Policy Insights

Informality and COVID-19 in Eurasia: The Sudden Loss of a Social Buffer

GLOBAL RELATIONS
Eurasia Competitiveness Programme

The sudden loss of a social buffer: COVID-19 and informality in Eurasia

Foreword

COVID-19 has triggered an economic and public health crisis that has profoundly affected informal firms and employment in the Eastern Partner region, Central Asia, Afghanistan and Mongolia, where they have historically represented a large portion of economic activity.

Previously, the informal sector has acted as a buffer in times of crisis and revealed its resilience in the transition to recovery, as it has offered subsistence revenues, flexible arrangements and opportunities for vulnerable workers and businesses alike. COVID-19 has been different, pushing governments to close market places and implement strict containment and social distancing measures, which have hit the informal sector hard – in many cases even more than the formal sector – leaving those engaged in it with no cushion on which to rely. Migrants in the informal sector had also to return home or remain in their countries of destinations, both generating a loss of revenues in economies heavily reliant on large remittance flows. In addition, most government support programmes in the region focused on the formal sector, leaving informal firms and workers with little or no support.

This note looks at the effects of the COVID-19 pandemic on informal workers and firms and discusses challenges that it has raised, including short- and long-term policy recommendations to ensure a sustainable and inclusive recovery for all. The note draws on previous OECD work on informality in Afghanistan and other regions of the world, including Latin America, South East Asia and the Middle East and Africa.

This note was presented and discussed on 11 March 2021 at the OECD webinar *Informality in Eurasia: the sudden loss of a social buffer*, which brought together policymakers, civil society representatives, the development community and the private sector from the OECD area and the Eurasia region. During the webinar, participants shared experiences and discussed the main issues and options for fostering business formalisation across the region in order to build back better. This final version reflects the webinar discussions and aims to foster co-operation and future work on informality.

Acknowledgments

This note summarises work carried out by the OECD Eurasia Competitiveness Programme in consultation with Eurasia governments, in close collaboration with the development community in the region, and with the participation of the private sector and business associations.

The OECD would like to thank the representatives of ministries, the private sector, business associations, non-governmental organisations and other stakeholders for their willingness to share with the OECD team valuable insights that contributed to the development of this note. Particular thanks go to: Ms Rūta Bilkštytė, Vice Minister of Finance of Lithuania; Ms Tamar Kitiashvili, Deputy Minister of Education, Science, Culture and Sport of Georgia; Mr Badriddin Abidov, Deputy Minister of Investment and Foreign Trade of Uzbekistan; Mr Abdul Karim Malekyar, Deputy Minister of Industry and Commerce of Afghanistan; Mr Oleksandr Romanishyn, Deputy Minister for Economic Development, Trade and Agriculture of Ukraine; Dr Wimonkan Kosumas, Deputy Director General, and Ms Attanisa Changchaitum, Deputy Director of the International Cooperation Department, Office of SME Promotion of Thailand; and Mr Robin Ord-Smith, Business Ombudsman of Kyrgyzstan.

A number of representatives of the development community and academia provided further support to the work: Ambassador Sven Olov Carlsson, Head of the Delegation of the European Union in Kazakhstan; Ms Jane Barrett, Director of Organization and Representation at Women in Informal Employment: Globalizing and Organizing (WIEGO); Ms Judith van Doorn, Specialist, Enabling Environment and Enterprise Formalisation, ILO; and Mr Rustamjon Urinboyev, Associate Professor, Lund University/Senior Researcher at Aleksanteri Institute.

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Executive summary

Economic informality is a pervasive reality in the Eastern Partner (EaP) countries and Central Asia. The region has a long history of informality, and the size of the informal economy has been estimated at between a third and half of the GDP in most countries of the region since the 1990s. For the most part, this concerns informal employment, but informal firms constitute an important part of the enterprise population across the region. The informal economy has long been an important provider of subsistence income and economic opportunities for both households and workers, especially own-account workers, some of them operating in the informal sector by necessity and others by choice. At the same time, it has also reduced the tax base and been a source of unfair competition to existing formal businesses. Moreover, reluctance to formalise leaves many informal businesses stuck in low-productivity traps.

COVID-19 has disproportionately affected informal firms, workers and entrepreneurs in Eurasia, as confinement policies and social distancing measures put pressure on social protection systems, returning migrants, and economic activities. Most countries, especially Azerbaijan, Georgia, Kazakhstan and Mongolia, imposed strict containment measures that hampered business operations, while border closures affected economies that traditionally rely on the export of labour, such as Ukraine, Kyrgyzstan and Tajikistan. Many migrants – in their majority informal - were stranded jobless in their countries of destination or compelled to return to their countries of origin, incurring loss of earnings in either case. Quarantine and local containment measures have forced informal activities to stop due to the immediate closure of public spaces, including small shops, informal service providers and street vendors. Many poor households and young workers relying on informal work lost their means of subsistence, while most of them do not benefit from traditional social protection systems.

Containment measures have prevented the informal economy from acting as a social buffer. Previous crises had primarily affected the formal sector, leading to a decline in formal business activities, increased bankruptcies, surges in unemployment and reductions in credit volumes. Laid-off workers tended to move to the informal sector, while informal firms had maintained a certain level of business operations, providing minimum revenues. However, the current pandemic has not spared the informal sector, as lockdowns, mobility restrictions and other containment measures reduced the scope for informal activity to smooth incomes and support consumption. Sectors characterised by high levels of informality were also among those hardest-hit, including agriculture, retail, and trade. Increases in poverty rates across the region show first signs of this loss, potentially reversing years of progress in improving living conditions.

The emergency measures introduced by virtually all countries of the region to support firms and workers affected by the COVID-19 crisis mostly targeted the formal sector, leaving the informal sector with little support in most cases. Public financial support for firms, ranging from preferential loans to credit guarantees and job retention schemes, has mostly covered formal workers and firms, as have social protection systems. However, some measures have reached the informal sector particularly in Azerbaijan, Kazakhstan, Mongolia and Uzbekistan. These include cash transfers, food vouchers, deferral of rent and utility payments, social assistance programmes and the expansion of social safety nets.

The post-pandemic recovery will call for longer-term policy responses from Eurasia governments to help the transition towards business formalisation. Promoting business formalisation can support sustainable, quality job creation, raise firm productivity and increase government revenues. It can also level the playing field, particularly among small enterprises, and support participation in global and local value chains based on stronger, formal supplier-customer contractual relations. Formal firms benefit from better access to government services, finance, technology and markets. They are also able to recruit more highly skilled workers and further invest in employee training, thus raising labour productivity. The informal sector, often seen as a problem, is in fact a reservoir of unrealised human and economic potential. In transitioning to the formal sector, individuals become embedded in formal firms, where they are more likely to be able to raise their own productivity – and hence, their wages – as well as to develop new skills and access new opportunities.

Efforts to foster greater formalisation will need to proceed in tandem with improvements in public service delivery, financial incentives and social benefits, with a limited role for enforcement measures. Ultimately, the creation of a better business environment will be instrumental in building a stronger and wider formal economy and helping Eurasia economies to slowly transition out of widespread informal activities. Policy to favour formalisation should be designed together with informal firms and workers, to ensure that they really reflect the needs of their intended beneficiaries. Policy dialogue and consultations with representatives of the informal economy are essential.

All this must be approached with a realistic appreciation of what policy can and cannot be expected to deliver in respect of formalisation – and over what time horizons it will be effective. Formalisation cannot be pursued in isolation from economic development overall. While better policies and institutions can indeed help nudge firms and workers towards formality at the margins, their impact will depend greatly on the degree to which the broader economic environment is conducive to firm growth. In short, the evidence is fairly clear that informality declines as countries develop and productivity rises. This is no surprise. Higher-productivity firms find it both easier to operate formally – they are productive enough to bear the costs of formalisation – and harder to grow while remaining informal. Strong growth in the formal sector draws resources and workers away from informal activities, bringing about a change in the overall balance between formal and informal activities. In the end, therefore, formalisation is above all about broad-based growth.

Introduction: the COVID-19 crisis and informal economies in Eurasia

COVID-19 reached the Eurasia region[1] comparatively late but had a severe impact on local economies, which rely on trade, commodity exports, labour migration and remittances (OECD, 2020[1]; OECD, 2020[2]). The pandemic and associated containment measures delivered a substantial shock to both demand and supply in Eurasia countries, as elsewhere. They created severe economic distress for informal workers, in particular, as they typically have limited opportunities for remote working and are often unable to comply with social distancing measures. At the same time, informal workers are often more exposed to the health consequences of the pandemic, as they tend to lack access to adequate medical resources, sanitation and hygiene facilities. Moreover, informal workers were often ineligible for unemployment and social security benefits, and were in any case difficult to trace. Returning migrant workers and low-income households are particularly vulnerable, as they have limited savings and access to financial support.

This is not an incidental feature of the crisis. Most of the region's economies rely substantially on informal labour, informal firms and entrepreneurs (with different statuses: formal or informal, individual or employer), all of which have been deeply affected by the crisis. While governments moved swiftly to support consumption and employment, many of these measures were limited to the formal sector, leaving informal workers and firms to cope as best they could (OECD, 2019[3]). There is thus a need – and an opportunity – for governments to design recovery plans that can address the vulnerabilities of informal workers and support firm formalisation. Public investments in social protection, fiscal and tax incentives and digitalisation could all form part of this effort.

This note considers the policy challenges raised by widespread informality in the context of the current crisis. It begins with the definition of informality and an overview of the economics of informality, drawing on cross-country studies from Eurasia, Latin America and elsewhere. The discussion then looks at the specific character of Eurasia's informal sectors, highlighting such factors as labour migration and the prevalence in some (though not all) Eurasia countries of informal firms, as well as informal labour. This is followed by an analysis of the impact of the current crisis on informal sectors in the Eastern Partner region and Central Asia, illustrating why the informal economy may not play the same buffering role that it has sometimes played in previous crises. The remaining sections of the paper look at actual and potential policy responses to informality. Again, they begin by highlighting some broad lessons from the wider economic literature on policy responses to informality and then turn to more specific proposals appropriate to the Eurasia countries in the current crisis.

[1] Here defined as the six countries of the Eastern Partnership (Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova and Ukraine), the former Soviet republics of Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan), Afghanistan and Mongolia.

A focus on firm informality

This report focuses much of its analysis on employment in the informal sector, and in particular on *firm informality*, rather than on informal employment (Box 1). Considering the diversity of forms that informality takes and the fluidity of informal arrangements, the ILO, in collaboration with the OECD and the World Bank, has identified a number of factors which help to define firm informality (OECD, 2019[4]):

1. Size, whereby an informal firm is any unregistered firm, for which there exist no accounting records with which the operations of the firm could be retraced (ILO, 2002[5]).
2. Registration, whereby the absence of registration with a government agency, for example, a tax authority, is used as a defining characteristic of an informal firm (Gelb et al., 2009[6]).
3. Compliance with public regulation, whereby state intervention is the defining variable of informality, with firms' regulatory compliance being the determinant of their formality (Benjamin et al., 2014[7]; Kanbur, 2009[8]),

While each of these criteria is useful in analysing certain characteristics of informality, they are, in isolation, incomplete for analysing the size and importance of the informal sector in a given economy. For example, a small firm may pay for an operating license but no social security taxes. Informality is therefore better understood as a continuum, with characteristics specific to the region taken into account (La Porta and Shleifer, 2014[9]; Benjamin et al., 2014[7]). Latin American countries, particularly Mexico, have been very active in measuring their relatively large informal sector, relying for instance on the Hussmanns' matrix (see Annex A), which may be adapted for use in Eurasia.

Box 1. Defining and measuring informality

The ILO considers all economic activity not or insufficiently covered by formal arrangements to constitute the *informal economy* (ILO, 2017[10]). The *informal economy* encompasses both *informal employment* and *employment in the informal sector*, in addition to households producing for their own consumption. Both concepts can be distinguished as per the following:

- The *informal sector* comprises informal enterprises, which are not registered with any national public authority. *Employment in the informal sector* is thus an enterprise-based notion, defined by the characteristics of the enterprise in which the workers are employed. It encompasses employers, employees, own-account workers and contributing family workers, whereas informal employment in the formal sector refers to employees and contributing family workers in formal enterprises without access to certain benefits and social protections (ILO, 2018[11]).
- *Informal employment* is an employment-based notion and is defined by the employment relationship and protections associated with the worker's job, thus depending on such factors as payment of social security contributions by the employer or, alternatively, entitlements to paid annual leave and sick leave. It thus refers to all unreported employment in the informal sector, formal sector and households – the total number of informal jobs.

This flexible definition helps cast light on countries' peculiarities and needs. It has fostered increased data collection on informality while maintaining some limitations for cross-country comparisons as regulations and definitions differ. Some countries, for instance, consider the criterion of non-registered enterprises as the key notion for defining informality, but registration requirements can vary across countries. Other countries merely take the employment size criterion into account (which again varies), while others may apply a combination of both variations.

Sources: (ILO, 2017[10]; ILO, 2018[12])

The choice of remaining informal and its cost for the economy

Ulyssea (2018[13]) distinguishes between the *extensive* and *intensive* margins of firm informality. The extensive margin relates to whether firms decide to register and the costs involved, whereas the intensive margin refers to the *degree* to which firms end up operating formally, as they may also hire workers entirely or partially on an informal basis. He thus argues that it is difficult to regard informality as a "simple binary choice, or as a dualistic economy". In fact, worldwide it remains common for some (usually less-productive) firms to have a foot in both the formal and informal economies, choosing to formalise if entry costs are low and other public benefits available, but continuing to hire workers and conduct some of their business informally. Formal firms may also choose to work with informal subcontractors – though those same formal firms may also complain of unfair competition from informal firms in similar activities (Ulyssea, 2018[13]).

Since the decision to formalise is a strategic choice made by some firms, their competitors' formalisation matters and co-ordination failures may arise, leading to persistent informality (Kenyon, 2013[14]). Even if many/most firms would see potential benefits in formalising, the first-movers may suffer significant competitive disadvantages. A co-ordinated policy push on the part of the government may thus be critical in helping to overcome such collective-action problems. A credible, long-term commitment is also essential because, while workers can often shift back and forth between formal and informal sectors, this can be more difficult for firms, particularly if they grow beyond a certain size. The decision to formalise is thus potentially irreversible (or reversible only at high cost). Firms may therefore be slow to take it in response to policy changes.

Firm informality and labour-market informality have to be distinguished: increasing the formality of firms at the extensive margin requires the creation of incentives for firms to formalise, while measures to address the intensive margin deal with the propensity of formal firms to hire workers informally as they grow. The two need not move in tandem: as Ulyssea (2018[13]) shows, some measures may increase the propensity of firms to register (an increase at the extensive margin) without affecting their tendency to hire workers informally (implying no change in informal employment). Moreover, increasing enforcement on the intensive margin (i.e., cracking down on informal employment) may generate a small reduction in informal employment, while leading to greater informality among firms (and, quite possibly, a net reduction in *all* employment). Firm growth, by contrast, may lead to a reduction in informal employment, as informality at the intensive margin tends to be decreasing in firm size. This is hardly surprising since larger firms are likely to be both more visible (and thus exposed to audit/enforcement) and more productive (and thus able to afford the costs of formal employment) (Ulyssea, 2018[13]).

Overall, informal firms and informal workers share one important characteristic: they tend to have low productivity relative to the formal economy. Informal firms are typically small, inefficient, and run by individuals with limited skills, and informal workers tend to be those who struggle to find more promising opportunities in formal employment. Many workers in the informal sector are self-employed individuals (so-called own-account workers) or are employed in family firms or farms; far fewer work for firms owned or operated by employers with hired workers. The critical problem is that the productivity of informal firms and workers is too low for them to operate successfully in the formal sector: the costs of taxation and regulatory compliance would be more than they could bear. Thus, few will transition to formality in the absence of measures that help them become more productive. The greater the potential productivity of the firm or individual, the larger the opportunity cost of remaining informal (La Porta and Shleifer, 2014[9]).

The macroeconomic context is also important here. In a stagnant or contracting economy, informality may be perceived to offer a better survival strategy, since opportunities for firm growth are limited. In a growing economy, the opportunity cost of informality should rise (La Porta and Shleifer, 2014[9]). The foregoing points to the main problem with informality from an economic development perspective: it is not only associated with low productivity; it can, if widespread, act as an important *impediment* to higher productivity and thus to job creation and inclusive growth. The development of an informal economy has a negative impact on resource allocation, quality of jobs and income distribution (La Porta and Shleifer, 2014[9]). Informality limits the capacity of the state to collect taxes and hence to finance policies promoting inclusive growth, through for example public investment in infrastructure and education, or the development of labour market programmes. It also limits the degree of redistribution that can be achieved through the taxes-and-benefits system. Informal workers lack many social protections, and informal activities reduce the tax base and weaken both the rule of law and the reach of public institutions, thus contributing to higher economic and social vulnerability. Informal firms are less able to access finance or to invest in productivity-enhancing facilities or technologies, and since the difficulties of operating informally are increasing in firm size, they have limited scope to grow. Formal firms are also affected, as the market distortions induced by informality undermine trust within the private sector itself. Informality puts a burden on formal activities in terms of taxation and unfair competition that grows with the scale of informal activities and reduces the incentive to operate formally.

Informality in Central Asia and Eastern Partner countries

The challenge of measuring informality in Eurasia

Measuring informality is difficult in any context, owing to the nature of the phenomenon, and the problem is exacerbated by insufficient statistical capabilities in many Eurasia countries and the lack of harmonised definitions. As a result, the estimates of the size of the informal economy diverge across different sources, which complicates the task of addressing issues related to the informal economy. Much can depend on which entity collects these data – city officials, bazaar administrators, unions or traders – and which definitions are used. The Eurasia region is no exception to these difficulties. The experience of Georgia highlights the importance and inconsistencies of the definitional debates (Box 2).

Box 2. Measuring the informal sector in Georgia

Measures of the size of the informal sector in Georgia are not aligned between international and national institutions, using different methodologies. According to IMF estimates, the informal economy accounted for 53.1% of GDP in 2015, one of the highest shares in the world. The IMF uses a definition, which focuses on the taxation of economic activity: "The shadow economy includes all economic activities, which are hidden from official authorities for monetary, regulatory, and institutional reasons". The chosen definition helps to explain Georgia's extremely high level of informality. In Georgia, many self-employed workers such as individual farmers and taxi drivers are exempted from paying taxes, putting them within the IMF definition of informality.

Georgia's statistical agency uses a set of definitions to classify different types of enterprises to estimate the size of the non-observed economy. According to Geostat's estimates, the non-observed economy comprised 27% of Georgia's GDP in 2018. The differences between the two estimates highlight the importance of definitions that take into account the specific characteristics of national economies.

Source: (Medina and Schneider, 2018[16]; National Statistics Office of Georgia, 2020[15])

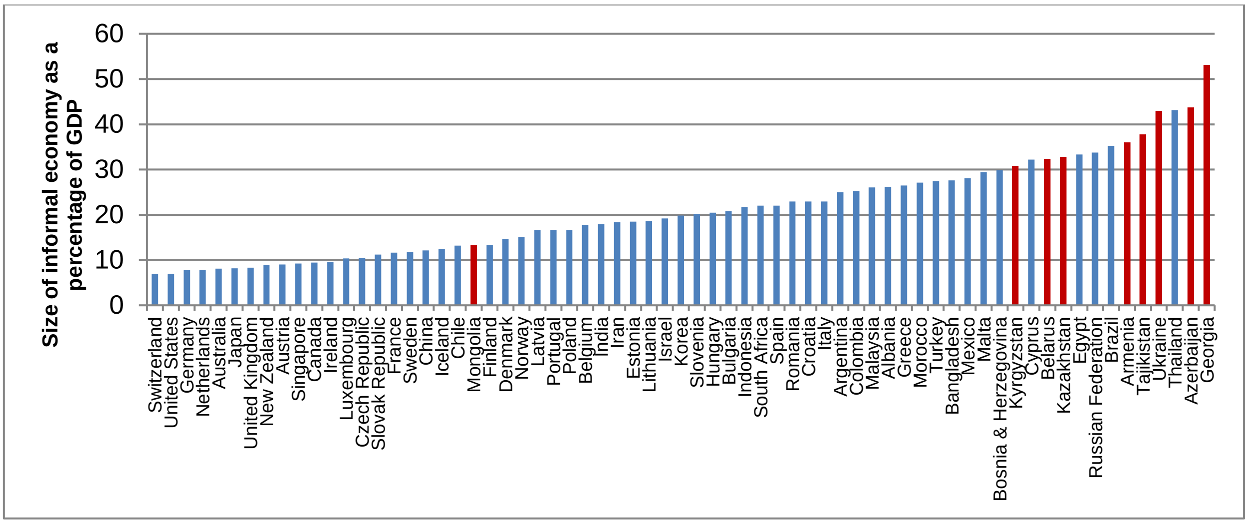
Across the region, the definition of informality varies as well, making it challenging to compare the size and extent of the countries' informal economies. In Central Asia, for example, definitions differ across countries:

- In Kazakhstan, the definition follows the international standard provided by the ILO. The key criterion defining the formal or informal nature of the enterprise is whether it has been registered with the government (Government of Kazakhstan, 2016[17]).
- In Uzbekistan, informally employed workers are those that are not registered with the tax authorities, as defined in the *Law on Employment.* The law states that individual entrepreneurs, contributing members of *dehkan* farms and self-employed workers paying social security contributions are considered to be formally employed, which is not aligned with the ILO definition.

