



The Informal Economy in Papua New Guinea

Findings and Policy Recommendations

November 12, 2024
Port Moresby, Papua New Guinea

Agenda

- Rationale
- Key Findings
- Policy Recommendations



Rationale

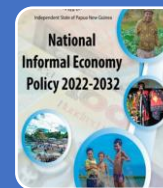


Rationale for the Study

- Informality in PNG is pervasive (80% of employment) and increased during the Covid-19 pandemic
- Registration of formal firms has increased since 2015, but not rapidly enough to significantly reduce the informal sector, where the majority of firms operate
- Data show a labor productivity gap between formal and informal firms
- The PNG Government developed policies for the informal economy (NIEP 2011-2015), which faced some implementation challenges, and is discussing a new NIEP 2024-2032



National Informal Economy Policy (NIEP) 2011-2015



NIEP 2022-2032

- **WB study** aims to contribute to policy dialogue towards the informal economy by:
 - providing **data and analysis** on the drivers of informality among firms; and
 - identifying **business environment constraints** and recommendations to address them

Key Findings



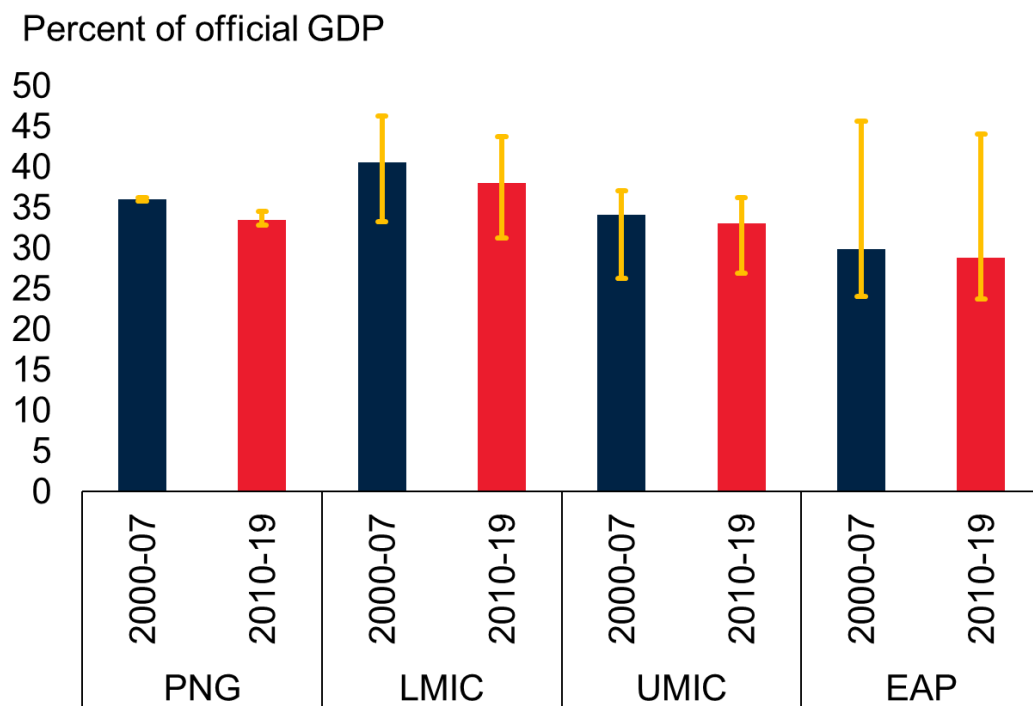
- 1) Levels and trends of informality in PNG
- 2) Macroeconomic performance & condition
- 3) Business climate driver



