



BEATEN OR BROKEN?

Informality and COVID-19

South Asia Economic Focus Fall 2020

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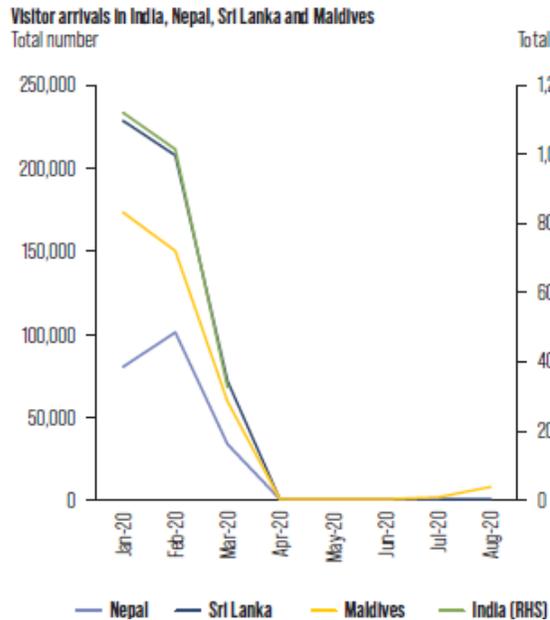


Presentation outline

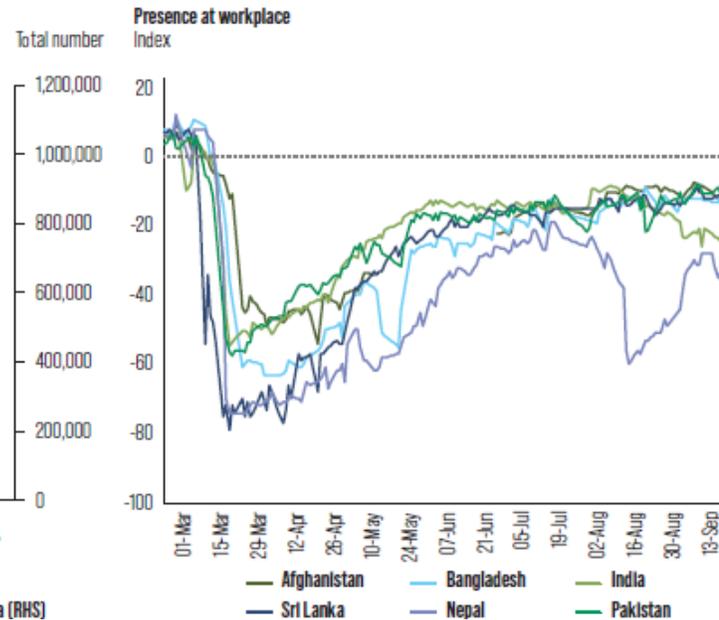
1. Recent Economic Developments
2. With a new world, a changing outlook
3. The impact of COVID-19 on the informal sector

Economic activity in South Asia came to a near stand-still...

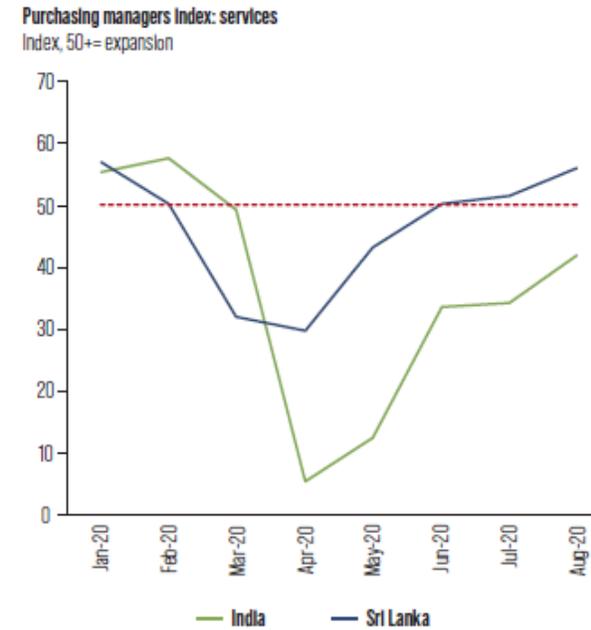
A. Visitor arrivals in South Asia dropped to zero.



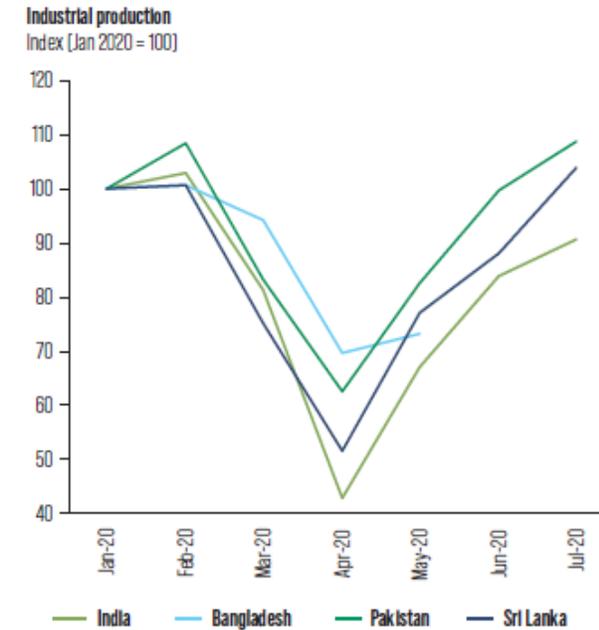
B. Presence at the workplace declined massively.



C. Services PMI indicators were at record lows.



D. Industrial production plummeted.



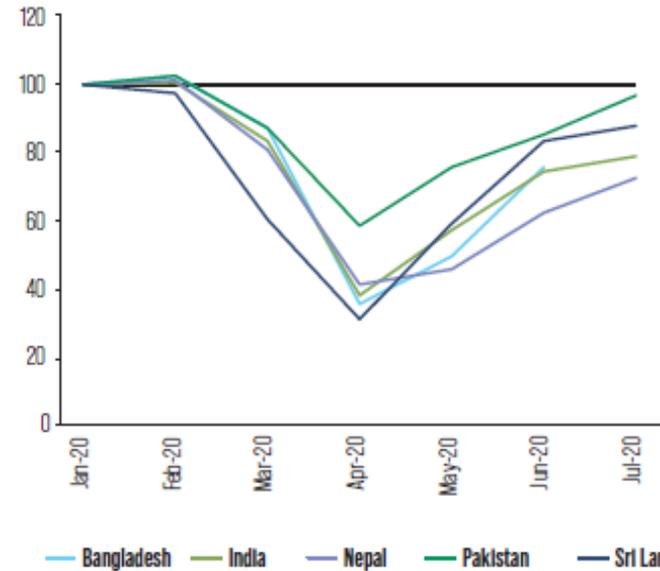
Sources: A. Ministry of Tourism of India and Maldives; Ministry of Culture, Tourism and Civil Aviation of Nepal; Sri Lanka Tourism Development Authority; B. Google COVID-19 Community Mobility Reports; C. IHS Markit, Central Bank of Sri Lanka and CEIC; D. World Bank.

- Travel restrictions prevented travelers from reaching South Asia, with immense consequences for tourism and related services.
- After lockdown measures were implemented mobility declined sharply, triggering unprecedented supply disruptions. These in turn impacted incomes and amplified risk aversion, which reduced demand. Services and manufacturing consequently collapsed.
- In countries with fiscal years ending in the summer months, official GDP growth has decelerated significantly.

..and high-frequency indicators suggest some recovery.

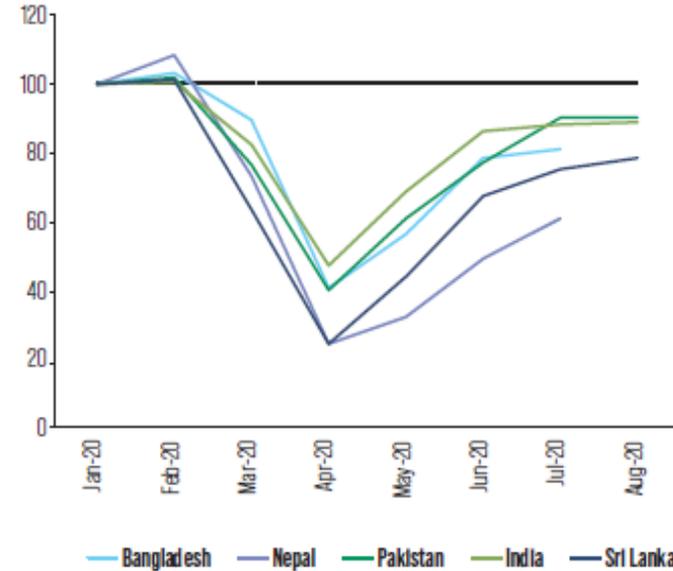
A. Activity indicators co-move strongly.

Activity Indicator for South Asian countries (extended analysis)
Index (January 2020 = 100)



B. Restricted indicators give similar results.

Activity Indicator for South Asian countries (reduced analysis)
Index (January 2020 = 100)



Variables included in the Activity Indicators						
Type of analysis	Bangladesh	India	Nepal	Pakistan	Sri Lanka	
Reduced analysis variables	<ul style="list-style-type: none"> Google Mobility: Grocery and pharmacy Google Mobility: Retail and recreation Google Mobility: Workplaces Electricity generation Government tax revenue, USD mln 	<ul style="list-style-type: none"> Google Mobility: Grocery and pharmacy Google Mobility: Retail and recreation Google Mobility: Workplaces Electricity generation E-way bill 	<ul style="list-style-type: none"> Google Mobility: Grocery and pharmacy Google Mobility: Retail and recreation Google Mobility: Workplaces Visitor arrivals 	<ul style="list-style-type: none"> Google Mobility: Grocery and pharmacy Google Mobility: Retail and recreation Google Mobility: Workplaces Passenger vehicle sales 	<ul style="list-style-type: none"> Google Mobility: Grocery and pharmacy Google Mobility: Retail and recreation Google Mobility: Workplaces Tourism receipts 	
Additional variables in extended analysis	<ul style="list-style-type: none"> Government tax revenue Ready Made Garment exports Imports vehicles 	<ul style="list-style-type: none"> Car registrations Exports non oil Industrial Production IPI: Infrastructure & Construction Goods Manufacturing PMI Services PMI Petroleum consumption Port cargo traffic Rail freight 	<ul style="list-style-type: none"> Domestic credit Exports 	<ul style="list-style-type: none"> Crude steel production Domestic credit Exports Industrial Production 	<ul style="list-style-type: none"> New car registrations Manufacturing PMI Services PMI Industrial Production 	

Notes: To construct the activity indicators, meaningful high-frequency indicators were selected and indexed to January; the loadings from a principal component analysis were used as weights to compute a common score (the activity indicator).

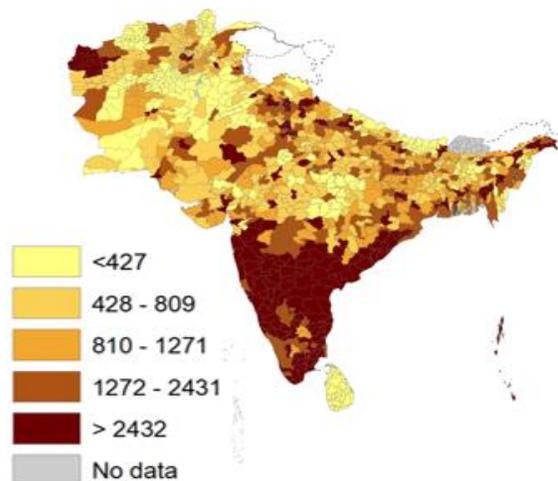
Sources: Google COVID-19 Community Mobility Reports, CEIC, and staff calculations.

- Information from different variables can be combined in a simple activity indicator with a statistical procedure that extracts their maximum common variance and combines them into a common score.
- Across the region, activity indicators troughed in April when the average monthly activity fell to only 40 percent of the pre-COVID level.
- Activity recovered across the board subsequently, but it remained 40 percent below pre-COVID levels in May, a quarter below in June, and 15 percent below in July.
- The speed of the recovery has notably slowed in August across the region.

The pandemic is not concentrated locally but impacts most areas in South Asia.

