

Informal Labor Markets in Times of Pandemic: Evidence for Latin America and Policy Options

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Outline of the Talk

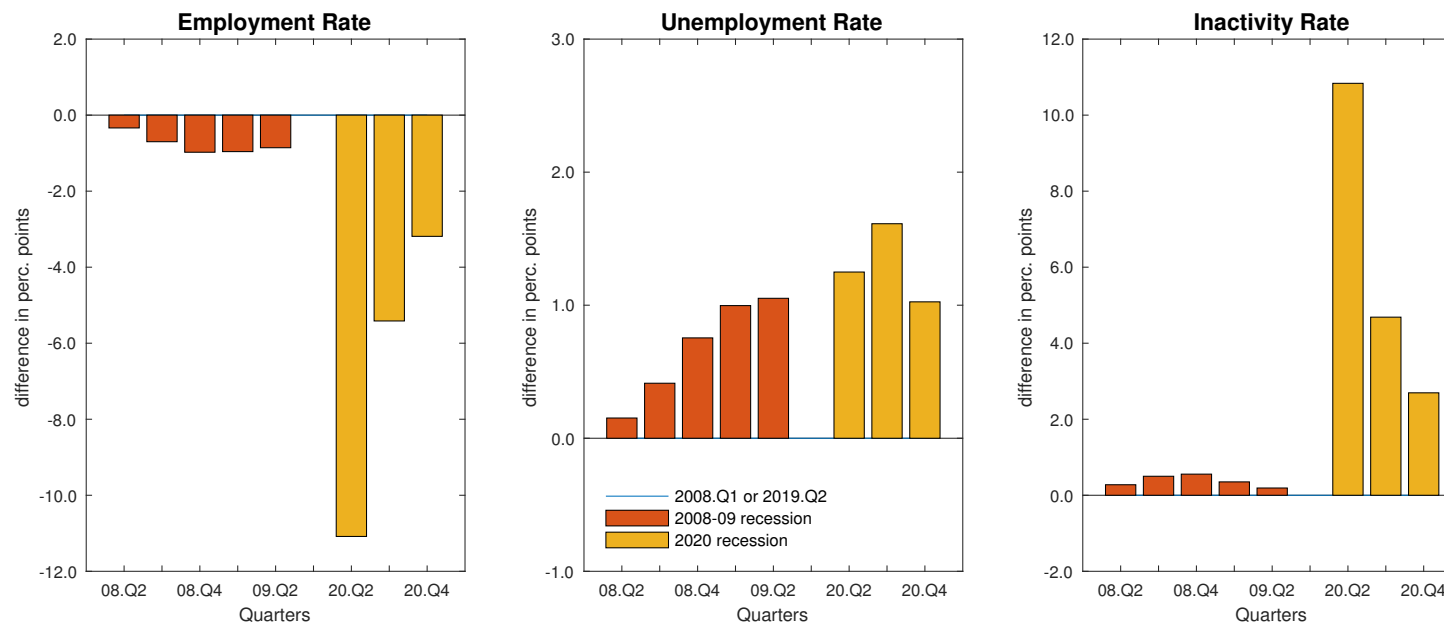
The COVID pandemic and the related confinement policies acted as an unprecedented shock to labor markets

Three questions that we address in this project:

- How were labor markets in Latin America affected?
 - ... starting from the evidence for Mexico and extending it to other LAC
 - Role of the participation and informality margins
 - Comparison with past recessions
 - Heterogeneity inside the labor force (age, gender, sector, ...)
- What can we say about the nature of the shocks affecting these economies?
- What type of labor market policies could help to speed-up the recovery?