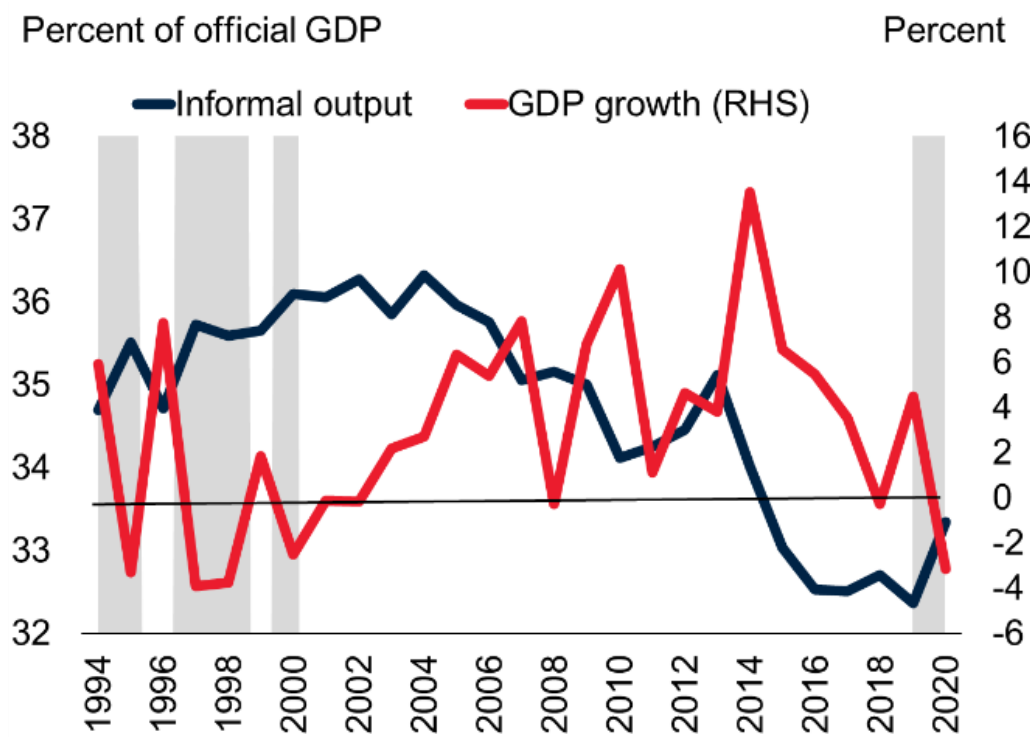
Levels and Trends: Persistence of Informality in PNG

Despite the decline since 2000, output informality in PNG remains higher than the regional average and has edged up during the economic downturn in 2020.

A. Output informality



B. Evolution of output informality

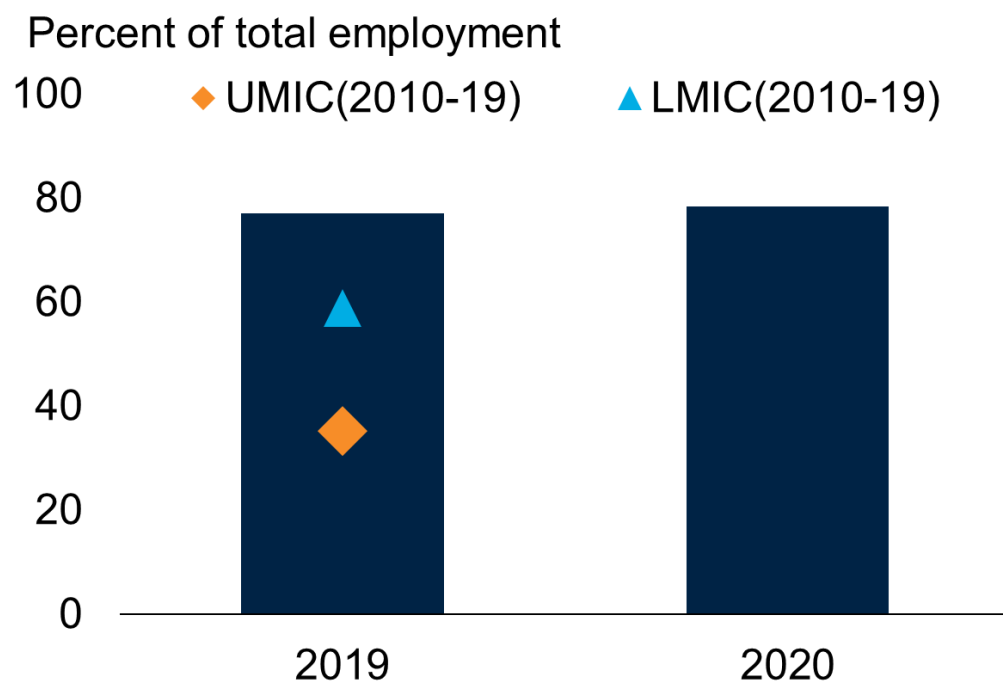


Notes: World Bank staff estimates. Output informality is proxied by the multiple indicators and multiple causes model-based (MIMIC) estimates of informal output in percent of official GDP. In the left panel, bars are medians for corresponding periods and country groups with whiskers showing the interquartile. In the left panel, the shaded areas are years when PNG GDP growth rates turn negative.

