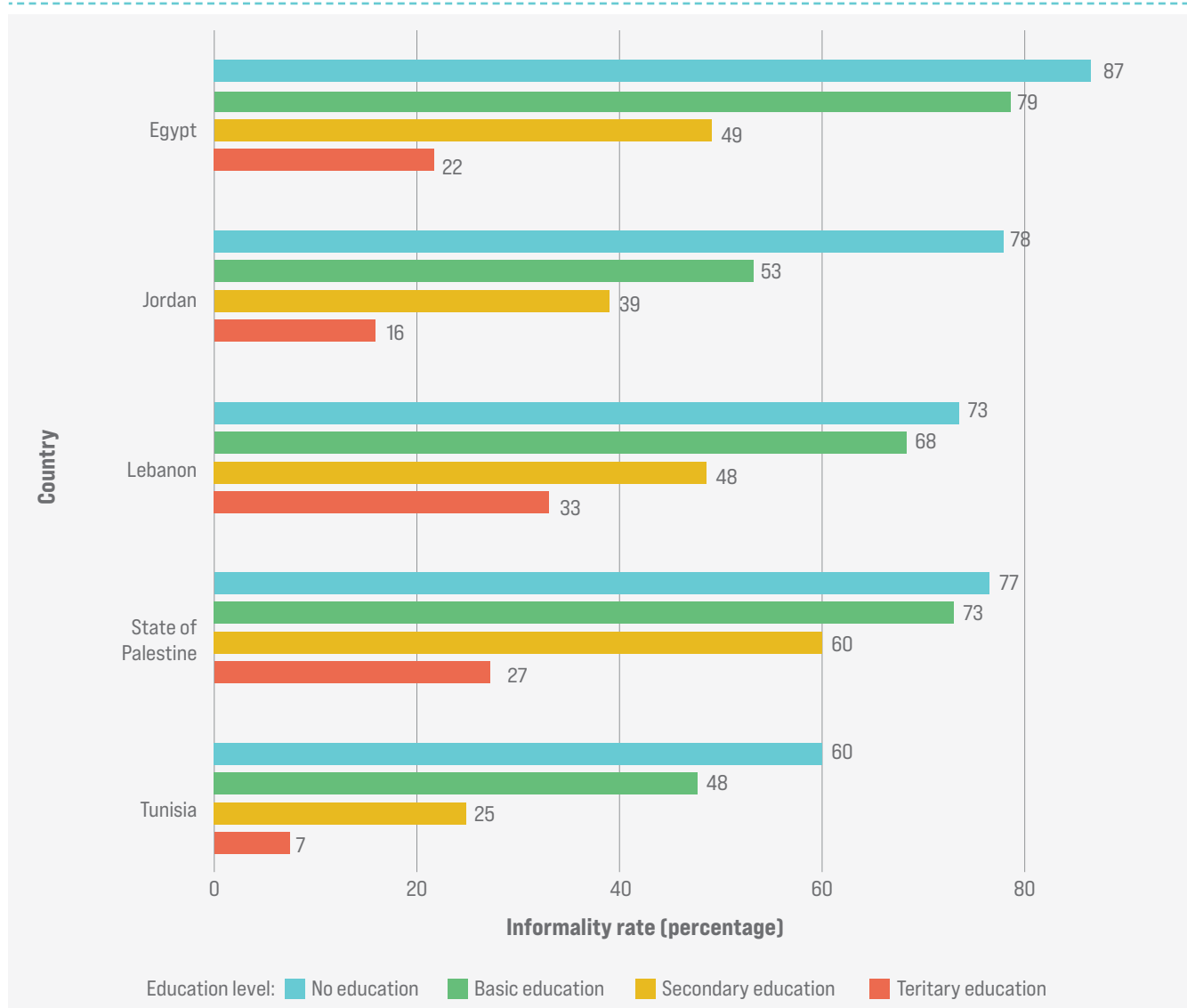
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05

One of the salient features of shadow economies in Arab countries is a low level of education in middle-income oil-poor economies, implying that informality could be inversely related to educational levels.¹⁷ To validate that theory, the association between educational attainment and informality in Egypt, Jordan, Lebanon, the State of Palestine, and Tunisia was examined (figure 5). The more education an individual has had, the less likely they are to work informally. However, the relationship between education and informality may not be causal or straightforward. The question is whether being

less educated constrains an individual to accept informal employment or whether higher levels of informality in economic activities tend to lead to the acquisition of less education. It has been argued that the length of education matters: the longer a person continues their education, the less likely it is that they will be employed informally.¹⁸ The findings by Pederson on the relationship between education and informality are also confirmed by figure 5 in that the highest levels of informality exist for those with no education, and this decreases to its lowest level for those with postgraduate education levels.¹⁹

Figure 5. Middle-class informality rates by educational attainment level (Percentage)



Source: ESCWA calculations, 2023.



