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## What Explains Prevalence of Informal Employment in European Countries: The Role of Labor Institutions, Governance, Immigrants, and Growth

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### Abstract:

European Social Survey data on 30 countries, covering years 2004-2009, are used to look into joint institutional [and other macro] determinants of the rates of dependent employment without a contract, informal self-employment, and unemployment (secondary jobs are not accounted for). Consistently with theoretical predictions, quality of business environment has a significant negative impact on prevalence of both types of informal employment. The share of non-contracted employees is negatively affected by perceived quality of public services and is positively related to economic growth. GDP per capita has a positive impact on informality in Europe at large and within Eastern and Southern Europe. Other things equal, the share of non-contracted employees in the labor force across all European countries increases with the minimum-to-average wage ratio, with union density, with the share of first and second generation immigrants, and with income inequality, but falls with stricter employment protection legislation (EPL) and higher tax wedge on labor. Thus it appears that in Europe at large, labor cost effects of EPL and taxes are weaker than their impact via perceptions of job security and law enforcement, along with tax morale and the income effect. Yet the EPL effect on informality is positive (i.e., cost-related) when either Eastern and Southern Europe or Western and Northern Europe are considered separately. Furthermore, within Western and Northern Europe, the minimum wage effect is negative, whilst within Eastern and Southern Europe, the union effect is negative. Various panel data methods are used to confirm the robustness of the results.

**Text:** See [Discussion Paper No. 5872](#)



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