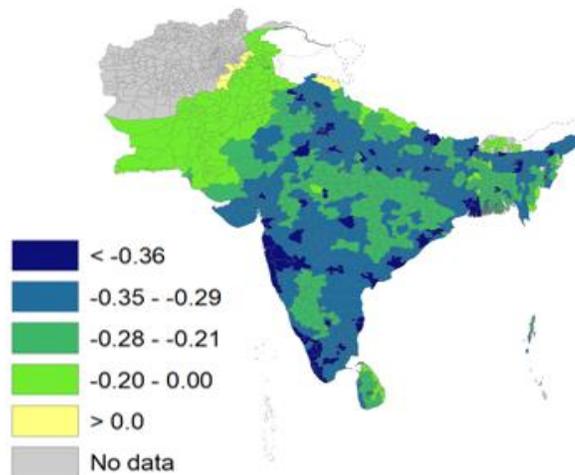
A. COVID-19 hit most areas

Recorded COVID-19 infections
Per million population, end of August 2020



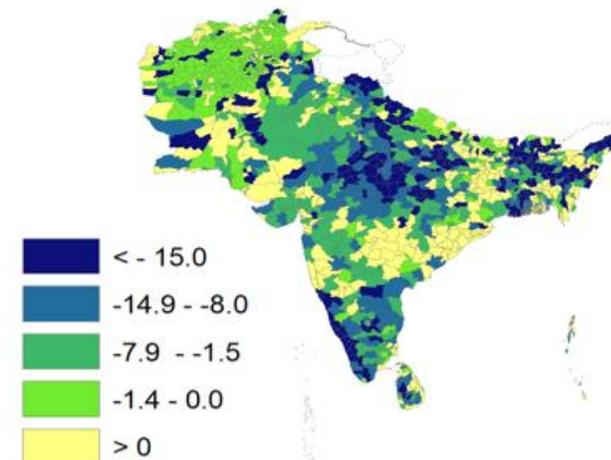
B. Mobility declined strongly

Change in mobility (daily movement range)
Percent, average from March to August 2020



C. Most districts became darker

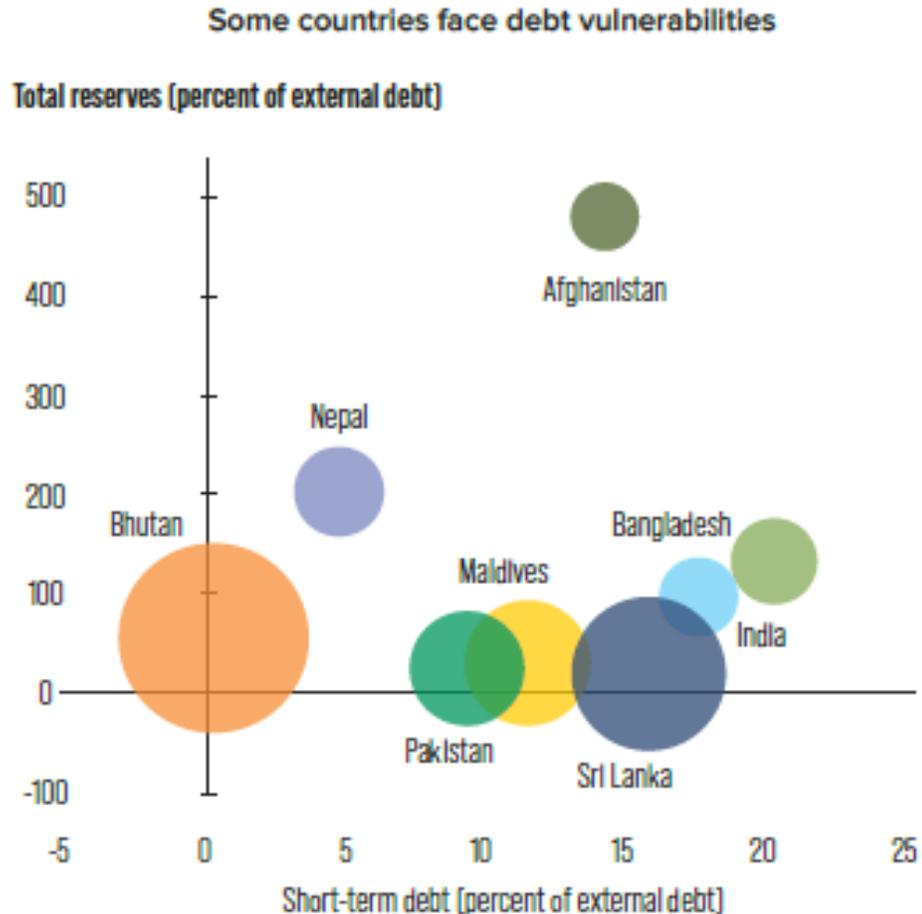
Change in nighttime light intensity
Percent, average from March to August 2020



Sources: Health Ministries and Disease Control Centers, Facebook Data for Good (<http://dataforgood.fb.com>) movement range maps, VIIRS-DNB Cloud Free Monthly Composites (version 1) made available by the Earth Observation Group at the National Geophysical Data Center of the National Oceanic and Atmospheric Administration (NOAA), and staff calculations.

- Indian districts with more COVID-19 cases per capita experienced larger declines in mobility and nighttime light intensity during the national lockdown (Beyer, Bedoya-Franco, Galdo 2020). Some of the observed heterogeneity in nighttime light changes across districts can hence be explained with voluntary reductions in mobility due to higher local prevalence of COVID-19.
- Without effectively reducing the risk of a COVID-19 infection, voluntary reductions of mobility make it unlikely that the economy will return to full potential even when restrictions are relaxed. This may explain why the recovery has recently slowed in some parts of South Asia.

Strong policy measures preserved macro-financial stability, but the situation is fragile, and policy tools have been exhausted.



Note: bubble size shows total external debt-to-GDP.

Sources: International Debt Statistics, World Bank, and staff calculation.

- South Asian countries proactively stabilized economic activity through monetary easing, fiscal stimulus, and supportive financial regulation.
- *They have preserved macro-financial stability thus far:*
 - After large outflows in March, capital flows were positive over the last months.
 - Terms of trade improved, and current account deficits narrowed or turned to surpluses. As a result, international reserves rose contributing to external stability.
 - Government bond yields remained constant or declined following monetary easing by central banks.
 - While stock prices plummeted in March and early April, they regained ground subsequently.
- But *risks have increased amid exhausted* policy tools in some countries:
 - Financial sector vulnerabilities have been exacerbated. In some countries, recent economic difficulties and relaxed prudential regulation threaten financial stability.
 - Rising inflation could constrain future monetary easing.
 - Fiscal deficits are rising across the region amid collapsing revenue.
 - Debt vulnerability is increasing in many countries and especially in Sri Lanka and Maldives



Presentation outline

1. Recent Economic Developments
2. With a new world, a changing outlook
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The economic impact on South Asia will be more severe than initially estimated.

Real GDP growth at constant market prices, 2019 and forecasts (percent)

Fiscal year		2019	2020(e)	2021(f)	2022(f)	Revision to forecasts from June 2020 (percentage points)		Revision to forecasts from October 2019 (percentage points)	
						2020(f)	2020(f)	2021(f)	
Calendar year basis									
South Asia region	January to December	4.1	-7.7	4.5	4.6	-5.0	-14.0	-2.2	
	Afghanistan December to December	3.9	-5.5	2.5	3.3	0.0	-8.5	-1.0	
	Maldives January to December	5.9	-19.5	9.5	12.5	-6.5	-25.0	3.9	
	Sri Lanka January to December	2.3	-6.7	3.3	2.0	-3.5	-10.0	-0.4	
Fiscal year basis									
		FY2018/19	FY2019/20(e)	FY2020/21(f)	FY2021/22(F)	FY2019/20(f)	FY2019/20(f)	FY2020/21(f)	
	Bangladesh July to June	8.1	2.0	1.6	3.4	0.4	-5.2	-5.7	
	Bhutan July to June	3.8	1.5	1.8	2.0	0.0	-5.9	-4.1	
	Nepal mid-July to mid-July	7.0	0.2	0.6	2.5	-1.6	-6.2	-5.9	
	Pakistan July to June	1.9	-1.5	0.5	2.0	1.1	-3.9	-2.5	
		FY2019/20	FY2020/21(e)	FY2021/22(f)	FY2022/23(f)	FY2020/21(f)	FY2020/21(f)	FY2021/22(f)	
	India April to March	4.2	-9.6	5.4	5.2	-6.4	-16.5	-1.8	

Note: (e)=estimate, (f)=forecast. For India, FY2020/21(e) runs from April 2020 through March 2021. June 2020 forecasts are from World Bank (2020a) and October 2019 are from World Bank (2019). Pakistan was reported at factor cost.

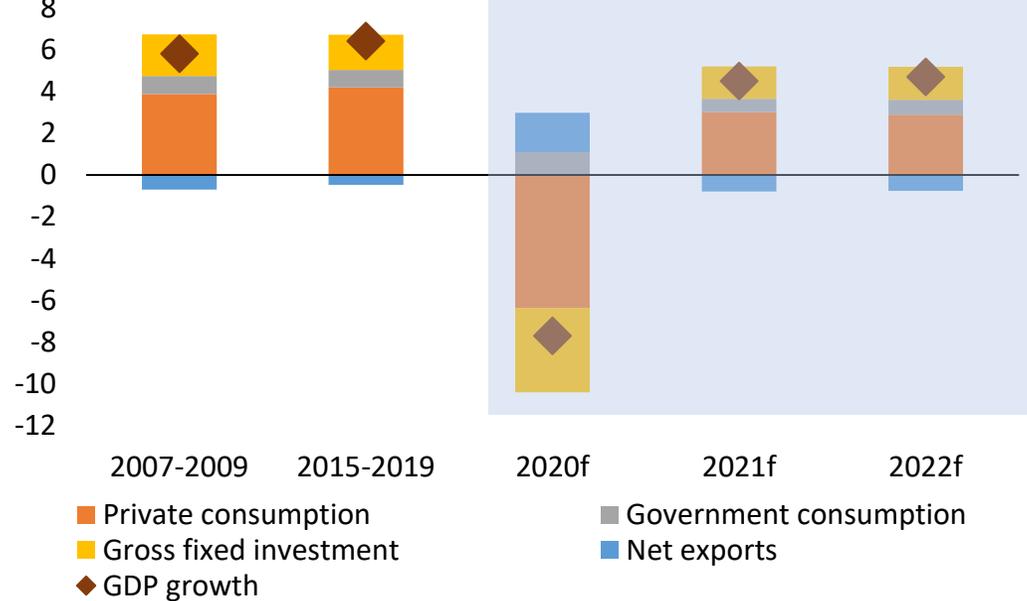
Source: World Bank

Stringent lockdowns, a collapse of tourism (for some), and income shocks to mostly urban households led to the *by far the largest GDP decline* on record.

A recession like no other will reverse trends made before COVID-19

Contribution to GDP growth in South Asia countries

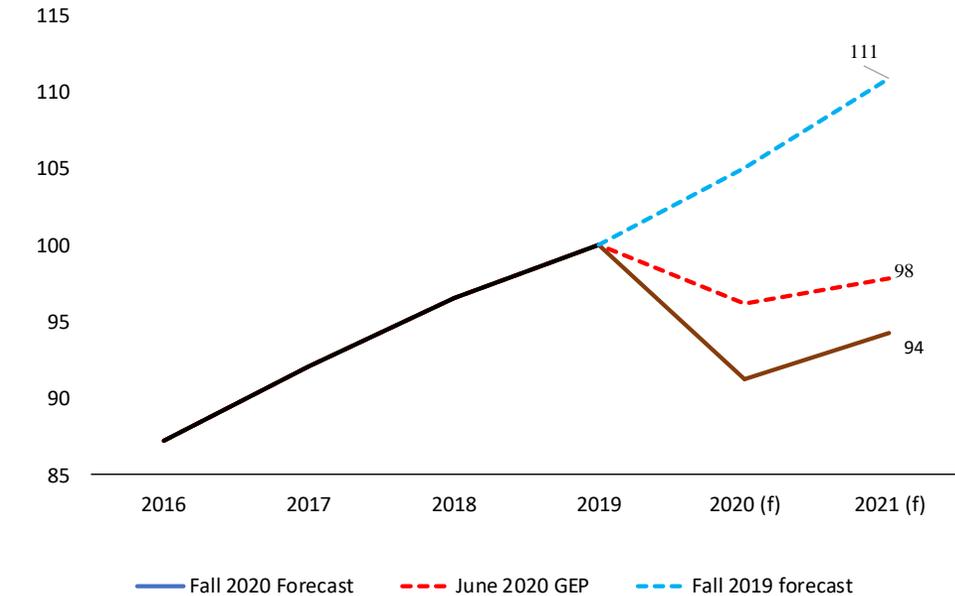
Percent, percentage points.