- In Kyrgyzstan, informal activities refer to "non-criminal, profit-yielding economic activities concealed to avoid taxation and/ or social security contributions" (OECD, 2020[18]). Thus, firms are informal if not registered as legal entities with the National Statistics Committee.
- Turkmenistan does not address the concept of informality in its *Law on Employment*.
- In Afghanistan, companies are considered formal if they register with the Afghanistan Central Business Registry (ACBR), which is located in Kabul and mostly covers enterprises in the capital city. Most businesses register at municipal level, unaware that this renders them informal.

In an attempt to reconcile and benchmark global figures on informality, the IMF estimated the size of the informal economy in a series of countries, including some Central Asian and EaP countries[2], a number of which were estimated to have among the largest informal sectors in the world (Figure 1).

Figure 1. Estimates of the size of the informal sector in 2015



Sources: (Medina and Schneider, 2018[16]; OECD, 2018[19])

For Central Asia, the IMF estimated the size of the informal sector in Tajikistan at 38% of GDP, Kazakhstan at 33%, Kyrgyzstan at 31% and Mongolia at 13% in 2015 (Medina and Schneider, 2018[16]). These figures are at the lower end of a wide range of estimates of the informal economy in Central Asia, which usually range between 30 and 50% of GDP. Other national and international sources propose different figures, using alternate definitions and methods. For instance, some studies in Mongolia find that 30-35% of the economy is informal, well above the IMF estimate (ILO, ECPRC and MONEF, 2015[20]). In Kyrgyzstan, official estimates of the size of the informal economy reach 23% of GDP, while other sources place it at around 40% (EBRD, 2020[21]).

The latest IMF estimates for much of the EaP region place its informal sectors among the largest in the world. Georgia (53.1% of GDP) and Azerbaijan (43.1%) have the largest informal economies measured by the study, followed closely by Armenia. It should be noted that these figures are markedly higher than the estimates reported by national governments (Box 1).

Limited understanding of both total and partial informality, together with a lack of statistics hinder informed policymaking on business formalisation in Eurasia. The lack of consistent estimates across countries and institutions makes it difficult to develop a comprehensive understanding of informality in the EaP region

[2] The definition used for economic informality in the paper is all economic activities hidden from the authorities, excluding "illegal or criminal activities, do-it-yourself, or other household activities".

and Central Asia, let alone to compare with confidence across countries. It also complicates efforts to design effective support measures in the midst of the current crisis. Hitherto, governments have relied on anecdotal or outdated information on their informal sectors, suggesting that an immediate revision of both definitions and estimation mechanisms is needed.

A long history of systemic informality

Eurasia's history and geography have added an additional layer of complexity, by fostering a large reliance on informality as a buffer throughout the post-communist transition. In fact, systemic informality has been supported by the resurgence of former trade and social models after the fall of the Soviet Union. Central Asia and the Eastern Partner region have a history of informal markets that predate the end of the Soviet Union and the transition to the market. Even before the transition from state-controlled economic systems began in the early 1990s, the region saw a great deal of community trading and informal markets for goods that were difficult to access because of the state's inability to provide them through official channels. These traditions live on.

After independence, the economies of the former Soviet republics experienced a severe and protracted recession, high inflation and rampant unemployment. Given low rates of formal job creation, informality provided a certain safety net. A significant share of households turned to petty trading, which gave rise to informal commerce, and employment in the informal sector rose dramatically.

In Central Asia in particular, with the support of the state, metal stalls and shipping containers – previously wholesale bazaars – were transformed into enclosed malls with security, sanitation and electricity. In this way, marketplaces became a key revenue-generating sector for many Central Asian economies (Karrar, 2019[22]). The increasing importance and size of bazaars went hand in hand with the emergence of a large population of self-employed shuttle traders importing low-cost consumer goods from China, Turkey, India and other low-cost producers. On some estimates, more than 20 million people were involved in this trade at one time or another. These traders rarely registered their businesses or paid taxes, and they did not receive much support from the state. Shuttle traders largely relied on personal networks in order to establish access to goods and services and used these connections to navigate border crossings. At checkpoints, shuttle traders often gave bribes and used gifts to avoid paying high tariffs on goods (Karrar, 2019[22]). These informal cross-border trading practices left imprints on current trading methods.

The rise of informality was accompanied by the stagnation of industry, especially in the EaP region. The lack of economic opportunities left many with little choice but to work in the informal sector. At the same time, the erosion of the social safety net and low incomes created incentives for workers and employers alike to complement formal labour with informal work. Especially during economic downturns, low official unemployment rates masked high rates of underemployment. In some sectors, like healthcare, it is common for workers to pursue informal work outside of official working hours. The hybrid arrangements of informal and formal work have negative implications for the functioning of the wider society and economy but are often beneficial in the short-term from the perspective of the employers and employees concerned. Employers can retain workers at lower cost and employees can complement their insufficient incomes.

Informality has also manifested itself in the societal realm. After the collapse of the Soviet Union, lower disposable incomes, higher unemployment and the reduced purchasing power of official salaries and pensions gave rise to the (re)establishment of informal relations and networks to gain access to goods through particular groups providing privileges to their own kin. Moreover, networks were not only based on kin relations, but "tribal affiliations, geographical proximity, shared schooling, shared workplace and friendships" (Werner, 1998[23]). Such relations were maintained through a gift-giving culture, granting favours and supplying voluntary labour. In many instances, these practices were rooted in the Soviet-era "economy of favours" commonly known as *blat* (Ledeneva, 1998[24]).

Afghanistan has its own experience with informality and close cultural and trade ties with Central Asia. What sets it apart is the country's 40 years of war, which has forced Afghanistan's firms to operate in a context characterised by conflict, corruption, and political instability. The conflict evidently left irreversible marks on the country's fragile private sector, with businesses and investors fleeing the country. The ups and downs of the conflict have been mirrored in the relationship between formal and informal sectors. Thus, as the security situation deteriorated in 2012-2016, the number of business registrations fell by 60%, suggesting a retreat into informality. The failure of successive governments to provide reliable public services to businesses has further reduced incentives to operate formally, as has widespread rent-seeking on the part of officials, which has undermined trust in public institutions.

The composition and features of Eurasia's economies have fostered informality

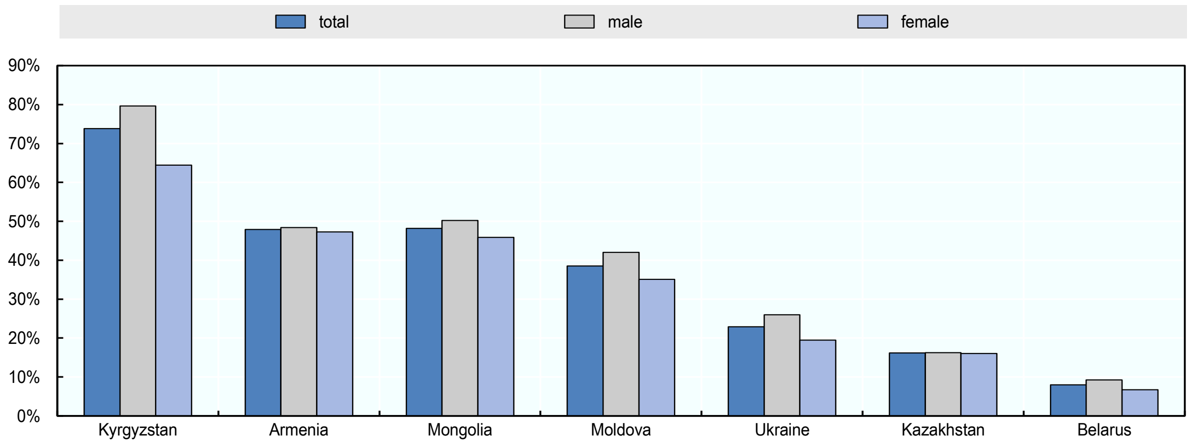
Sectors characterised by high levels of informal employment loom large in the region

Across the world, informal employment tends to be most prevalent in agriculture, self-employment, and among young workers (ILO, 2018[11]). The Eurasia region is no exception, as the majority of the region features large agricultural sectors, with informal workers and households, widespread self-employment, and a young population, including labour migrants, fuelling a number of economies across the region.

According to the ILO, the informal share of total employment ranges from less than 10% in Belarus to an estimated 73% in Kyrgyzstan (Figure 2). ILO employment data on informality (which do not include Azerbaijan and Georgia) show informal labour markets to be most prevalent in Kyrgyzstan, Mongolia and Armenia, where roughly half of all workers are in the informal sector, and in Moldova (above 40%). In terms of overall employment, the informal sector plays a significantly smaller role in Ukraine (under 30%) and Belarus (under 10%). Trends in informal employment in Ukraine highlight divergence across regions. Informal employment is significantly more prevalent in western Ukraine than in Kyiv or the large industrial cities in central or eastern Ukraine. In Kyiv, Dnipropetrovsk and Poltava regions, less than 15% of workers are employed in the informal sectors, compared with estimates of over 40% of workers in Chernivtsi region (Fehling, 2020[25]).

Informality also goes hand in hand with low labour market inclusiveness, including for women, migrants and the youth, not least because large portions of the workforce are left unprotected from statutory or collectively agreed labour standards as well as social insurance.

Figure 2. Informal employment among men and women, last available year



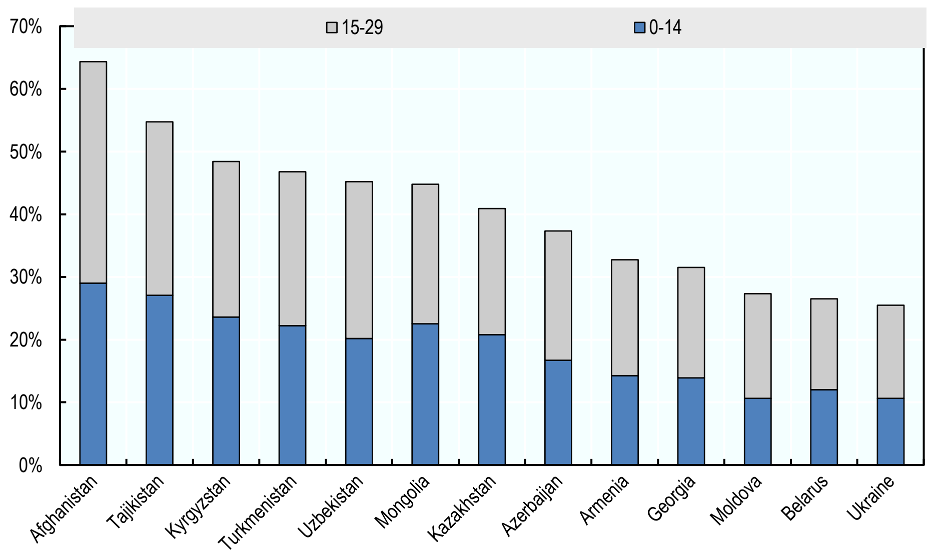
Note: Data is for the most recent year (ARM 2017, BLR 2018, KAZ 2017, KGZ 2018, MDA 2018, MNG 2019, UKR 2017). Data for KGZ and MNG are imputed [ILO harmonised series].
Source: ILO Database.

Eurasia's young population is more likely to be unemployed and to work informally

Globally, young people are more prone to informality, with 62.4% of young people employed informally, compared to 52% of all adults (ILO, 2020[26]). They have more difficulty entering the formal labour market and many countries lack instruments to ease education-to-work transitions, such as apprenticeships. Lack of skills, experience and professional networks represent important barriers to labour market entry. In addition, youth informal employment can have lasting effects on future adult labour market outcomes, with early wage penalty effects and difficulties entering the formal labour market (Cruces, Ham and Viollaz, 2012[27]).

A number of Eurasia countries have exceptionally young populations, especially those in Central Asia and, to a lesser extent, the South Caucasus (Figure 3). Belarus, Moldova and Ukraine have far smaller shares of young people in the total population. For many countries, therefore, rising cohorts of younger people constitute a source of pressure on labour markets where job creation has largely been slow and often of poor quality. Rapid population growth can slow formalisation since it sustains the supply of low-skilled informal workers and the demand for low-quality goods. This fuels both informality and outward migration.

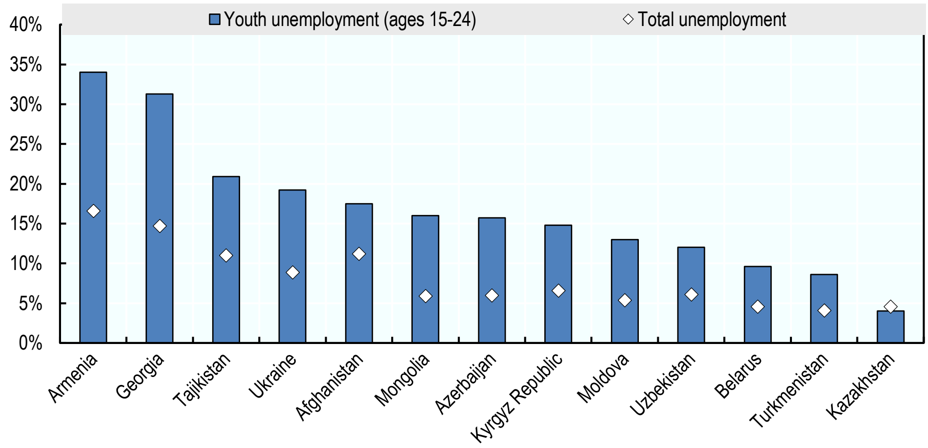
Figure 3. Estimated share of population under 30 years of age across Eurasia, 2019



Source: World Bank, World Development Indicators, OECD calculations.

Young people have predominated among both long-term and seasonal outbound migrants, and are disproportionately represented in informal labour markets. As a result, younger workers tend to be largely excluded from official social protection schemes. Armenia and Georgia, in particular, struggle with a high level of youth unemployment (estimated at 34% in Armenia and 31% in Georgia), while those in employment often find themselves in vulnerable situations as own-account workers, unpaid family workers, or workers without formal contracts. In 2016, an estimated 40.6% of employed Armenians aged 15-29 was reckoned to be informal (ETF, 2019[28]). Tajikistan also has a high incidence of youth unemployment and informality. In 2020, 21% of Tajikistan's youth were unemployed, compared to 11% of adults. With limited job opportunities in the local formal private sector, young people will tend to move to the informal sector or migrate abroad.

Figure 4. Youth unemployment and total unemployment (% of total workforce), 2020



Note: Youth unemployment defined as the share of youth, aged 15-24, not in employment, education or training (%).
Source: ILO

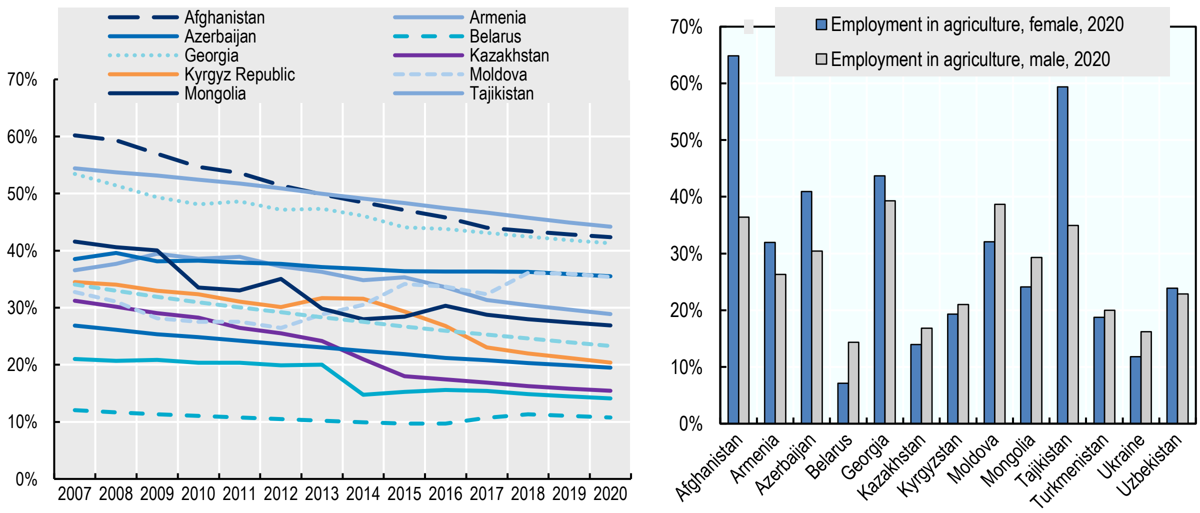
Tackling youth unemployment has been a frequently stated priority across the region, with the majority of countries having put in place policies to foster the transition into the formal labour market. Many of these efforts, however, are insufficient or not on track, as labour market policies are not implemented at the necessary scale to help large numbers of youth transition into formal employment (OECD, 2018[29]).

Agriculture accounts for a large share of employment, largely informal, in Eurasia

Agriculture, another sector that is typically characterised by above-average levels of informality, remains an important sector in many of the region's economies. Its GDP share ranges from a mere 4% of GDP in Kazakhstan to 26% in Uzbekistan, but its share of employment is far larger, albeit declining in recent decades (Figure 5). This is particularly true for women in countries like Afghanistan, Azerbaijan, Georgia and Tajikistan where agriculture accounts for more than 40% of female employment.

Figure 5. Employment in agriculture has been declining

Employment in agriculture (% of total employment), 2007-2020	Employment in agriculture, (% of total employment, female/male), 2020



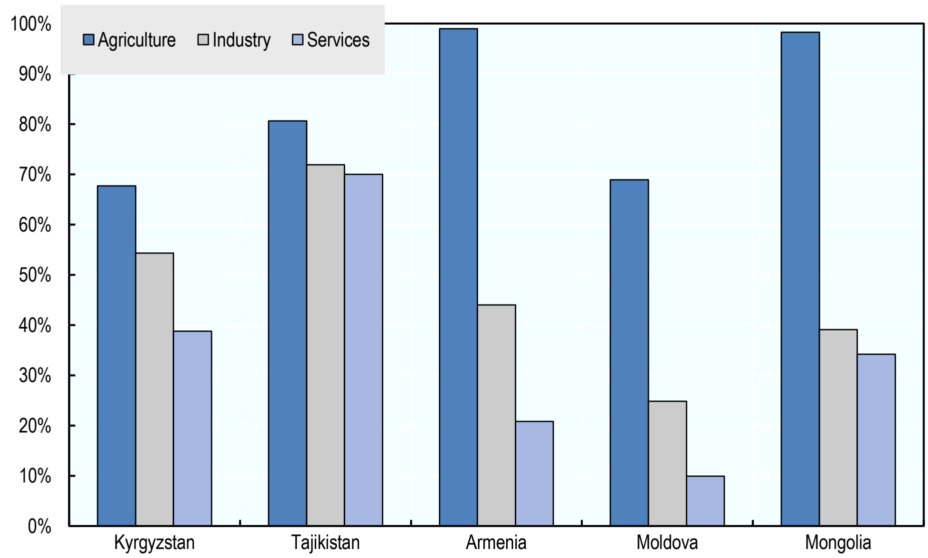
Source: World Bank, 2020

The most recent figures available for several Eurasia countries[3] suggest that more than two-thirds of employment in the agricultural sector is informal in all of them, with the informal share reaching 99% of total agricultural employment in Armenia (Figure 6) (ILO, 2018[11]).

Following independence in the early 1990s, the Eurasia countries undertook extensive land distribution and privatisation initiatives. Agricultural land belonging to large-scale collective and state farms was divided amongst the rural population, often in a non-transparent and highly inequitable manner. Misappropriation and asset stripping were common, with rural elites often exploiting new legislation and institutions for their own benefit. These events are still reflected in today's land tenure systems. Across the region, farm structures are characterised by a relatively small number of large-scale agricultural enterprises, and a large number of micro and small-scale household farms (known in Central Asia as *dehkan* farms). Such farms can either be subsistence-oriented or semi-commercial enterprises, but they tend in either case to have low productivity and limited access to markets. They are often engaged in the production of fruits, vegetables or livestock, and produce the majority of high-value agricultural products across Central Asia (IFAD, 2018[30]). In some countries in Central Asia, *dehkan* farms are required to register their plot and pay social contributions based on the number of contributors on the farm, which discourages them from officially recording all workers on the plot (FAO, 2016[31]).

