The Long Shadow of Informality

Policy Brief

Chapter 5: Informality in Emerging Market and Developing Economies: Regional Dimensions

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Informality declined in emerging market and developing economy (EMDE) regions between the 1990s and the 2010s, yet it remains widespread. Informality is associated with a range of factors that differ across regions and countries. A balanced policy mix tailored to economy-specific circumstances can mitigate the adverse effects of informality.

Declining informality in EMDEs. Output informality (the informal share of total output) declined in all regions during the two decades before the COVID-19 pandemic, particularly in South Asia (SAR) and East Asia and Pacific (EAP; **figure 1**). Employment informality (measured as self-employment as a share of total employment) declined the most in South Asia (SAR), Sub-Saharan Africa (SSA), and the Middle East and North Africa (MNA).

High, but varying, incidence of informality across regions. Even with the declines, informality remains far more widespread in EMDEs than in advanced economies. Informal output in EMDEs averaged 33 percent of official GDP during 2010-18, versus 18 percent in advanced economies. Self-employment accounted for 42 percent of total employment in EMDEs, far above the 14 percent in advanced economies. Output informality is highest in SSA, Europe and Central Asia (ECA), and Latin America and the Caribbean (LAC), at more than one-third of official GDP in 2010-18. Informal employment is highest in SSA and SAR, at about 60 percent of total employment. MNA has the lowest output and employment informality, although there is wide within-region divergence.

Informality associated with a range of factors. Key correlates of high informality include low human capital, large agricultural sectors, and poor business climates. But there are also important region-specific factors. In EAP, for instance, formal job creation and social protection did not keep pace with large-scale rural-to-urban migration in recent decades. In ECA, the high shares of informal output in some economies are partly a legacy of the transition from centrally planned to market economies in the 1990s. In LAC, trade liberalization reforms of the 1990s contributed to growing informality in some economies, as formal firms that were unable to compete in a liberalized formal economy retreated into informality. In MNA and SSA, disruptions from armed conflicts have forced people to earn their livelihoods in the informal economy.

Tailored policy response needed. A balanced policy mix tailored to economy-specific circumstances can help mitigate the adverse effects of informality (see also Ohnsorge and Yu 2021). In ECA, LAC, and much of MNA, policies have centered around easing regulatory burdens and building more effective and accountable institutions—in particular, strengthening enforcement and reducing corruption. In SSA, policies have focused on unlocking the latent economic potential of the informal sector through investing in human capital and improving access to resources to increase labor productivity.

Figure 1. Informality in EMDE regions

Output informality declined in all regions and employment informality declined in three out of six regions between the 1990s and the 2010s. EMDEs account for half of the world's informal output and more than 90 percent of its informal employment. Key correlates of high informality include low human capital, large agricultural sectors, and poor business climates.
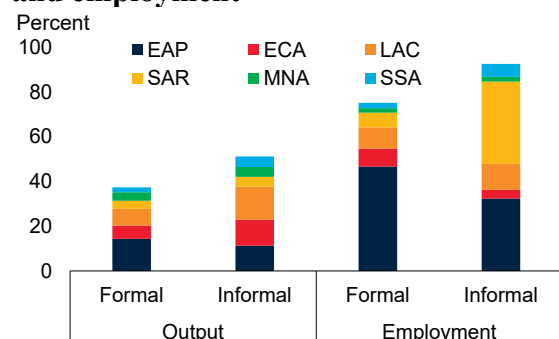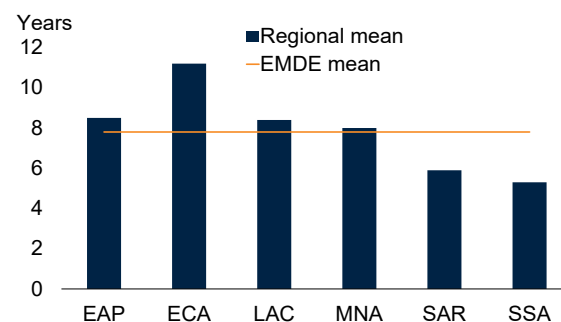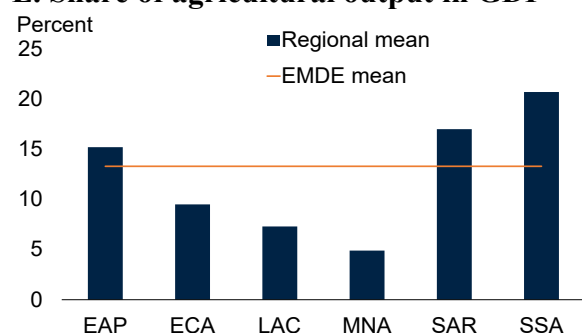
A. Output informality