More men in informal employment, except in agriculture

16

06

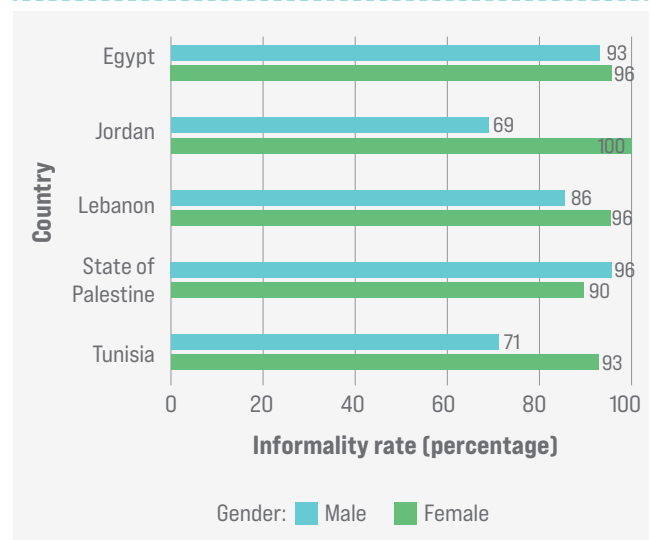
Informal employment for women includes street vending; selling goods and services at local markets, bazaars or stalls; precarious self-employment; and forming a family business without a specific legal framework. In general, women are less likely to work in the informal economy than men, except in the agriculture sector, as shown in figure 6. The State of Palestine is an exception in this case.

Figure 1 at the beginning of this paper illustrates the higher number of males working in the informal sector compared with females with percentages of 70.2 per cent and 61.8 per cent, respectively. That difference may be due to two key factors. Firstly, female unemployment in the Arab world is three times that of males, and the labour force participation rate of females is 14 per cent the rate of males. Secondly, females tend to look for formal public-sector employment as compared with males due to decent work conditions and less precarious working situations that tend to prevail in the public sector.

Figure 7 shows the difference in hourly wages between middle-class males and females for formal and informal workers in the State of Palestine. Examining the gender wage differential in informal employment is particularly important because, within the Arab region, the State of Palestine has one of the highest gender wage gaps

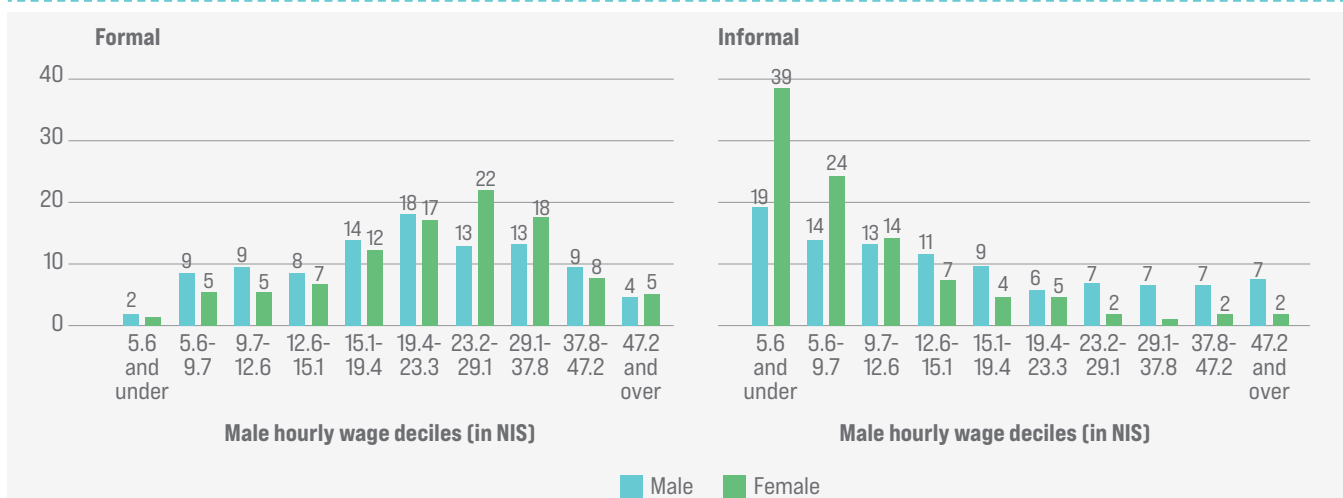
in the industry and services sector, a sector that employs a large number of middle-class workers.²⁰ Figure 7 shows a clear gender pay gap that is more evident among those in informal employment. For middle-class workers in informal employment, 39 per cent of females are in the lowest hourly wage decile compared to 19 per cent of middle-class males. These percentages show an inverse relationship as the hourly wage deciles increase, with many more males in the top hourly wage decile compared to females working informally.