Informality tends to be more prevalent in agriculture, largely because the investment in fixed capital required for other sectors, such as manufacturing, may create more stringent pressures to formalise. It also remains difficult for governments to collect information from farming entities, as "the boundary between the production intended for the market and the production intended for own-use is difficult to establish" (ILO, 2019[32]; OECD, 2019[4]). As a result, those engaged in the agricultural sectors in the region either underreport their income or completely function outside the formal sector. This is possible largely due to the dominance of small-scale agricultural plots across Eurasia.

Figure 6. Share of informal employment in agriculture, industry and services



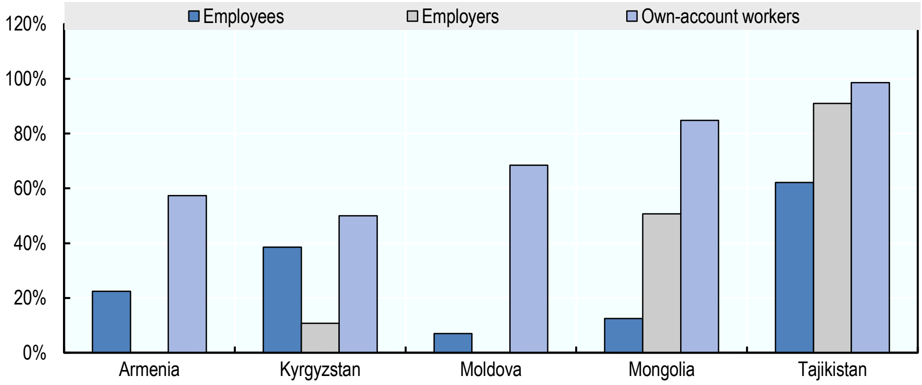
Note: The distribution of total employment is based on national micro-datasets used for the estimates of informal and formal employment. Global and regional estimates might slightly differ from those presented in ILOSTAT Employment by sector -- ILO modelled estimates, May 2018.
Source: (ILO, 2018[11])

[3] Armenia (99% of employment in agriculture is informal), Moldova (69%), Kyrgyzstan (68%), Mongolia (98%) and Tajikistan (80.6%), all in 2018.

Informal firms and vulnerable employment are closely connected

Vulnerable employment, consisting of employers, own-account workers and contributing family workers, remains a pervasive phenomenon in Eurasia, partly due to the predominance of small firms, complex regulatory environments – which can deter firm registration – and large agricultural sectors across the region. Small, unregistered business structures active in traditional sectors and activities, such as self-employed bazaar and shuttle traders, small manufacturers and small agricultural farms, account for a large share of vulnerable employment. Entrepreneurial structures and micro-enterprises in the region are very often significant employers, hiding bigger and much more complex business structures, as in the case of Kyrgyzstan (Box 3), which creates the conditions for even more widespread employment precarity. The ILO also finds that categories falling under vulnerable employment are "more prone to have informal work arrangements and less likely to have social security coverage and to benefit from social dialogue" (ILO, 2018[33]). While these types of positions provide flexibility, they are also correlated with lower productivity and limited fiscal resources.

Figure 7. Share of informal employment in total employment by status, excluding agriculture, 2018



Note: The distribution of total employment is based on national micro-datasets used for the estimates of informal and formal employment. Global and regional estimates might slightly differ from those presented in ILOSTAT Employment by sector -- ILO modelled estimates, May 2018.
Source: (ILO, 2018[34])

Globally, own-account workers (who do not employ others) constitute 45% of total informal employment. They are more likely than dependent employees to work informally, as it remains easier for micro- and small firms to underreport income, or to fail to register their employees to avoid social security contributions. Some self-employed may also be employers or *de facto* employees, requested (or required) by their employers to operate as self-employed in order to bypass tax liabilities, social security contributions and labour regulations (OECD, 2008[35]). The status as an own-account worker usually entails fewer and simpler regulations and procedures and allows more flexibility. In an effort to stimulate formalisation, some governments in the region have put in place facilitated registration procedures for individual entrepreneurs, which over the long-term may have fostered tendencies to remain small and partially informal, as for example in Kyrgyzstan (Box 3). Governments thus face important limitations when trying to detect informal self-employment, whilst self-employed businesses remain important contributors to the formal and informal economies in Eurasia, alongside contributing family workers (ILO, 2018[11]).

In EaP countries and Central Asia, vulnerable employment categories represent a significant share of informal employment including own-account workers (29.7%), contributing family workers (8.7%) and employers (5.3%) (Figure 7). Around half of those informally employed in Azerbaijan and Georgia are own-account workers, relying on seasonal work related to tourism. Own-account workers also represent 56.5% of Afghanistan's informal employment, compared to 34% in Uzbekistan, 28% in Mongolia, and 21% in Turkmenistan (ILO estimates). In Kazakhstan, where an estimated 25% of the total workforce was self-employed in 2019, 44% of those in the informal economy were designated as self-employed. In Uzbekistan's informal sector, an estimated 65% work in private firms, compared to 33% being self-employed.

Contributing family workers[4] also operate almost entirely in the informal economy, as estimates suggest that only 1% are covered by formal contracts. The high proportions of contributing family workers in Central Asia are tied to the predominance of small-plot based agriculture (*dehkan* farms), which remain outside of the social protection system (Khitarishvili, 2016[36]). Most contributing family workers may be declared as non-income, but live in dual households deriving utility from household businesses that are often undeclared.

Box 3. Kyrgyzstan's efforts to formalise micro-entrepreneurs

In 2006, Kyrgyzstan's government introduced a patent system as an incentive for companies to formalise. The patent is a simple fee-based certificate allowing an individual to operate formally up to a given income threshold and with a renewable time limit. In the garment sector, individual entrepreneurs are allowed to employ up to 75 people; in all other sectors except agriculture, they may employ up to 35. An individual entrepreneur with a patent is not required to report to the tax authorities and needs only to purchase a patent and extend its validity, which varies from 30 to 180 days. The patent holder is neither asked to keep record of income and expenses nor required to pay income tax. More than one million patents were issued in 2018, generating around 3.2% of total tax revenue. The number of issued patents has been increasing constantly, with a corresponding decline in the share of collected taxes.

The effects of the patent system are complex. Patents stimulate the growth and semi-formalisation of individual entrepreneurs. At the same time, entrepreneurs often prefer to remain under the simplified regime to reduce the costs of tax accounting and tax payments, and therefore lack an incentive to grow to the extent that they enter (or re-enter) the general tax regime. According to the World Bank, SMEs take advantage of the relatively high turnover threshold for the patent system and remain within it even as they grow by (i) organising part of their activities in the informal economy and/or (ii) operating under what would otherwise be commercially counterproductive arrangements (e.g. splitting up firms).Further simplification of the general tax regime along with a reduction of the turnover threshold for the patent system could help address this. Similarly, the ILO finds that, although the patent system fostered formalisation in the garment sector, it encouraged businesses to stay small. It therefore acknowledges that changes to the patent system may generate costs and insecurity among garment producers.

Although the individual entrepreneurship and patent system foster formalisation, they may simultaneously discourage firms from growing. The contribution to GDP of entrepreneurs under the patent system has grown rapidly since its introduction, with their contribution to GDP increasing from 14% in 2001 to 24% in 2017, while the SME share has remained fairly stable around 10% over the same period of time.

Source: (Kalikova and Associates, 2020[37]; Kyrgyzstan's National Statistical Committee, 2019[38])

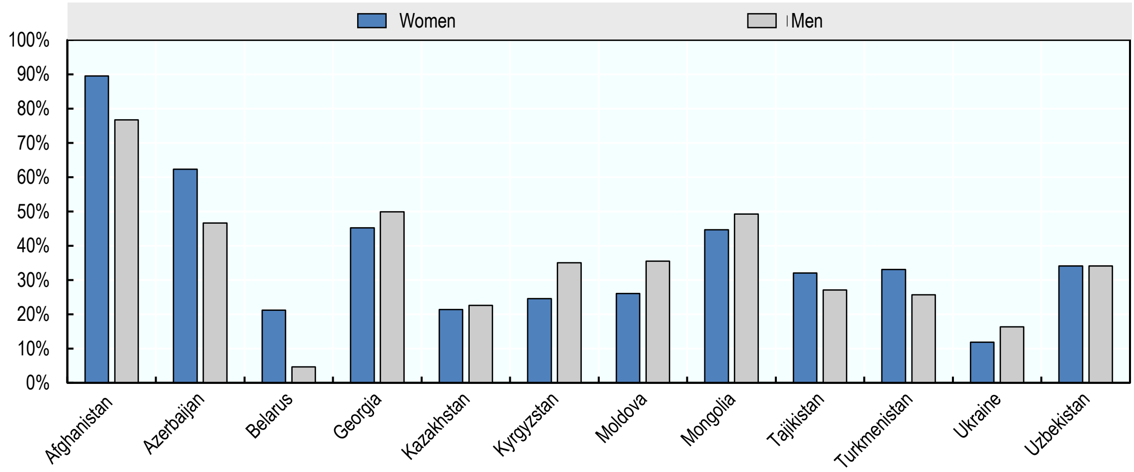
Women tend to take on more precarious positions, making them vulnerable in a crisis

Almost half of employed women in the region work in the informal sector (OECD, 2019[39]). Women and men have similar probabilities of taking on informal positions in the region, but women tend to be

[4] A contributing family worker is a person who holds a self-employment job in a market-oriented establishment operated by a related person living in the same household, and who cannot be regarded as a partner because of the degree of his or her commitment to the operation of the establishment, in terms of the working time or other factors to be determined by national circumstances, is not at a level comparable with that of the head of the establishment.

overrepresented in the most vulnerable segments of the informal labour market, be it as contributing family workers, self-employed, part-time employees or domestic workers (Figure 8). Across Eurasia, the percentage of employees in informal employment is significantly higher for part-time employees (44%), workers in temporary employment (57%) and “temporary part-time jobs” (64%).

Figure 8. Vulnerable employment (% of men’s and women’s total employment)



Source: World Bank 2020, based on ILO estimates.

Women in Central and Western Asia dominate the category of contributing family workers, unpaid work that accounts for 28% of women’s employment compared to 9% of men’s (ILO, 2018[11]). Women in informal employment are also more likely to find informal employment in agriculture – which often results in the sale of agricultural produce grown on own garden plots – or in non-agricultural informal activities, such as garment production, shuttle trade or local market trade. The ADB has reported that 70-80% of bazaar vendors and 50% of bazaar-based shuttle traders in Uzbekistan are women. This is particularly true for young women, as almost two-thirds of the youth population not in education, employment or training (NEET) are young women (OECD, 2019[39]).

There are several reasons for women’s predominance in vulnerable employment. The region tends to have underfunded social and health systems, pushing women to stay in vulnerable employment, as they choose positions allowing to them juggle their jobs with unpaid care work. Home-based positions tend to provide flexibility for women to combine household work and childcare. In the region, women allocate five hours per day on average to unpaid care work, compared with two hours for men (OECD, 2014[41]; OECD, 2019[39]). In Kyrgyzstan and Kazakhstan, 80% of women reported a rise in household chores following the onset of COVID-19, compared with 58% of men (UN Women, 2020[42]). When looking for work opportunities, gender-specific constraints outside the home, including discriminatory laws, informal norms and social practices concentrate their representation in home and family-based occupations and informal activities (OECD, 2019[39]). Women’s engagement in informal and small-scale activities in the region also stems from their lack of networks, finance and business knowledge. Women in Eurasia also tend to work in lower-paid jobs, earning 30% less than men do on average. The evidence suggests that gender pay gaps tend to be larger in the informal economy (OECD, 2019[39]).

Women’s overrepresentation in vulnerable employment, often part-time, with shorter hours and lower earnings, leaves them less eligible for social protection. Women also have more interruptions due to maternity and care work, which significantly reduces their overall potential contributions to social security systems. Thus, governments are encouraged to adopt a particular focus on women, as official security schemes often exclude large numbers of women from their databases (OECD/ILO, 2019[43]).

Informality and labour migration

Limited opportunities in the formal private sector encourage workers to operate in the informal sector or migrate to find revenues and escape poverty. Formal labour markets have proven unable to absorb new entrants, resulting in high unemployment, especially for youth (Figure 4 above). The Uzbek Ministry of Employment and Labour Relations, for instance, reports that COVID-19 has brought home 500 000 returning labour migrants aiming to enter the formal labour market over the year (Eurasianet, 2020[44]).

Such push factors as undiversified economies, low salaries, high unemployment rates, job shortages and increasing poverty have fostered labour migration. This has led to the departure of young, sometimes highly skilled or technical workers who are unable to support local businesses and economic development. Legal employment restrictions can also limit the willingness of companies to hire formal employees and encourage them to offer informal employment.

Russia has been a central destination for informal and formal migrants and the origin of significant flows of remittances and job opportunities (Box 4). Informal migrants constitute up to 60% of migrants to Russia, where many experience harsh living conditions and enjoy little protection from the law (Rocheva and Varshaver, 2017[45]; Chatterjee, 2020[46]).

In turn, governments in the region struggle with the challenge of returning migrants who have difficulty integrating into domestic labour markets and making most of skills acquired abroad. For instance, returning Ukrainian migrants have complained about the lack of support from the government to reintegrate their skills in the labour market. In particular, they claim that the labour market is underdeveloped, and that skills acquired abroad cannot be employed in the local economy (Semchuk, 2020[47]).

Box 4. Informal and formal migration from Eurasia countries to Russia

An estimated 2.7 to 4.2 million Central Asian labour migrants were working in Russia in 2016, equivalent to 10-16% of the economically active population of Central Asia (Ryazantsev, 2016[48]). Currently, 40-60% of migrants are assumed to work informally in Russia (Eraliev and Urinboyev, 2020[49]; UNDP and Eurasian Development Bank, 2015[50]).

Most Eurasia countries benefit from a visa-free regime to Russia, simplifying the travel for migrants. Once in Russia, they are granted 30 days to obtain a work permit and formally register. Although entry is facilitated, the path to formal employment remains arduous: requirements to work as a foreign citizen are complicated and the permit to work legally is both costly and complex to obtain, thus pushing many migrants towards informality. Anecdotal evidence suggests stark labour informality across all Russian sectors, suppressing wages and causing negative perceptions of migrants.

The Russian authorities have reacted to this over the past decade, strengthening laws and introducing strict penalties. In 2014, the *90-180 law* came into force, allowing non-Russians to remain in Russia for 90 days within a 180-day period. Those that overstayed were banned from re-entering the country for a minimum of three years. However, continuously tightening restrictions had rather adverse effects, with migrants preferring to extend their stays in Russia, making the most of their sometimes illegally obtained and costly documents – resulting in an increased number of undocumented migrants in Russia. The UNDP concludes that “more restrictive frameworks tend to promote irregular migration and informality” (UNDP and Eurasian Development Bank, 2015[50]).

Labour migrants have been vulnerable to exploitation, both by intermediaries organising their trips abroad, as well as employers in host countries. Lacking official contracts, migrants often end up not being paid what they were promised – without access to or knowledge of their legal rights and face the risk of being expelled to their home countries and banned from re-entry.

Sources: (Ryazantsev, 2016[48]; Rocheva and Varshaver, 2017[45]; UNDP and Eurasian Development Bank, 2015[50])

Barriers to formalisation across the Eurasia region

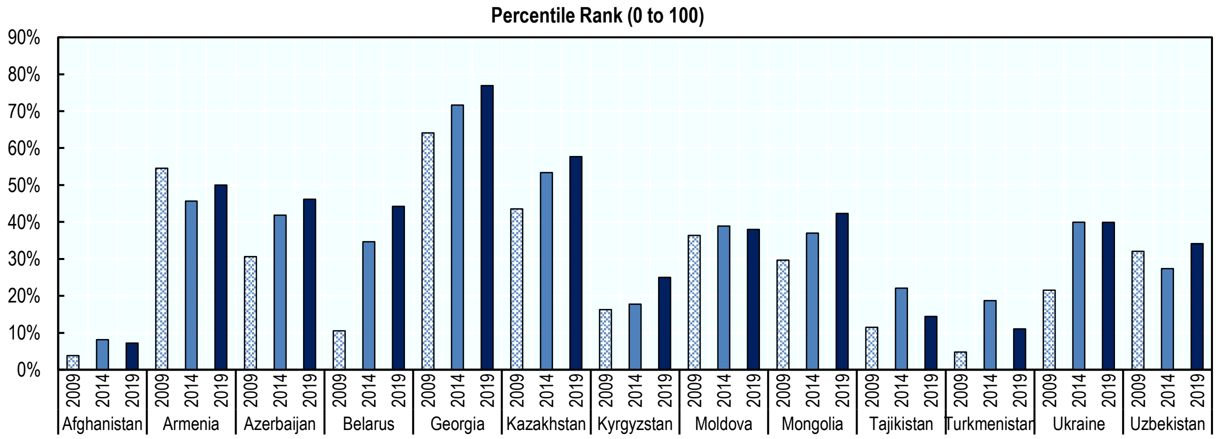
A number of cross-regional challenges further complicate governments' efforts to tackle informality in the EaP region and Central Asia. While some countries have worked hard to improve the business environment in ways that would foster formalisation, a number of broader strongly connected issues remain to be resolved.

Low trust in government and the effect of tax avoidance on public services

Trust in government has been eroding in many countries over the past decade in the wake of the 2008-2009 crisis and is being challenged again by the COVID-19 outbreak (OECD, 2019[51]; Edelman, 2020[52]; Devine et al., 2020[53]). While trust in government increased at the onset of the pandemic in spring 2020, it declined again at the beginning of 2021 as issues continued to arise in the fight against COVID-19 (Edelman, 2021[54]). Trust has an effect on the behaviours of firms and citizens in their responses to public services and compliance with tax and regulations (OECD, 2017[54]). Users' experiences with the provision of public services and interactions with public agencies have a deep influence on their confidence in the government. Perceptions of government effectiveness and corruption have been found to be closely correlated with trust in government (OECD, 2019[51]). In particular, entrepreneurs, business owners and workers will be more likely to remain informal if they distrust public authorities and officials and see bribery risks and sources of inefficiencies as barriers to formalisation.

Despite important public service reforms, such as the establishment of one-stop shops, the streamlining of licenses and the digitalisation of procedures, many countries have shown limited capacity to deliver public services to businesses; fragmented procedures and weak implementation have severely undermined public trust in the authorities. Government effectiveness has improved in virtually all counties of the region over the past decade, but it remains limited in most (Figure 9). This will fail to convince informal businesses to formalise, as the benefits associated with it are low. Enhancing the quality of public services can support increasing trust in government and contribute to formalisation.

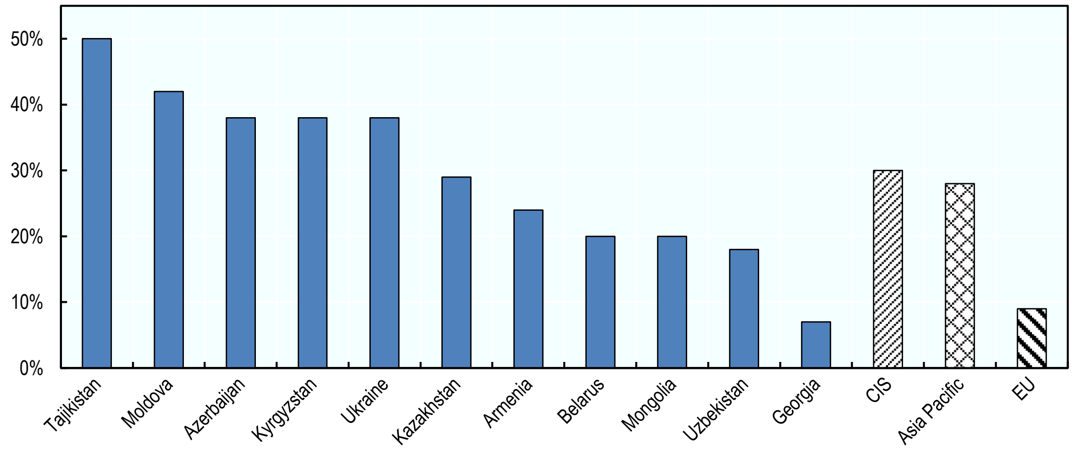
Figure 9. Government effectiveness in Eurasia



Note: The indicator measures the country's percentile rank on a range of aggregated indicators related to government effectiveness. Close cross-country comparison requires taking into account significant margins of error not represented on this graph.
Source: (World Bank, 2020[55])

Corruption is another key driver of trust in government. High levels of corruption encourage firms to avoid interactions with officials and stay under the radar of inspections of any sort. Firms will negatively weigh the benefits associated with formalisation against the procedures and possible predatory and corrupt behaviour that they fear from officials. Across Eurasia, the *perception of corruption* remains high, with all countries of the region ranking below 100 in an overall dataset of 180 countries, except Georgia and Belarus (Transparency International, 2019[56]).[5] More importantly perhaps, the level of corruption actually reported by businesses remain high in the region, with more than 30% of businesses in the 2017 Global Corruption Barometer reporting that they had had to bribe public officials in the previous 12 months (Figure 10). Such perceptions and realities of informal profit seeking discourage formalisation and encourage businesses to remain informal and avoid interactions with public officials.

