BOX 1.4 How does informality aggravate the impact of COVID-19?

COVID-19 will take an especially heavy humanitarian and economic toll on emerging markets and developing economies (EMDEs) with large informal sectors. Participants in the informal sector—workers and small enterprises—are often not registered with the government and hence have no access to government benefits. Informality is associated with underdevelopment in a wide range of areas, such as widespread poverty, lack of access to financial systems, deficient public health and medical resources, and weak social safety nets. These vulnerabilities have amplified the economic shock to livelihoods from COVID-19 and threatened to throw large numbers of people into extreme poverty. The impact is likely to be particularly severe on women, due to their outsized participation in sectors that are more affected by the pandemic. While the effects of the crisis continue, it is critical to implement effective delivery channels to quickly provide the support that informal workers and firms need to survive. Unconditional support programs would be advisable in many EMDEs. Given their limited resources, low-income countries will require increased international funding for the effective implementation of such programs.

Informal activity is widespread in emerging markets and developing economies (EMDEs; World Bank 2019a; Figure 1.4.1). Participants generally are not registered with the government and do not have access to social benefits, with their activity largely unmonitored by authorities. The informal sector is often associated with underdevelopment, labor-intensive industry, less educated and poorly paid workers, limited access to financial and medical service, and poor or non-existent coverage by social security. These features are likely to intensify the spread of COVID-19 among informal workers and worsen its adverse health and economic impacts. Confirmed COVID-19 cases have been rising rapidly in EMDEs with extensive informality since the end of March, despite a low level of testing.

Against this background, this box addresses the following questions.

• What is the role of the informal economy in EMDEs?
• How may widespread informality alter the impact of the pandemic?
• How do policies to mitigate the impact of pandemic need to be tailored in the presence of large informal economies?

Informality in EMDEs

Widespread informality in EMDEs. The informal sector, on average, accounts for about a third of official GDP and about 70 percent of total employment in EMDEs (World Bank 2019a; Figure 1.4.1). Informal enterprises account for 8 out of every 10 enterprises in the world (ILO 2020b). The size of the informal economy varies widely across regions and countries. The share of informal output is highest in Sub-Saharan Africa, Europe and Central Asia, and Latin America and the Caribbean, averaging around 40 percent of GDP in those regions between 2010 and 2016. The share of self-employment, another measure of informality, is highest in Sub-Saharan Africa, South Asia, and East Asia and the Pacific, ranging from 50 percent to 62 percent of total employment. Informality is particularly prominent in some EMDEs. For example, in 2016, the informal economy accounted for more than 60 percent of GDP in the Democratic Republic of Congo and Zimbabwe. The sector accounted for 90 percent of total employment in countries like Mali, Mozambique, and Côte d’Ivoire. In Kenya and India, about 8 out of 10 workers were self-employed.¹

Characteristics of informal workers. Workers in the informal sector tend to be lower-skilled and lower-paid, with less access to finance or social safety nets than workers in the formal sector (Loayza 2018; Perry et al. 2007; World Bank 2019a). They often live and work in crowded conditions and conduct all transactions in cash—factors that enable the spread of disease (Chodorow-Reich et al. 2020; Surico and Galeotti 2020). Informal workers on average have incomes 19 percent lower than formal workers, and have limited savings (World Bank 2019a; Figure 1.4.2). In the one-third of EMDEs with the most pervasive informality, 40 percent of the population would be driven into poverty if they had to cover direct out-of-pocket payments for an unexpected health care emergency. In these economies, unemployment benefits are only available to a miniscule fraction of the population (on average, less than 2.5 percent).