Mexico: A Tale of Two Recessions

Mexico: Evolution of Labor Market Rates in Two Recessions

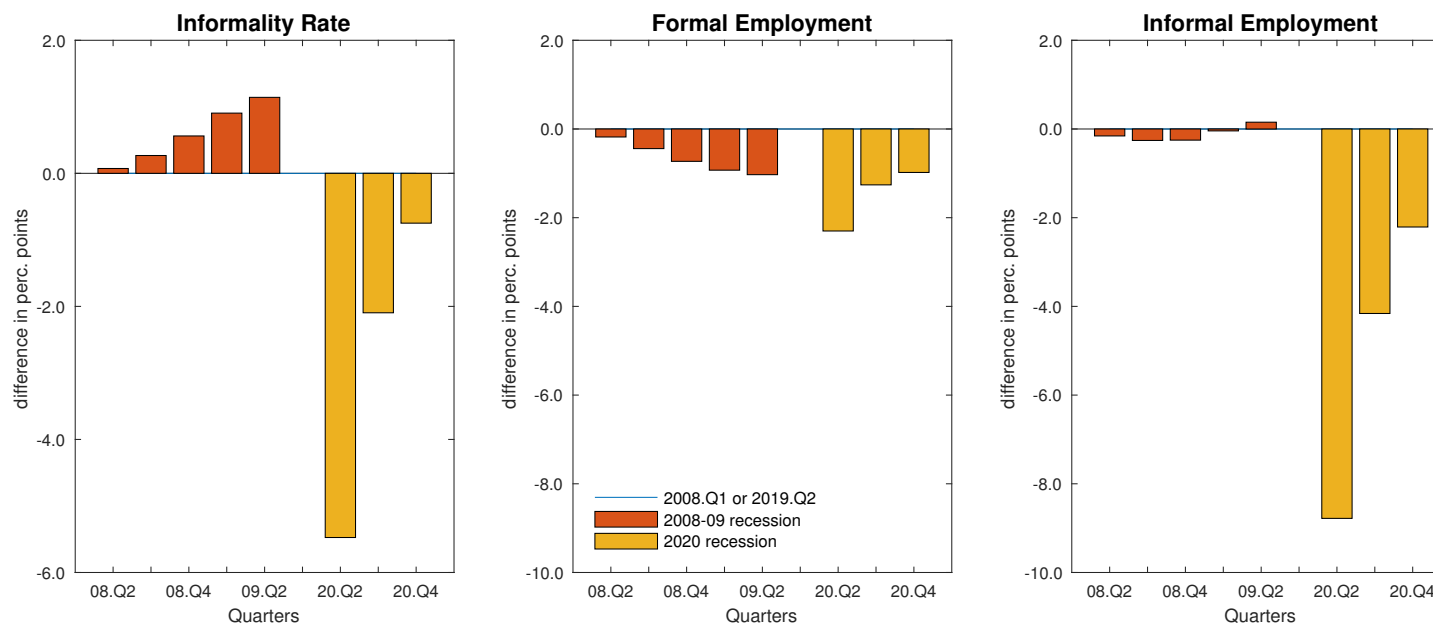


Relative to past recessions, in this pandemic we observe

- Large fall in employment in the first quarter (2020.Q2)
 - ... mirrored by a decline in the participation rate
- Rapid recovery in the second half of 2020

Mexico: Informal Employment and Informality Rate

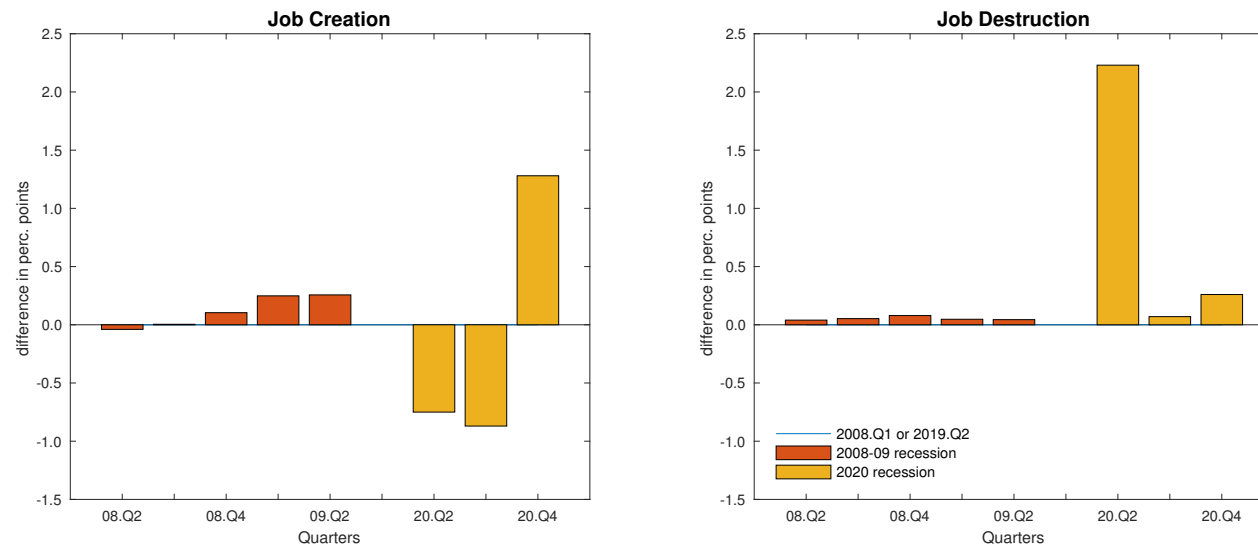
Mexico: Evolution of Informality Rate in Two Recessions