Figure 10. Global Corruption Barometer for Eurasia countries, Bribery Rate, 2017



Note: Bribery rate measures the percentage of households/citizens that reported that they had to pay a bribe to have access to a public service during the last twelve months; Afghanistan and Turkmenistan are not part of the study; CIS, Asia Pacific and EU are regional averages.
Source: (Transparency International, 2017[57])

Studies show that trust in government is correlated with the willingness to pay taxes, which remains limited in the region (Anderson, 2015[58]). Tax contributions in most of the region are comparatively low, with countries such as Afghanistan and Azerbaijan recording minimal tax revenues relative to GDP (9% and 13% respectively), compared with 22% in Georgia and 35% in OECD countries in 2018.[6] This directly affects governments' ability to deliver efficient services and dedicate appropriate funding to enhance the business environment and promote formalisation, be it through compliance mechanisms or better public services. Of course, those countries with the lowest levels of tax collection tend to have large informal sectors, causing a vicious cycle of informality – limited fiscal space affects public service provision, thus reducing the ability to attract firms into the formal sector. Firms in Afghanistan, for instance, complain about limited access to infrastructure and unreliable electricity, problems that do not enhance the appeal of formalisation (OECD, 2019[4]).

[5] To be sure, perception indexes can be a misleading indicator of corruption levels; for example, a single high-profile case can have a big impact on outsiders' perceptions, for better or for worse, but gradual improvement or deterioration may be registered only with a delay. However, this is true only up to a point. The evidence suggests that countries with a reputation for corruption generally do have serious problems with it (Mocan, 2004[130]; Olken, 2009[132]).

[6] In Azerbaijan's case, hydrocarbon revenues offset this, reducing the need to increase tax pressure on the non-extractive sector.

The vicious circle between tax avoidance and the resulting under provision of public goods may affect agents' assessment of the costs and benefits of formalisation. Overall improvements in the business environment, anticorruption and communication about government reforms are needed to break this vicious circle. Yet many entrepreneurs in the informal sector do not even think much about whether or not to formalise, as they do not perceive themselves as business owners. This can be especially true for smallholders engaged in subsistence agriculture. Some entrepreneurs in the informal sector also exhibit little desire to grow. As a result, many are unlikely to register despite incentives to formalise.

Weaknesses in the formal business environment as drivers of informality

Eurasia countries have worked to improve the business environment over the last two decades, in particular for SMEs. SMEs have been widely identified as engines for sustainable economic and employment growth. Most governments in the region have designed SME development strategies to support job creation, new economic opportunities and diversification of production, employment and exports away from natural resources and heavy industries. They have simplified regulations, enhanced access to finance, improved human capital and supported SME internationalisation among other things. SME agencies and other institutions have been established to implement such support measures.

Many of these improvements in the SME environment are reflected in the OECD SME Policy Index (SMEPI) for Eastern Partner countries, with all six countries recording substantial progress between the first assessment in 2012 and the latest one in 2020 (Box 5). The SMEPI shows that Eastern Partner governments have worked hard to create an SME-friendly environment that should benefit the development of the formal economy and encourage the transition of informal firms into the formal sector.

Box 5. The SME Policy Index for Eastern Partner Countries 2020

The latest edition of the SME Policy index (SMEPI) for Eastern Partner countries was released in March 2020 as a joint exercise with the OECD, ETF and EBRD, with the support of the European Commission. The SMEPI builds on the EU's Small Business Act for Europe and has proven a strong analytical, benchmarking and monitoring tool to drive SME policy design and implementation in the region. The SMEPI is structured around five main pillars: responsive government, entrepreneurial human capital, access to finance, access to markets, and innovation and business support. The SMEPI 2020 edition also includes an assessment of level playing field conditions (competition, contract enforcement and business integrity).

The 2020 assessment captures how Eastern Partner governments have strengthened the institutional environment for SMEs, reduced the regulatory burden and digitalised procedures. They have amended their tax codes and simplified tax administration. They have also focused their efforts on improving the access of firms to critical resources, including financing, human capital and innovation, and ramped up their support for SME internationalisation.

However, enterprise support institutions often remain under-resourced, with businesses lacking support in upskilling, financial resources and internationalisation. Commercial justice remains an issue that challenges the fundamentals of formal transactions and contracts. Business integrity and compliance with the law are also irregularly observed, calling for better enforcement and business transparency across the region. The SMEPI also notes the need to create a more competition-friendly business environment, in which new and more efficient firms can challenge incumbents.

Source: (OECD et al., 2020[59])

In Central Asia, too, governments have improved the legal environment for business by passing new legislation, such as Kazakhstan's Entrepreneurial Code, creating online and physical one-stop shops, and developing public support programmes in a number of areas, including access to finance, skills, innovation, exports and digitalisation (OECD, 2021[56]). These recent reform efforts have translated into improvements in the World Bank's Doing Business Indicator (DBI). Kazakhstan has regularly been a top reformer and now ranks 25th following major reforms. Uzbekistan and Tajikistan were also among the top reformers in the DBI in 2018 and 2019. However, most other indicators of the quality of the business environment – and the performance of these countries in terms of innovation, firm growth and entrepreneurship – suggest that there is still much to do, not least because of important implementation gaps: formal policy settings are often far removed from the day-to-day realities facing firms.

The prevalence of State-Owned Enterprises (SOEs) in the region hinders competition and creates unfavourable operating conditions for small suppliers and competitors. Small firms have difficulty following and complying with fragmented business legislation, and report irregular inspections and sanctions. Regulatory barriers remain high in selected sectors, especially regulated sectors such as agriculture, mining, and transport (OECD, 2018[61]). Dispute settlement is often reported as biased by firms, the majority of which stating that they would not risk entering into court proceedings against the state or SOEs during interviews carried out by the OECD (OECD, 2021[56]; OECD, 2020[58]).

Registration has been simplified in most Eurasia countries

Entry costs are the first obstacles faced by firms that consider starting formal activities. The administrative burden and costs associated with registering a firm are among the main factors that can prevent formalisation (Bruhn, 2008[63]). Both EaP and Central Asian countries have streamlined and digitalised their business registration procedures, reducing the number of steps and creating one-stop shops to address those administrative requests (OECD, 2021[56]). Noticeable improvements have been recorded in the World Bank's DBI on *Starting a Business,* with Armenia, Georgia and Azerbaijan in the top 10 and most countries of the region among the top 50 on this indicator (World Bank, 2020[64]). However, once the business is registered, owners very often have to visit other government agencies for tax and labour administration procedures as well as operations, which can make the first steps and the first year complex for newly-established companies, discouraging registration in the first place. Studies have also found that improvements in registration alone are not enough to convince businesses to formalise (Bruhn, 2008[63]).

Taxation remains a key obstacle for firms

Unsurprisingly, taxation remains a key obstacle to firm formalisation both globally and in the region (Levy, 2008[65]). Tax rates in Eurasia countries remain rather favourable when compared with other emerging economies, and below the average of OECD countries (with the exception of Tajikistan). However, when combined with social contributions, tax policy can be a powerful disincentive to firm registration, as seen in Kyrgyzstan (EBRD, 2019[66]). Most countries in the region have introduced and progressively improved simplified tax regimes for SMEs (OECD et al., 2020[55]; OECD, 2021[56]). Constant changes in tax regulations make it hard for firms to comply with the latest rules, despite the progress made in digitalisation. Arbitrary interpretations and sometimes predatory behaviour from the tax organs remain all too frequent. The development of simplified SME regimes in most of the region has so far been insufficient to foster substantial improvements in business registration and tax compliance, partly because the benefits associated with tax compliance have not been obvious and simplified regimes have not solved issues regarding the interpretation of tax laws and VAT procedures (OECD, 2021[56]).

Implementation gaps cause an additional layer of complexity for firms

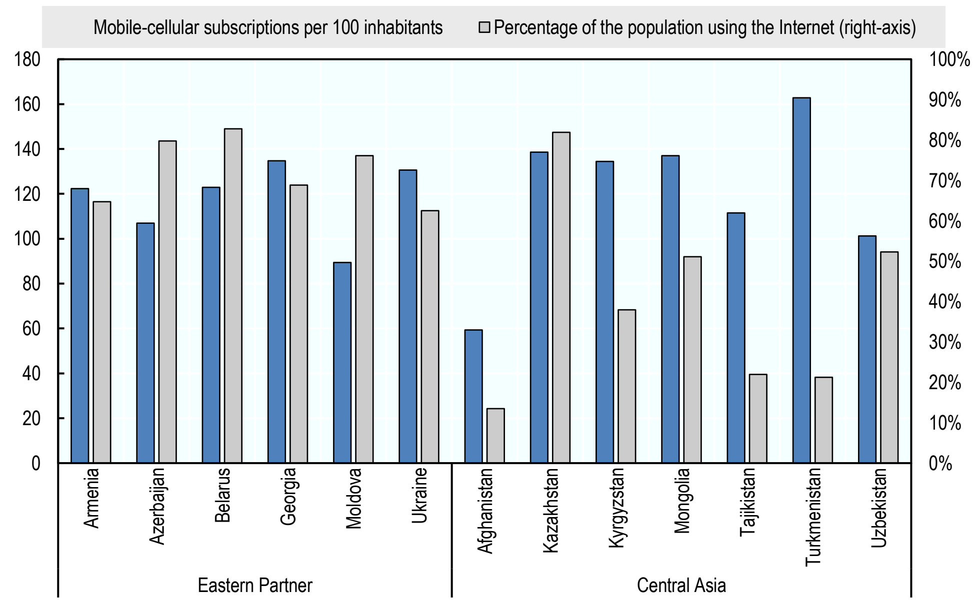
Thus, important shortcomings remain in the region's business environments, which discourage formalisation. In particular, SMEs still face sometimes large implementation gaps between the *de jure* improvements and the *de facto* situation. If business registration has become easier across the region, licensing procedures are still cumbersome in a number of areas (environment, construction). These regulatory and implementation gaps ensure a certain level of complexity for administrative procedures, foster corruption and limit the trust of companies in the public administration, reducing the benefits of operating in the formal sector and discouraging companies from formalising (OECD, 2021[56]). Access to finance is also an obstacle for doing business in the region, despite the development of bank credit and new public financial programmes.

Limited digital connectivity and access to services

Digitalisation of public services can improve the business environment and encourage informal businesses to transition to the formal sector. As the time and costs of administrative procedures fall, information can be disseminated more effectively and service delivery becomes more predictable. The removal of physical interactions also eliminates many opportunities for corruption, with integrated e-payment platforms allowing businesses to pay fees directly and avoid the risk of graft.

The development of digital infrastructure varies considerably across the EaP region and Central Asia (Figure11). In the EaP countries, internet penetration rates range from 62.5% of the population in Ukraine to 83% in Belarus. In Central Asia, it is low in all countries except for Kazakhstan (82%). Less than a quarter of the populations of Afghanistan, Tajikistan and Turkmenistan are connected to the internet. Mobile phone subscriptions, however, are higher across the region – sometimes far higher – and greater than 100 (per 100 inhabitants) in all countries except Afghanistan and Moldova. This points to the potential of focusing on mobile-friendly platforms.

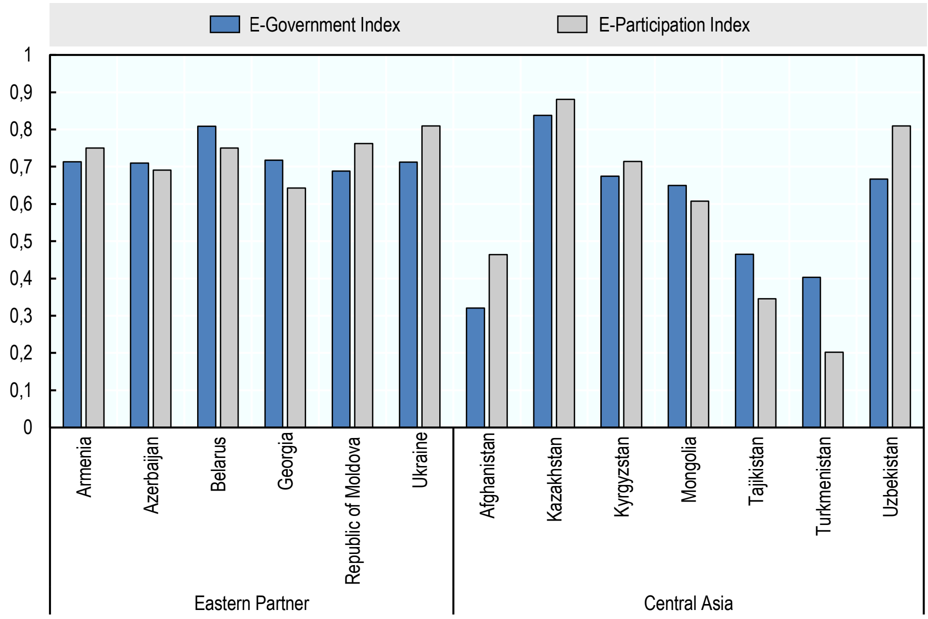
Figure 11. Digital infrastructure, 2020



Source: (ITU, 2020[67]).

E-government services are available in all Eurasia countries, though their range and quality vary (Figure 12). In some cases, inconsistent application of digital solutions results from poor sequencing and a lack of policy coherence. For instance, efforts to popularise e-payment platforms must be accompanied by the development of online authentication and security procedures if they are to succeed. The UN's e-Government Development Index measures the readiness and capacity of national institutions to use ICTs to deliver public services. The e-Participation Index measures the extent of online information availability, online public consultations, and citizens' involvement in decision processes.

Figure 12. E-Government Development Index and E-Participation Index, 2020



Note: The EGDI measures the readiness and capacity of a country to use ICTs to deliver public services. The EPI measures the extent of online information availability, of online public consultations, and of citizens' involvement in decision-making processes.
Source: (United Nations, 2020[68]).

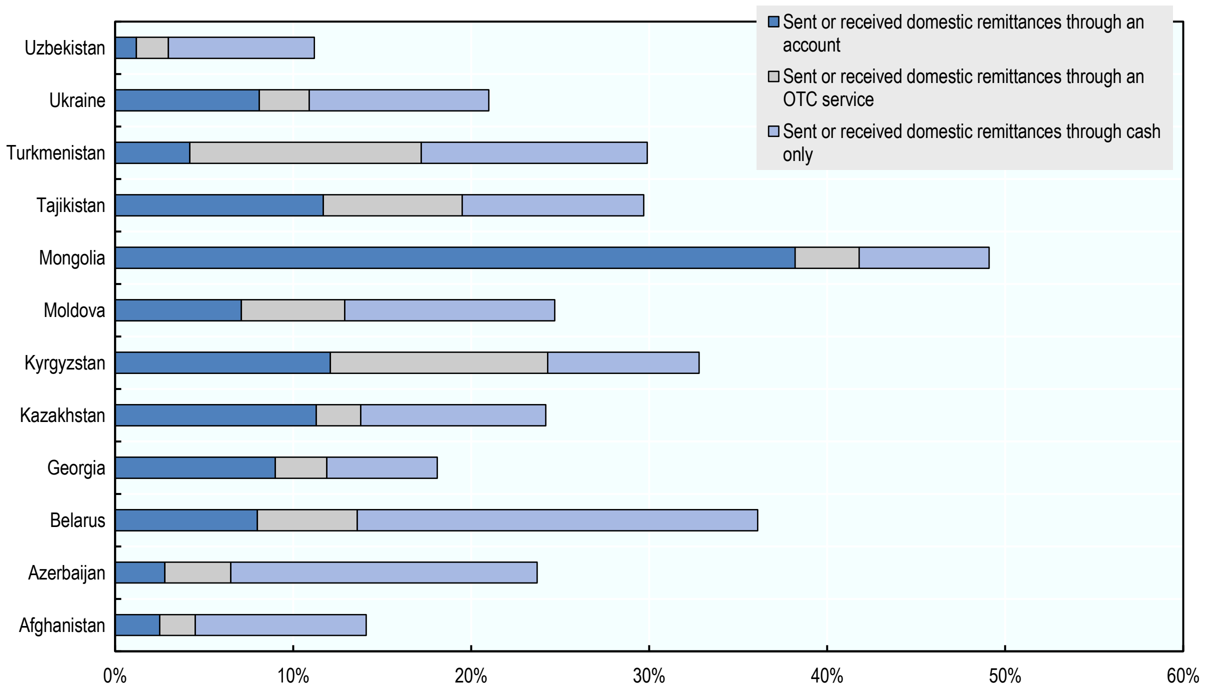
Reliance on largely informal remittance flows

Remittances sustain consumption in many Eurasia countries, with inflows reaching up to a third of GDP in Kyrgyzstan and Tajikistan in some years. Remittances account for roughly half of the household budget of migrants' families. For instance, in Tajikistan, a survey indicated that remittances make up the majority of income in 45% of households (Ryazantsev, 2016[48]). They increase the wealth and living standards of recipients. While they sometimes are saved in the formal banking sector or used for investment, a significant share of remittances is used for immediate needs (chiefly consumption), ranging from 57% in Tajikistan to 72% in Armenia, and 80% in Georgia (Prokhorova, 2018[69]). The impact of falling remittances on the consumption of remittance-dependent households is therefore substantial, the more so given that such households typically have low savings.

Multiple studies and the data available show that many labour migrants use informal channels to send remittances or take their earnings back in cash (Figure 13) (UNDP and Eurasian Development Bank, 2015[50]). Only around 20% of labour migrants in Kazakhstan are estimated to use official transmission channels, and many cross-border migrants carry their earnings in their pockets (UNDP and Eurasian Development Bank, 2015[50]). Globally, it has been estimated that up to 75% of remittances are sent through informal channels. There are big regional differences though, depending on the availability and pricing of formal money transfer mechanisms. Prices for sending money from Russia have halved since 2011, which has contributed to a rise in formal transmission.

Informal remittance flows tend to be used for consumption rather than savings or investment. This limits the size of deposits in banks and other financial institutions, reducing opportunities for recipients to use bank loans and financial products, and contributing to the small size of existing credit activities and formal financial systems in Eurasia countries.

Figure 13. Remittance channels



Note: no data available for Armenia
Source: World Bank (2017).

Low levels of financial inclusion

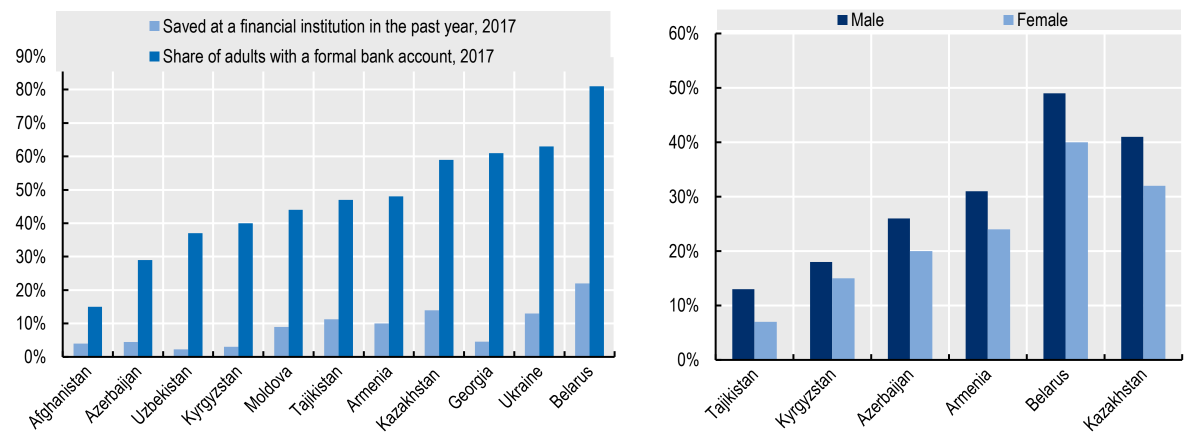
Although financial inclusion has risen significantly in the region, access to financial services remains limited, hindering the ability of governments to support most vulnerable groups through direct cash transfers or financial programmes that would require bank accounts. Both inadequate provision of appropriate financial products on the supply side and lack of awareness of those products on the demand side hinder effective financial intermediation (OECD, 2018[70]).