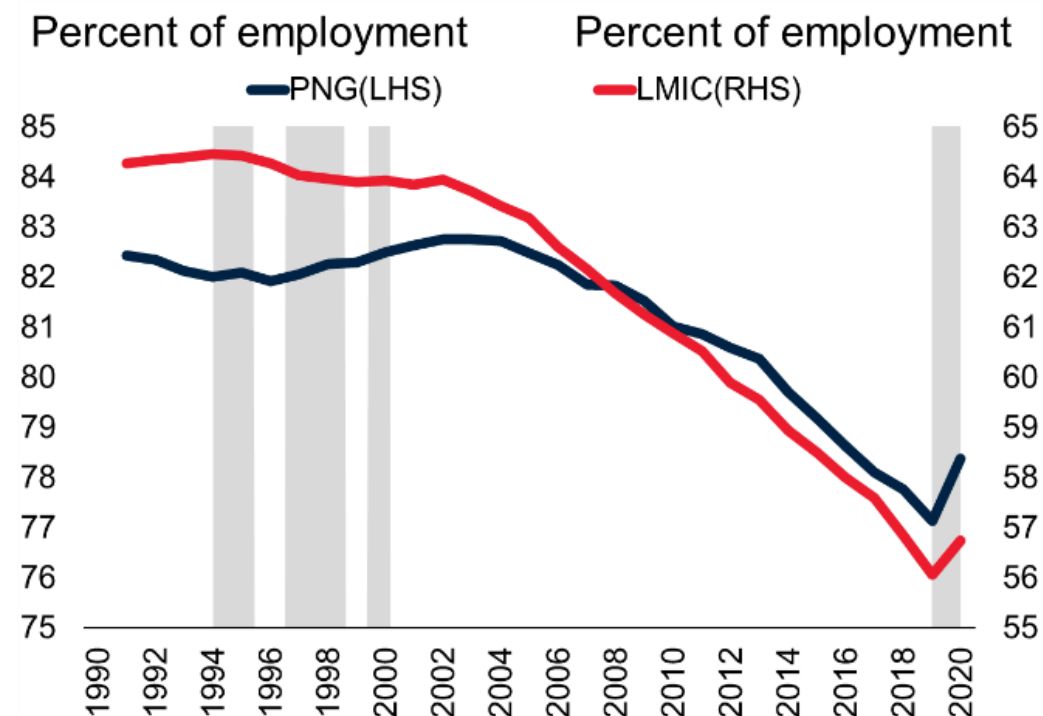
Levels and Trends: Employment Informality

Like output informality, there has been a downward trend in employment informality since 2000. Nevertheless, the ILO-modeled estimates suggest that self-employment can account for 80 percent of total employment in PNG.

A. Employment informality



B. Evolution of employment informality



Notes: World Bank staff estimates. LFS = "Labor Force Survey", ILO = "estimates from International Labor Organization", LMIC = "lower middle-income countries", and UMIC = "upper middle-income countries". Employment informality is proxied by the share of self-employment in percent of total employment (ILO model estimates). On the left panel, the bars show levels of employment informality (proxied by self-employment) in 2019 and 2020. The light blue triangle (the yellow diamond) is the simple average for LMICs (UMICs) over the period 2010–19. In the right panel, lines are simple averages for PNG and LMICs (RHS). The shaded areas are years when GDP growth rates turned negative in PNG..