- Unprecedented *fall* in the informality rate during the pandemic recession
 - ... driven by a huge decline of informal employment in 2020.Q2
- Recovery of employment in second half of 2020
 - ... with a rebound in the informality rate

Mexico: Job Creation and Job Destruction

Mexico: Job Creation and Destruction in Two Recessions (% of POP)



- Employment contraction in 2020.Q2 driven almost entirely by job destruction
- Job destruction has receded by the end of 2020
 - ... while job creation plays a major role in the recovery of employment

Mexico: Additional Findings

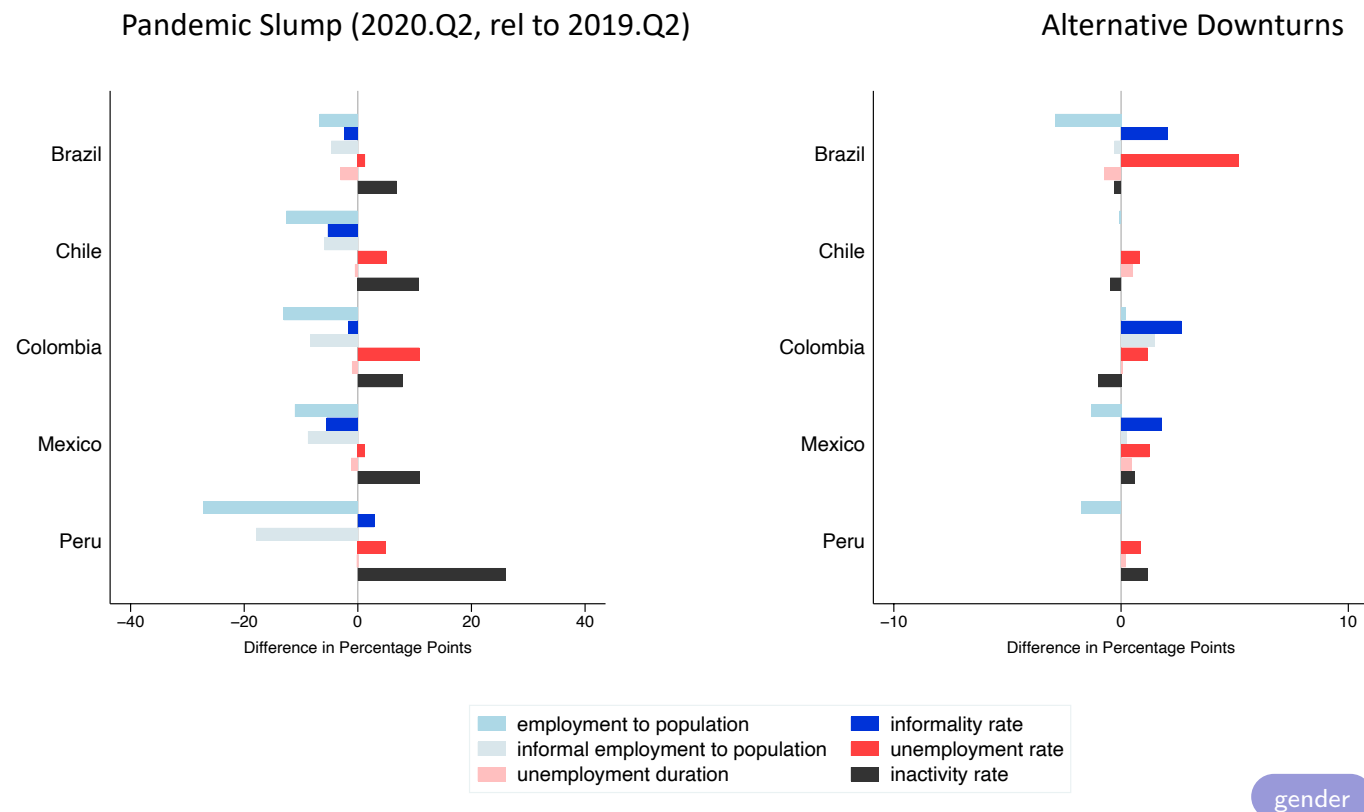
- Bigger role for two non-conventional margins at the onset of the pandemic
 - Increase in **temporary layoffs**, in particular from the informal sector
 - Increase in **absent employees**, more so in the formal sector