Note: South Asia aggregates are converted to calendar year.

South Asia real GDP per capita forecast

Index, 2019=100

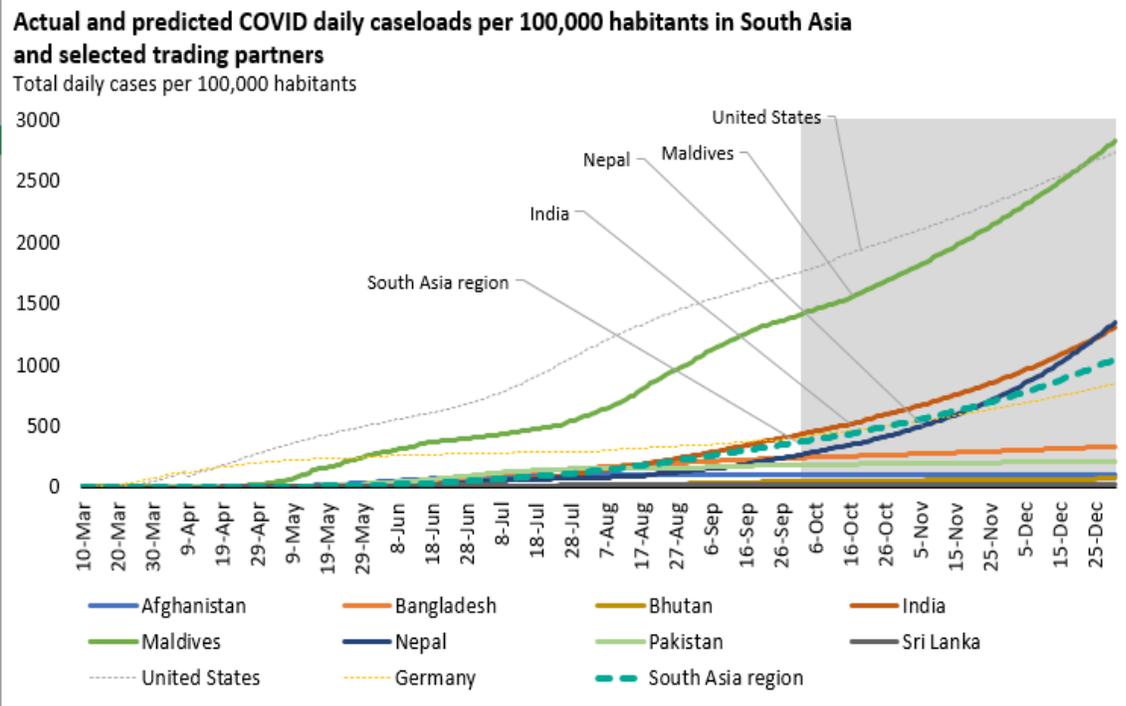
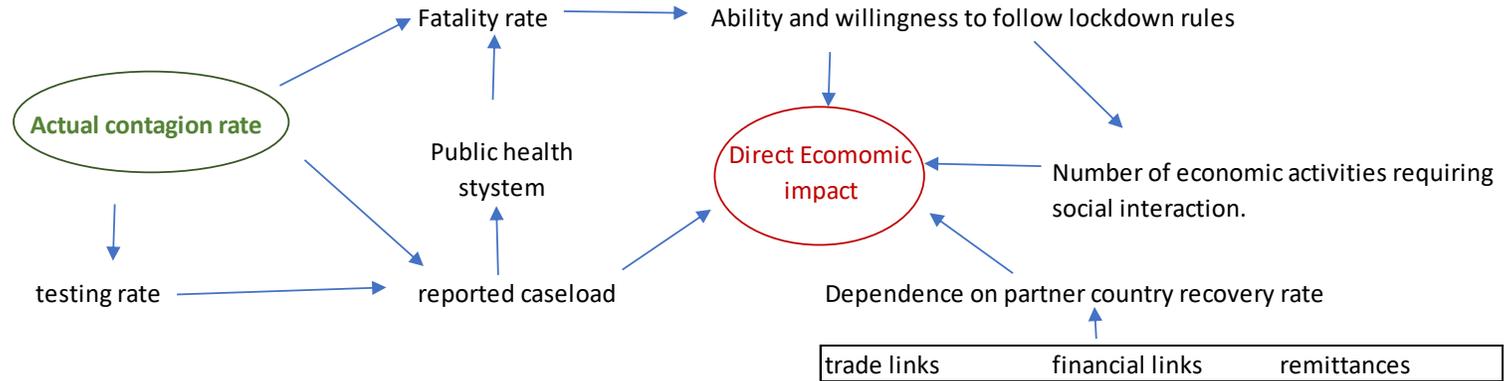


Source: World Bank and staff calculations

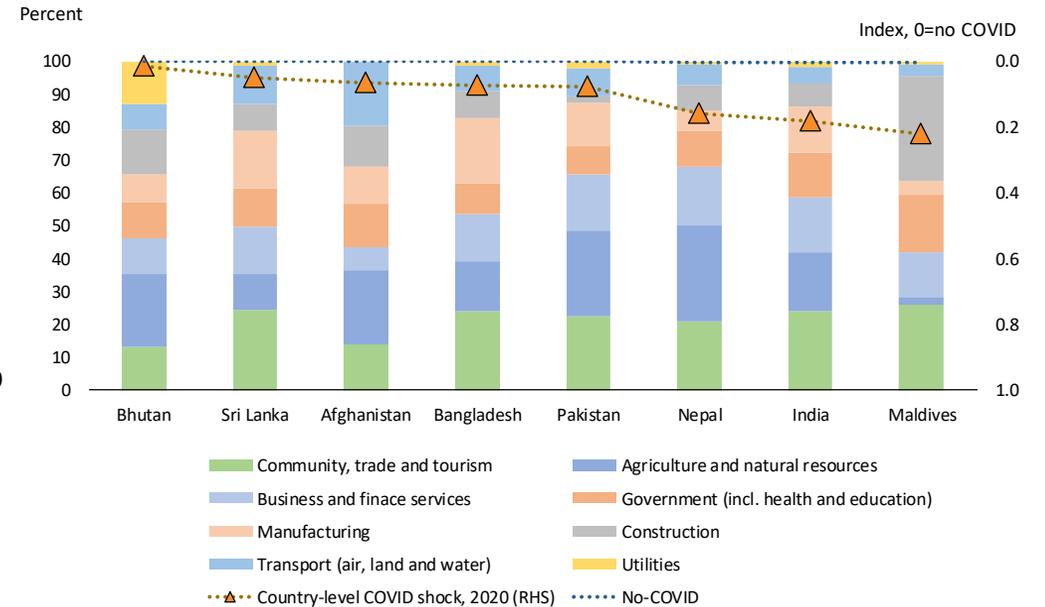
- Unlike global financial crisis and recent trends, 2020 will see a drop in private consumption and investment in the region like no other. Inflation should remain steady.
- Dwindling imports, return of migrants with savings and faster external recovery will lead to temporary improvement in net exports and external balances. This will change in 2021.
- The setback in per-capita income growth will lead to rising poverty, a reflection of the loss of livelihoods that has devastated the region: more than half of post-COVID new extreme poor are from South Asia.

Mapping from COVID-19 caseload to direct economic shock is required.

There is **extraordinary** uncertainty to the forecasts.



COVID shock and share of economic activities in GDP on the



...leads to 4-step construction of supply-side **COVID shock**. Then apply to Macro-Fiscal Model.

Source: World Bank and staff calculations

Note: The shaded area is projected based on linear regression model with balanced sample of 107 countries.

Source: Ourworldindata.org, Country officials

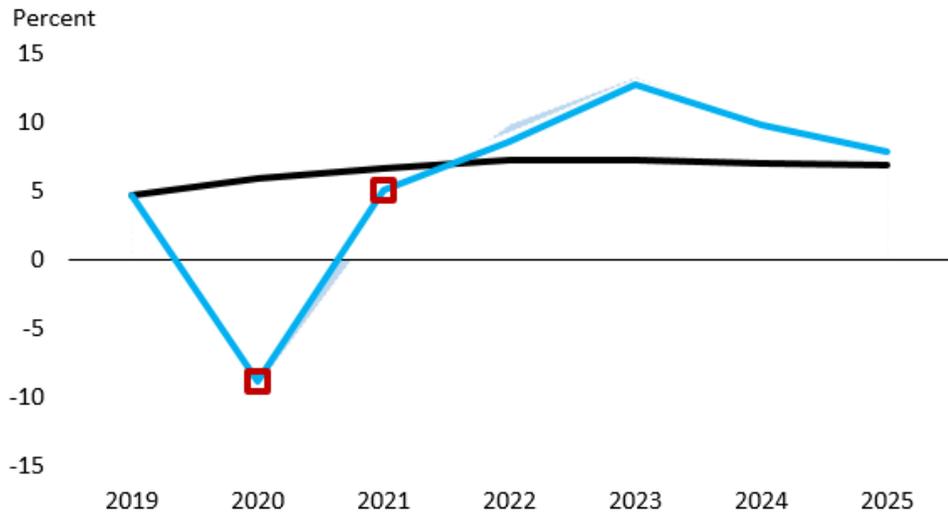
Compared to a no-COVID counterfactual, the region is unable to completely recoup the loss over the medium-term amid consumption losses.

- The forecast growth recovery starting in 2021 still leaves the region worse off: by 2025 the region will have permanently lost 6.6 percentage points of pre-COVID GDP.
- Pattern is evident even assuming faster or slower international recovery (*shaded area*), although individually NPL, PAK, BAN and SRI see larger consumption falls given their dependence on remittances.

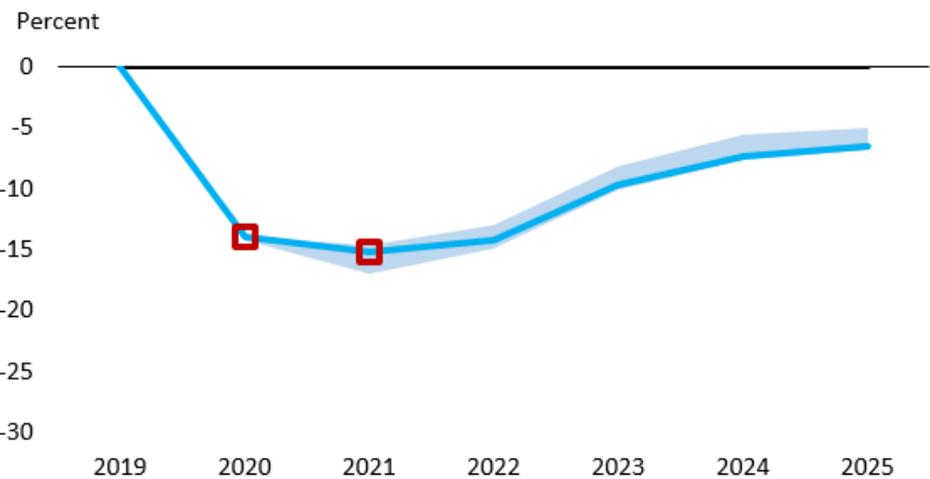


South Asia region countries	Remittances to GDP in 2019 (%)	Change in private consumption, calendar year (%)	
		2020 baseline scenario	2020 worse international decline and depressed remittances scenario
Nepal	27.3	-20.9	-24.3
Pakistan	7.9	-8.8	-11.1
Sri Lanka	7.8	-16.7	-17.2
Bangladesh	5.8	-14.2	-15.5
Afghanistan	4.6	-7.1	-7.6
India	2.8	-19.0	-19.1
Bhutan	1.7	-2.2	-2.3
Maldives	0.1		

South Asia real GDP growth



South Asia real GDP deviation from No-COVID scenario



— No-COVID —■— Baseline, and forecast for 2020, 2021

Note: The blue shade confidence band refers to worse international downturn and depressed remittances and faster international recovery scenarios. Excludes Maldives.