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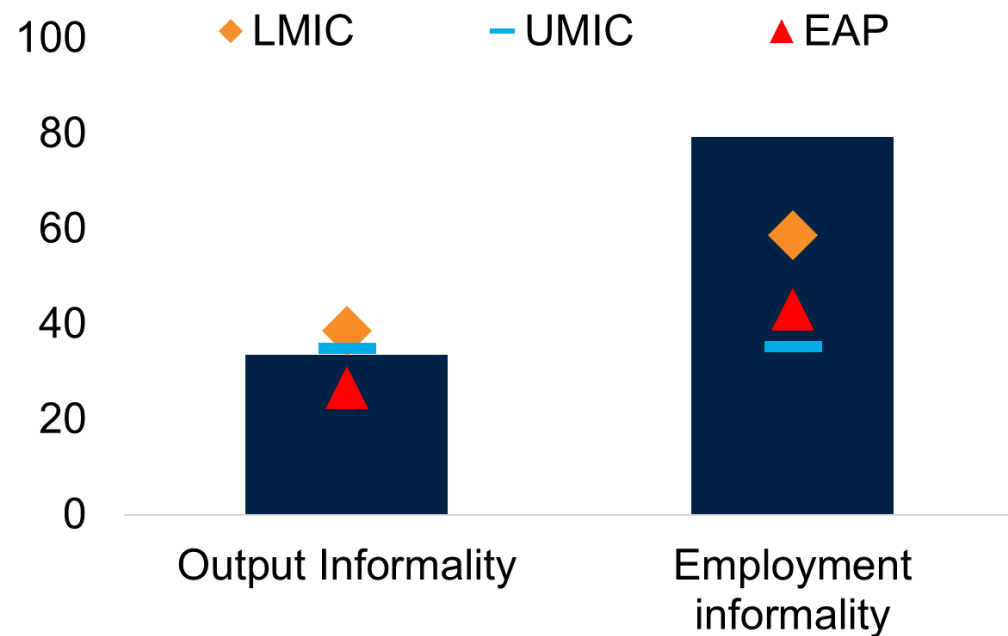


Levels and Trends: Output Informality vs Employment Informality

In PNG, the level of employment informality clearly exceeds the level of output informality, suggesting a large gap in labor productivity between formal and informal sectors.

A. Output informality vs employment informality

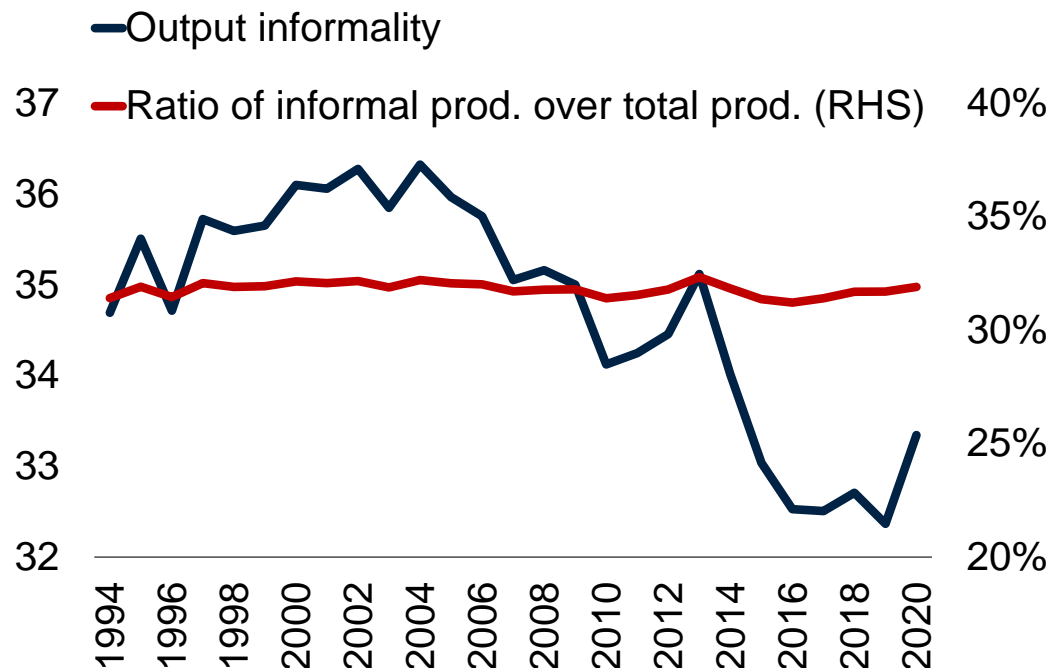
Percent of GDP / Percent of total employment