... fading away by the end of 2020

table

- A larger impact of the pandemic on women, younger workers, and in contact-intensive sectors (services)
- However, the fall in informality is not driven by a composition effect only

Latin American Labor Markets during the Pandemic



- We confirm observed changes in labor markets for Mexico for 2020.Q2
 - Large drop in overall employment, linked to decline in participation rates
 - Sizable decline in informality rate (one exception: Peru)

A Model of Informal Labor Markets

Key elements of the model

- Small open economy subject to technology and interest rate shocks
 - Endogenous participation (leisure choice)
 - Formal and informal (self-employed) sectors
 - Matching frictions in the formal labor market

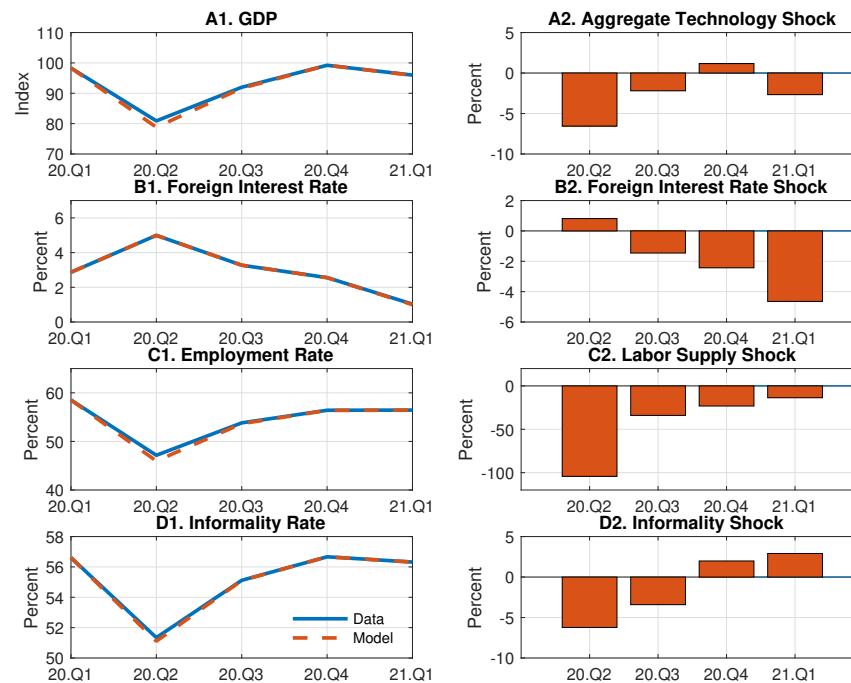
Baseline model calibrated to Mexican data *before* the pandemics

calibration

- Extended model with two new shocks
 - A shock to labor supply (disutility of work parameter)
 - A sector-specific productivity shock (*relative* informality parameter)