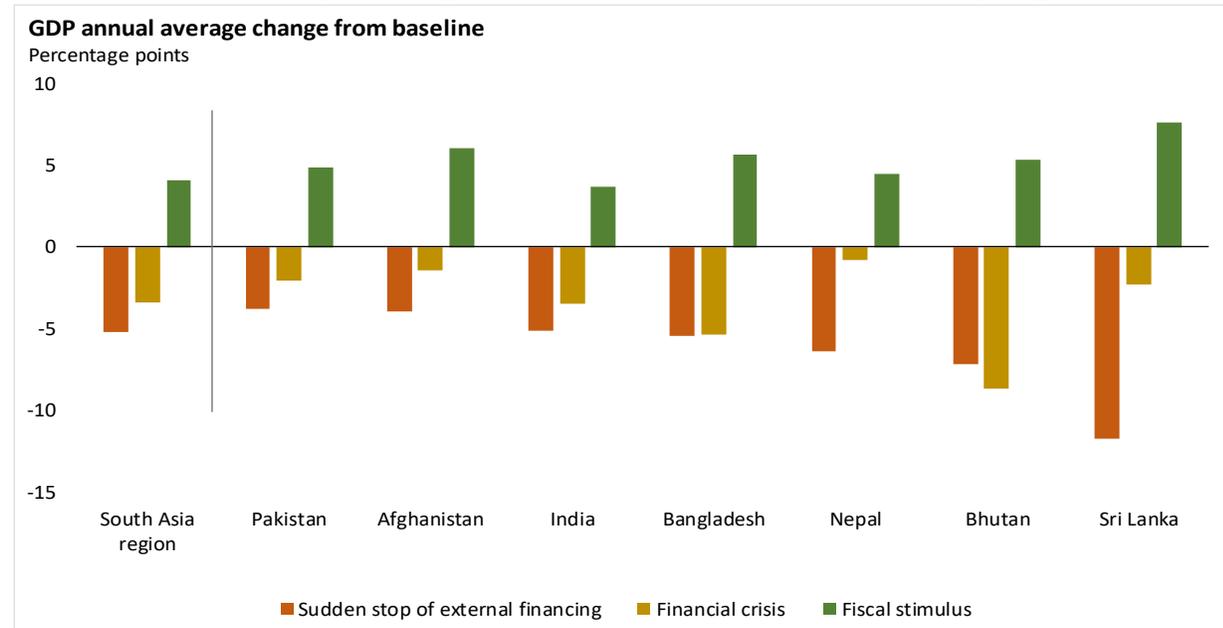
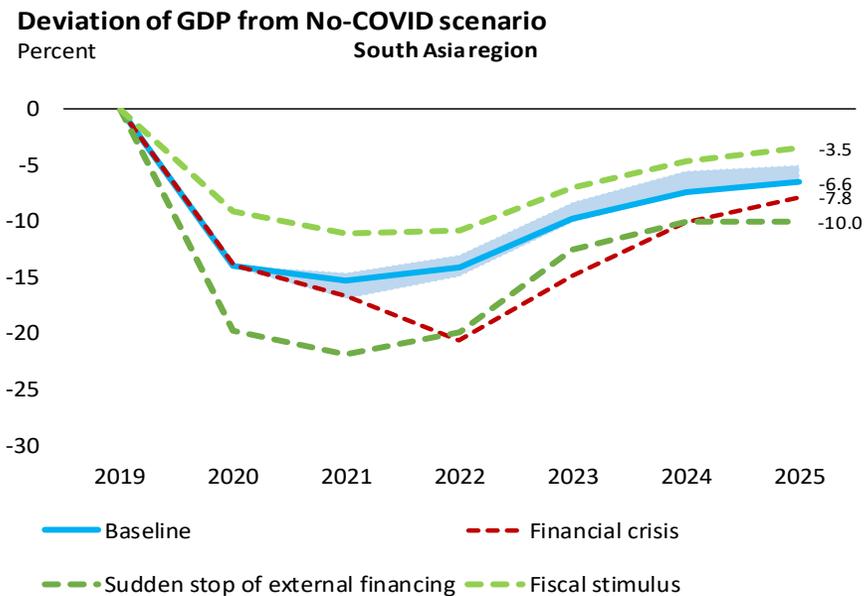
Source: Staff calculations using MFM0d

The ability of policymakers to manage the recession and cooperation of external financiers can significantly speed up South Asia's recovery...

Even with a recovery in 2021 or so, secondary shocks could create knock-on effects that delay or enhance the recovery.

We simulate three alternative scenarios:

- Financial crisis:** Despite progress in containing the virus, bankruptcies amid pre-existing vulnerabilities in the banking sector and high levels of non-performing loans lead to a financial crisis at end-2021. With no credit to the private sector, private investment drops precipitously.
- Sudden stop of external financing:** In addition to slow recovery in trading partner economies, vulnerabilities in the global financial system manifest and external creditors become highly risk averse. No new external financing available for South Asia except bilateral and multilateral creditors cover enough for debt service payments.
- Fiscal stimulus:** With available external financing, significant increased spending on health and revival-related programs.

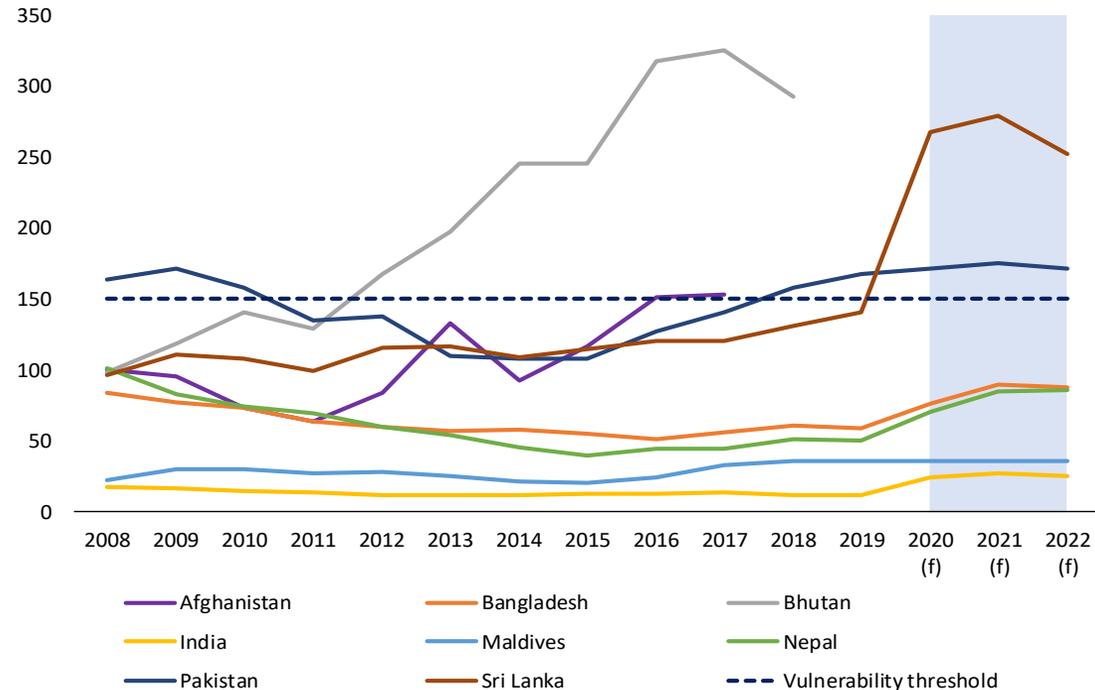


Prudent fiscal policies amid ample external financing significantly mitigates GDP loss.

...which means that debt sustainability and transparency of government accounts is paramount.

General government external debt 2008-2019 and forecast

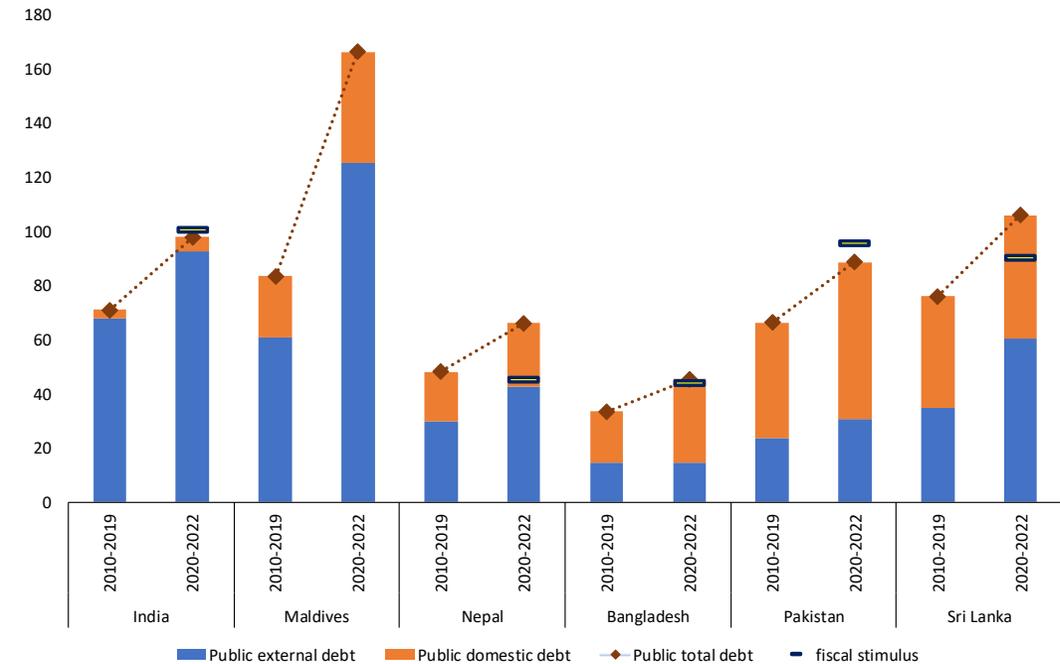
Percent of exports of goods, services and remittances inflow



Source: International Debt Statistics, Macro Poverty Outlook, World Bank

Domestic and external public debt to GDP: historical, forecasts and fiscal stimulus scenario

Percent



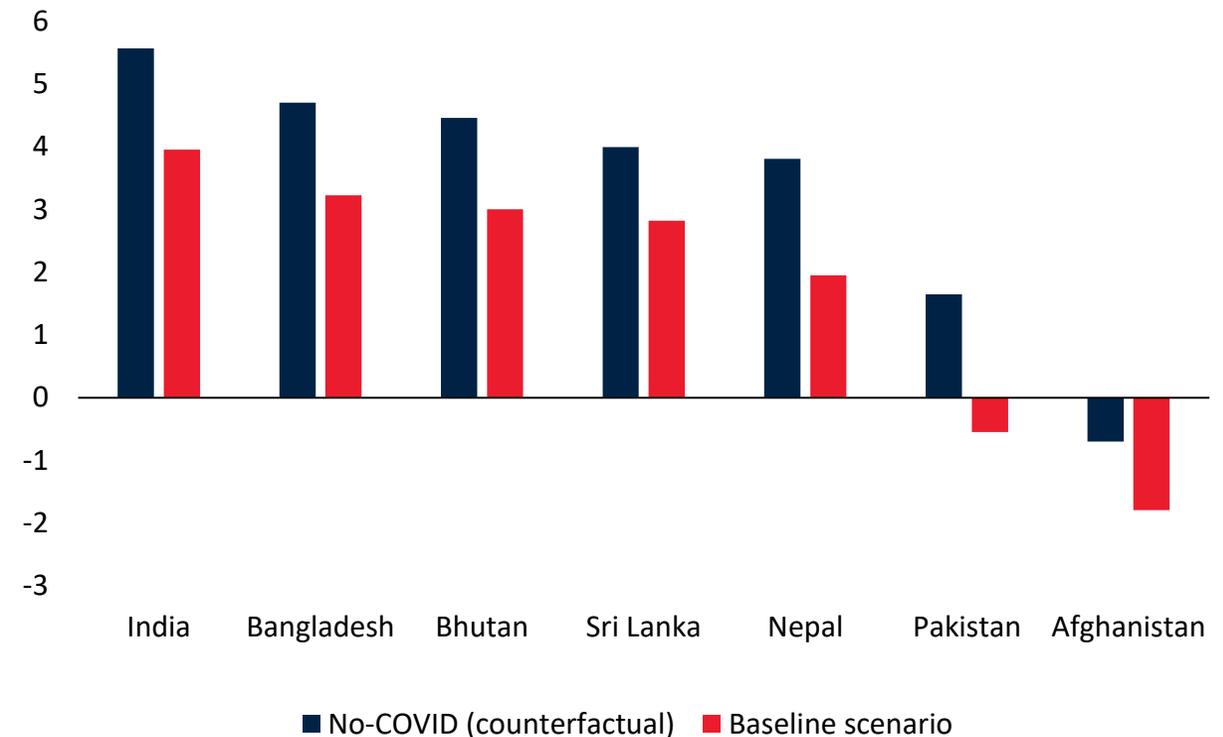
Source: Macro Poverty Outlook and staff calculations using MFMod.

