

Impact of COVID-19 on the Informal Economy

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ABSTRACT

The informal economy has been at a disadvantage for many years, but its importance has not been discussed very often. This paper examines the challenges of the informal economy after COVID-19. Although the pandemic has hit the global economy significantly, the impact on informal workers has been the most significant. Women, the less educated, and many in developing nations face income loss, lack of social security, and inequality. These issues demonstrate the need for urgent reforms in the informal economy to prevent future crises. The paper presents plausible goals that nations' governments should aim for to ensure long-term growth.

Informal Economy vs. Formal Economy

The term "informal economy" refers to workers and working conditions relative to the "formal economy." The "formal economy" refers to all economic activities by workers that are covered by labor law, such as an 8-hour workday and overtime pay at one and a half times the standard rate. They also receive specific social security measures, including workers' compensation insurance, sickness, unemployment, and retirement. The "informal economy" lacks formal legal arrangements in comparison to the "formal economy."

The concept of informal economy was adopted by the International Labor Organization (ILO) of the United Nations in a widely read study on Kenya in 1972. The main aims of the ILO are to promote legal protection and social security for workers. At that time, most workers in developed countries had such protections, and the term "informal economy" primarily referred to the working conditions of laborers in developing countries. "According to this study, the informal sector has the following characteristics: easy entry for the new enterprise, reliance on indigenous resources, family ownership, small-scale operations, unregulated and competitive markets, labour-intensive technology, and informally acquired skills of workers" (Papola, 1980, p. 819). The informal economy does not include criminal activities. Although the employment arrangements in the informal economy lack formal legal arrangements, the economic activities still produce and distribute legal goods and services.

Causes and Shortcomings of the Informal Economy

Informal employment poses a major challenge for economies and labor markets globally. According to an ILO Press release dated April 30, 2018, more than 60 percent of the world's employed population is reported to be in the "informal economy." This global problem needs urgent attention (*More than 60 per cent of the world's employed population are in the informal economy*, 2018).

The existence of the informal economy can be attributed to several factors. In emerging and developing countries, labor market segmentation prevents low-skilled workers from accessing formal jobs with legal benefits. These countries, in their pursuit of improved global competitiveness and increased foreign investment, often witness foreign investors outsourcing or subcontracting working processes to enhance efficiency. This practice, while beneficial for the economy, promotes employment arrangements for informal workers. "Agriculture is the industry sector with the highest level of informal employment (93.6 percent) around the world"

(International Labour Organization, 2018, p. 20). For example, in China, when industrialization continues to develop, farmers not only engage in agriculture and rural sideline production but also go to urban areas to do some informal work to support a living.

While informal work offers employment flexibility in some economies, the informal sector is often connected with low productivity, small scale, limited financing channels, reduced tax revenues, lack of social protection, gender inequality, and income inequality. Women are disproportionately represented in the informal economy. They tend to hold some of the most vulnerable and lowest-paying jobs (Malta et al., 2019).

COVID-19 Impacts on the Informal Economy

We must address informality, improve productivity, reduce global poverty, and resolve gender and income inequality. The urgency of these tasks has increased due to the outbreak and recovery of the COVID-19 pandemic.

The COVID-19 pandemic has severely hit the global economy, but informal workers have been hit disproportionately. As of April 22, 2020, the full lockdown has significantly impacted approximately 1.6 billion informal economy workers worldwide, including those in India, Bangladesh, Pakistan, and Nigeria. It has made the lives of many people living at the bottom of society even worse. Women and the less educated have experienced the biggest losses in employment and labor income because of the greater portion of job informality among these groups. In China, the government adopted an aggressive lockdown policy. Most of China's offline micro businesses (OMBs) in the informal sector cannot work from home. They are usually informally employed without social insurance. They rely heavily on cash flow and are vulnerable to sudden income collapse. In the second week of COVID-19, active OMBs fell by 54% and 41% in urban and rural areas respectively (Guo et al., 2021). From a global perspective and by region, the expected income loss for informal economy workers is most prominent in Africa (81 percent), Northern America (82 percent), and Latin America and the Caribbean (80 percent) (International Labour Organization, 2020).

Emerging market countries with the highest informality rates have the largest populations under lockdown measures. In order to fight the COVID-19 pandemic, governments have made substantial investments in healthcare systems and provided relief packages for companies and those most in need, including informal workers. Due to extensive short-term spending to handle the crisis, governments are facing a liquidity crunch issue. So, they issue new public debt to improve liquidity and keep stimulus packages. They also look for alternatives such as debt relief services with the International Monetary Fund, the World Bank, and the Asian Development Bank, and issue bonds in international markets. "For example, since the beginning of the pandemic, Nigeria, Colombia, Pakistan and Chile have received loans from the IMF. Also, Chile, Colombia, Indonesia, Mexico, Philippines and South Africa have issued government bonds to raise resources to fight the Covid-19 pandemic" (Johnson, n.d.).

Reforming the Informal Economy to Promote Growth After COVID-19

The COVID-19 pandemic has served as a strong warning to all of us. It exposes the instability of the economic structures and the vulnerability of the healthcare system. Informality increases the difficulties in dealing with the pandemic and ensuring a strong recovery due to a larger volume of unemployment, poverty, lack of healthcare, and inequality. It may result in ongoing dislocations of resources and cost more on a long-term basis.

Governments should aim to transition to more formal economies. Some of these policies might set the stage for more extensive reforms in informal economies to make faster and more equitable recovery and prevent future crises.

1. Increase educational opportunities and improve educational equality. Equip people with the educational background and professional skills for employment in the formal economy. Technology has changed education during COVID-19. New online platforms are valuable tools to reach vulnerable populations and evaluate their progress efficiently.
2. Create tax incentives for small businesses, simplify taxation, and lower payroll taxes to promote formal employment. Tax systems should avoid inadvertently favoring the informal economy among individuals and companies.
3. Simplify procedures for obtaining a work permit and enable online applications, while encouraging more informal workers to apply and gain access to government programs. Some good examples are Brazil's eSocial electronic employment registration system, and e-work permits for refugees and host communities in Jordan (Branch & Leung, n.d.).
4. Allow informal businesses to access formal or bank-provided financial services. Online banking and mobile services could help them reach a broader range of financial resources, including small business loans and other support services (The Informal Sector: Compounding the Damage of Covid-19, n.d.).
5. Provide affordable childcare facilities close to the workplace. This will allow parents to take formal work and balance work and family responsibilities. (WIEGO, 2021).
6. Develop digital technologies and online channels. Digital tools are being used to design and implement the policy to accelerate the transition to formality. Digitalization can improve government regulations, reach informal workers, provide social protection, increase productivity, and contribute to sustainable and inclusive development (Branch & Leung, n.d.).

Conclusion

The informal economy seriously affects the economic development of nations. The COVID-19 pandemic reveals risks for informal workers concerning poverty, inequality, and higher social costs. Formalization is an appropriate solution to ensure long-term growth.

The factors of the informal economy across countries are very complicated. Each country must gradually promote the transition to formalization according to each nation's conditions. Governments should cooperate to facilitate dialogue, support debt relief, develop digital technology, and enhance social protection. Over time, with the collective efforts of all countries, the goal of transition from the informal to the formal economy will be achieved.

Acknowledgments

I would like to thank my advisor for the valuable insight provided to me on this topic.

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