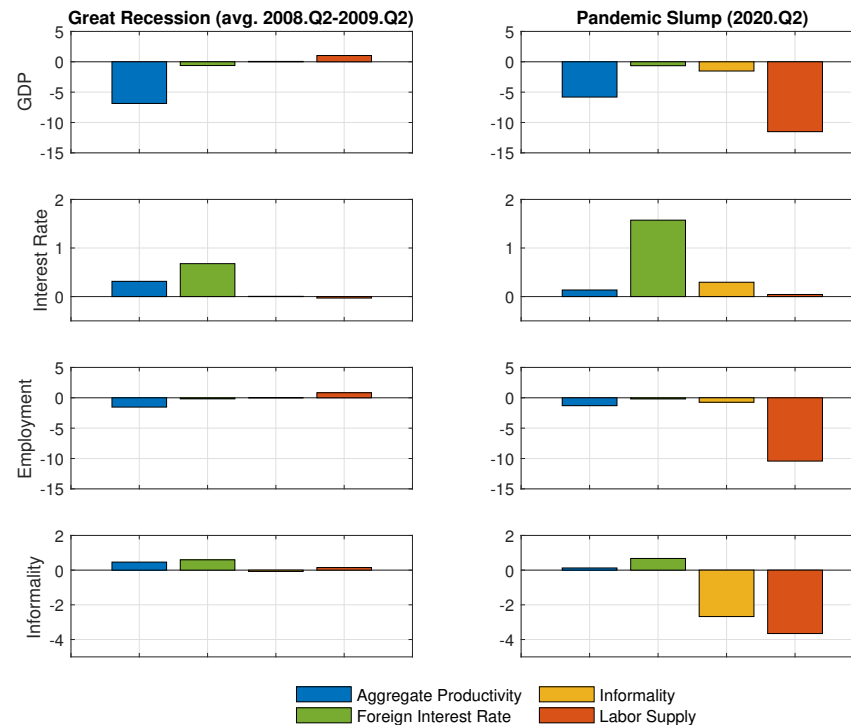
These shocks are reduced-form representations of the impact of COVID-19

Accounting Exercise: Shocks Recovered



- Accounting exercise: recover shocks that rationalize the behavior of GDP, interest rate, employment, and informality rate up to 2020.Q4

Accounting Exercise: Contribution of Shocks



- Huge role for the “new” shocks in accounting for the fall in output, employment and the informality rate
 - ... in contrast to the 2008-09 Great Recession

Policy Options: Summary of Results after One Year

Policy Instrument	Employment Rate	Informality Rate	GDP	Fiscal Cost % GDP	Size
No Policy Intervention	-1.72	0.33	-1.84	-	-
Payroll Tax Cut	0.00	-5.57	4.18	7.49	19.9
Hiring Subsidy	0.00	-5.57	4.18	0.23	53.4
Informal Income Subsidy	0.00	3.73	-1.61	4.13	11.0

- Payroll tax cuts and hiring subsidies incentivize job creation in the formal sector
 - ... reducing informality and fostering labor productivity
- Hiring subsidies are more cost-effective in promoting formal employment
- Informal income subsidies incentivize informal employment
 - ... dragging productivity and GDP in the recovery

Policy Options: Some Caveats

- Our framework does not allow for a feedback from policies to the pandemic itself
 - Would require an epidemiological model
- The model ignores distributional issues
 - Representative household
 - No role for income protection of poor households
 - Would require heterogeneous-agents framework (with incomplete markets)
- Separations in the model are exogenous
 - No role for policies protecting existing formal jobs
 - Would require model of heterogeneous firms

Conclusions

- The pandemic recession is different from previous downturns
 - Larger drop in employment, quicker recovery
 - Informal sector affected the most on impact, rapid rebound
 - Job destruction to inactivity plays a key role in the initial fall in employment
- The pandemic and the related confinement policies affects the labor market through several channels
 - Labor supply vs. demand (wages?)
 - Sector-specific shocks to contact-intensive activities
- Policies to incentivize the recovery of employment should focus on formal job creation
 - How to target this particular margin?