B. The ratio of informal productivity over total productivity in PNG

Percent of official GDP

Ratio

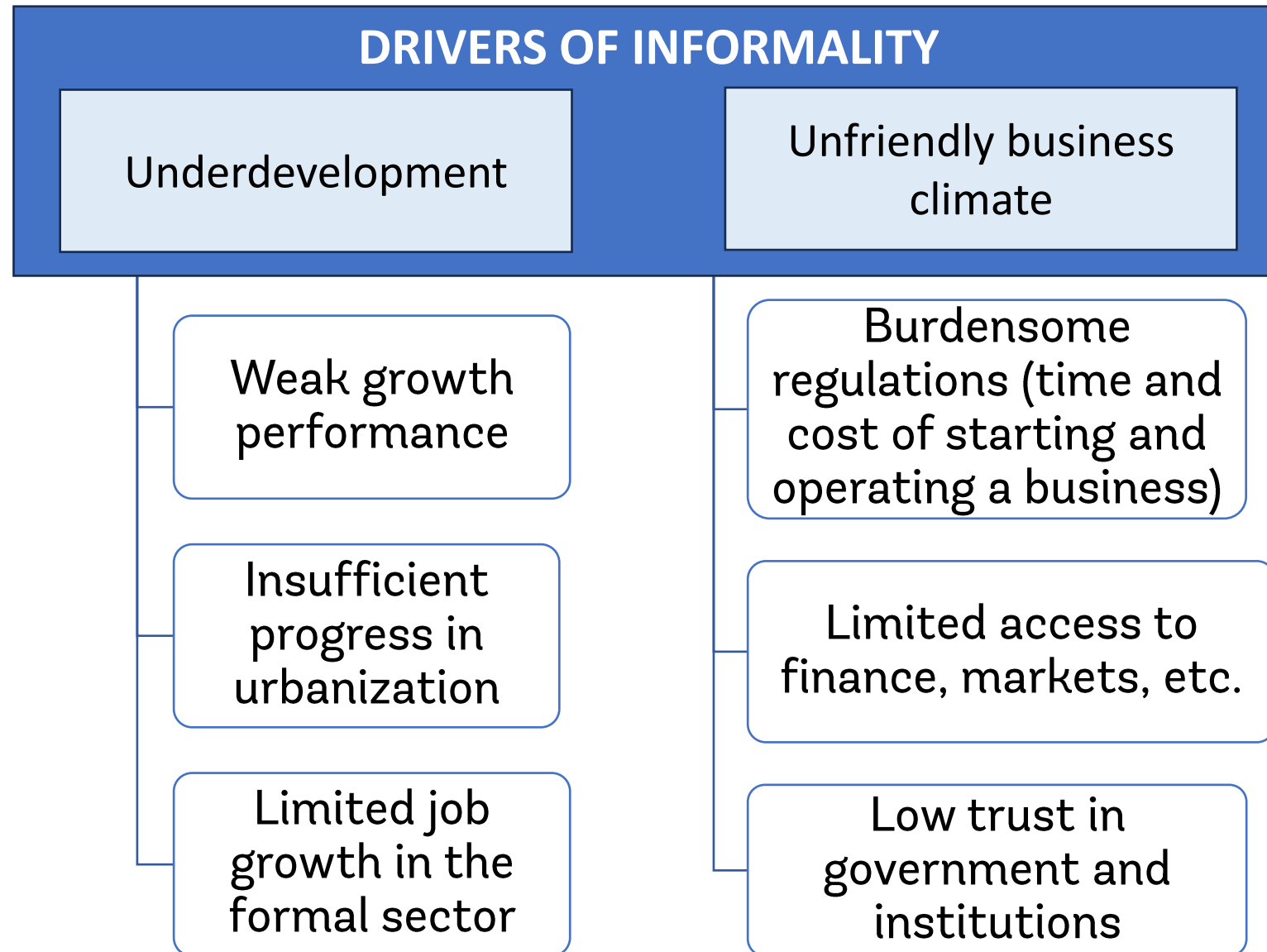


Notes: World Bank staff estimates. Output informality is proxied by the multiple indicators and multiple causes model-based (MIMIC) estimates of informal output in percent of official GDP. Employment informality is proxied by the share of self-employment in percent of total employment (ILO model estimates).