In 2017, barely half of the region's citizens held accounts at financial institutions, compared to 91.2% in OECD countries. Unsurprisingly, among the poorest 40%, only 40.3% hold accounts. Saving rates also remain low, limiting households' ability to cushion shocks, with the majority saving cash or giving money to friends and family to save on their behalf (Figure 14). Studies have shown that the majority of incoming remittances are used for subsistence spending, rather than savings or investments (Asian Development Bank Institute, 2019[71]). Low levels of financial inclusion push people into informal borrowing, where they are exposed to predatory lending practices and high interest rates. Fewer than 25% of adults in the Eurasia region have borrowed from formal sources (World Bank, 2019[72]).

There are many reasons for low levels of financial inclusion: limited financial literacy, lack of trust in financial institutions, a desire to stay off the tax authorities' radar, and a low ability/propensity to save. An OECD study of financial literacy in Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan and Tajikistan found that while some basic concepts, such as the interest rate on loans, were relatively well understood, fewer than a third of respondents achieved the minimum target score for financial literacy. In addition, gender differences in financial knowledge can be detected across the region. Levels of financial inclusion are also lower for women, highlighting the risks associated with support measures that target households rather than individuals.

Figure 14. Measures of financial inclusion

Account ownership and saved at a financial institution	Gender differences in financial knowledge



Note: Percentage of respondents achieving minimum target score of 5 out of 7 by gender. Financial knowledge refers to a basic knowledge of financial concepts and the ability to apply numeracy skills in a financial context ensure that consumers can act autonomously to manage their financial matters and react to news and events that may have implications for their financial well-being.
Source: World Bank (2020), https://data.worldbank.org/indicator/FX.OWN.TOTL.ZS ; (OECD, 2018[70])

Overstretched social protection and healthcare systems

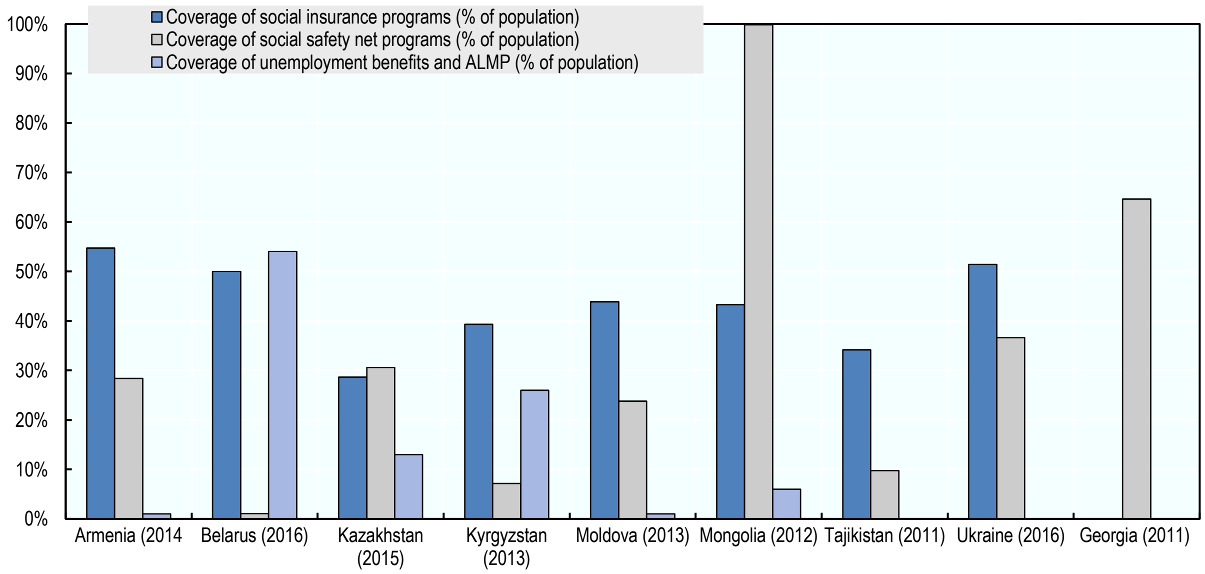
Social insurance programmes in Eurasia, including old age contributory pensions, social security and health insurance benefits, and unemployment programmes, remain limited (Figure 15). Even where coverage is in place, such programmes provide little support: Kyrgyzstan's official unemployment scheme, for instance, requests much paper work to apply and merely provides KGS 250 monthly (USD 3.90) for no more than six months per year, discouraging applicants. At the same time, more than 58% of the labour force lacks pension coverage (OECD, 2018[29]).

Limited social protection systems in the region are partly a result of the low social contributions resulting from widespread labour informality, and large numbers of small-scale subsistence farmers, labour migrants and self-employed workers. In 2020, the share of vulnerable employment in the Eurasia region averaged 38%, leaving large swathes of the population without social protection. Coverage for women, in particular, has been low. Migrant remittances and traditional informal safety nets have partially offset the limitations of formal social protection schemes, but they remain inadequate in times of crisis (OECD/ILO, 2019[43]).

Against the background of low formal contributions, the region has put in place social safety nets that target low-income populations, rather than relying on contributory schemes. Some countries, including Georgia, Ukraine and Uzbekistan, have introduced social pension schemes, which also allow individuals who have not made regular contributions to benefit, including informal workers. Georgia established a non-contributory pension scheme offering a flat-rate benefit to pensioners, which has been effective in reducing household poverty across the country. Similar schemes in Uzbekistan and Ukraine have significantly reduced intergenerational poverty rates. Kyrgyzstan also inherited a set of Soviet social assistance programmes, including targeted cash-based programmes for both low-income families and disadvantaged groups, amounting to 0.5% of GDP in 2009 (United Nations, 2020[73]). Kazakhstan has extended its maternity coverage scheme to the informal sector. Although the system is clearly divided, with benefits depending on previous contributions (which defines formality in Kazakhstan), it acknowledges the large presence of women in the informal sector (ILO, 2014[74]).

There is a strong argument for such safety nets in terms of social welfare and equity, particularly in the context of the current crisis. Over time, however, contribution-based social insurances may offer incentives for workers to declare earnings in order to secure access to benefits. The problem for much of the region at present is two-fold. First, low earnings mean that most workers may reckon they would gain little by contributing, and, secondly, trust in state institutions, which are often unstable and fraught with corruption, tends to be low. This reduces the incentive to see social security contributions as a form of savings rather than simply a loss. Political instability and low trust both give potential contributors reason to focus on relatively short time horizons rather than contributing towards benefits they will receive in the distant future, if ever.

Figure 15. Social insurance and safety net programmes across the region



Note: Data chosen for latest year available. Coverage of *social insurance programs* shows the percentage of population participating in programs that provide old age contributory pensions and social security and health insurance benefits. Coverage of *social safety net programs* shows the percentage of population participating in cash transfers and last resort programs, non-contributory social pensions, conditional cash transfers, in-kind food transfers, school feeding, and public works programs. Coverage of *unemployment benefits and active labour market programs* shows the percentage of population participating in unemployment compensation, severance pay, and early retirement.
Source: World Bank

While countries have acknowledged outdated social insurance schemes and begun reforming them, one of the remaining challenges is making them fiscally sustainable without creating incentives for firms and workers to remain informal (OECD, 2019[3]). Social contributions across the region have also been limited by the lack of understanding of social contribution payments, compliance requirements and benefits, and very often a reluctance to contribute financially. Social protection schemes must be linked appropriately to a conducive macroeconomic framework, including fiscal and monetary policies that promote full and decent employment and support the fiscal sustainability of social protection systems (United Nations, 2020[73])

The impact of COVID-19 on informal firms and workers

The informal sector as a social buffer

The role of the informal sector during economic downturns is not straightforward and remains under-examined, partly due to the lack of data and information available. One recent study argues that the informal sector acts as both buffer and amplifier in an economic crisis (Colombo et al., 2019[75]). The size of the informal economy often grows as some workers, who are laid off and exit the formal labour markets, enter the informal sector instead of falling into unemployment or dropping out of the labour force. The informal economy plays an important role in providing subsistence revenues to laid-off workers and their households who are not covered by social protection systems. They might take temporary informal jobs in formal and informal businesses or start new economic activities as self-employed. Ponzeck and Ulyssea (2018[13]) offer empirical evidence from Brazil suggesting that this employment-buffer effect is particularly strong where formal labour markets are heavily regulated.

At the same time, a larger informal sector seems to be correlated with a deeper economic contraction and longer lasting negative economic effects. This appears to reflect the fact that, in economies with large informal sectors, economic downturns cause a larger reallocation of resources and labour towards less productive sectors (i.e., those outside the formal economy), and also limit governments' ability to implement counter-cyclical policies. At an individual level, workers can also find themselves trapped in informal jobs during the recovery period, with few opportunities for skill development and limited opportunities to join more productive (formal) companies. A study of urban informal workers in 10 countries across Africa, Asia and Latin America in 2009 found that the informal sector is affected in much the same way as formal firms and their workers during times of crisis. Home-based workers, street vendors and waste pickers experienced a sharp drop in demand and prices. As more people entered the informal economy, increased competition forced informal workers to work longer hours, cut back on food and healthcare expenses, and accept lower selling prices and reduced incomes (Horn, 2009[76]).

During the global financial crisis of 2008-09, countries in Eurasia witnessed declining remittance inflows and a severe upheaval on domestic labour markets. The informal sector expanded in most countries, acting as a social and economic buffer at a time when formal jobs and remittances were falling sharply. Women in Tajikistan's informal sector were particularly affected; an estimated 60% of women who were self-employed in 2007 had no paid work in 2009. Women were also more likely to transition out of the formal sector, with over 40% of women in the formal sector moving out of wage employment during the crisis (compared with 30% of men) (Kroeger and Meier, 2011[77]). Outward labour migration was an important coping strategy for households in Tajikistan and Kyrgyzstan, resulting in a sharp increase in the population of informal workers in Russia (Danzer and Ivaschenko, 2010[78]).

Ukraine, in particular, has experienced a series of economic shocks over the past decade that have affected the formal and informal labour markets. The country has a high level of labour market informality, with the informal sector accounting for an estimated 24% of total employment in 2016. While detrimental to productivity growth and labour mobility, the informal sector provides an important source of income to unskilled workers in sectors such as trade and construction. The prevalence of informal jobs grew during the 2008-09 crisis and continued rising during the recession of 2014-15, due to large-scale job losses in the formal sector in conflict-affected regions and the massive increase in internally displaced persons (OECD, 2018[79]). This increase in informal work helped households maintain subsistence revenues and stay out of poverty during troubled times.

COVID-19: a different kind of crisis

Despite the difficulty of tracing the size of the informal sector across the Eurasia region, it is clear that its role remains immense. The informal sector has acted as a buffer throughout crises, it revealed its resilience amidst the transition phase, and it has offered flexible arrangements and opportunities for vulnerable workers and businesses alike. Yet COVID-19 has been different from previous crises and hit the informal sector with even more gravity than anticipated – leaving those engaged in it with no cushion on which to rely. Most government support programmes focused on the formal sector, leaving large segments of the population with little or no support. It thus remains crucial to assess how COVID-19 has affected already vulnerable segments in society, and how it has exacerbated existing challenges, in order to offer immediate and long-term solutions to tackling informality throughout.

Interruption of business activities, trade and financial flows have hit informal and formal activities

Lockdowns, quarantine measures and social distancing policies have halted the operations of many formal and informal businesses in Eurasia, and beyond. Mobility restrictions, limitations on operating hours and number of customers and the cost of sanitary equipment have led to business closures or reduced activity. With restrictions applied to public places, informal workers have been affected in their day-to-day trading activities by being deprived of the opportunity to interact with customers and suppliers. Informal workers are particularly present in many of the sectors most affected by the crisis, including transport, retail, catering and restaurants. Their situation can be worsened by the disruption of food supply chains, increasing food prices and reducing its availability (ILO, 2020[80]).

COVID-19 has affected sectors heavily dependent on cross-border and intra-regional trade. Shuttle and market traders were forced to discontinue operations or conduct their work illegally, with official trade and cross-border movement largely halted. Waste pickers and informal taxi drivers also felt the effects of the sudden lockdowns. Since the majority of these jobs are concentrated in the informal sector, and without any social insurance coverage, those affected had little choice but to continue working amidst the pandemic, albeit with often limited access to healthcare and government support. Lockdown measures prompted protests in several countries across the region including Georgia, Kazakhstan, and Ukraine.

The informal sector is also likely to grow with business failures and job losses linked to the fall in demand due to COVID-19. Many employees losing formal jobs will try to make ends meet by engaging in informal activities in the short-term (ILO, 2020[80]). Formal SMEs can also make the decision to operate (at least partly) informally because of overall economic conditions, difficulties in paying taxes and obtaining licenses, and a lack of public support. Initial evidence from Eurasia countries indicates that the informal sector has grown since the onset of the pandemic. For instance in a recent survey in Tajikistan, close to 40% of respondents who said they had a job in March-May 2020 specified that it was an informal job, while another 40% replied that they would be willing to accept an informal job (UNDP, 2020[81]).

Poverty, vulnerable employment and unemployment rates have risen sharply

The COVID-19 pandemic has hit the most vulnerable groups across the region, leading to a spike in poverty and unemployment among formal and informal workers. The World Bank estimates that an additional 2.2 million people may have slipped into poverty in emerging Europe and Central Asia by the end of 2020, with Central Asia accounting for around 58% of them. The ILO focuses its estimates on informal workers, finding that COVID-19 and the response to it threaten the livelihoods of nearly 75% of informal workers, with lockdown measures having reduced the incomes of informal workers by 60%.

Lost earnings could result in an increase in relative poverty for informal workers and their families by nearly 34 percentage points globally (ILO, 2020[80]). Eurasia countries report rising poverty rates across the region, resulting from reduced incomes and lower migrant remittances. The growth of vulnerable employment across the region will also worsen inequality, due to the pandemic's disproportionate impact on vulnerable and precarious workers. The poverty rate in Kyrgyzstan is expected to increase by 5.8 percentage points in 2020, while 90% of Afghans and 47% of Tajiks are now living under the poverty line. In Ukraine, Kossov (2020[82]) estimated that 45% of Ukrainians would live in poverty by the end of 2020, up from 31% the year before. According to the study, 60% of Ukrainians have experienced financial losses and 38% have lost part of their regular income. Informal workers are the most affected, as they are most commonly employed in the most exposed sectors and have lower savings. The crisis could therefore continue to significantly increase poverty amongst informal workers and their families.

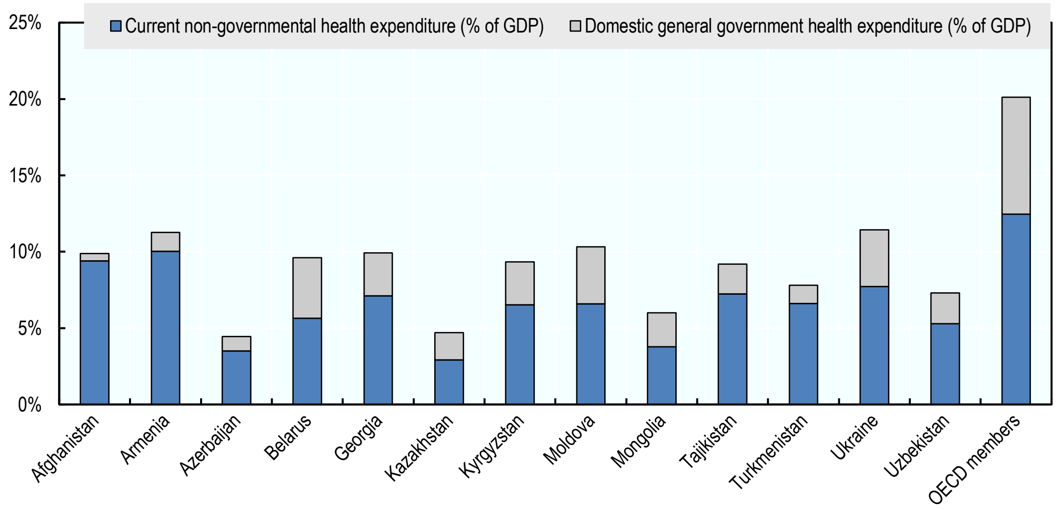
There are, of course, exceptions. One of the ironies of the pandemic has been to underscore how many essential sectors (agriculture, waste disposal, cleaning) rely heavily on informal labour. It has become clearer that informal activity is by no means marginal to overall social welfare. Individuals in such activities may be better able than most to keep working and earning, but they are also at greater risk of infection as they lack the means to acquire personal protective equipment.

Established social protection systems are crucial social and economic stabilisers during crisis periods, cushioning impacts on individuals, and acting counter cyclically on the economy as a whole. Countries with weaker social protection systems in terms of coverage, funding and benefit levels were not only hit harder by the immediate impacts of COVID-19, but have so far also found it harder to recover, showing continuing downward trends in output and high unemployment rates (United Nations, 2020[73]).

The Eurasia region generally suffers from weak healthcare systems. Total healthcare spending tends to be low by international standards and public share of healthcare expenditure is relatively small in most of the region, so the share of households' out-of-pocket expenditures for health services is unusually high (OECD, 2020[1]). In Eurasia, around 56% of healthcare expenditure is out-of-pocket, compared to a global average of 38% (Figure 16). In countries such as Armenia (84%), Azerbaijan (84%), Afghanistan (75%) and Turkmenistan (73%), the share of household (as opposed to public) spending on healthcare is particularly high, which creates serious problems in access to care, particularly for informal and vulnerable households, increasing further the social and economic gaps in the region (World Bank, 2017[83]).

COVID-19 has worsened the access of informal workers and their families to health systems that were in many cases severely stretched by the surge in COVID-19 cases. Health-system capacities in many countries were saturated during the first months of the pandemic, aggravating problems with access to healthcare services for large segments of the region's population (IMF, 2020[84]). Informal workers and their families are usually without health insurance or the means to pay for treatment.

Figure 16. Health expenditures, current and out-of-pocket, 2018



Source: World Bank, World Development Indicators

Informal workers and their households are also more exposed to the COVID-19 pandemic due to their living and housing conditions, which can make meaningful social distancing impossible. High population densities in urban centres and poor housing increase the risk of accelerated spread of the pandemic. In rural areas, poor access to water, sanitation and basic health services are powerful contamination vectors (ILO, 2020[80]). Respect for mobility restrictions also depends largely on the capacity of local governments and municipal authorities to implement containment measures. This will have an impact on informal workers' ability to do business, particularly in public spaces (e.g. street vendors in large urban areas).

Policy responses have typically offered limited or no support to informal workers and firms

Most governments across the EaP region and Central Asia have developed financial and employment support packages to help businesses weather the crisis. These measures – ranging from tax deferrals to credit guarantees and digitalisation support measures – have mostly targeted formal firms, with informal firms largely left aside. Access to finance, though, is another matter. The crisis has dried up business liquidity and informal firms did not have access to government financial assistance programmes, such as new guarantees and loans.

Nevertheless, direct cash transfers to poor households or other types of subsidies have reached the informal economy (e.g. waivers or delays on rent and utility payments). Countries such as Kazakhstan, Mongolia, and Georgia, often in co-operation with the development community, have offered cash-based transfers to vulnerable groups. Georgia, for example, offered a one-time assistance to informal and self-employed workers beyond proof of their loss of income. Some countries in the region already had cash-transfer systems in place ahead of the pandemic and expanded their coverage amidst the crisis, including Kyrgyzstan and Afghanistan.