Mexico: Two Non-Conventional Margins

	Overall Employment			Informal Employment			Formal Employment		
	% Change			% Change			% Change		
	(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)
Great Recession	-2.3	-2.3	-2.4	0.7	0.8	0.3	-6.6	-6.4	-6.4
2019.Q2-2020.Q2	-29.4	-19.1	-7.2	-31.1	-26.8	-6.2	-26.7	-9.1	-8.5
2019.Q2-2020.Q4	-5.7	-5.5	-4.0	-6.6	-6.7	-4.2	-4.6	-3.9	-3.6
<i>Relative to column 2:</i>									
Great Recession	1.0	1.0	1.1	1.0	1.0	0.5	1.0	1.0	1.0
2019.Q2-2020.Q2	1.5	1.0	0.4	1.2	1.0	0.2	2.9	1.0	0.9
2019.Q2-2020.Q4	1.0	1.0	0.7	1.0	1.0	0.6	1.2	1.0	0.9

2: baseline employment rate (over population)

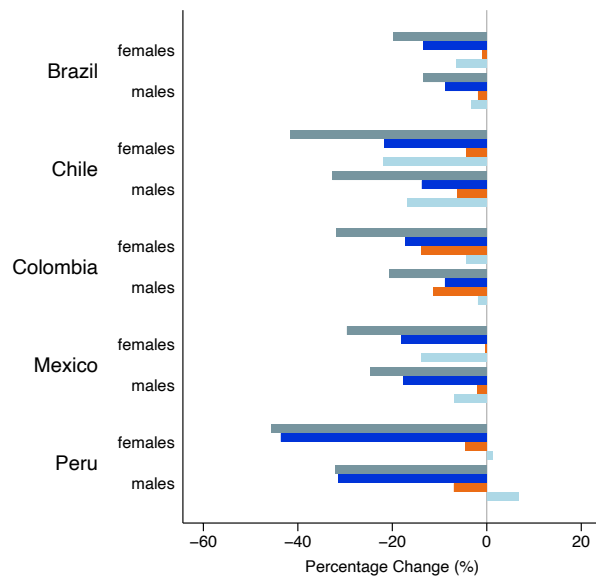
3: baseline employment rate **plus temporary layoffs**

1: baseline employment rate **minus absent employees**

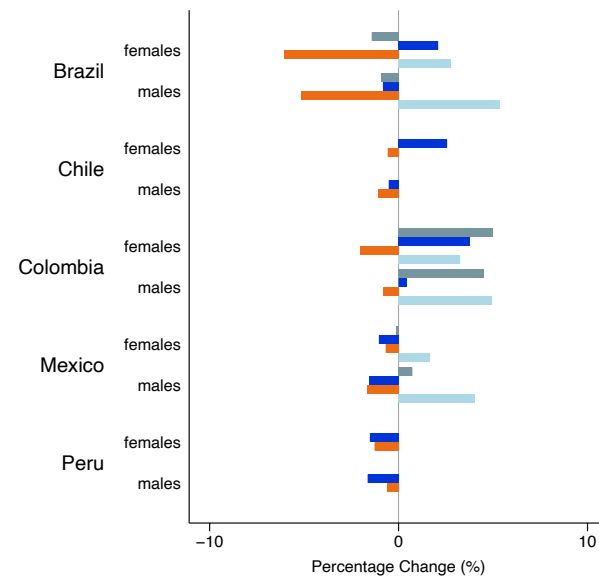
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Latin America: Employment by Gender during the Pandemic

Pandemic Slump (2020.Q2, rel to 2019.Q2)