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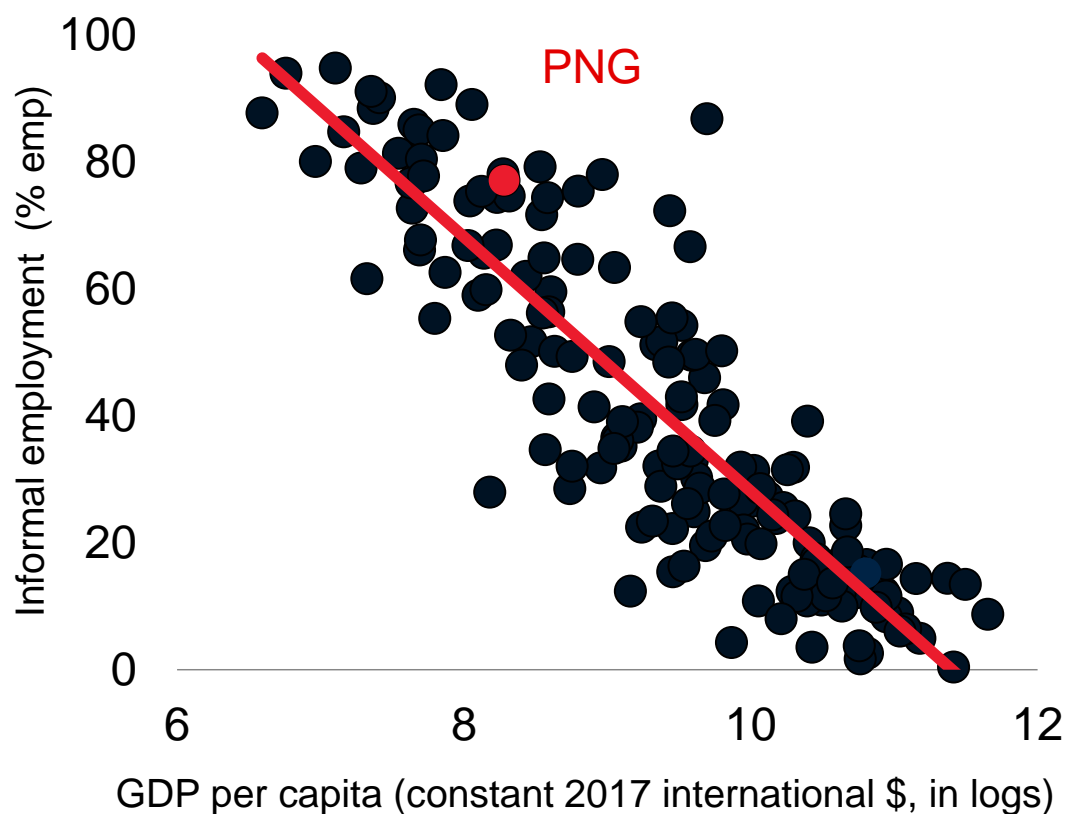
Key Drivers of Informality in PNG