- Sri Lanka and Pakistan are forecasted to be vulnerable on the external front, while India and Maldives will see debt-to-GDP ratios rise due to domestic debt accumulation.
- External financing is a global responsibility in a pandemic—not just South Asia's. But the region needs to take the breathing space provided by DSSI to take stock of financing, increase transparency and reach out to creditors.

Potential output growth per person will be 1 percent lower on average over the medium-term...

- The pandemic will leave deep scars amid losses in productivity and physical capital.
- We anticipate a reallocation of resources across sectors, favoring digitization.

Estimated average annual growth in potential output per capita, 2020-2025
Percent

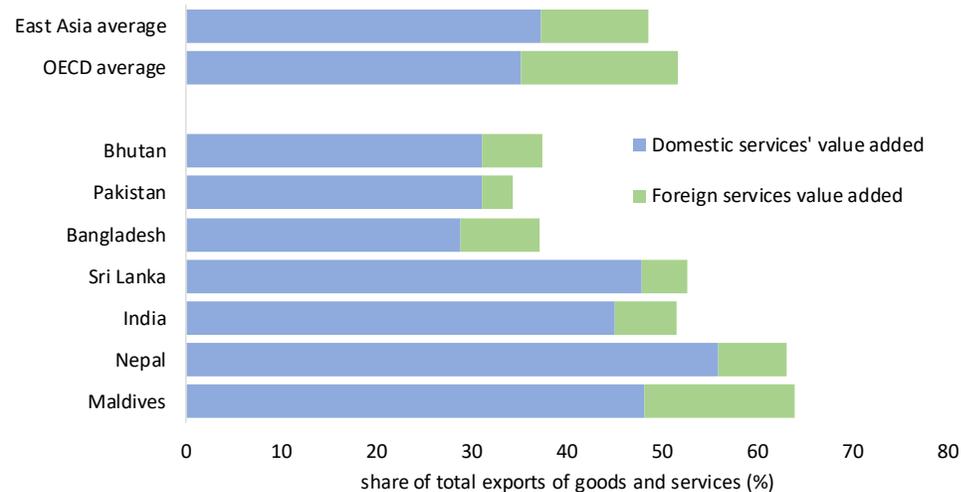


Source: Staff calculations using MFMod

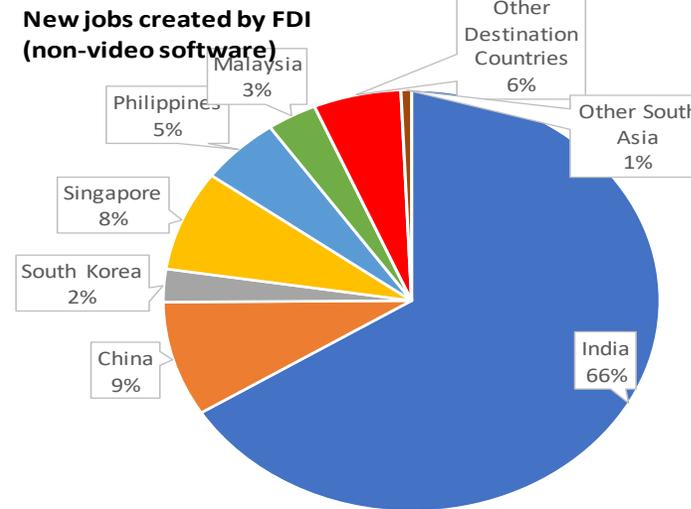
...and there is an opportunity for the region to integrate more into Global Value Chains given its comparative advantages in services.

- We argue that *international production sharing* will transform but will not go away.
- Services will be a crucial part of GVCs, and the region's services value added as a share of exports is high.
- Region's comparative advantage in skill-intensive services such as software, IT and professional business already in large demand from multinationals.

Services value added contribution to exports by country, 2019



Source: World Bank (2019), MRIOT, FDI Markets, Financial Times (2020)

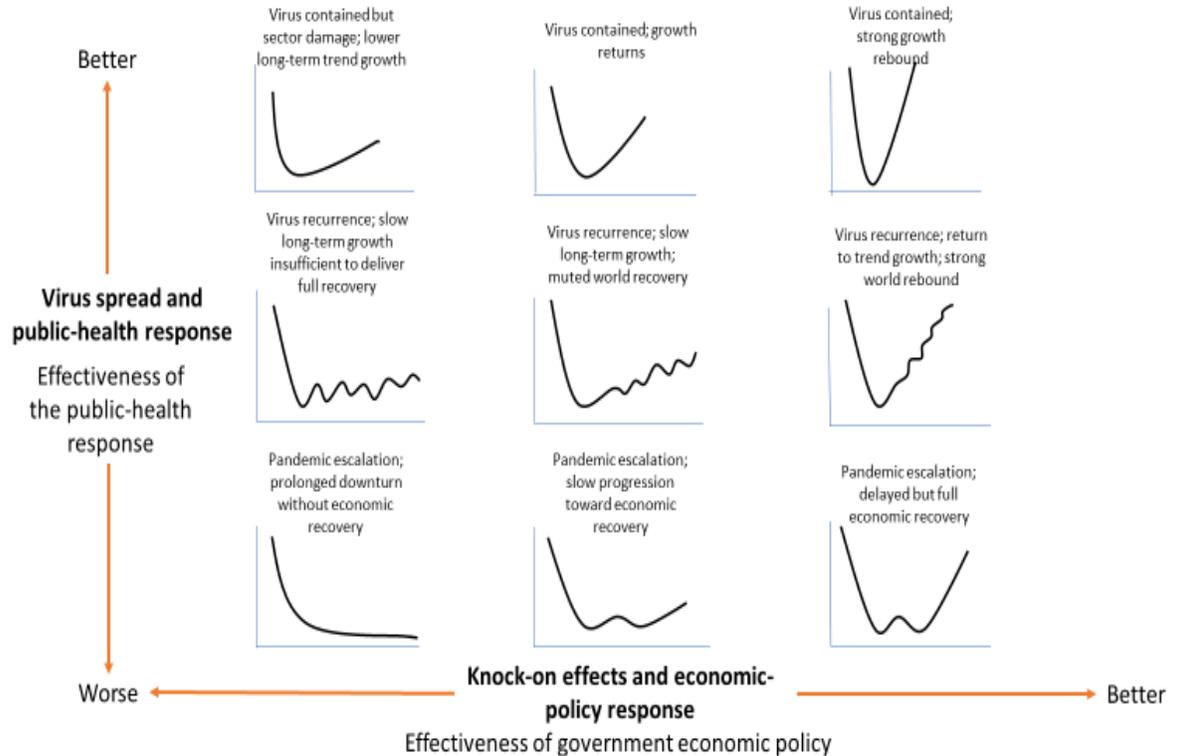


- Digitization will accelerate post-COVID, which will improve firms' ability to coordinate supply chains and logistics from everywhere (perform tasks for one firm while physically located elsewhere).
- But South Asia *needs to prepare to take advantage of such opportunities* by improving logistics, lowering effective tariffs, improving regulatory environment and creating digital free-trade zones.

Government policies matter...even more so during a pandemic!

- *Focus on job creation* and support of livelihoods during recovery. This includes digital job-matching platforms across the region. Scarce funds should not be used to bail out unviable sectors.
- *Tourism has great potential in the long-run.* Seize the opportunity to move to a regional model; continue expanding tourism bubbles.
- *Enable vaccine development.* Indian producers--and to a lesser extent Bangladesh--can be part of the solution to the epidemic.
- *Build back better*—there are job opportunities in expanding green sectors.
- *Rethink* social protection amid informality (next)

Possible course of post-pandemic long-term GDP growth as a function of health and economic policy effectiveness



Source: McKinsey and Company (2020)



Presentation outline

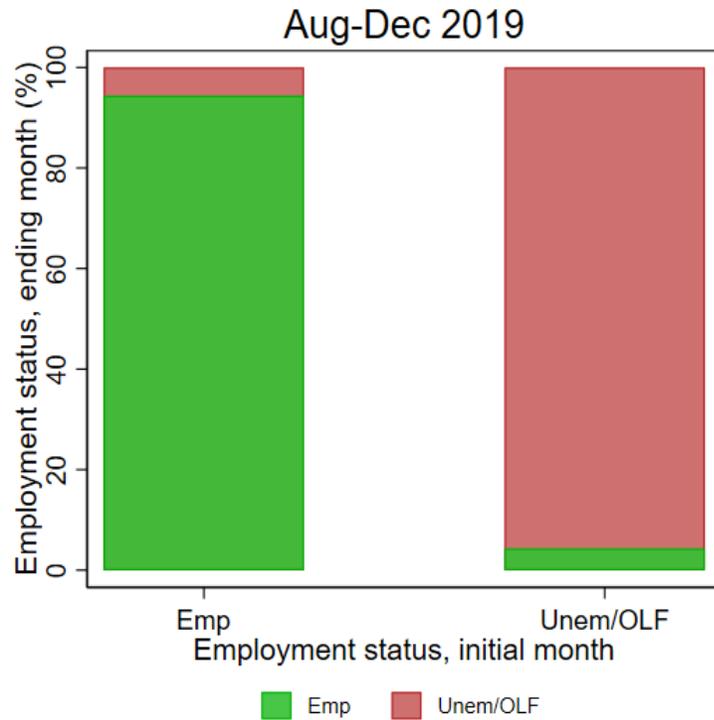
1. Recent Economic Developments
2. With a new world, a changing outlook
3. The impact of COVID-19 on the informal sector
 - a) Informality and the Covid-19 crisis
 - b) Can the digital economy help the informal sector in COVID times?
 - c) Understanding key characteristics of the informal sector is critical for policy effectiveness
 - d) Policy discussion

Main Messages

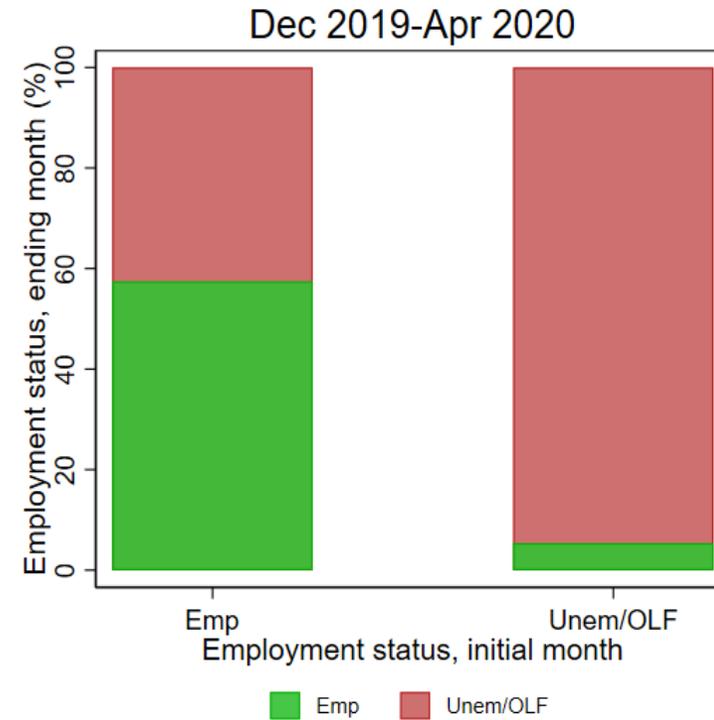
- COVID-19 impact is biased against and has exacerbated informality
 - Informal wage workers were the most susceptible to job loss in early COVID-19
 - Many workers- formal and informal- turned to informal self-employment
 - The bottom half the income distribution- the bulk of which is informal- has suffered the biggest income declines
- The informal sector cannot (especially in the short run) expect huge benefits from key aspects of the digital economy
- The region has quickly expanded relief policies; but some long-term challenges remain or have even been exacerbated (expanding social insurance, and designing growth policies for informal firms)

The early phase of COVID-19 saw a surge in job loss...