Percent of GDP
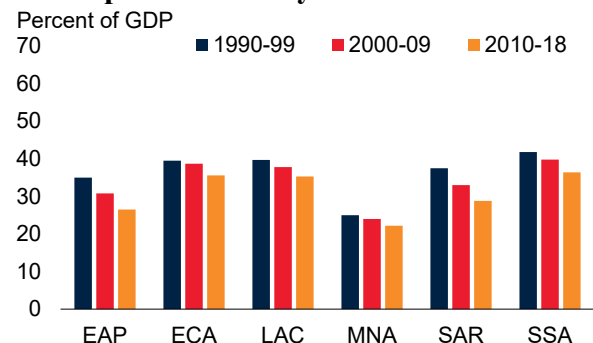
B. Employment informality

Percent of employment
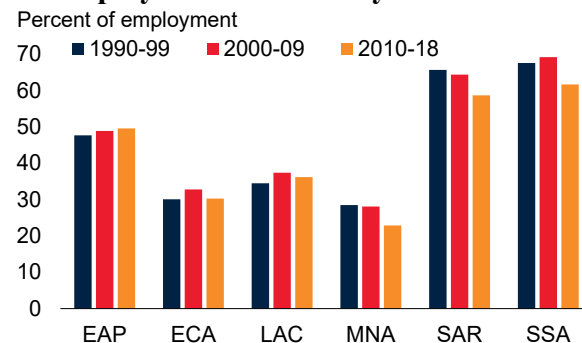
C. EMDE regions' share of world output and employment

Percent

D. Duration of schooling

Years

E. Share of agricultural output in GDP

Percent

F. Control of corruption

Index (-2.5=worst, 2.5=best)
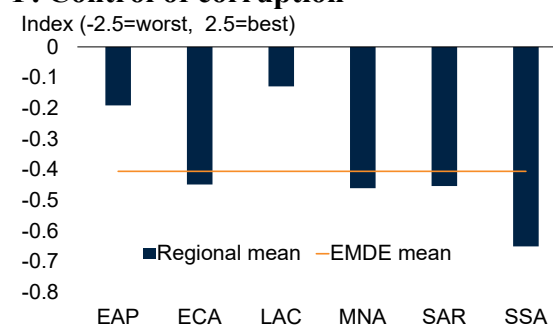
Sources: Barro and Lee (2013); International Labour Organization; Vorisek et al. (2021); World Bank.
A. Informal output is proxied by dynamic general equilibrium (DGE) model-based estimates, in percent of official GDP. Bars show unweighted group averages. B. Informal employment is the share of self-employment in total employment. Bars show unweighted group averages. C.E. Bars and lines show averages for 2010-18. D. Bars and line show average years of schooling for those aged 15 and older. Data for 2010. F. Bars and line show averages for 2018.
A.-F. EAP = East Asia and Pacific; ECA = Europe and Central Asia; EMDE = emerging market and developing economies; LAC = Latin America and the Caribbean; MNA = Middle East and North Africa; SAR = South Asia; SSA = Sub-Saharan Africa.