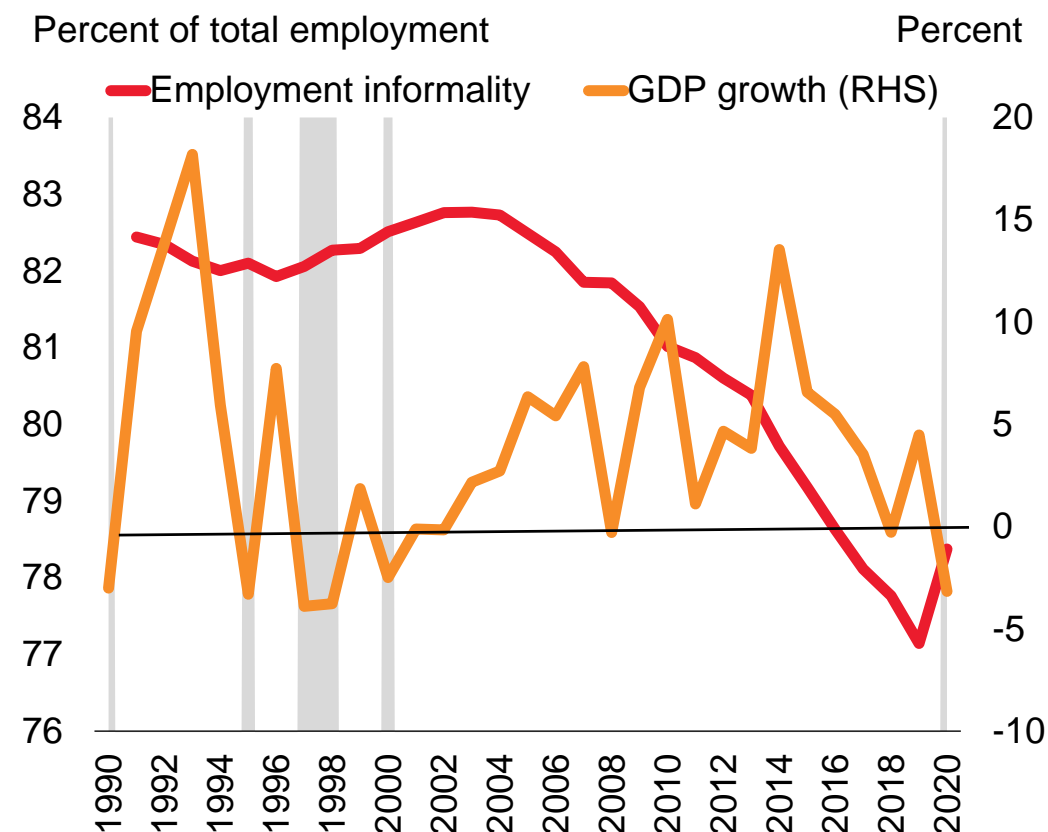
Underdevelopment and Lack of Sustained Growth

At the macro level, underdevelopment, lack of sustained growth, slow progress in urbanization, and limited job growth in the formal sector have been associated with informality in PNG.

A. Informality and income per capita



B. Recession and informality in PNG



Notes: World Bank staff estimates. Employment informality is proxied by the share of self-employment in percent of total employment (ILO model estimates). In the left panel, the data are from 2019 with the red dot representing PNG. In the right panel, the shaded areas show years when growth rates turned negative.