Labor market transition rates: Before COVID



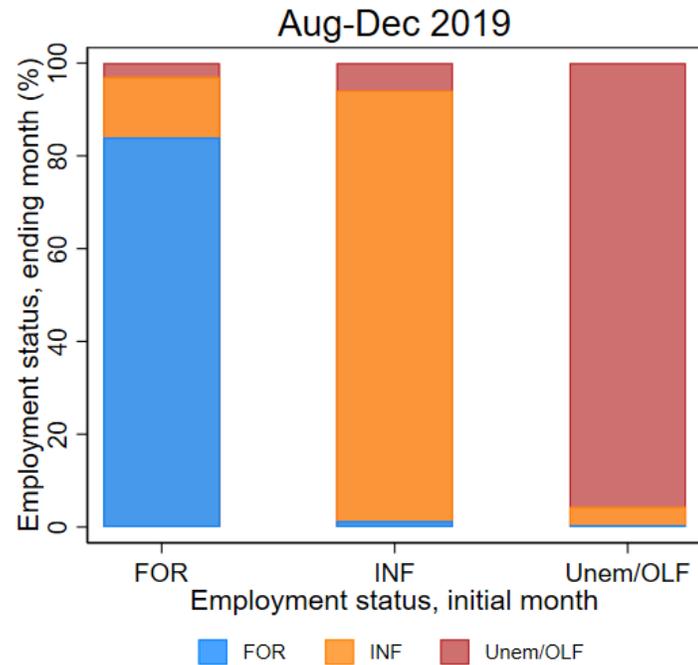
Labor market transition rates: Early COVID



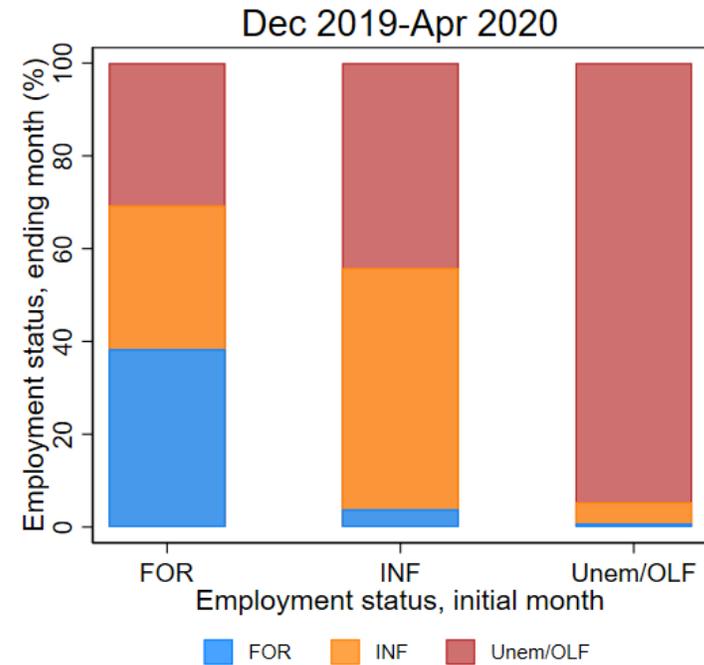
Source: Staff calculations based on CMIE CPHS Panel Survey

...particularly in the informal sector

Before COVID

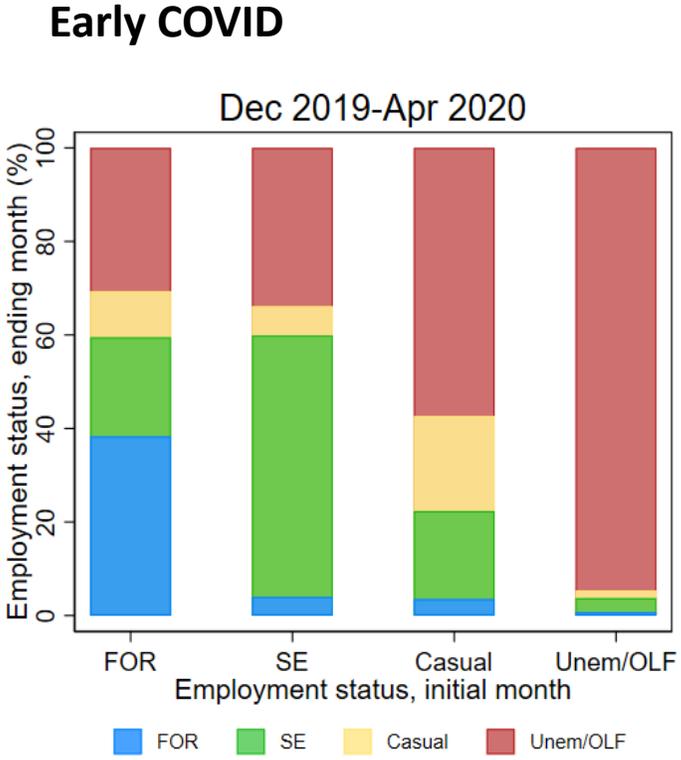
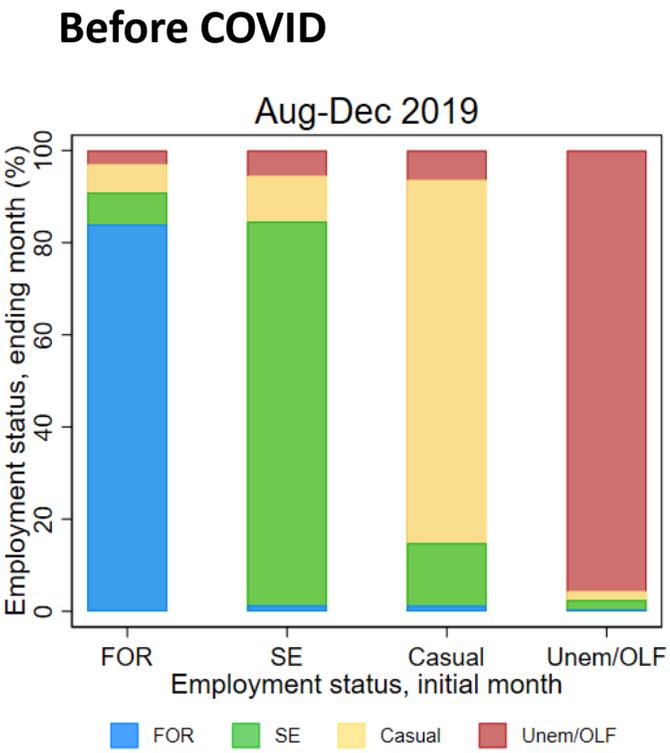


Early COVID



Source: Staff calculations based on CMIE CPHS Panel Survey

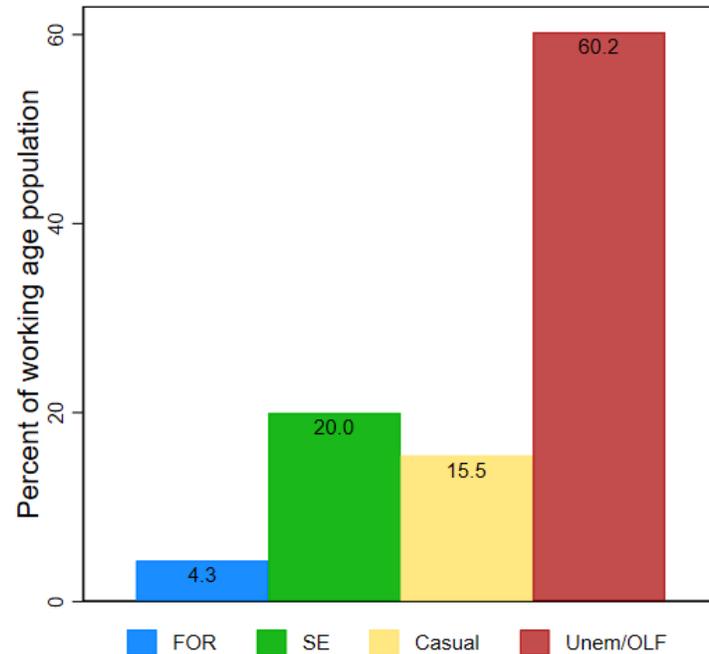
While informal wage employment experienced the highest rates of job loss, informal self-employment was stable and even experienced above-normal inflows



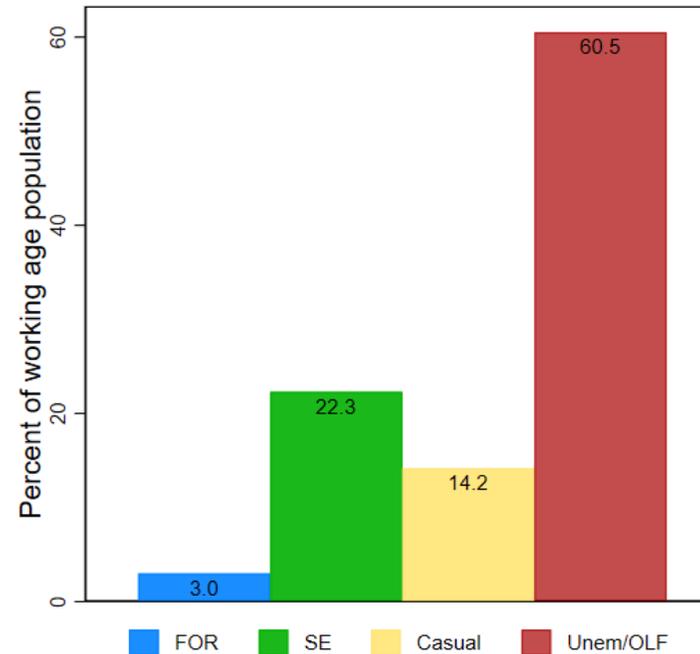
Source: Staff calculations based on CMIE CPHS Panel Survey

Six months in, the informal self-employment sector has become even larger, while wage employment has shrunk

Composition of workforce: Pre-COVID



Composition of workforce: Post-covid

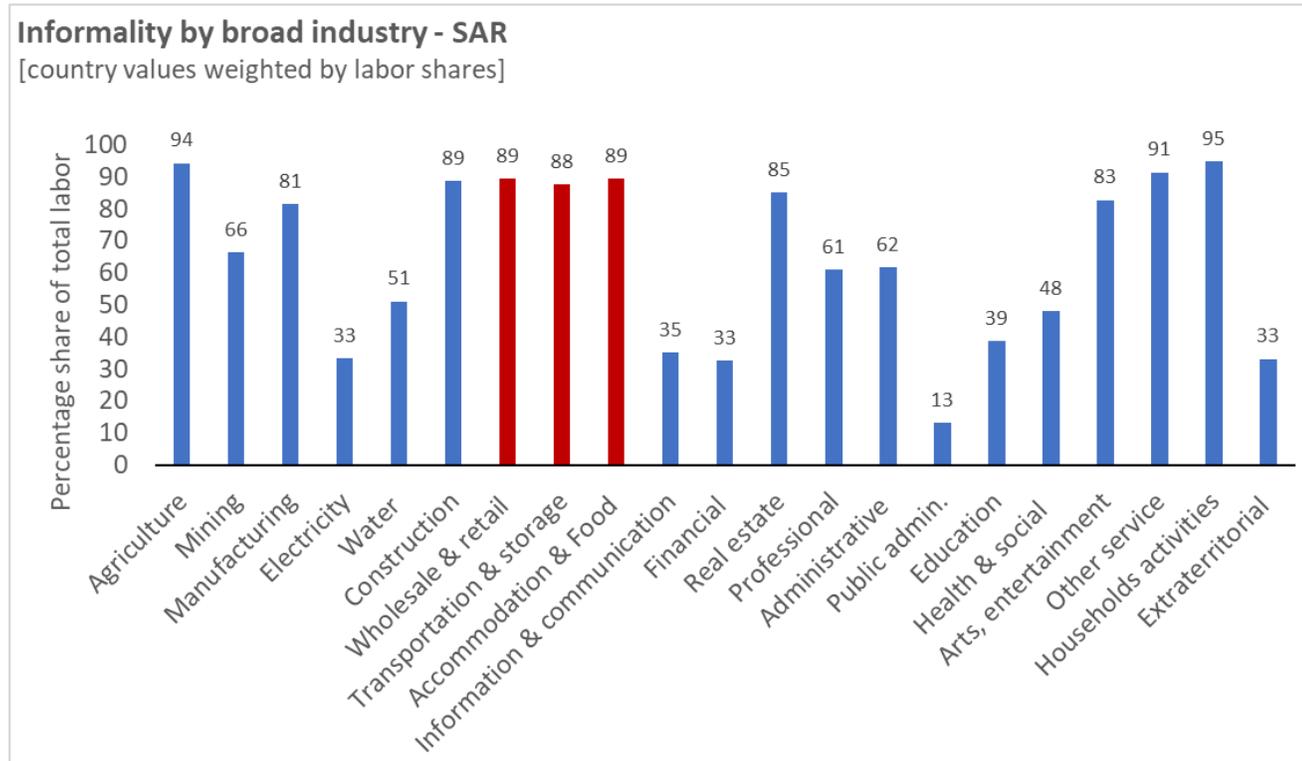


- By August 2020, job loss among wage employees had slowed down compared to the early days of COVID
- However, formal wage employees continued to move into the informal sector, esp. into self-employment, at unprecedented rates
- Outflows from unemployment/OLF increased, but mainly into the informal sector