Figure 6. Middle-class informality rates in agriculture by gender (Percentage)



Source: ESCWA calculations, 2023.

Figure 7. Hourly pay of middle-class working males and females by formality status (Percentage)



Source: ESCWA calculations, 2023.

Conclusions and recommendations

07

The analysis presented provides evidence that workers in the lower middle class face greater challenges in terms of informality than the highly-educated upper middle class. One finding is that informality correlates negatively with education across all social classes. Hence, policymakers should seek to reduce informal employment among the Arab middle class and to increase social protection coverage in the sectors of agriculture, industry, trade, and transportation, which are the dominant areas of informal employment among middle-class workers. Furthermore, policymakers should be aware that enhancing education, specifically by expanding educational access to all, may reduce informality. A well-functioning institutional system can decrease rates of informality across economic sectors.

With regard to firm size, this paper concludes that middle-class workers who are employed by or own microenterprises record the highest shares of informality. Increased efforts should be directed at formalizing and facilitating their registration. This paper also discusses middle-class gender disparities in employment and pay that are even larger in informal employment. Middle-class females tend to receive wages within the lowest wage deciles in the informal economy.

At the macroeconomic level, informality is interconnected with sectoral policy, monetary policy, fiscal policy, and exchange rate regimes.

Rethinking macroeconomic policies and labour regulations is the only way to formalize informal firms, and create decent work for those in the informal sector. The recommendation is to adjust labour legislation in a nuanced and targeted manner and to redesign the tax base in several countries to incentivize firms and individuals to register and formalize their activities. In addition, minimum wage levels could be applied nationally, in countries where minimum wages are either restricted to the public sector or available only to nationals.²¹ Arab States should also make labour regulations gender-friendly to reduce informality and gender disparities.

The COVID-19 pandemic led Governments to introduce new social protection programmes and reform existing ones. Those changes have had a significant impact on private-sector development. Furthermore, subsidy reforms can provide a much needed resource for cash transfer programmes aimed at assisting both the poor and the missing middle. Previous attempts at subsidy reform have mostly left the lower middle class worse off, and budget surpluses have tended to be only partially redirected to support programmes to alleviate poverty. Redesigning the redistribution schemes to cover the missing middle is an important area of reform, particularly as those of working age have the potential to make a productive contribution to the economy if they are supported through periods of vulnerability.

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Endnotes

- 1 <https://ilo.org/public/english/bureau/stat/download/papers/def.pdf>.
- 2 Hussmanns, 2004.
- 3 Gatti and others, 2014.
- 4 Kassem, 2009; Arab NGO Network for Development (ANND), 2016.
- 5 Economic and Social Commission for Western Asia (ESCWA), 2021.
- 6 ESCWA, 2017.
- 7 See Working paper No. 8 for further information.
- 8 International Labour Organization (ILO), 2019.
- 9 Gatti and others, 2014.
- 10 See Working paper No. 5 for further information.
- 11 Kassem 2009; ANND, 2016.
- 12 Gatti and others, 2014.
- 13 Dreher and Schneider, 2006.
- 14 Bhattacharya and Rei, 2008.
- 15 Galiani and Weinschelbaum, 2012.
- 16 Krafft and others, 2021.
- 17 Renooy, 1990; Haanwinckel and Soares, 2017.
- 18 Pedersen, 2003.
- 19 It should be noted that one out of five members of the middle class with a university education has an informal job in Egypt and the State of Palestine.
- 20 ESCWA, 2019.
- 21 World Economic Forum and World Bank, 2018.



Employment in informal work by those in the middle class remains a pervasive and pressing conundrum in the Arab region. This paper provides evidence that there are greater ramifications for those in the lower middle class as opposed to highly educated members of the upper middle class. Hence, a lack of education across all social classes correlates with informality. When looking at the size of employers, those in the middle class who work in or own microenterprises are most likely to be categorized as informal. Those findings mean that efforts should be directed at formalizing such enterprises through registration and addressing financing needs and tax burdens that are currently impediments to registration. This paper also discusses middle-class gender disparities in employment and pay, disparities that are particularly egregious among those in informal employment. For example, middle-class females are in the lowest wage deciles. Understanding the factors that contribute to informality among the middle class is critical to promoting prosperity among members of that class in a sustainable and equitable manner.

