

The Long Shadow of Informality



Policy Brief

Chapter 2: Characteristics of the Informal Economy

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Informality remains pervasive in emerging market and developing economies (EMDEs), notwithstanding a declining trend over the past three decades. Like the formal economy, the informal economy undergoes business cycles, with output movements that resemble those in the formal economy. Informal employment movements, in contrast, are more muted.

High informality in EMDEs. The livelihoods of the poor in EMDEs often depend on informal economic activity. Depending on country circumstances and worker characteristics, workers may choose informal employment for a wide range of reasons. Thus, informal workers range from agricultural day laborers to self-employed firm owners with a few employees. In EMDEs, informal-economy output on average accounts for about one-third of GDP and informal employment constitutes about 70 percent of total employment (of which self-employment accounts for more than one-half; **figure 1**).

The first comprehensive database of informality. The chapter offers a comprehensive database of informality measures developed in the literature, with a focus on measures that have broad cross-country and long historical coverage. The resulting dataset combines multiple cross-country databases and data provided by almost 90 national statistical agencies. It includes 12 measures of informality for up to 196 economies (36 advanced economies and 160 EMDEs) for as long as 1950-2018. These measures are grouped into output-, employment-, and perception-related measures of informality.

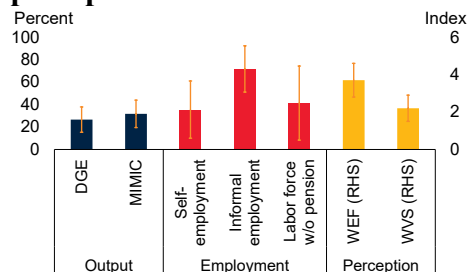
Decline in informal output and employment, steady perceptions of informality. Both output and employment measures of informality have trended downward since 1990, on average and in the vast majority of countries. In contrast, perception-based measures have tended to be highly stable over time. The trend decline in informality in part reflected improvements in business climates and other policies that were conducive to lowering informality (see [Ohnsorge and Yu 2021](#)).

Informal-economy business cycles. Just like the formal economy, the informal economy undergoes business cycles, and these are somewhat larger for EMDEs than for advanced economies. Cyclical movements in informal-economy output do not differ statistically significantly from those in formal-economy output. Meanwhile, unlike formal employment, which contracts significantly in advanced economies during formal-economy recessions, informal employment in both advanced economies and EMDEs remains stable during informal-economy business cycles.

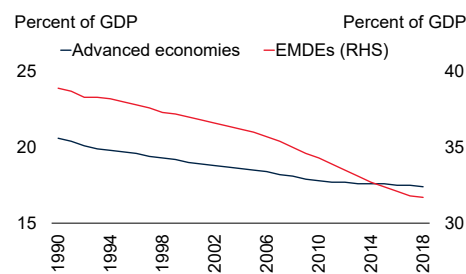
Figure 1. Informality in EMDEs

The informal sector accounts for about one-third of GDP and more than 70 percent of employment (of which self-employment accounts for more than one-half) in EMDEs. Since 1990, the share of informal output and employment has declined despite perceptions of informality remaining stable. Output movements through informal- and formal-economy business cycles are similar, but informal employment is largely unresponsive to informal-economy business cycles—in contrast to formal employment’s sensitivity to formal-economy business cycles.

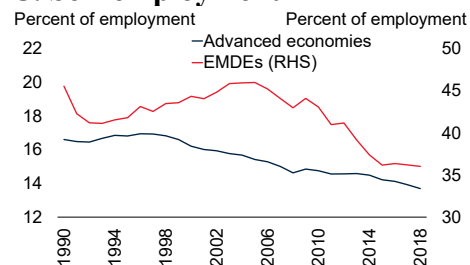
A. Informality: Output, employment, and perceptions



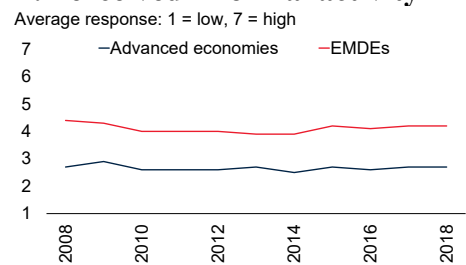
B. Output informality



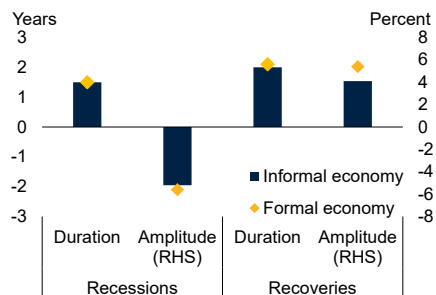
C. Self-employment



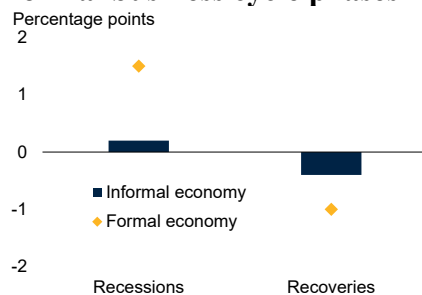
D. Perceived informal activity



E. Duration and amplitude of informal and formal business cycle phases



F. Changes in informal and formal employment growth over informal and formal business cycle phases



Sources: [Elgin et al. \(2021\)](#); World Bank; World Economic Forum.

A. Unweighted averages for latest available year. Whiskers are +/-1 standard deviation. Data on informal employment are for EMDEs, all other data are for global averages. See table 2.1.A for details. B.-D. Group means. Output informality (B) defined as dynamic general-equilibrium-based estimates in percent of official GDP. Self-employment in percent of total employment (C), with missing data for self-employment interpolated for earlier years or using the latest available observation for recent years. WEF (World Economic Forum) index of informality (D) ranges from “1= Most economic activity is undeclared or unregistered” to “7 = Most economic activity is declared or registered”. E.F. Data for informal-economy and formal-economy recessions and recoveries starting and ending in 1990-2018. Informal output proxied by dynamic-general-equilibrium-based estimates (E); informal employment proxied by self-employment (F). For recessions and recoveries, business cycle turning points determined based on formal and informal GDP levels using the algorithm of Harding and Pagan (2002). Recovery is defined as the time it takes for output to return from the trough of the recession to the pre-recession peak. Its corresponding “Duration” and “Amplitude” (E) are defined as in Claessens, Kose, and Terrones (2012). All statistics are sample means. Differences are not statistically significant. See tables 2.5 and 2.6 for details.