Alternative Downturns



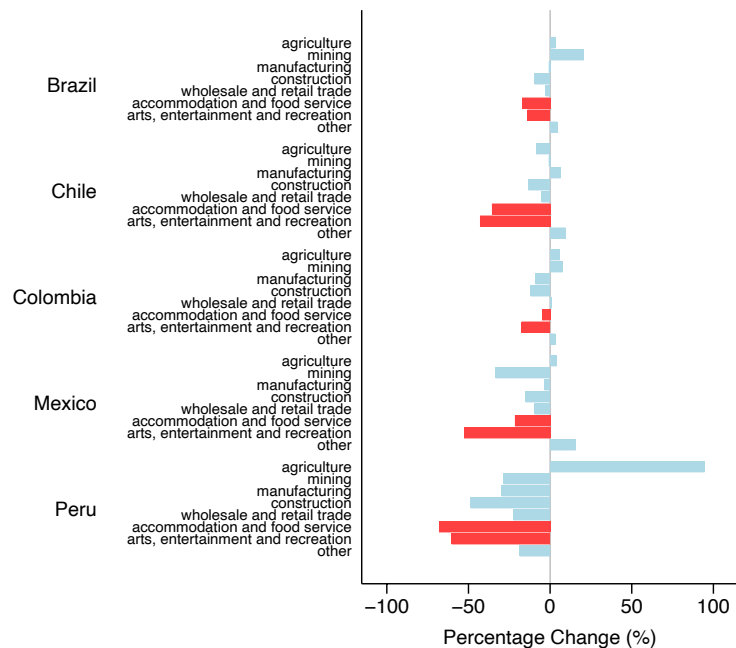
informal employment to population
 labor force to population
 employment to labor force
 informality rate

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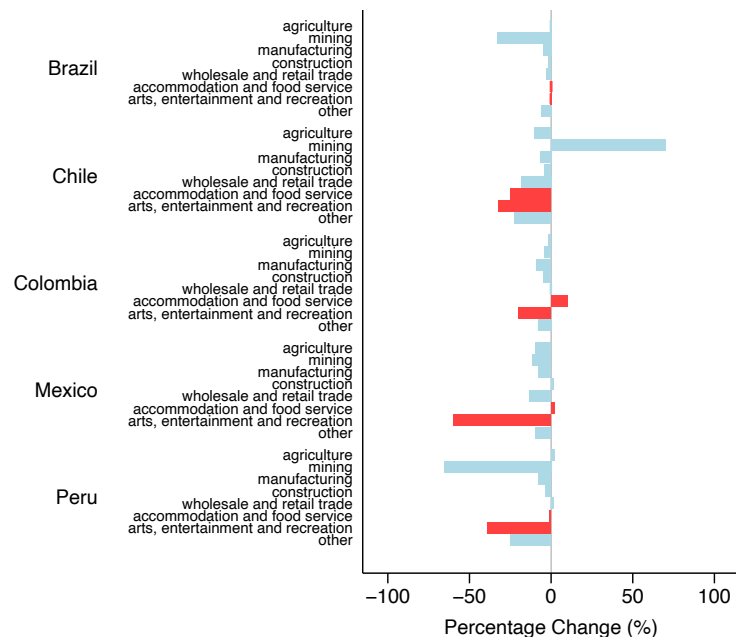
Latin America: Employment by Sector during the Pandemic

Pandemic Slump (2020.Q2, rel. to 2019.Q2)

Employment Rate



Informality Rate



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Model Calibration: Business Cycle Properties

Relative Volatility	Data	Model	Correlation with Output	Data	Model
	1	2		3	4
$\sigma(Y)$	1.35	1.35	-	-	-
$\sigma(C)/\sigma(Y)$	0.93	1.01	$Corr(C, Y)$	0.97	0.85
$\sigma(I)/\sigma(Y)$	2.33	2.33	$Corr(I, Y)$	0.87	0.75
$\sigma(L)/\sigma(Y)$	0.40	0.40	$Corr(L, Y)$	0.67	0.99
$\sigma(l^s)/\sigma(Y)$	0.49	0.49	$Corr(l^s, Y)$	-0.56	-0.30
$\sigma(1 + i^*)$	0.49	0.49	$Corr(1 + i^*, Y)$	-0.23	-0.23

- The model reproduces by construction the volatilities of output, investment, employment and the informality rate
 - ... and the volatility and counter-cyclicality of the foreign interest rate

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