Characteristics of informal firms. Informal firms tend to be labor-intensive and more prevalent in the services sector. These have been hard hit by measures to curtail

¹ Common employment measures of informality are self-employment and informal employment, relative to total employment. The self-employed work on their own account, or with one or a few partners, or in a cooperative. Informal employment comprises all workers of the informal sector and informal workers outside the informal sector (see World Bank 2019a for details).
Social interactions (Benjamin and Mbaye 2012; Surico and Galeotti 2020). In EMDE service sectors, about 72 percent of firms are informal, compared with 33 percent in manufacturing sectors (see Amin, Ohnsorge, and Okou 2019 for sample coverage). Agricultural employment in EMDEs is roughly 90 percent informal. Epidemic-control measures have already disrupted access to markets and inputs and may also eventually threaten the food security of smallholder farmers (Cullen 2020; FAO 2020b; ILO 2018).

Broad development challenges. A larger informal economy is associated with weaker economic, fiscal, institutional, and developmental outcomes. GDP per capita in countries with above-median informality is about one-third to one-half that of countries below the median informality (World Bank 2019a). Health systems in EMDEs is roughly 90 percent informal. Epidemic-control measures have already disrupted access to markets and inputs and may also eventually threaten the food security of smallholder farmers (Cullen 2020; FAO 2020b; ILO 2018).

Health and sanitation. Although the populations of EMDEs with the most pervasive informality tend to be younger, they also tend to be less healthy, live in less sanitary conditions, and only have access to weak public health and medical systems (Figure 1.4.3). In the one third of EMDEs with the most pervasive informality, sanitation facilities are accessible to only 34 percent of the population, and clean drinking water is available to only 55 percent of the population, compared to 80 percent in the one third of EMDEs with the least pervasive informality. Hand-washing facilities are available for only 40 percent of the population in the former group. Access to medical care is also extremely limited, with only three-fifths the number of doctors and nurses per 1,000 people than the EMDEs with the least informality. In countries like Malawi and Kenya, thousands of people have access to only one or two ICU beds (Murthy, Leligdowicz, and Adhikari 2015).

In the one third of EMDEs with the most pervasive informality, 5.3 percent of the population is aged 65 or above, compared with 6.2 percent in the one third of EMDEs with the least pervasive informality. In the one third of EMDEs with the most pervasive informality, the number of deaths per 1,000 people caused by communicable diseases and maternal, perinatal and nutrition conditions are about two times higher than in the one third of EMDEs with the least pervasive informality.
Government policy effectiveness. Countries with pervasive informality are less likely to have the institutional and fiscal capacity to mount an effective response to the pandemic. Tax avoidance is prevalent in the informal sector, resulting in limited fiscal resources (Besley and Persson 2014). For example, government revenues and expenditures in the EMDEs with the most pervasive informality are 5-10 percentage points of GDP, on average, below those with the least pervasive informality (World Bank 2019a; Figure 1.4.3). In addition, governments are less effective, and corruption is more rampant, in countries with more pervasive informality (Loayza, Oviedo, and Servén 2006). Moreover, less than a quarter of informal firms use bank accounts and about one-half of small informal firms identified lack of access to finance as a major obstacle to their operations, which makes it difficult to use the financial system to channel support to the informal economy (Farazi 2014; Schneider, Buehn, and Montenegro 2010). The rising availability of digital payments—whether on mobile phones, cards, or online—provided an alternative financial channel for governments to reach the informal sector. However, it
remains in doubt that whether sufficient cash-in and cash-out points are in place to allow people using digital payments to deposit and withdraw cash safely and reliably (World Bank 2017).³ The lack of registration also makes it a challenge to provide effective support to informal workers and firms via official fiscal measures (such as tax deduction).

Impact of the COVID-19 outbreak

The impact of COVID-19 is likely to be worse in EMDEs with widespread informality, as it is expected to intensify the pandemic’s adverse health and economic consequences while weakening the effect of policies.