Rapidly declining flows of remittances are drying up income for many

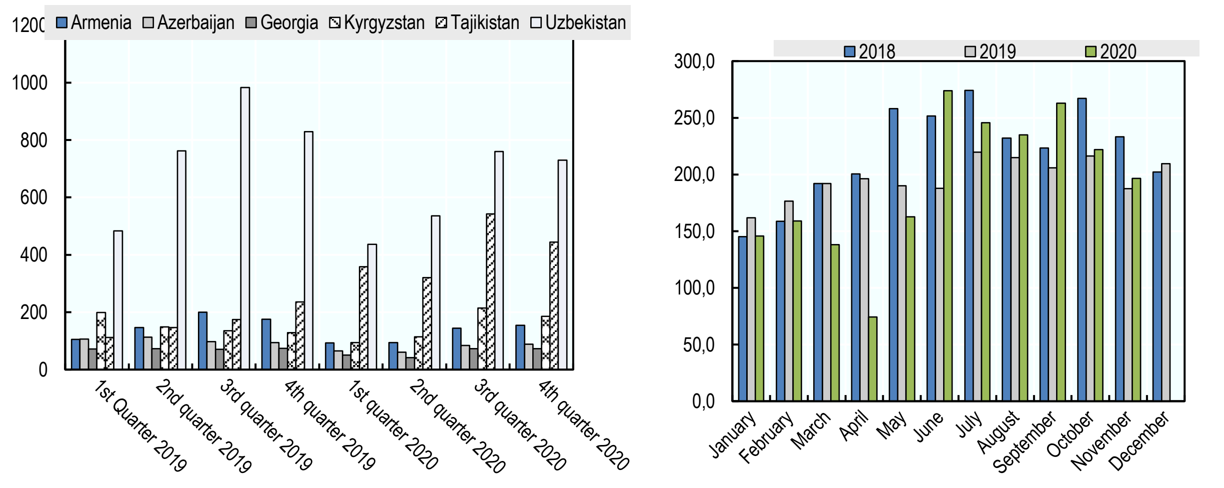
Labour market contractions and imposed lockdowns, combined with exchange-rate movements, immediately affected migrants' revenues and remittances. Even the sending of remittances became arduous, as banks and money service providers in many places were placed under lockdown. In the first quarter of 2020, remittances from Russia to the Commonwealth of Independent States (CIS) countries were down 48%. The region registered the sharpest decline in remittances world-wide. In Ukraine, the region's largest recipient of remittance income, remittance inflows fell by 14% year on year in the second quarter (Semchuk, 2020[47]). In Kyrgyzstan, remittances dropped by 19% in the second quarter of 2020 (year on year), though they quickly recovered thereafter, and other Eurasia countries follow similar trends (Figure 17). In an average year, the value of remittance is lowest in the first quarter but increases during the rest of the year with seasonal employment playing a bigger role in the summer. In contrast, in 2020, the flow of remittances in the second quarter remained at the same level as in the first quarter but then resumed a more regular pattern from the third quarter onwards.

The rebound in remittance payments in the third and fourth quarters of 2020 was quick, and the overall value of remittance payments increased in many Eurasia countries in 2020 compared to the previous year. For Ukraine, the dollar value of received remittances increased by 1.7%. The limited economic impact of the COVID-19 pandemic in Poland, the main source of remittances to Ukraine, contributed to this growth. According to data from the Russian Central Bank, remittances to CIS countries from Russia in 2020 decreased by 0.4% compared to 2019. The steep drop in the value of remittances in the second quarter, 18.2%, was followed by a growth of over 8% year-to-year in the third and the fourth quarters. Available country data on Kyrgyzstan confirm this upward trend for the third and fourth quarter (Figure 17). However, these data must be interpreted with caution: the World Bank finds that "the smaller-than-expected hit to remittances in 2020 likely is explained in part by a shift from informal remittances carried by hand and via travel to formal remittances sent digitally", perhaps as a result of travel restrictions (World Bank, 2020[85]).

Figure 17. Migrant remittances in Eurasia, 2019-2020

Migrant remittances from Russia to selected Eurasia countries, 2019-2020, million USD

Remittances to Kyrgyzstan, 2018-2020, million USD



Source: Quarterly data of the (Central Bank of the Russian Federation, 2021[87])

The impact of COVID-19 on vulnerable groups

COVID-19 has disproportionately affected migrants and their families despite the resilience of migration flows

The pandemic has exacerbated the vulnerability of labour migrants – in their majority informal – whilst underlining the reliance of both sending and recipient countries on migrant labour. Lockdowns imposed across Moscow – which houses approximately three million Central Asian migrants – and other Russian regions led to massive job losses and suppression of economic opportunities, both formal and informal. Migrants are most commonly employed in such sectors as construction, catering, retail trade and transport services, all sectors hit especially hard by the pandemic. According to the Russian Presidential Academy of National Economy and Public Administration (RANEPA), 40% of Central Asian migrants reported a permanent job loss and 75% experienced unpaid leave, compared to 23% and 48% of the local population (Gurevich and Kolesnikov, 2020[88]). The IOM found that 60% of migrants had difficulty paying rent, and 40% could not afford food. Indeed, money transfers ***to*** Russia increased by 47% in the first quarter, to support migrants abroad. Thus, for those remaining in Russia, the social and economic impact was severe and highlighted the particularly acute vulnerabilities endured by migrants. Many of them were left unprotected, vulnerable to exploitation and poverty, and most often without access to healthcare, social protection or other measures offered by governments throughout the lockdown.

These developments prompted many migrants to return home, for example to Afghanistan, which experienced an influx of returnees (Box 6). However, for those who attempted to undertake this journey, containment measures created a series of further challenges. In one survey of Tajik migrants in Russia, some 46% said that they were unable to return to Tajikistan, while 80% of those still in Tajikistan but seeking to return to Russia were blocked. Tajikistan's Labour and Social Protection Ministry estimates that the flow of migrants to Russia dropped by 57% in 2020.

By January 2021, hundreds of migrants still found themselves stuck at numerous borders, with more migrants arriving at makeshift camps by the day, as their return overland to Tajikistan, Kyrgyzstan and Uzbekistan is dependent on the periodic granting of transit permission from Kazakhstan (Gershkovich, 2020[89]). Following hunger strikes organised by Uzbek and Kyrgyz labour migrants, Central Asian governments provided charter flights to support the repatriation of some migrants, while enforcing quarantine measures for those returning.

Box 6. Returning migrants cause distress for Afghanistan's formal labour markets

Afghanistan is the source of a large population of migrants to neighbouring countries with several million Afghans living abroad, particularly in Iran and Pakistan. The pandemic has led to an important wave of returning migration, mostly of informal workers and migrants. Shortly after the outbreak of the pandemic in Iran and Pakistan, a surge of refugees, totalling 375 000, returned to Afghanistan.

This surge in return migrants created risks for both the returnees – since access to healthcare remains limited and costly in Afghanistan – but also for in-country Afghans, as returnees might have brought the virus with them. Iran and Pakistan have been estimated to host approximately 2.4 million refugees who fled the war in Afghanistan, seeking work as undocumented and informal migrants. Their precarious situations in their host countries, with little to no access to education, healthcare, or social security, and the rise of the pandemic convinced many to return home, hoping for more support and medical coverage there. Afghanistan's absorption capacity was limited, however, causing further distress for the country.

Source: (OECD, 2020[1]); (IOM, 2020[90])

Despite difficult conditions (made worse by COVID-19), surveys suggest that migrants plan to return to their countries of destination, once borders re-open and the effects of the pandemic fade (FAO, 2020[91]).

The pandemic has also created problems in countries and sectors that rely on seasonal migration, internally and across international frontiers (UIF, 2020[92]). Lockdowns and movement restrictions have disrupted agricultural supply chains, including the processing and distribution of food. Food security rapidly became a factor affecting policies to retain migrants in recipient countries. The Russian authorities legalised the stay of foreigners with documents expiring throughout the state of emergency. Seasonal workers were considered as essential to economic stability and food security (Semchuk, 2020[47]).

Anecdotal evidence suggests that informal migrants remaining in their countries of destination during the COVID-19 outbreak have shifted towards sectors in need – such as food production or manual agricultural labour. Migrants have reported on unsafe working conditions in these sectors, without access to adequate sanitation and protective equipment. They also face overcrowded settlements and work commutes which raise the risk of infections, coupled with barriers in accessing information on COVID-19 (FAO, 2020[91]).

The COVID-19 crisis has also hit vulnerable workers, women and youth

The COVID-19 pandemic has gravely hit many activities typically undertaken by the self-employed, domestic workers or contributing family workers. Self-employed workers are particularly overrepresented in hospitality and personal services, such as hairdressing. Contributing family workers tend to be heavily employed in agriculture, which has seen stark disruptions in trade and supply chains during the pandemic, directly translating in higher poverty rates in rural areas. Domestic workers – 75% of whom are informal worldwide – also faced a heightened risk of contracting the virus, as their work requires proximity to children, the ill and the elderly.

A 2020 study[7] conducted by *Women in Informal Employment: Globalizing and Organizing* (WIEGO) found that domestic workers – in their majority female – reported losses of clients, fears of infection and an increased exposure to chemicals, with many facing no choice other than continuing to work. The study further highlighted the difficulty of working informally under conditions of lockdown, as 79% of female informal workers did not work in April 2020, compared to 66% of men. Further, 41% of women had not yet returned to work by mid-year, compared to 25% of men. The study also finds that domestic workers and contributing family workers have the lowest earnings and highest poverty risk among informal wage segments (Chen, 2016[40]; WIEGO, forthcoming[93]). The survey shows the harsh effects of the pandemic on the most vulnerable segments in informal employment and shows the importance of co-operating with member-based organisations of representing informal workers when collecting data and evidence on the informal sector.

At the same time, informal employment categories often benefit from simplified, specific legal statuses with little or no insurance coverage, social protection or access to healthcare – issues which have been even more salient during the pandemic. Djankov and Panizza (2020[94]) find "a statistically significant increase in the share of self-employment for about three years following an epidemic", with a longer-lasting and even more drastic size of the informal economy. Governments in the region, including Uzbekistan, Kazakhstan, Georgia and Ukraine, have acknowledged the intricate position of self-employed workers and thus granted that category easier access to social assistance benefits.

Young people (15-25) have also proven particularly vulnerable during the pandemic: they were the first to be affected by job losses, as they tend to be relatively junior and to work in sectors such as tourism, transport, retail and other services. Youth labour force participation, therefore, declined globally, and youth

[7] Phone interviews with 2,292 respondents from 12 cities in Ghana, India, Thailand, Senegal, Tanzania, India, South Africa, Peru, Mexico, Bulgaria, USA, India. The sample included member-based organisations of informal workers across three job types, including domestic workers, street vendors and home based earners.

unemployment has been on the rise. With shrinking job opportunities in the private sector, and lasting effects from the last financial crisis, young people are more likely than older workers to move to the informal sector with temporary, low-paid jobs.

Women are also more prone to the adverse effects of the pandemic (OECD, 2020[95]). Although women with home-based informal jobs would have been able to continue their work, women were disproportionately employed in hard-hit sectors like the garment sector or shuttle trading, both also characterised by high levels of informality. Thus, the lack of well-developed social safety nets led to rising poverty amongst women in informal sectors. With childcare reduced as well, women's employment rates have dropped drastically during the crisis; self-employed women have reported reduced working hours, at up to 77% in Kyrgyzstan (Titan et al., 2020[96]). The pandemic is further expected to exacerbate existing socio-economic challenges for women, which may push them further into informality. The disproportionate impact of the crisis on women highlights the importance of reducing gender inequalities as governments and international donor organisations deploy support measures and the imperative of ensuring women's participation in decision making with respect to recovery policies (OECD, 2020[97]).

Responding to informality: What can policy do?

Untargeted policy responses to informality in Eurasia countries

Tackling the informal economy has long been an important government concern in most of the region. Nevertheless, few governments have designed specific plans or policy responses to reduce the level of informality and help informal firms and workers transition to the formal sector. With the COVID-19 context hitting both the formal and informal sectors, Uzbekistan recently passed a decree dedicated to the reduction of the informal economy, including a wide range of formalisation, tax and anticorruption measures (Box 7). Kyrgyzstan is another exception, having adopted an *Action Plan to Reduce the Informal Economy in the Kyrgyz Republic for 2015-2017*, but its implementation was very limited following changes in government and priorities. Measures to fight informality are very often included in different pieces of legislation linked to SMEs, tax or employment.

Many Eurasia countries identify reducing informality as one of the objectives of their reform plans to support SMEs. This includes improvements in registration procedures, reduction in the administrative burdens, simplification of tax administration and new measures to curb corruption. The creation of one-stop shops and digitalisation of procedures have been important drivers of enhanced government-business relations. In Eastern Partner countries, most of these efforts were recorded in the OECD SME Policy Index (OECD et al., 2020[59]). For example, Azerbaijan has introduced revisions to the tax code aimed at enlarging the tax base and reducing informality, and Ukraine has been working on an action plan to increase the transparency of labour relations and help reduce informal employment.

Countries in Central Asia have developed a series of national strategies and plans to boost formal SMEs and support their contributions to economic activity, revenues, jobs and exports. As part of these reform efforts, many measures can help reduce the size of the informal economy. New regulations and amendments have been passed to improve the legal environment for small firms and the number of licenses is being reduced. Virtually all countries have plans for further digitalisation of government regulations, procedures and services for business, including registration, licensing, permits, customs and tax (OECD, 2021[56]). However, few policy documents include specific references to tackling informing employment or informal businesses. Kyrgyzstan's development programme 2018-2020 mentions the formalisation of businesses as one of the objectives of the simplification of the tax regime and the better coverage of informal workers among the goals of the expansion of social protection systems (Kyrgyzstan, 2018[98]). Tajikistan's National Development Programme 2030 aims at "increasing the share of formal employment in the economy" notably by creating a package of tax incentives (Tajikistan, 2016[99]). These, however, are exceptions, and, in any case, implementation has been patchy.

In addition to taxation and labour laws, one of the most commonly used policy options in the region is the streamlining of business registration procedures. Physical and virtual one-stop shops for business registration have been established in most countries and official procedures have been substantially reduced (World Bank, 2020[64]). However, the international evidence suggests that simplifying business registration alone has not made a significant impact on business formalisation, underlining the need for a more comprehensive plan and set of measures. All Eurasia countries still lack comprehensive strategies and plans to address informality and help the transition to the formal sector (OECD et al., 2020[59]).

Box 7. Uzbekistan's Presidential Decree to reduce the shadow economy, October 2020

Uzbekistan's economy is, like other countries in the region, characterised by high informality, particularly in sectors such as trade and catering, transport, housing construction and repair. To counter rising informality in these sectors, the President of Uzbekistan in October 2020 signed a decree "on organisational measures to reduce the shadow economy and improve the efficiency of tax authorities". The decree establishes a Department for the Analysis of the Shadow Economy under the Ministry of Economic Development and Poverty Reduction and aims to develop digital methods to tackle corruption and informal activity.

The decree is divided in three parts:

- **Measures to reduce the shadow economy by creating favourable conditions for formal business.** These measures aim to identify the causes and factors contributing to the formation of the shadow economy, and take comprehensive measures to eliminate them. They include providing assistance to entrepreneurs, particularly with information on permits and licenses, and promoting formalisation through media and public campaigns. Local roadmaps should be designed to take into account the characteristics of each district and city and identify the responsible bodies and organisations. They cover the introduction of digital business registration procedures, simplification of the taxation system, and the development of a methodology for the statistical evaluation of the shadow economy. Specific tax measures have also been designed for businesses involved in construction, real estate and public catering.
- **Anti-corruption measures**. They include trainings, anti-corruption analysis of investment projects, and public ratings of the level of corruption in government and regional bodies.
- **Improving tax and customs administration**. A series of measures would further aim to expand the tax base and circumvent tax evasion. The decree aims to encourage the development of contactless technologies, particularly when paying for goods sold by self-employed persons and artisans, and in public catering. It also envisages expanding the experiment carried out in Tashkent to hold bonus games based on a QR code or a fiscal mark reflected in the checks of online cash registers. Other measures on the expansion of ATMs in the country and the modernisation of IT equipment in the Centre of State Tax Committee have also been included in the decree. Finally, the decree mentions the development and approval of a roadmap for the accession of Uzbekistan to the OECD Automatic Exchange of Information (AEOI).

Source: (LexUZ, 2020[100])

Principles for policy design

Before considering specific policy options for reducing informality, it is important to take a realistic view of what formalisation policies can and cannot deliver and to see formalisation in the broader context of economic development. While policy can indeed help nudge firms and workers towards formality, it will be more successful when the broader economic environment is conducive to firm growth. As noted above, informality declines as countries develop (La Porta and Shleifer, 2014[9]; La Porta and Shleifer, 2008[101]). This is hardly surprising, as higher-productivity firms find it both easier to operate formally – they are productive enough to bear the costs of formalisation – and harder to grow while remaining informal. Strong growth in the formal sector draws resources and workers away from informal activities – very often as more new labour-market entrants (and also some of those who are self-employed in the informal sector) move into dependent employment in growing companies. This brings about a change in the overall balance between formal and informal activities (Ghani and Kanbur, 2013[102]).

This suggests several important points that should be borne in mind when considering policies to encourage formalisation:

- *The critical drivers of formalisation are those that foster growth*. Reforms to the broader business environment and the development of human capital and, particularly, entrepreneurial skills. The greater the potential productivity of the firm or individual, the larger the opportunity cost of remaining informal. The growth of formal firms run by skilled and educated entrepreneurs is probably the single biggest factor reducing informality.
- *Tackling informality requires an integrated strategy*. Streamlining business registrations should be pursued in parallel with tax simplifications and financial incentives. Extending social protection should be complemented by measures to raise the productivity, earnings and wages of informal workers, improve working conditions and facilitate sustainable transitions to formality. For instance, governments can put in place or raise minimum wages; offer training schemes, and implement stricter occupational, safety and health at work through prevention, reporting and labour inspection mechanisms.
- Policy makers should *focus more on encouraging formal activity than on discouraging informal activity*. Since most informal firms are relatively inefficient, policies designed with an enforcement focus, in an effort to tax or regulate informal firms, are more likely to drive them out of business than to prompt them to formalise.
- By contrast, *policies that help make firms more productive could encourage them to formalise*, at least on Ulyssea's "extensive margin" (Ulyssea, 2018[13]). Moreover, such policies are beneficial to firms already in the formal sector or to entrepreneurs ready to create new formal firms. Thus, the policy impact is felt through two channels that affect the balance of activity between formal and informal sectors: the formalisation of some existing informal firms and the growth of new and incumbent formal-sector firms. The second channel may ultimately matter more than the first. It may also have particular benefits for workers, since more-productive firms will offer better jobs and greater opportunities for upskilling to workers.
- *Policies designed to support the development of managers' and entrepreneurs' human capital* could make a substantial contribution to formalisation, since better managers will have more to gain from operating in the formal sector.
- *The informal sector should be consulted* to improve the understanding of its dynamics and better select appropriate solutions. Informal firms and workers should be allowed to form self-representative organisations. These organisations should in turn be involved in public-private dialogue platforms that discuss how to enhance business conditions and firm formalisation.

The preceding points highlight the need to foster a growing population of formal *firms*. This is critical because turning small private enterprises into engines of growth and job creation requires precisely the development of *firm capabilities*. It is not the skills or performance of individual entrepreneurs that will generate growth, since scaling up and productivity growth depend on more-complex organisation of labour and more-sophisticated management. Eurasia needs more dynamic private *companies*.

Informal *firms* should therefore constitute the main target group for formalisation policies, as those who operate at a suboptimal level can expect higher benefits from being formal than self-employed workers. Indeed, a growing business requires stronger legal protections, has higher financing needs, and requires the creation of stable and sustainable work relations through contracts with commercial partners, including the government – these are strong justifications and incentives for formalisation. Regardless of whether the lack of scale is a cause or a consequence of low productivity, formalisation can have a positive effect on firms that are able to expand their consumer base (de Mel, McKenzie and Woodruff, 2013[103]).

Closely linked to this is the need for *effective, qualified managers* to run those companies. La Porta and Shleifer (2008; 2014) emphasise the significance of managerial human capital as a determinant of firm productivity. Firms with more qualified managers substantially outperform other firms with similar overall workforce human capital – managers' skills can make the difference, even when workers have broadly similar skill sets.[8] Workers moving from informal to formal firms benefit, too, as they may see an increase in productivity – and wages – as a result of the shift. The productivity differential between the two groups of firms stems more from the efficiency of management, technology, etc. than from differences between the two groups of workers. Policies and programmes to support the development of managerial human capital can thus play a crucial role in supporting the emergence of productive, growing firms.

Overall, governments should place the emphasis on encouraging formalisation via growth rather than cracking down on informal firms. While the discussion that follows presents a number of measures that can make it easier for firms to become formal, it does so in the understanding that the larger economic context, particularly framework conditions for investment, will be absolutely critical to progress.

Immediate priorities: protecting people and providing liquidity

The COVID-19 crisis has brought informality to the fore. Informal workers without formal sources of income and government support faced the choice either to continue working and risk their and their families' health or to abide by lockdowns and other containment measures, which meant loss of livelihood. Some countries have acknowledged their large informal sectors and included them in income support programmes.

