



**Asia-Pacific  
Economic Cooperation**

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**Addressing Informality: Transitioning to the Formal  
Economy (Policy Support Unit Policy Brief No. 57,  
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Economic Cooperation

# Addressing informality Transitioning to the formal economy

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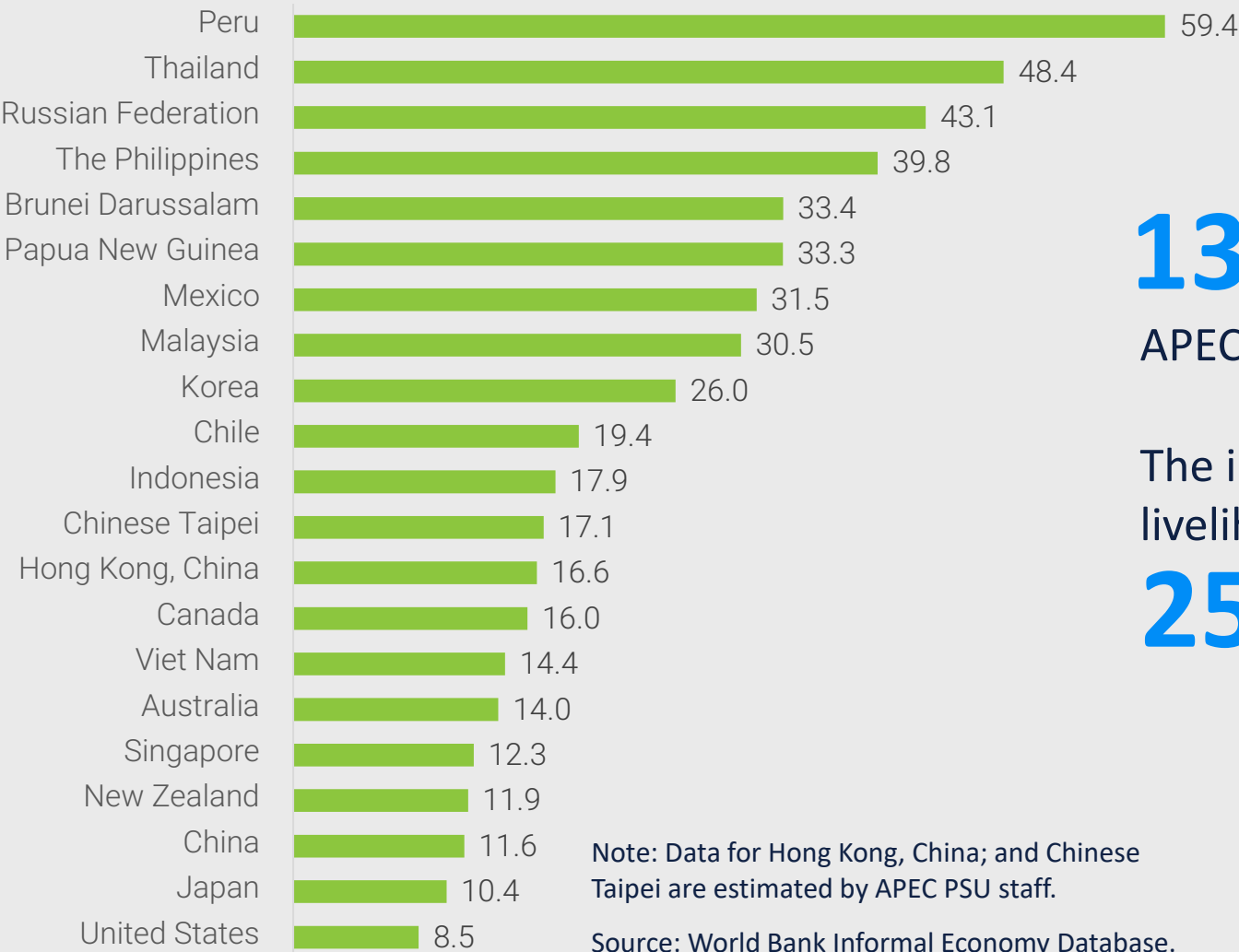
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7-8 February 2024

# Informality remains pervasive in many APEC economies

Fig 1. Estimates of informal output in 2020 (as percent of GDP)



Note: Data for Hong Kong, China; and Chinese Taipei are estimated by APEC PSU staff.  
Source: World Bank Informal Economy Database.