³These cash-in and cash-out points are often in the form of a bank agent, a mobile money agent, or an automated teller machine (ATM; Klapper and Singer 2017).
BOX 1.4 How does informality aggravate the impact of COVID-19? (continued)

Health consequences. Health consequences of the pandemic are expected to be more adverse in EMDEs with more pervasive informality. In these countries, lack of an adequate public health system worsens the transmission of infectious disease. Access to clean water and handwashing facilities is often difficult or unfeasible. Living quarters and working environments are often overcrowded and insanitary. In Sub-Saharan Africa where informality is pervasive, 70 percent of city dwellers live in crowded slums (World Bank 2019b). Lack of medical facilities and a generally less healthy population are likely to worsen the severity of infections and to limit the ability to treat those infected (Dahab et al. 2020). The absence of social safety nets will mean that informal market participants will be unable to afford to stay at home, or to adhere to social-distancing requirements, which will undermine policy efforts to slow down the spread of COVID-19 (Loayza and Pennings 2020).

Economic consequences. Lockdowns hit informal market participants especially hard in the service sector, where informal firms and employment are particularly common (Panizza 2020). For instance, in South Asia, about one out of four households currently living in poverty is engaged in informal activities in the service and construction sectors, which have been significantly affected by closures and disruptions (World Bank 2020j). In addition, women are overrepresented in service sectors that are subject to high risks during the pandemic: 42 percent of women workers are working in sectors such as wholesale and retail trade, compared to 32 percent of men (ILO 2020c). Also, about 80 percent of informal firms rely on internal funds and financing from family and moneylenders for working capital, making them especially vulnerable to the disruption to cashflows caused by mitigation and other control measures (Farazi 2014). Informal workers too have limited financial resources to buffer temporary income losses during the containment period, making them more likely to be pushed into poverty.4 The health crisis also causes immediate revenue losses for firms, forcing them to temporarily or permanently close their businesses. This could trigger an unprecedented surge in unemployment and a potential expansion of the informal economy (ILO 2020b).

Past pandemics, such as the Ebola epidemic in West Africa in 2014-15, provide a stark illustration of the vulnerability of smallholder farmers (World Bank 2015). The agricultural sector has the highest level of informal employment—estimated at more than 90 percent (ILO 2018). Farmers producing for the urban market may experience massive income losses as they are unable to sell their produce during the lockdowns (ILO 2020d). Small informal firms play a critical role in the food supply chain and are likely to run into operational distress and insolvency due to logistical breakdowns during containment periods (FAO 2020b; World Bank 2020g; ILO 2020b). Since they are among the poorest and most vulnerable groups of society, informal workers, especially farmers, may have reduced access to food in the event of sharp income losses.

In countries with wide-spread informality, governments may have neither the resources nor the administrative structures in place to effectively deliver well-targeted relief to those most in need (Muralidharan, Niehaus, and Sukhtankar 2016). In a number of EMDEs with widespread informality, existing social benefit systems, such as ration cards, are plagued by corruption that weakens their capacity to deliver support to the most vulnerable (Peisakhin and Pinto 2010; World Bank 2004).

Policy implications

Informality adds to the challenges of dealing with the pandemic. Fiscal resources need to be used to strengthen the public health system to prevent, contain, and treat the virus, and support the livelihoods of informal participants during the outbreak. As conventional measures—such as wage subsidies and tax relief—would hardly reach informal firms and workers, innovative emergency measures should be considered to deliver income support to informal

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4 It is estimated that in the absence of any alternative income sources, lost labor income during the containment period could result in an increase in relative poverty for informal workers and their families of more than 21 percentage points in upper-middle-income countries and 56 points in lower and low-income countries (ILO 2020c). This could lead to further increase in income inequality among workers (ILO 2020a).

5 In 2014-2016, the Ebola outbreak was followed by an economic crisis in West Africa, triggered by massive health and social spending to cope with the outbreak and compounded by the almost simultaneous collapse in commodity prices (World Bank 2014; Cangul, Sdralevich, and Sian 2017).