The immediate priority for governments should be to support informal workers who continue working amidst the pandemic and to offer immediate social protection to those who cannot or who have lost much of their livelihood following the onset of the pandemic. This will mitigate the sudden loss of income and help maintain consumption, while facilitating the access to basic services and healthcare. In particular, cash transfers could be offered as an immediate solution to ensure all citizens receive support during lockdowns and the post-pandemic phase, which is expected to see sluggish growth. These immediate responses, however, merely serve to counter the drastic rise in poverty and inequality: in the long-term, governments are encouraged to address firm formalisation and barriers to firm formalisation.

Targeting informal workers

When designing support programmes, it remains essential to **target recipients**. Kazakhstan, for instance, put in place a programme offering cash-based assistance to self-employed citizens, thus hoping to reach informal firms as well. However, the wave of registrations quickly overwhelmed the programme, with 2.5 million applicants by August 2020. This reveals the challenge in identifying informal workers, find themselves covered neither by social insurance systems nor social assistance programmes. Associating informal firms and workers to existing policy dialogue will enable them to take part into regular and structured discussions on their needs and possible solutions to help them survive the crisis and transition to the formal sector.

To best target informal workers, governments could rely on small administrative units or communities to register those in their jurisdictions to receive benefits – hence, to make use of territorial targeting. For Afghanistan's food donation programme, selected beneficiaries were identified by a diverse group of local actors. Kyrgyzstan similarly collaborated with municipal and social services departments to establish a list of families eligible for food packages. Latin American countries have conducted similar regional exercises in order to disburse transfers rapidly. Large locally maintained registries were provided with immediate

[8] Managerial skills include but are not limited to: "skills related to business planning; complying with regulations and quality control; human resources planning (recruitment, training and skills development); and allocation of resources" (OECD, 2013[73]). In most economies with large informal sectors, there is little difference between the labour forces employed by formal and informal firms. Instead, it is the education and skills of the entrepreneurs that count.

additional resources, which allowed for awareness-raising on their end. In line with this experience, governments are encouraged to co-operate with local actors to create comprehensive and up-to-date social records in order to identify target populations rapidly in crisis situations.

Countries with poor ID systems and weak bank coverage can use digital means, in particular mobile phones and money transfers, to identify beneficiaries most in need of immediate support (IMF, 2020[104]). In Brazil, for instance, more than 50 million citizens made use of a smartphone application to apply for emergency grants. Chile also handed out debit cards in order to facilitate transfers, similar to Costa Rica which coupled transfers with the opening of bank accounts (Arnold, Garda and Gonzalez-Pandiella, 2020[105]). Other governments are making use of administrative information from health, energy and tax systems: Afghanistan's government for instance made use of households registered as electricity recipients and telecom subscribers to identify low-income groups. To support this targeting over the long-term, governments should aim for a universal ID-system, which links to socioeconomic data on households and individuals and can foster an effective delivery (Diez et al., 2020[106]).

Cash transfers

Across Eurasia, as in OECD countries, governments have been ordering confinement measures and lockdowns, thus paralyzing most of the economy, both formal and informal. To ensure basic income support, cash transfer mechanisms to the most vulnerable households should be developed, in particular, to reach the informal sector (Box 8).

Box 8. Cash transfers can rapidly support informal workers and businesses

Cash transfers are gaining traction as part of governments' efforts to protect households from employment and income shocks. Universal transfers can be considered as complementary income support tools to existing support schemes that may be under high pressure amidst a crisis. Multiple disbursement mechanisms exist, be it new cash transfers, increases in the amount or expanding the population coverage of existing cash transfers, or the early disbursement of transfers, while the current COVID-19 pandemic fosters digital payments.

Several countries have targeted informal workers in their schemes, including Brazil, which offered a three-month emergency income for independent and informal workers, titled corona-vouchers, for those with a monthly income of less than half the minimum wage.

The pandemic has further confirmed the strength of cash transfers. Evaluations of previous transfer programmes showed that the transfers are used as planned – namely on primary goods and needs - and do not discourage recipients to pick up work. Cash transfer programmes also allow countries to identify vulnerable groups in society, and build platforms of co-operation, which are crucial for the recovery phase. Although financing unconditional transfers will require additional funds, building on existing schemes can make the costs manageable. Brazil's conditional cash transfer scheme on education, the *Bolsa Familia* programme costs around 0.5% of GDP and benefits 13.4 million families. The programme was bolstered with an additional 0.04% of GDP to add 1 million beneficiaries amidst COVID-19. Egypt's cash transfer, which includes the Takaful and Karama Cash Transfer Program and a one-off monetary compensation program for informal workers, has increased by more than 150 percent compared with pre-COVID-19 levels.

Policymakers should also be clear about the exceptional nature of such programmes to avoid difficulty in scaling them down after the crisis. Effectively transitioning from a crisis cash transfer to a more resilient social protection will require significant investment in most Eurasia countries in universal citizen registries, integrated socio-economic and tax databases, electronic transfer systems, and expanded financial inclusion.

Source: (Diez et al., 2020[106]) (United Nations, 2020[107]) (OECD, 2019[3]) (Arnold, Garda and Gonzalez-Pandiella, 2020[105]) (IMF, 2020[104])

Emergency relief social programmes and allowances

Emergency relief programmes could be considered, which reach both formal and informal workers and their households alike, including targeted financial support, child allowances and programmes enhancing shelter and food relief, such as in-kind donations or food vouchers. Food can be provided directly, or through existing school meal programmes, as implemented by 24 OECD countries to date. Selected price controls to limit price hikes for essential goods and utilities could also mitigate panic buying or usage. Belarus, for instance, restricted the importer mark-up to 10% and enforced limits on total mark-ups regarding basic foodstuffs.

Kazakhstan and Kyrgyzstan provided in-kind and financial support to low income families promptly following the COVID-19 outbreak, while Afghanistan provided food baskets through a network of local bakeries. Other countries in the region expanded their social assistance schemes to vulnerable groups in particular: Uzbekistan increased the number of social allowance recipients, targeting poor families with children, in particular, Armenia is offering a one-time cash transfer to families enrolled in the family benefit system, similar to Ukraine's one-off cash assistance for pensioners and recipients of state social assistance (United Nations, 2020[73]). These programmes help to counteract rising poverty rates. Importantly, these types of programmes should be offered unconditionally. Governments also have the option to collaborate with the private sector or civil society in order to expand their reach: in Ecuador, for instance private firms helped the government set up a platform for the government to distribute virtually food baskets across the country.

Governments could extend **unemployment benefits** to informal workers, helping them abide by lockdown regulations. The Moroccan government, for instance, reacted to COVID-19 by expanding its unemployment scheme beyond the formal sector. Payments were facilitated through mobile payment platforms, allowing for a simultaneous collection of information on the extent of the informal sector. To finance this, the government set up a *Special Fund for the Management and Response to COVID-19*, which benefitted from donations from citizens and businesses alike. North Macedonia also expanded its unemployment insurance to informal workers, which benefitted up to 20 000 families. Countries in the region have expanded their unemployment schemes – which could be further enhanced as lockdowns continue: Azerbaijan for instance offered state aid to 300 000 micro-entrepreneurs and expanded the eligibility criteria for unemployment benefits. Ukraine similarly offered job retention schemes for SMEs.

Supporting informal business operations and liquidity

Governments can further aim to encourage informal firms to register by offering easier access to financial support. Here different approaches exist, either extending formal financial programmes to informal firms or offering interest-free loans to informal workers. For instance, Gabon put in place a lending mechanism with facilitated lending for informal and formal firms alike. Colombia also enhanced the access to soft loans to informal workers and provided free digital banking products to enhance the chances for informal workers to make use of them.

Short-term measures could also include utility payment freezes,suspensions of evictions and rental payments. Many countries of the region offered these short-term measures during the first lockdown. Afghanistan's government waived rent and utility payments in parts of Kabul and put in place extensions for salary payments, payments to vendors, and rental payments. Across Latin America, governments went further than suspending payments and made sure that basic services, including electrical power supply, water would continue to be supplied to all households, for instance in Colombia (see Box 9).

Measures such as the provision of masks and other equipment are also needed to help informal and formal firms ensure the health and safety of workers, such as ensuring supply and price controls on essential medical equipment.

Financing upskilling programmes to help informal workers develop their competencies and shift to highly skilled jobs can be used. Skilling programmes can take place while workers are on the job. Indonesia offered subsidised vouchers for unemployed workers for training. The programme is estimated to benefit 5.6 million informal workers, on top of unemployment benefits disbursed through e-wallet platforms.

Since some sectors are prone to informality than others, sector-specific rescue plans and measures may be needed and can be designed in consultation with informal workers, local government bodies and NGOs. Hard-hit sectors could be identified ahead of the rescue plans to make sure those in need receive support through emergency funds and new working conditions. In catering services, delivery can be promoted with specific guidelines prepared by the government and the private sector. Teleworking could be supported by law and the provision of basic digital services at reasonable rates. Protective equipment and working conditions allowing social distancing could be provided to waste pickers and street vendors. In Zimbabwe, for instance, the informal economy association has been negotiating on the behalf of vendors to make sure they may continue their work in sanitary conditions during lockdown. This can encourage governments to engage in social dialogue that can act as a tool to communicate regulations, preventive measures and raise awareness amongst informal workers (ILO, 2020[80]).

Box 9. Colombia's immediate support to informal firms amidst COVID-19

An estimated 46% of employment in Colombia is informal. Following the COVID-19 outbreak, Colombia's government rapidly put in place a bundle of programmes that directly and indirectly support informal firms and workers. The following support measures were put in place:

- solidarity income cash transfers with one off payments of USD 108 for 3 million households identified through the social registry (SISBEN) and tax collection databases;
- utility payment freezes;
- reconnecting the access to water for those that could not pay the bills throughout the crisis;
- freezing of utility prices;
- temporary subsidies for informal workers not receiving any existing subsidies;
- delivery of food baskets to vulnerable families;
- suspensions of evictions and banning of increase of rental payments;
- deferral of payments of public services in the framework of 36 months, without interest; and
- exemption of mobile services from taxes since April 2020.

Source: (Arnold, Garda and Gonzalez-Pandiella, 2020[105])

Helping vulnerable groups: the self-employed

The self-employed represent most of the region's informal workforce and will also need to receive income support, access to credit or flexible payment deadlines. Measures such as those undertaken by Italy's government may be considered where resources permit (Box 10). Ukraine has put in place simplified tax regimes and reimbursed salaries for self-employed workers, while Moldova offered them minimum wage benefits.

Box 10. Support to self-employed workers in Italy

Italy has been one of the countries most affected by COVID-19 and has adopted strict containment measures to mitigate the impact of the pandemic and protect the population. To counter the effects of COVID-19 and containment measures on firms, the government has adopted a large range of measures for businesses of all sizes that benefit the self-employed, including tax and social security reliefs and deferrals, credit guarantees and soft loans. The government has also provided tax credits to help finance commercial rents and workplace sanitation.

Specific measures were also designed for the self-employed. Italy has provided the self-employed (not enrolled in a professional order) with a non-taxable EUR 600 cash transfer and has set up a fund of last resort amounting to EUR 300m to support employees and self-employed workers who are not covered by the cash transfer but have ceased, reduced or suspended work due to the COVID-19 outbreak. Like SMEs, the self-employed also benefit from a moratorium on loans that represent an estimated EUR 220bn.

Source: (Ministry of Economy and Finance of Italy, 2020[108])

Helping vulnerable groups: migrants

Migrants remain vulnerable across the region. Immediate support to those abroad, facing job and revenue losses is needed, including direct cash transfers, healthcare, and immediate housing and shelter. The Uzbek Embassy in Moscow, for instance, created a programme offering Uzbek labour migrants who have tested positive for COVID-19 12 000 roubles (USD175) paid onto their bank cards. A number of OECD countries modified access to unemployment benefits, with changes benefitting migrants with less stable contracts.

Host countries can also help provide immediate relief to migrants by extending working visas. Russia and Poland did so promptly following the outbreak of the pandemic, extending permits or removing obligations to leave (OECD, 2020[109]). Portugal granted all migrants temporary citizenship rights, which gives them direct access to the country's healthcare system (FAO, 2020[91]). Poland also removed the obligatory quarantine measures for migrants when crossing the border, instead providing free-of-charge testing opportunities (Semchuk, 2020[47]). Considering the rising trend of migrants shifting towards sectors lacking labour, governments could also issue guidance and ensure occupational safety and health measures are put in place, particularly in agriculture.

In general, both sending and recipient countries should aim to enhance information points for migrants. State-run and independent migrant resource centres will be able to supply labour migrants with information on their legal rights, and job opportunities. Ahead of the pandemic, Kyrgyzstan had put in place consulates in selected cities, in addition to strengthening outreach to diaspora organisations. After the crisis erupted, the government established additional consular hotlines. The Russian authorities are developing chatbots to respond to migrant needs. More information in relevant languages (Ukrainian/Russian) could help migrants protect their rights and receive information.

Sending governments also have a responsibility to support repatriation of those migrants wanting to return home, including access to support services and healthcare. Facilitating their social integration upon their return is also crucial. Uzbekistan, for instance, has offered returning migrants easier access to loans and credit guarantee schemes to survive the lockdown months and potentially invest in other opportunities.

Longer-term priorities: better incentives, regulations and access to resources

Principles of action for a long-term response

Informality is a complex reality that requires a multi-faceted approach. Governments should consider using a mix of different policy levers to promote formalisation. This section offers some broad principles for designing policy responses to tackle informality. While governments in OECD member and non-member economies have designed different programmes and strategies to address the problem, there is ample evidence that there is not one single recipe to provoke mass migration from formal to informal sectors. Different contexts across countries will call for tailored approaches to formalisation. Policies to promote formalisation often work at the margins and take time. Certain measures may work better in some places than others. For instance, while focusing on simplifying business registrations has worked in certain contexts (de Soto, 1989[110]), it has proven of little influence in most (La Porta and Shleifer, 2014[9]).

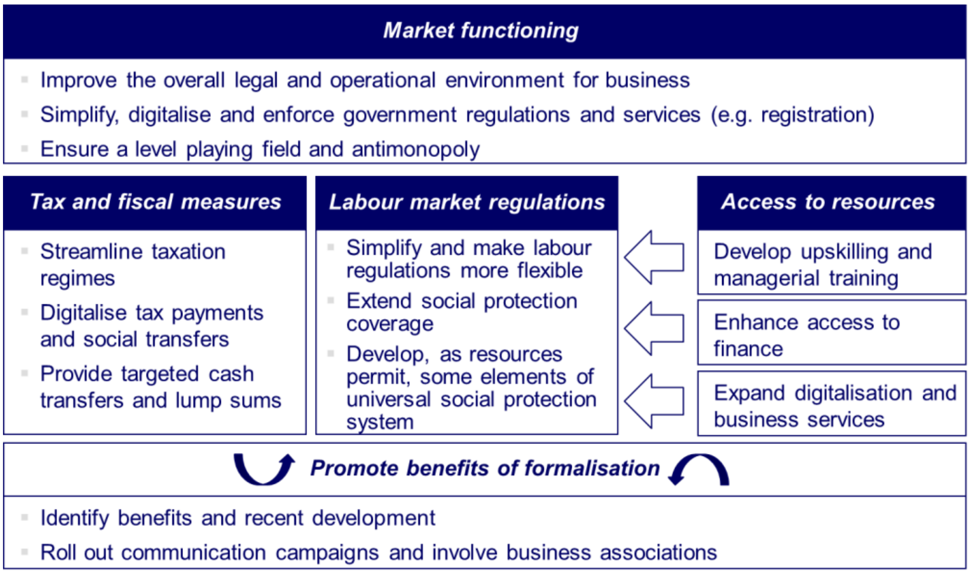
As noted above, *the critical long-term drivers of formalisation are those that foster productivity growth*: reforms to the broader business environment, the development of human capital and, particularly, entrepreneurial skills and to the financial system. Improvements to legal and regulatory frameworks for SMEs are needed to tackle informality, complemented by supportive implementation institutions such, as SME agencies and funds. While policy can help nudge firms towards formality, it will be more successful when institutions and policies overall are more supportive of growth, particularly productivity growth.

Overall, policymakers should focus more on encouraging formal activity than on discouraging informal activity. Particularly in an economy where informal activity is widespread, an enforcement-based approach is likely to increase unemployment and poverty. Such approaches are likely to lead to a cycle of inspections, sanctions and cessation of activities. They risk undermining trust in state institutions and encouraging hide-and-seek strategies. By contrast, policies that help make firms more productive could encourage them to formalise and support the transition to the formal sector, while creating positive examples for others and helping them escape the "prisoner's dilemma" of formalisation (Gans-Morse, 2017[111]). Moreover, such policies are beneficial to firms already in the formal sector or to entrepreneurs ready to create new formal firms.

Framework and measures for a long-term response

Guided by those principles, policies targeting informality could be framed around five blocks covering: market functioning, labour market regulations, fiscal and tax measures, access to resources and advocacy of formalisation benefits (Figure 18). These policies aim to improve the overall framework conditions for all firms and address specific needs of firms to create incentives and promote formalisation. Specific solutions tailored to each context can be selected and adapted in consultations with both the local formal and informal sectors.

Figure 18. A long-term policy framework to address informality



Source: OECD

Market functioning

The **overall market conditions and legal environment for business** are cornerstones of healthy private sector development and of business formalisation. Firms will be more willing to formalise if they consider that the business environment and conditions in which they operate are conducive to future growth. Complex regulations and unpredictable enforcement will deter this and impede the development of those firms that do operate in the formal sector. Streamlining and enhancing product market regulations can reduce administrative burdens and barriers to doing business. Important progress has been made within the WB Doing Business exercise over recent years and efforts to reduce the regulatory burden on firms should be pursued, for example by consolidating fragmented laws into comprehensive laws or codes, cancelling unnecessary licensing and renewal processes, or using X-IN, Y-OUT approaches (OECD, 2021[56]). Many governments in the region are progressively simplifying and digitalising SME regulations through the introduction of consolidated legislation that brings together all previous regulations, such as the *Entrepreneurial Code* in Kazakhstan, and the creation of digital one-stop shops (OECD, 2021[56]).

Improvements in the **quality and delivery of public services**, particularly business registration and licensing, can reduce the reluctance of informal business owners to engage with the administration and comply with regulations (Levy, 2008[65]). This includes the creation of physical and online one-stop shops (OSS) to reduce transaction costs with the administration. Georgia provides a successful example of establishing OSS, notably through its Public Service Halls and the unified online portal my.gov.ge.

Sound **competition** policies and the creation of a level competitive playing field are also significant determinants of firm competitiveness. Abuse of dominant positions, including by State-Owned Enterprises (SOEs), and laws restricting entry or competition can make it harder for local firms to grow, develop new products and compete, especially in their roles as suppliers or potential business disrupters. Governments need to promote competitive neutrality by strengthening competition regulations and institutions such as antimonopoly agencies and improving enforcement in order to enhance market functioning and foster companies' readiness to compete in the formal sector. Competition authorities can also help formalisation by removing sectoral entry barriers and by using advocacy to encourage overall regulatory simplifications (OECD, 2009[112]). Unfair competitive practices by large formal firms over informal firms need also to be investigated and addressed. Nevertheless, it is important to note that all firms should abide by competition laws, as competition from informal firms is frequently cited as a problem by formal companies (EBRD and World Bank, 2020[113]).

Effective regulatory and contract enforcement will increase overall trust of informal and formal businesses in government and in the judicial system. Effective and consistent enforcement of regulations for firms of all sizes can help decrease informal practices. Governments can foster better enforcement by following OECD Best Practice Principles for Regulatory Enforcement and Inspections (OECD, 2014[114]), which are supported by a corresponding checklist that can provide practical guidance (OECD, 2018[115]). Better planning, selectivity and co-ordination of inspections appear crucial to increase the compliance and trust of firms. Risk management tools can be introduced into inspection systems to rationalise and avoid multiple inspections. A clear scale of proportionate sanctions in case of legal violations can also support both better enforcement and greater confidence in the regulatory system. As part of these efforts, fighting **corruption** remains a crucial objective to build confidence in state institutions and encourage formalisation; initiatives and institutions supporting public sector integrity should be strengthened (OECD, 2020[62]). Critical in this context are steps to strengthen the independence, integrity and effectiveness of judiciaries in the region.

COVID-19 has further accelerated a long-term trend towards **government digitalisation**. The development of digital one-stop-shops, electronic taxation, online payment systems and electronic signatures is simplifying firms' relations with the administration including from remote places. Unifying existing government websites into a single platform and prioritising the integration of essential services such as licensing, taxation and notarial services in such platforms would address concerns about regulatory burdens expressed by firms (OECD, 2021[56]). However, it should be noted that entrepreneurs in the region often have poor digital literacy and access to digital devices and infrastructure, which limits the impact of digitalisation measures. The development of mobile applications for smartphones, with mobile connectivity much higher than internet connection in the region, can help mitigate these limitations. Kyrgyzstan, for instance, has accelerated the digitalisation of government services during the pandemic through the national *Tunduk* initiative, incorporating more than 85 public services as well as tax and notary services (OECD, 2020[18]). If further promoted and replicated, these long-term initiatives could contribute to increasing formalisation.