Source: Staff calculations based on CMIE CPHS Panel Survey

The most affected sectors – high face-to-face contact intensity services— employ informal workers in high proportions

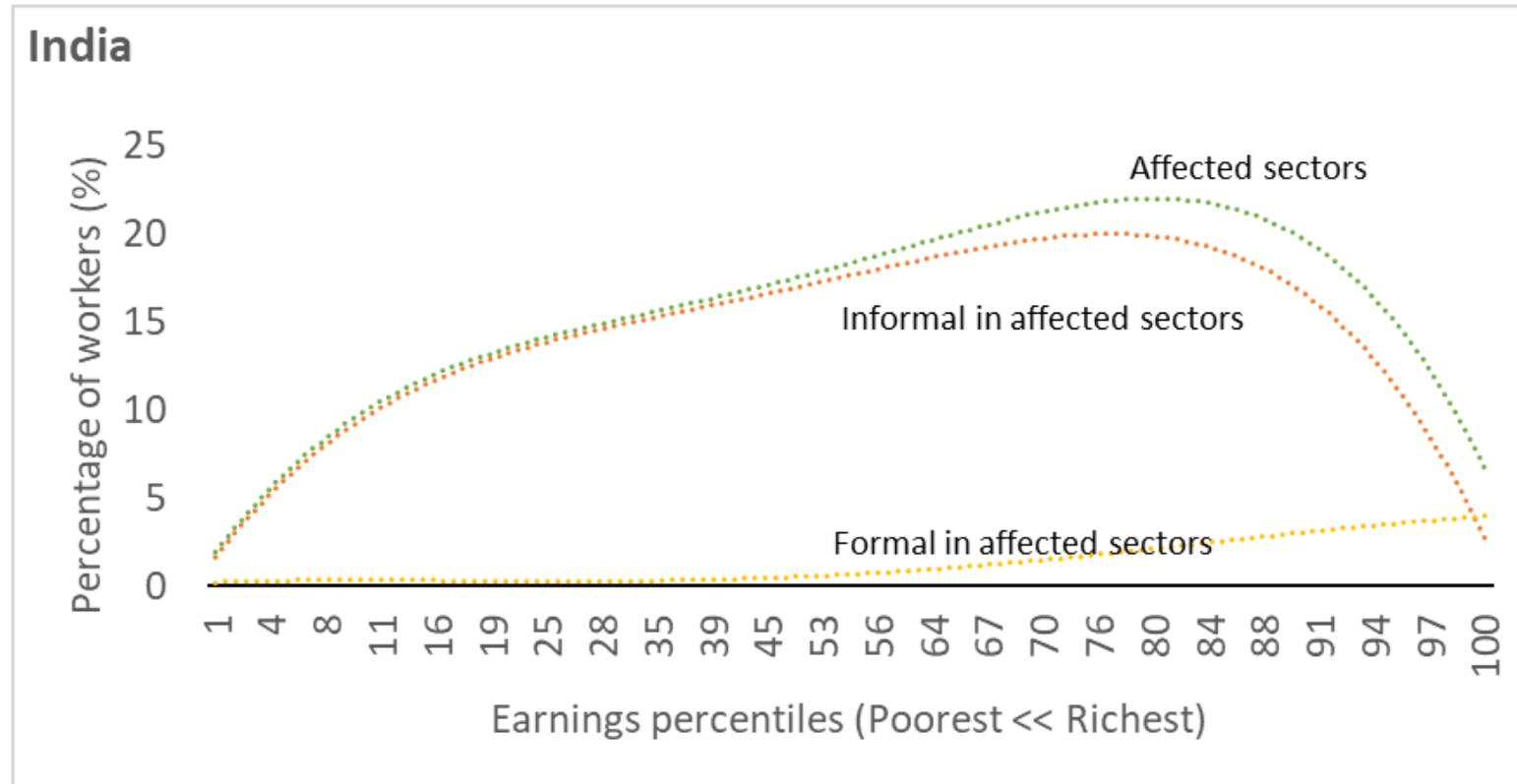
Informality by industry: SAR Average



Note: Cross-country weighted average, using Bangladesh LFS 2017, India PLFS 2017-18, Pakistan LFS 2017 and Sri Lank LFS 2015

Informal works in affected sectors have varied income levels

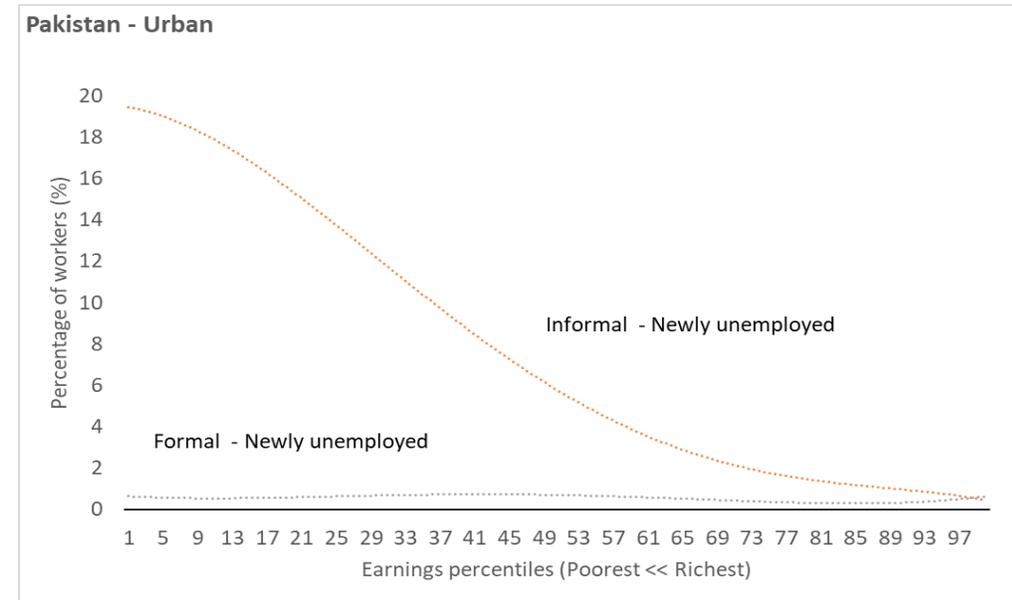
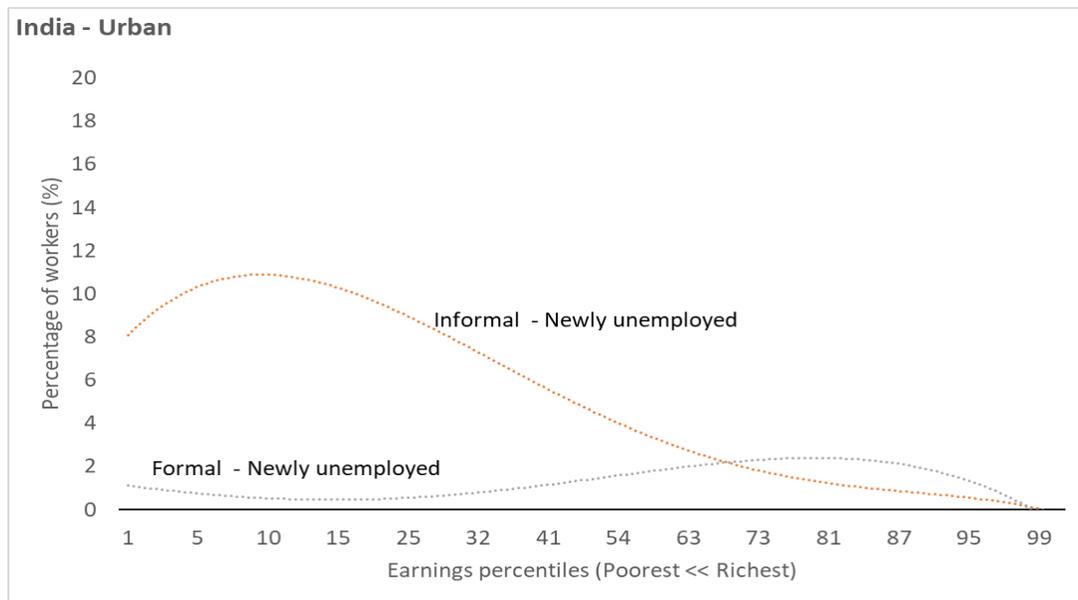
Percent of workers in affected sectors, by earnings percentile



Source: India PLFS 2017-18

Low and middle-income informal workers from urban areas are particularly vulnerable to job loss

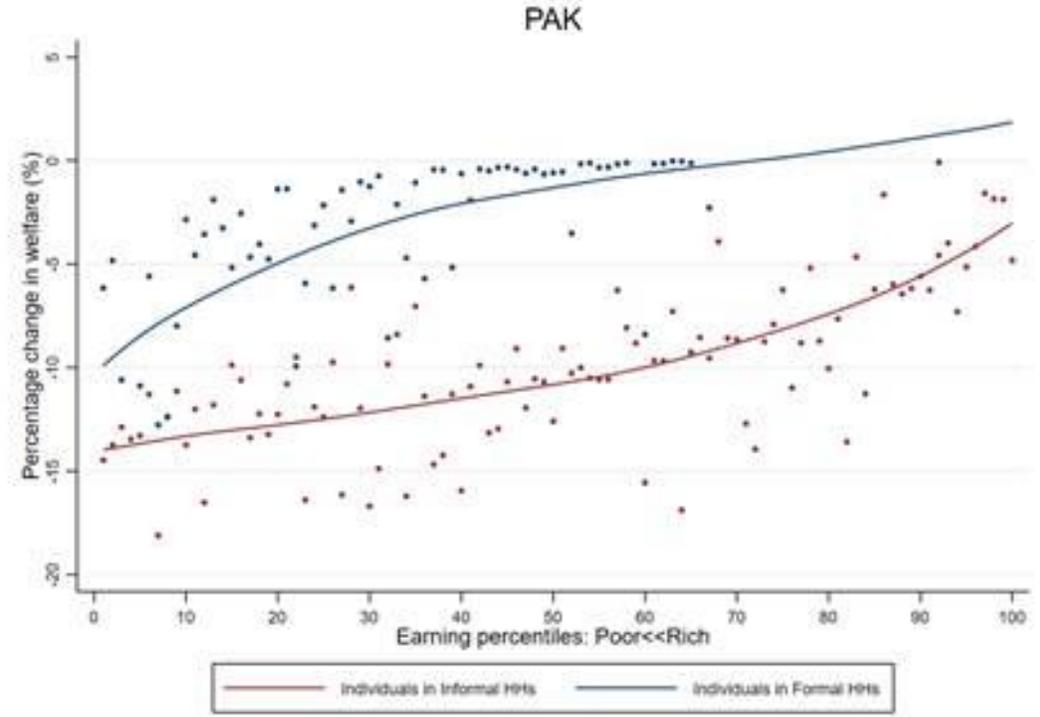
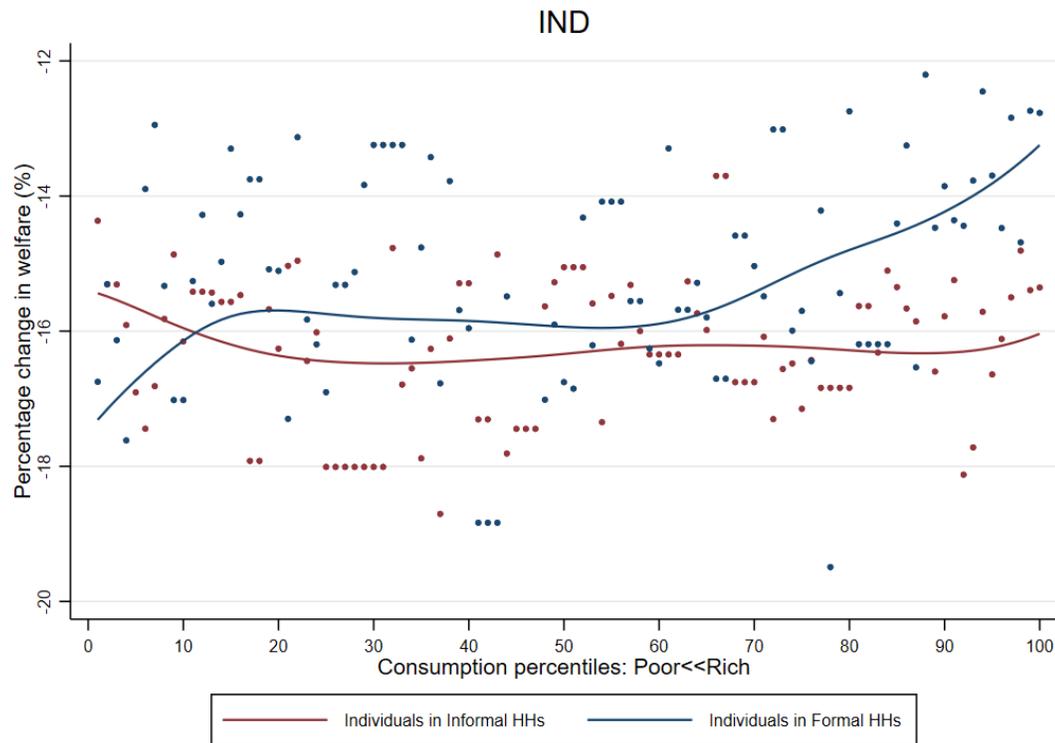
Incidence of job loss by earnings percentile: Simulation results