6 Farmers may be increasingly impacted by the health crisis, if the virus spreads further into rural areas (ILO 2020c). In the case of Senegal and India, the inability of informal (or self-employed) workers to earn a living and gain access to health care has led to migration from urban to rural areas, which may cause the virus to spread further.
workers, and credit support to informal firms (World Bank 2020g). When managing the trade-off between coverage and costs, policymakers need to strive for a maximum reach of informal participants during the crisis, prioritizing temporary and reversible measures to minimize the fiscal burden afterwards. In some situations, however, the crisis has exposed gaps in a patchwork of social security facilities that should be filled, perhaps in the context of a through reform.

- **Expand existing social safety nets.** The first line of response includes existing social protection and social assistance programs that could be quickly scaled up and expanded to provide immediate but temporary relief to families whose earnings have been adversely affected by the outbreak (World Bank 2020a, 2020e). Food aid, cash (or in-kind) transfers, rent or utility bill waivers, can be particularly effective in countries with pervasive informality, as they are easy to implement and have wide reach outside the formal sector (Özler 2020).

- **Utilize flexible platforms and technologies to reach informal workers.** Cash transfer and other support programs could utilize various existing registries and platforms that have a wider coverage than banking or tax systems (Aker et al. 2016; Aron 2018). Such platforms should have sufficient coverages, provide possibilities to establish identities, and connect accounts with beneficiaries (World Bank 2020m). Examples include existing national social registries (e.g., Brazil), new online platforms (Thailand and Brazil), new mobile payment devices (Morocco), and databases in health (Morocco) and energy (El Salvador) sectors. Public transfers via mobile money have been shown to improve food security and assets as compared to manual cash transfers in the short-term (Aker et al 2016; Haushofer and Shapiro 2016). “Big data” analyses and geographic (or age-group, social group) targeting may help expand program coverage by identifying vulnerable groups that are not on any existing registry (Loayza and Pennings 2020; World Bank 2019a, 2020a, 2020m).

- **Facilitate access to finance for informal firms.** To support informal firms, access to finance should be provided to help firms stay in business, keep jobs, and maintain links to local and global value chains (World Bank 2020a, 2020n). Such support could be provided, potentially under government guarantees, by commercial banks, microfinance institutions, digital lending platforms, corporate supply chains, or other intermediaries. Easier access to credit, collateralization of existing properties, and online or mobile banking should help owners of informal firms to tap the available financial resources, especially with the help of digital technologies.

- **Consider untargeted and unconditional programs when needed.** Targeted programs reduce the risk that payments end up with those who do not need it, especially in the absence of effective targeting and delivery systems (Gentilini 2020; Loayza and Pennings 2020). In EMDEs where informality is pervasive and most of the population is either poor or near-poor, simple untargeted transfers may be better. Attempts to exclude the relatively few who are not in need would likely slow relief down and reduce the desired coverage of informal workers (Özler 2020). In practice, support programs that made formalization a condition of assistance have reduced the number of intended beneficiaries and have not offered net benefits to many informal enterprises (Campos, Goldstein, and McKenzie 2018). During the emergency and the potentially weak recovery right afterwards, the need is to quickly reach as many informal workers and firms as possible. To this end, in many EMDEs, unconditional support programs would be advisable. Given their limited resources, low-income countries would require international funding for the effective implementation of such programs.

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7 See the policy section of Chapter 1 for details on the conventional measures. See ILO (2020b) for details on the importance of reducing the exposure of informal workers and their families to the virus and the risks of contagion and while ensuring their access to health care.

8 Where conditional programs exist, waiving conditionality for a period could ensure wider coverage in the context of a health emergency (World Bank 2020a). See World Bank (2020m) for a summary of country examples.

9 Cash-in and cash-out points—a bank agent, a mobile money agent, or an automated teller machine—should be provided to ensure the success of public transfers via digital platforms (World Bank 2017).

10 Moving to digital wage payments can also contribute to women’s economic empowerment, which merits special attention from policy makers when promoting formal business participation (Klapper 2017; Klapper, Miller, and Hess 2019).
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