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

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* The views expressed here are those of the authors and do not necessarily reflect those of Banco de México or its Board of Governors. This project was sponsored by the Inter-American Development Bank. Leyva declares having worked for this project ad honorem.
A Tale of Two Countries and Two Recessions

Mexico

Brazil

Employment Rate

Informality Rate

Formal Employment Rate

Unemployment Rate

Informal Employment Rate

Inactivity Rate

Difference in Percentage Points

Quarters

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Job Creation and Job Destruction by Type of Employment

Mexico

Brazil

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Latin American Labor Markets during the Pandemic (absolute changes)

Pandemic Slump

- Brazil
- Chile
- Colombia
- Mexico
- Peru

Difference in Percentage Points

<table>
<thead>
<tr>
<th>Country</th>
<th>Employment to Population</th>
<th>Informality Rate</th>
<th>Unemployment Rate</th>
<th>Unemployment Duration (months)</th>
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Previous Downturns

- Brazil
- Chile
- Colombia
- Mexico
- Peru

Difference in Percentage Points

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A Model of Informal Labor Markets

- 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

Calibrated to Mexican data before the pandemic

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

Reduced-form representations of the impact of the pandemic
Accounting Exercise: Shocks Recovered

A1. GDP

A2. Aggregate Productivity Shock

B1. Foreign Interest Rate

B2. Foreign Interest Rate Shock

C1. Employment Rate

C2. Labor Supply Shock

D1. Informality Rate

D2. Informality Shock

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Placebo Test: Accounting for the Great Recession

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## Policy Options: Summary of Results after One Year

<table>
<thead>
<tr>
<th>Policy Instrument</th>
<th>Employment Rate</th>
<th>Informality Rate</th>
<th>GDP</th>
<th>Fiscal Cost % GDP</th>
<th>Policy Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Policy Intervention</td>
<td>−1.72</td>
<td>0.33</td>
<td>−1.84</td>
<td>–</td>
<td>–</td>
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<tr>
<td>Payroll Tax Cut</td>
<td>0.00</td>
<td>−5.57</td>
<td>4.18</td>
<td>7.49</td>
<td>19.9</td>
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<td>Hiring Subsidy</td>
<td>0.00</td>
<td>−5.57</td>
<td>4.18</td>
<td>0.23</td>
<td>53.4</td>
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<tr>
<td>Informal Income Subsidy</td>
<td>0.00</td>
<td>3.73</td>
<td>−1.61</td>
<td>4.13</td>
<td>11.0</td>
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