Source: Staff calculations using data from India PLFS 2017-18 and Pakistan LFS 2017, and model simulation

Low and middle-income informal workers are likely to have experienced the biggest fall in welfare

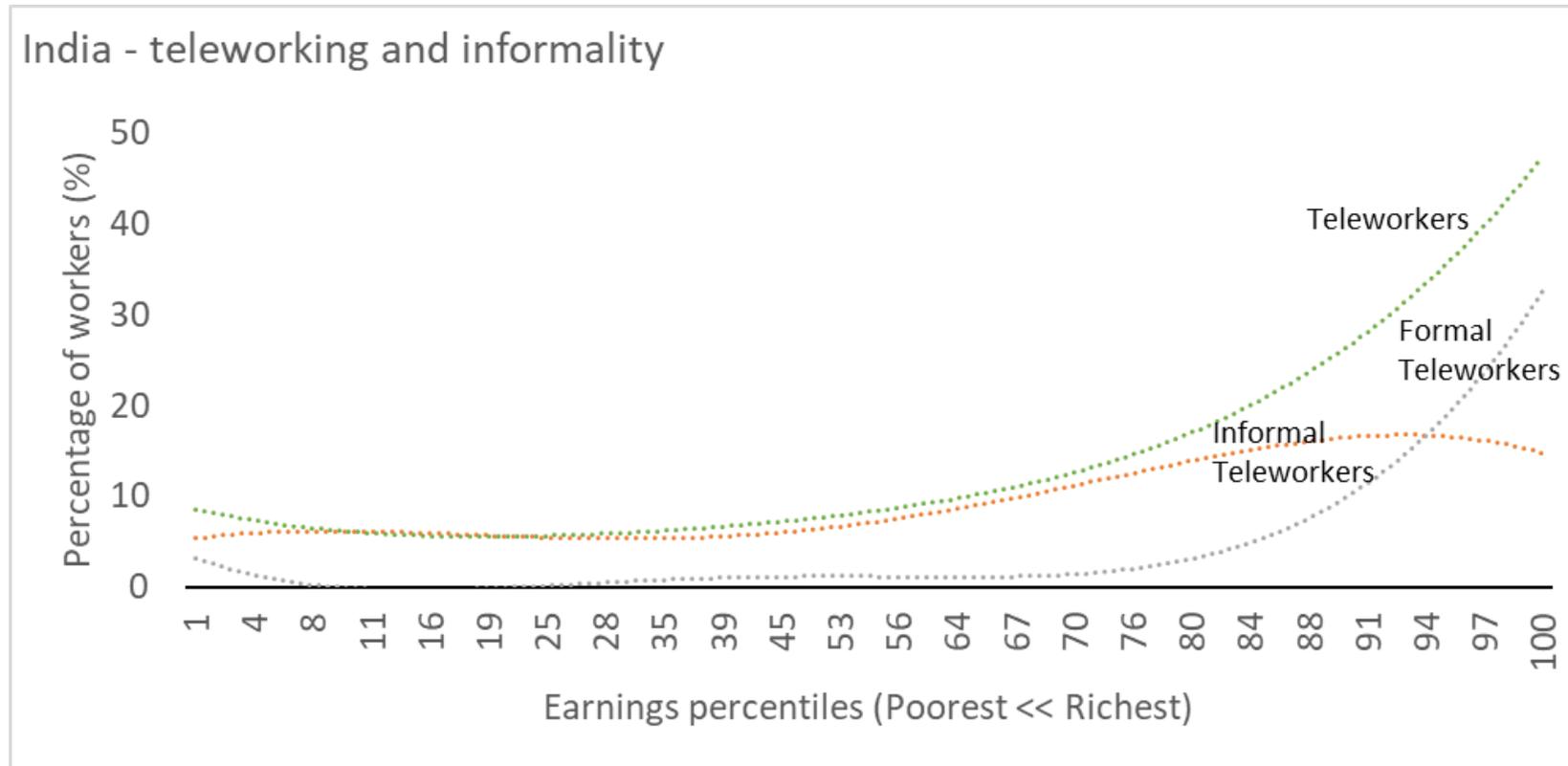
Estimated % change in welfare by income percentile



Source: Staff calculations using data from India PLFS 2017-18 and Pakistan LFS 2017, and model simulation

Low and middle-income workers have limited access to teleworking opportunities

Teleworking status by wage percentile, formal and informal



Source: Staff calculation based on India's PLFS 2017-18 and the occupational classification scheme in Dingel and Nieman (2020)

The informal sector cannot, in the short run, expect huge benefits from digital platforms

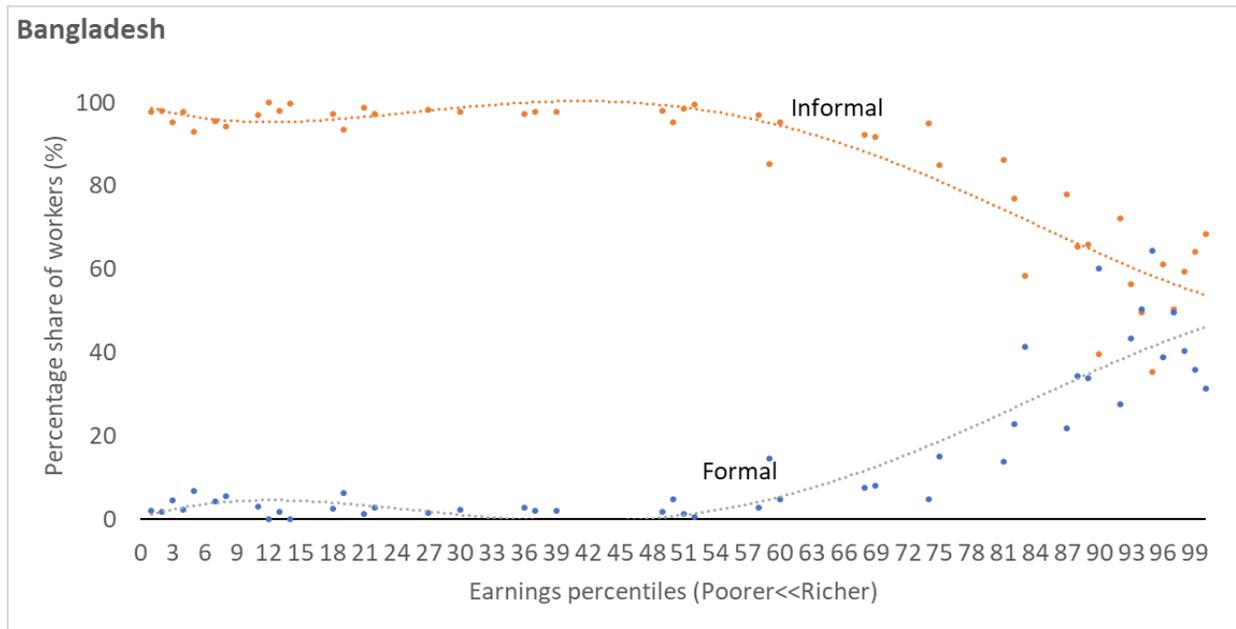
- Digital platforms have the potential to transform the informal sector by increasing market access
- But much of the informal sector lacks the capabilities to take advantage of these opportunities
- Digital platforms can remove some barriers to growth but not all

Among firms with a Facebook Business Page, informal firms are still relatively disadvantaged

Probit marginal effects					
	Digital platforms help (1)	Frequent FB use for business (2)	Engages in intl trade (3)	Access to credit (4)	Uses ecommerce (5)
Informal (if < 10 empl.)	0.0686*** (0.00670)	0.0689*** (0.00772)	-0.157*** -0.0069	-0.137*** -0.00727	0.0400*** -0.00841
SAR	-0.0281*** (0.00387)	-0.0839*** (0.00588)	-0.0673*** -0.00201	0.00216 -0.00158	0.0333*** -0.00135
Observations	3617	40306	48001	23450	24235
Pseudo R-squared	0.099	0.0821	0.0307	0.0465	0.0319

* p<0.10, ** p<0.05, *** p<0.010. Standard errors in parentheses are clustered at the country level. All regressions include country effects and control for firm level characteristics like age, gender and industry. Columns 1-2 use data from the survey round of 2019 winter and Column 3-5 use data from 2019 spring.

Quickly expanding the reach of social assistance programs is important: the vulnerable informal sector is pervasive across income levels

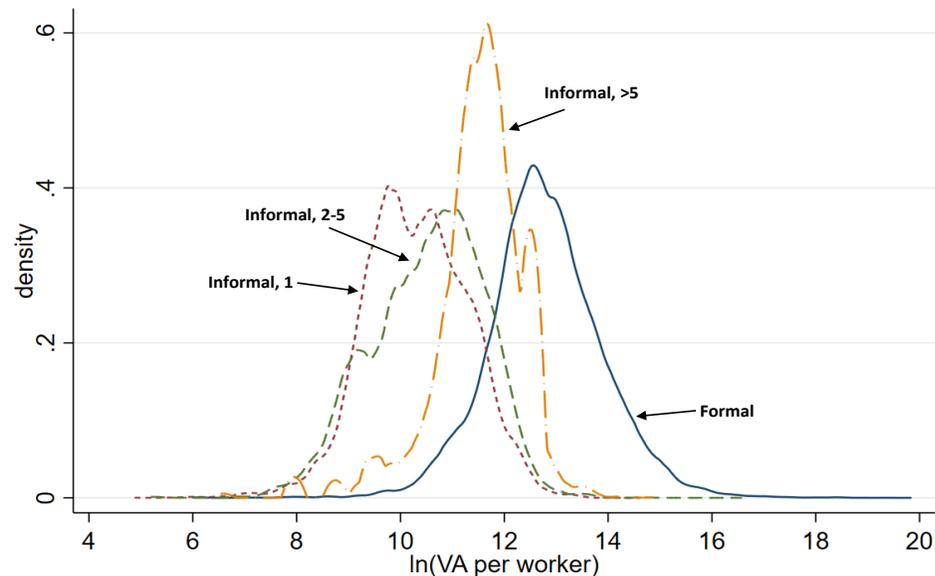


Source: Staff calculations using Bangladesh LFS 2017

- The COVID-19 response in South Asia has mainly consisted of an expansion of social assistance programs
- Programs that are means-tested and/or deliver assistance through formal financial and labor market channels do not fully reach vulnerable informal workers above the poverty line
- In the long run, social protection systems need to be redesigned to be more inclusive, including by leveraging technology and big data
- The challenge is to design a system flexible enough to be effective for the current but also future crises

Considering the low labor productivity and heterogeneity of the informal sector, tailored policies to increase productivity are needed

Value added per worker in India's manufacturing sector



- Despite decades of fast GDP growth, informal medium, small and micro firms are still the most common types of firms in SAR
- Their labor productivity levels remain stubbornly low
- They face different types of constraints: access to capital, skills and markets

Policy instruments for supporting the informal sector in COVID times should differ according to target group and time frame

Time frame	Short run, relief	Long run, build better
Target		
Workers and households	Expansion of social assistance (food subsidies, public works, and cash transfers)	Towards universal social protection, expand social insurance;
		Closing digital gaps
Firms	Liquidity support (grants, credit)	Four main areas:
		1) Capital
		2) Access/matching with workers
		3) Efficiency
4) Access to markets		



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Thank you