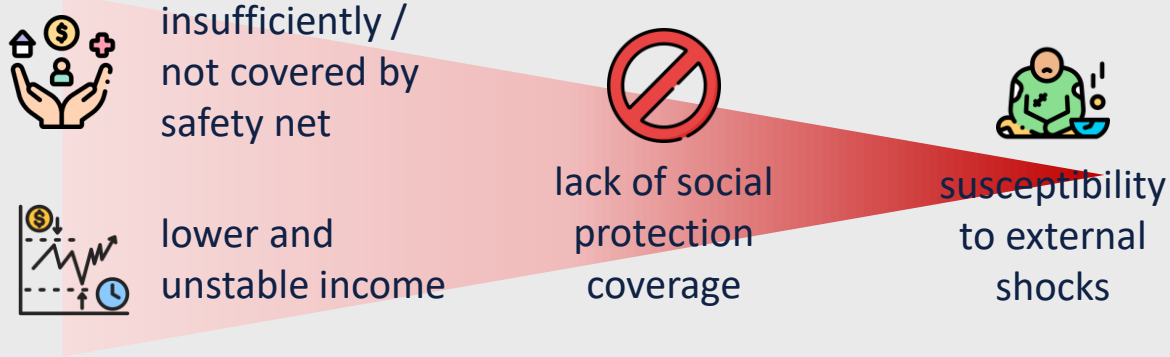
**13.4%** of GDP  
APEC-wide estimate of informal output in 2020

The informal sector is a large source of livelihood for many people

**25.8% to 80.2%** of total employment  
*Source: ILO (2023)*

# Why is it an issue?

## Informal workers are more vulnerable



## Lower productivity of the economy

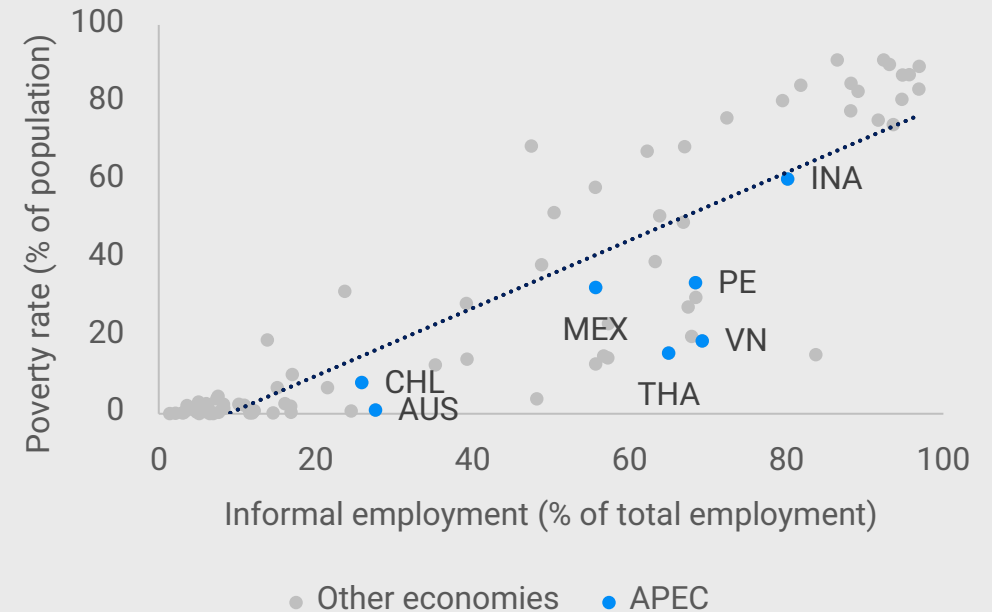
Informal firms on average have **79% lower labour productivity** than formal firms (Amin, et. al, 2019)



## Informality and poverty are often intertwined

- *Low pay: 40% - 67% lower median earnings (ILO, 2023)*
- *Lack of opportunity and subsistence issue*

**Fig 2. Informal employment and poverty rates (2018-2022)**



Note: Poverty as measured by IPL of USD 6.25 per day in 2017 PPP.

Source: World Bank and ILO (2023)

## Less resources to deliver public goods/services

**5.4%** of GDP potential loss in tax revenue from informal activities in APEC

# Why does informality exist?

## Bureaucratic barriers



cost and length  
of procedures



difficulties with  
regulatory compliance



lack of flexibility  
in the labour market



large statutory  
salary deductions

# Why does informality exist? – *cont.*

## Human capital issues



lack of proper qualification



size of informal economy  
greater in economies with  
lower educational attainment