Simplifying and digitalising tax administration

With tax being one of the key barriers for firms to formalise, acting on **tax policies and administration** is an important lever to be considered by governments. Tax preferences are often provided to SMEs to lower the overall tax burden and can help reduce preferences for informal activities; small firms may benefit from exemptions, lower and single/simplified tax rates, R&D tax credits and deductions (OECD, 2015[116]). Streamlining and digitalising tax administration can also minimise physical interactions with tax officials and thus eliminate many corruption opportunities. Simplified tax regimes for SMEs and entrepreneurs, including simplified filing procedures, quarterly to annual declarations and lump-sum payment, have been consistently implemented in OECD economies and can reduce red tape and facilitate compliance with tax regulations, allowing both informal and formal firms to focus on core business activities. Mexico, for example, has developed a specific SME tax regime that represents a gradual introduction to the tax system, largely intended to curb informality (OECD, 2015[116]). Along with updates and streamlining of tax codes, digitalisation of tax administration has widely expanded in Eurasia countries and should be pursued to help decrease tax compliance costs (OECD, 2021[56]).

Direct fiscal measures such as cash transfers and lump sums have also been used to reach the informal sector, particularly in the context of COVID-19. Cash transfers have helped provide substance revenues for poor households and workers. Digital transfers via mobile phones were widely employed to reach informal workers, who are very often not covered by traditional social protection and do not have access to banking services. There has been some discussion of linking such support to formalisation, but little has been done to this end so far, chiefly because the recovery objective has trumped formalisation as a policy priority (Bosio and Djankov, 2020[117]). For example in Morocco, the government transferred funds to informal sector workers via a digital platform to provide immediate relief (OECD, 2020[118]). This may help identify informal workers and encourage them to register in the longer term, but that depends on the degree to which they perceive more lasting benefits available to formal firms. Brazil has extended the reach of the *Bolsa Familia* programme that helps provide cash transfers to poor families and households on a schooling conditionality. Since the crisis began, the number of beneficiary families has increased by 1.2m to 14.2m (World Bank, 2020[119]).

Simplifying labour regulations and improving social protection

Burdensome and costly **labour regulations** contribute to the development of informal work by making formal workers more expensive to hire, fire and pay. There is undeniably a balance to find between labour market flexibility and social protection for formal workers. Several OECD member countries, including Hungary, Mexico and Turkey have faced the issue of informality and worked towards simplifying and making the labour code more flexible. Specific measures include lifting restrictions on hiring and firing procedures such as severance payments (OECD, 2009[112]). The high tax wedge on labour has also often been cited as an incentive to hire informal workers.[9] As typical informal workers are low-skilled and low-paid, measures could focus on decreasing the tax wedge for workers on low pay. While the average tax wedge remains low in the region compared to OECD countries (36% of total labour costs in the latter), it appears to be relatively flat across income levels, suggesting that targeting lower income groups could support employment formalisation, especially in contexts where social contributions were likely to increase (OECD, 2020[120]).

Informal workers often lack protection from labour regulations but also **from social security,** with employers lacking the willingness or capacity to pay social contributions and comply with requirements. A wide range of legal and financial instruments have been used, particularly in Latin America, to support formalisation and ease eligibility criteria for contributory coverage (OECD, 2019[3]). These include reduced contribution levels for smaller firms on a temporary basis, simplified special mechanisms for categories of workers, tax deductions to promote payment of contributions, tax breaks and favourable modalities for firms that formalise, and simplified social security registration for workers and employers. National legislation sometimes does not require social contributions from small firms and should be extended. Social contribution payments can be streamlined and included in simplified tax regimes. Social coverage for young workers can be initially subsidised, or contributions for newly registered workers be progressively increased as was implemented in Argentina with the *régimen de promoción y protección del empleo registrad*o, along with tax and registration simplifications (ILO, 2020[121]). Firms that comply with social obligations can in turn benefit from incentives such as public financial or upskilling programmes.

A crucial step in the extension of contributory social coverage to the informal economy has been the extension of social and labour rights to domestic workers through a mix of enforcement and simplification measures (Brazil, Ecuador, South Africa and Uruguay). One development has been the establishment of national health insurance in some countries (e.g., the Philippines) with a view to providing universal access to health care through adapted contribution payments combined with tax financing. Thailand has focussed on the provision of free primary health care services funded through general taxation, which led to a dramatic increase in coverage. Another approach has been to extend social protection through non-contributory, tax-financed, cash transfers delivered in various forms. These target low-income households

[9] The (OECD, 2020[131]) defines the tax wedge as "the ratio between the amount of taxes paid by an average single worker (a single person at 100% of average earnings) without children and the corresponding total labour cost for the employer. The average tax wedge measures the extent to which tax on labour income discourages employment."

and are sometimes conditional on human development requirements, as is Brazil's *Bolsa Família* programme (Box 8), or unconditional, like China's Dibao programme (OECD/ILO, 2019[43]).

To expand social coverage to the self-employed, self-employed workers need to be able to build up rights to the types of out-of-work support that are available to standard employees. For instance, a number of OECD countries include the self-employed in their unemployment and sickness insurance schemes (Spain, Lithuania, Belgium, and Korea). Some countries have also fostered the inclusion of self-employed workers in social insurance schemes through simplified registration, tax and contribution payment mechanisms (Argentina, Peru and Uruguay), and others have harnessed digital and mobile technology to facilitate the access to social protection (Turkey and Uruguay) (OECD/ILO, 2019[43]).

Formalisation can support the access of workers to social protection schemes, but this will take time for firms and workers that are far from the formal economy. It also depends, as noted above, on establishing a degree of trust in the stability, integrity and effectiveness of public institutions: workers and firms must believe that tax and regulatory compliance will deliver real benefits over the long term.

The development, as resources permit, of some elements of **universal social protection system** could further provide the resources and the incentives for firms and workers to formalise and benefit from better social protection. Governments should consider progressively transitioning to a universal social system coverage that could provide a social protection floor to formal and informal workers, using a combination of contributory and non-contributory schemes. Countries such as Brazil and Thailand have been successful in extending social protection coverage to informal workers through large social programmes (ILO, 2020[121]). The idea of a universal basic income has also resurfaced during the COVID-19 pandemic, but its scope goes beyond the debate on informality, notwithstanding the issue of financing.

Improving the access to resources as incentives for business formalisation

When approaching informality, governments should reflect on the fundamental inputs and resources needed to open a business, starting with human and financial resources.

Labour market programmes, such as public works programmes (PWPs) and skills training, have received attention in many countries with large gaps in the provision of quality jobs. Among different approaches, employment guarantee schemes (EGSs) aim to guarantee employment to a specific population over a sustained or indefinite period. The *Mahatma Gandhi National Rural Employment Guarantee Scheme* in India provides a guarantee anchored in national law (Breitkreuz et al., 2017[122]). Comprehensive skills development in the informal economy are less common, but some universities and professional organisations in South Africa and other selected countries offer skills development programmes focused on entrepreneurship training for people running certain informal production and service units (OECD, 2018[123]).

Policies designed to support the development of managers' and entrepreneurs' **human capital** could make a substantial contribution to formalisation since better managers will have more to gain from operating in the formal sector. As seen above, the growth of formal firms run by skilled and educated entrepreneurs is probably the single biggest factor reducing informality (La Porta and Shleifer, 2014[9]).

While policymakers should rightly be concerned with developing the skills of all their citizens, the evidence suggests that it is *managerial* human capital that offers the key to formalisation in many contexts. Vouchers enabling access to programmes in universities and training centres can be made available to entrepreneurs and SMEs to encourage upskilling. Specific education programmes for entrepreneurs can be developed within universities, business schools and incubators with the support of international organisations. These programmes can be hosted by SME agencies, chambers of commerce or relevant public and private institutions. Limited entry fees could be set to encourage participation while maintaining high levels of commitment. Access to such programmes can foster entrepreneurial and managerial training and encourage entrepreneurs to benefit from, and to value, public support initiatives, especially if they are combined with easy access to public services in the same facilities. Structures as diverse as Georgia's Innovation and Technology Agency and French business incubator Station F provide training for entrepreneurs, incubation services, and one-stop shop for public services at the same place.

Access to finance has repeatedly been assessed as a key obstacle to the growth of both formal and informal businesses in developing countries. Improved access to the formal financial system, including microcredit and banks, could contribute to helping informal firms consider moving to the formal sector. Public financial programmes supported by the government and donors could be extended to informal companies under the conditions that they consider registration at the inception or during the course of the programme. These initiatives can take the format of interest-free loans, loan guarantees, access to financial online platforms such as crowdfunding sites, and equity investments. Stimulating diaspora financing by promoting local business projects and initiatives can also further attract financial resources to domestic firms and increase the interest of informal firms to benefit from a new source of financial transfers.

Given the importance of migrant remittances in much of the region, governments could do much to reduce the cost of sending **remittances** via the formal system, using digital platforms, while enforcing vigilance against fraud and financial crime. Pakistan, for instance, offered tax incentives to money transfer service providers to offset reduction in fees (IMF, 2020[124]). A positive correlation between remittances and financial inclusion can be seen when the remittance-to-GDP ratio is above a certain level (estimated at around 13%), as is the case in several Eurasia countries (Ben Naceur, Chami and Trabelsi, 2020[125]). This calls for strengthening the capacity of formal financial institutions to receive remittances and inject them into the formal economy, and for enhancing financial literacy and inclusion of local entrepreneurs. These efforts should be accompanied by steps to promote financial literacy among both migrants and the general population, in order to foster investments and savings. The OECD's principles on financial education and awareness could be leveraged to put in place national financial literacy strategies with targeted measures.

In addition to digitalising public services, governments have also ramped up their **support for online business initiatives**. Korea, for instance, has helped businesses move from brick-and-mortar shops to online activities during the crisis. The development of e-commerce platforms has been expanding in recent years in the Eurasia region and has increased visibility of domestic firms while making supplier-customer intermediation easier. Promoting access to such initiatives and business opportunities to informal businesses could help them boost their activities and revenues and further raise their interest in formalisation. For instance, Thailand has combined digitalisation support and financial programmes to collect information on informal firms and workers and create incentives for them to formalise (Box 11).

Advocacy for the benefits of formalisation

Better incentives and enforcement of regulations and should be supported by awareness activities regarding formalisation. Governments should also attempt to persuade businesses of the benefits of going formal, for instance by publicising existing administrative procedures and developments, promoting public programmes on credit or training available to formal firms and displaying the benefits of social coverage for workers and for firms. This could take the form of media campaigns, local events and consultations with business associations and local networks of formal and informal firms (OECD, 2019[4]; OECD, 2009[112]; ILO, 2020[121]).

Tripartite policy dialogue is instrumental for all policy responses to formalisation. Informal businesses and workers need to be represented during government consultations with business associations and unions. This will help increase the understanding of the local informal economy, advocate the benefits of formalisation and find common solutions. It will provide an opportunity to inform and discuss formalisation plan and measures on a regular and structured basis. It also requires that governments allow and encourage the creation of informal firms and workers' self-representative organisations. For instance, waste pickers in Asia have progressively set up their own representative organisations at the local level that progressively evolved into forming a Global Alliance (Global Alliance of Waste Pickers, 2021[126]).

Box 11. Thailand's approach: Encouraging formalisation through digitalisation

Thailand has a large informal sector that is estimated to generate more than 45% of GDP (A.T. Kearney and Visa, 2018[120]). The sector has been evolving from necessity entrepreneurs to increasingly opportunity-oriented entrepreneurship. Freelancers in sectors like graphic design, online marketing and web programmes have been expanding and represented more than 2 million workers in 2019, a significant share of whom were informal.

Before COVID-19, the government developed its own approach to formalisation, using both supportive and regulatory measures. For example, an Amendment of the Revenue code Act (No.48, B.E.2562) requires financial institutions to report to the Revenue Department on any account holders who have more than 400 financial transactions per year with more than 66 000 USD (Baht 2m). The government has also developed incubation, training, internationalisation and marketing support.

The government's approach has also evolved towards targeting opportunity-driven entrepreneurs through digitalisation. This included a wide range of instruments and financial support measures such as providing entrepreneurs with access to digital government services, simple bookkeeping software, government financial institutions and a procurement e-platform, while supporting digital payments.

Thailand has developed number of specific digital financial schemes to foster formalisation and support the informal sector during COVID-19 and beyond:

- The Blue Flag scheme provides a social welfare Smart card with monthly subsidies to make purchases at more than 90,000 small local shops. Transaction data for more than 14.55 million card holders have been reported to the Ministry of Finance as part of this scheme;
- The *Rao Mai Ting Gun* ("No one is left behind") scheme and the *Rao Chana* schemes were started as part of the efforts to cushion the impact of COVID-19 on vulnerable and informal workers. They provide direct subsidies of USD 230-500 (Bath 7,000-15,000) to temporary workers, contract employees, freelancers, the self-employed and informal workers.
- The *Khon La Kring* or 50:50 Co-Sharing Scheme provides a USD 5 subsidy per person per day (up to $100 within three month) that is stored on a government e-wallet and can be used for transactions with 1.3m small shops and street vendors. Half of this amount needs to be paid by users while the other half is matched by the government.
- The "We travel together" scheme targets the tourism sector and provides a subsidy on a government e-wallet that can be spent at 7 400 hotels and 62 700 restaurants, as well as tour operators, health- and wellness-related businesses.

These schemes have helped to collect data on the transfer and use of money of the beneficiaries in the informal economy, through government e-wallets, which can inform policy-making. They have also supported the informal sector during challenging times and acted as gradual formalisation benefits.

Source: (Thailand's OSMEP, 2021[125])

Conclusion

COVID-19 has required rapid action to address the plight of informal workers and firms during the crisis, not least in view of the lockdowns and other restrictions implemented by governments in an effort to contain the pandemic. Governments will need to continue supporting the informal sector within their financial capacities, extending existing support measures to informal workers and firms with little discrimination in the pandemic context, and gradually winding down some of the support schemes as recovery takes hold. In particular, support to vulnerable population such as cash transfers should be considered in the short term following the examples of Colombia and Morocco. Such measures will probably not accelerate business formalisation in the short term, but they can help governments gather more information and promote the benefits of formalisation to a wider population of informal firms, workers and necessity entrepreneurs.

Over the long run, efforts to reduce informality cannot be separated from broader questions of economic development and productive transformation. While better policies and institutions can indeed help encourage formalisation at the intensive and extensive margins, the overriding priority must be the creation of conditions conducive to firm growth. The overall improvement of the business climate should therefore be both the foundation of governments' business formalisation efforts and the heart of their private sector development agendas. A healthy business climate, a level-playing field and effective government services can best build the trust of businesses in the administration and encourage firms to start or transition to the formal sector. In that regard, Eurasia countries could further streamline the regulatory environment for firms, develop sound competition policies and institutions, and enhance the digitalisation, integrity and efficiency of public-sector service delivery. Efforts to fight corruption should also be enhanced and be visible for firms in their daily interactions with the administration.

That said, there are important steps that can be taken to address informality directly. These begin with a better understanding of the issues raised by informality. A clearer definition of informality and better measurement of the informal sector are essential in developing appropriate policy responses. Harmonised definitions across public institutions (Statistical Agencies, Ministries, SME Agencies) at country level would help governments better understand the scope and size of the informal sector and help inform better policy-making.

While consistent regulatory enforcement and compliance are important, the approach to informality cannot be based primarily on an enforcement logic, which may simply aggravate the problem. Positive incentives for formalisation are essential in encouraging firms to operate in the formal sector. Managers and workers must conclude that the benefits associated with formalisation outweigh the perceived costs and risks. These benefits can include better access to public services and to finance, upskilling programmes for would-be entrepreneurs, managers and workers, and specific fiscal regimes for entrepreneurs and SMEs that can help new firms progressively integrate into the fiscal base.

Digitalisation can help. COVID-19 has accelerated the digitalisation agenda, and governments can further support the digitalisation of firms for instance by enhancing or funding their access to online solutions and e-commerce platforms. Support for digitalisation can be attractive to informal firms that are willing to scale up and expand to new markets. The mandate of SME agencies in the region could be expanded to include the formalisation of firms, as most agencies are in charge of the implementation of measures for the formal economy.

The pandemic has also underlined the importance of social protection and labour regulations. Expanding the social coverage in Eurasia countries should remain a priority, with universal coverage as a long-term goal. Governments also need to find the right balance between protective labour laws and flexible regulations that can allow the hiring and the social coverage of formal workers, including the youth and the elderly. In principle, the development of more contributions-based pension and social insurance schemes could be a strong incentive for formalisation for employees, but this will take time and will not be easy. As noted above, it will depend on building sufficient credibility and trust in state institutions, so that workers believe they really will benefit. It also depends on rising wage – and thus productivity – levels.

The improvements and new measures designed by the government should be promoted and the benefits of formalisation clearly communicated to the business community and the shadow economy. Mass-media campaigns and roundtables with business associations have proven useful in different contexts, including some South-East Asian countries.

The approach to business informality presented here is neither a panacea nor a quick fix. Informality is a multi-faceted phenomenon and a wide range of situations and challenges call for different policy responses. However, a comprehensive approach that encompasses both economy-wide challenges and targeted measures for informal SMEs offers the best prospects of success. Measures that target formalisation are likely to achieve little without improvements in the overall business climate including the rule of law, integrity, tax policy and tax administration, labour market policies and skills development. At the same time, such measures can provide a more supportive framework for strong, inclusive and sustainable growth.

The informal sector will remain a pervasive reality in Eurasia for decades to come, but careful and tailored policy design, experiments and implementation, as well as persuasion can help reduce it progressively as Eurasia economies grow richer, and can support smooth transitions for informal workers into the formal economy.

Annex A. A matrix to measure informality

In the absence of a harmonised definition and statistics on informality, A matrix has been developed (the Hussmanns matrix) to better define and measure the informal sector and informal employment (Hussmanns, 2004[127]). The matrix has been applied to Mexico by the National Institute of Statistics, Geography and Informatics (INEGI) and can provide a good illustration of the diversity and data needs on informality (Table 1).

Table 1. Hussmanns matrix

Applied to Mexico, second quarter 2017 (million)

Classification according to type of economic unit	Classification by status in employment										Total	
	Paid dependent worker				Employers		Own account workers		Auxiliary contributing workers not salary paid			
	Salary workers		Dependent workers not salary paid									
	Informal	Formal	Informal	Formal	Informal	Formal	Informal	Formal	Informal	Formal	Informal	Formal
Informal sector	3.92		0.79		0.88		7.50		0.98		14.08	
Paid domestic work	2.27	0.07	0.02	0.00							2.29	0.07
Corporates, government and institutions	5.72	18.84	0.89	0.21		1.15		1.66	0.60		7.20	21.87
Agricultural	2.41	0.38	0.15	0.02		0.37	2.46		0.91		5.93	0.77
Subtotal	14.32	19.29	1.85	0.24	0.88	1.52	9.97	1.66	2.49		29.50	22.70
Total	33.60		2.08		2.40		11.63		2.49		52.20	

Source: (Negrete and Luna, 2017[128])

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INFORMALITY AND COVID-19 IN EURASIA: THE SUDDEN LOSS OF A SOCIAL BUFFER

CCOVID-19 has triggered an economic and public health crisis that has had a particularly severe effect on informal businesses and workers in the Easter Partner countries and Central Asia, regions where they have historically represented a large share of economic activity.

The informal sector has previously acted as a sort of social buffer in times of crisis and has been a source of resilience for many precarious workers in transition economies. For many in the region, informal economic activity has provided subsistence revenues, flexible arrangements and opportunities for vulnerable workers and businesses alike.

COVID-19 is different. Many of the key arenas for informal work were among the first to be hit by the crisis: governments had to close market places and implement strict containment and social distancing measures. Many informal workers were left with nothing to fall back on. Migrants had to return home or remain without work in their countries of destination, often with a loss of income in both cases. This had a significant impact on those of the region's economies that are heavily reliant on remittances. In addition, most government support programmes in the region focused on the formal sector, leaving the informal sector with little or no support.

This Policy Note looks at the impact of the crisis on those who make their living in the informal economy in the region and discusses how governments can address the short-term effects of COVID-19 on the informal sector and build on this crisis response to advance business formalisation over the long term. This Note offers a comprehensive approach to firm formalisation and contributes to a long-standing conversation on the informal economy with Eurasia governments, the private sector and international partners that ultimately calls for careful and tailored policy design, experiments and implementation.

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