## Institutional issues



no respect for rule of law



law enforcement



rampant corruption



rent-seeking practices

# Why does informality exist? – cont.

Fig. 6 Perception on judicial independence and informality

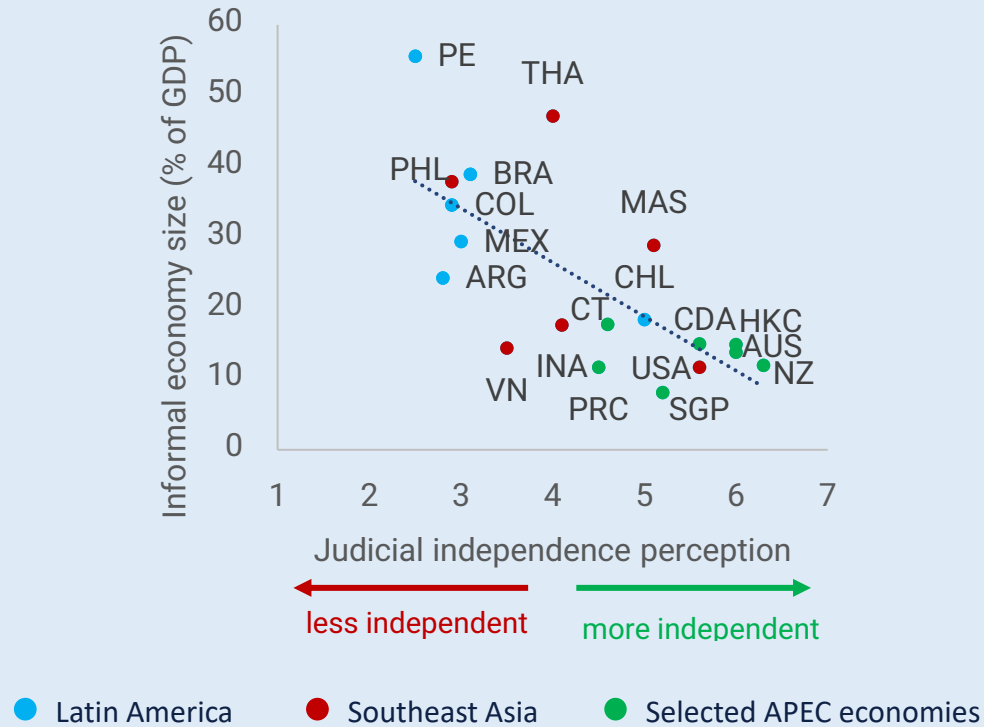
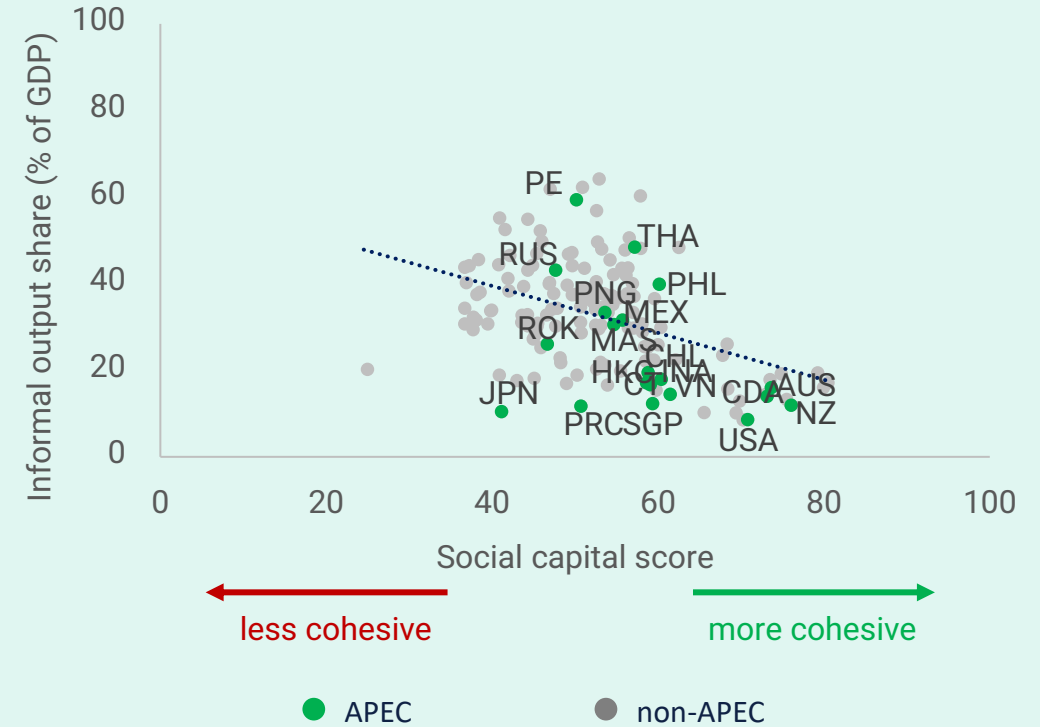


Fig. 7 Social capital index and informality



## Institutional issues also shape the dynamics of informality

*When rule of law is not respected and enforced, rent-seeking practices are prevalent, and social cohesion is poor, the benefits of formalising are low, thus making it more difficult to convince informal actors to formalise*



# What should be done to promote formalisation?

1

Create a better environment for businesses to flourish



reducing  
registration fees

*but more  
than that is  
needed*



eliminating **cumbersome administrative procedures** for businesses



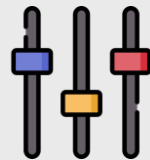
improving **inter-institutional coordination** to avoid repetitive tasks



enhancing financial sector competitiveness to **widen access to affordable credits**, especially for MSMEs



**carefully designing tax and social safety systems** to reduce complexities and compliance costs

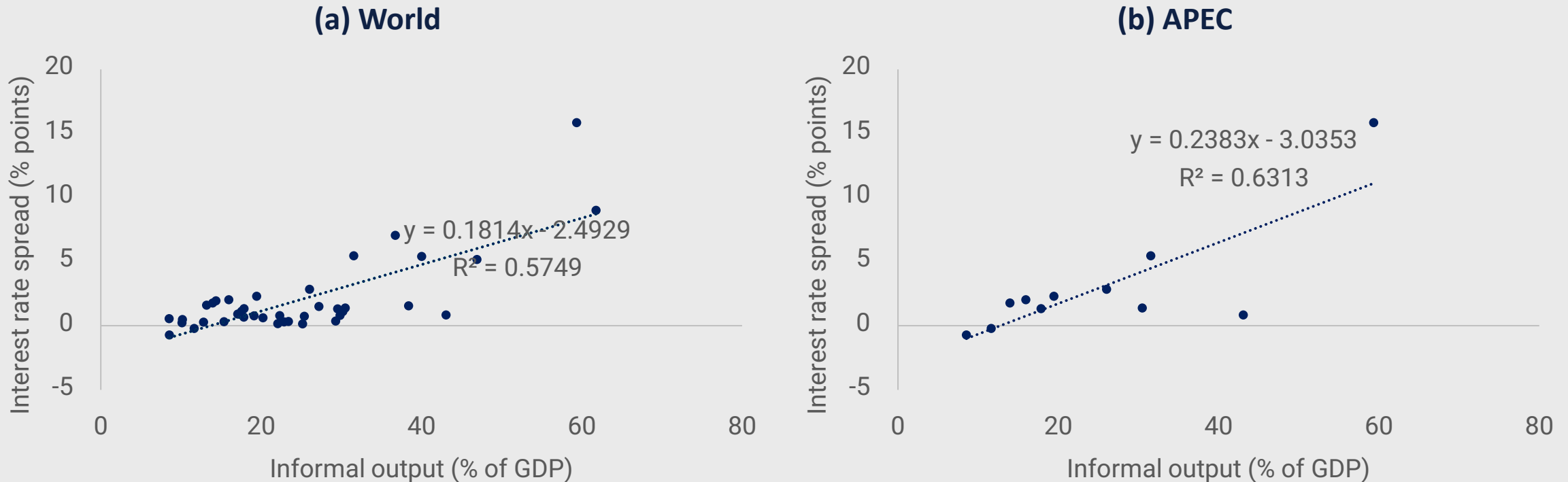


allowing **more flexibility** to hiring and dismissing workers, with sufficient social safety nets to facilitate reinsertion of workers into the economy



# High borrowing costs for MSMEs impede formalisation

Fig. 8 Informality and interest rate spread between MSMEs and large firms



*The greater the difference between the loan interest rate charged to MSMEs and large firms, the more an economy is likely to experience persistent informality*

# What should be done to promote formalisation? – *cont.*

## 2 Incentives and deterrents

- **Balanced approach:** reducing barriers to formalise but enforce rules to make going informal more costly
- **Seeing is believing:** ensuring accessibility to public services to show tangible benefits of formalisation
- **Change people's mindset:** promoting good practices (invoicing, timely tax payment, etc.) by handing out small but meaningful rewards
- **Effective, not harsh:** putting in place solid enforcement and detection systems, but avoid zero-tolerance approach to punish informal activities

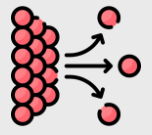
## 3 Develop human capital



widen access to  
education and  
training



improving  
educational  
outcomes



knowledge  
diffusion about  
formalisation

## 4 Strengthen institutions



whole-of-  
government  
approach



better  
governance



eradicate  
corruption



improve  
transparency

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