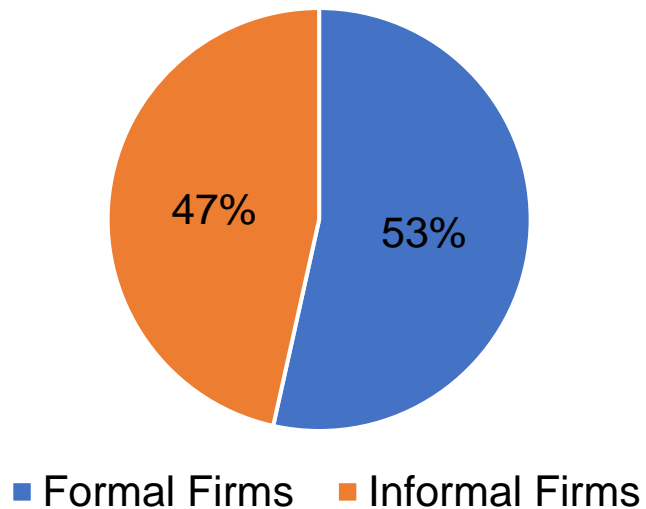


Characteristics of Informal Firms in PNG

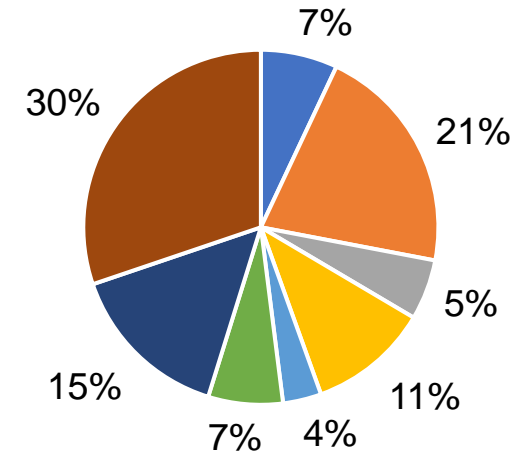
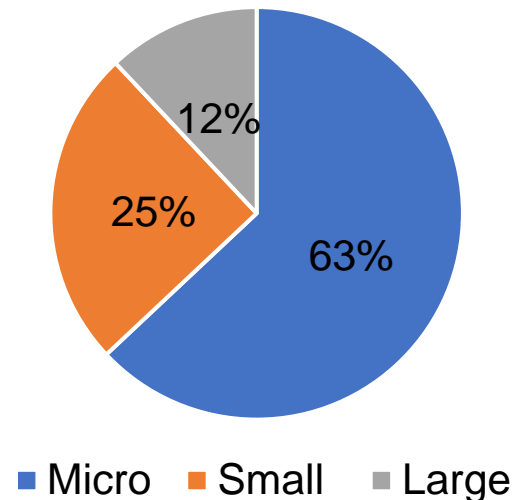
Implementation of the *National Capital District Informal Business Survey*, to examine the micro-level dynamics that govern informal and formal businesses across Port Moresby.

Heterogeneity in type and size of surveyed firms; sectoral composition; and ownership

Firm Status



Firm Size

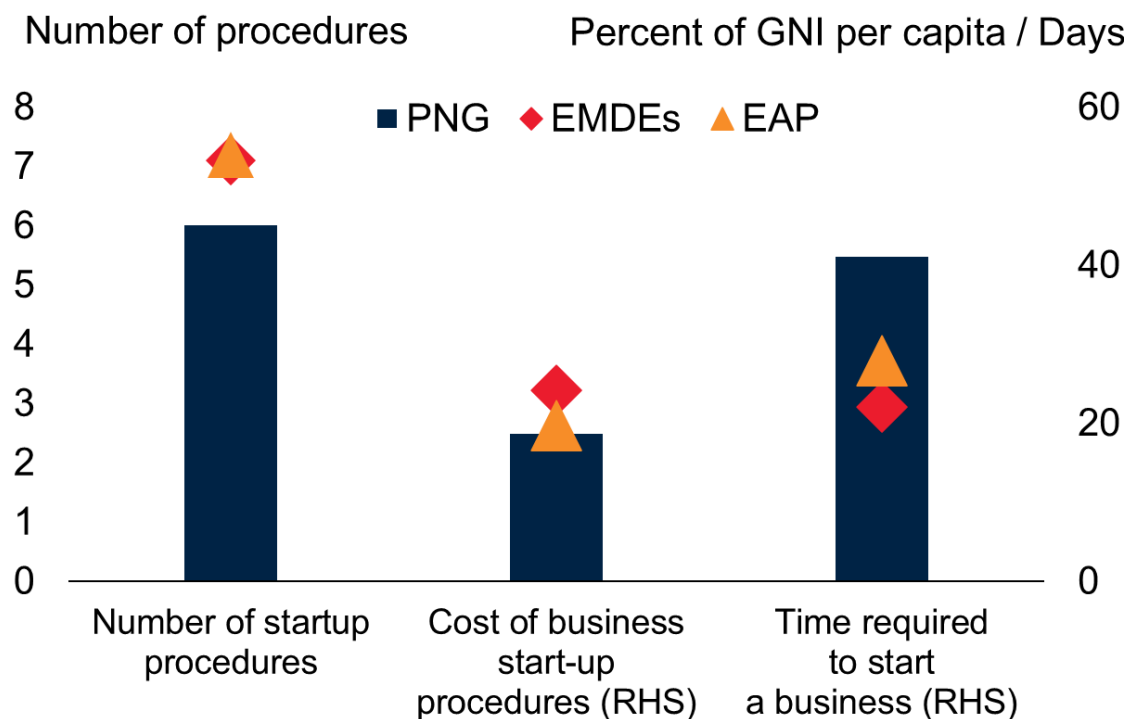


- Agriculture, forestry, and fishing
- Wholesale and retail trade
- Transportation and storage
- Accommodation and food services
- Information and communication
- Financial and insurance services
- Other service activities
- Other sectors

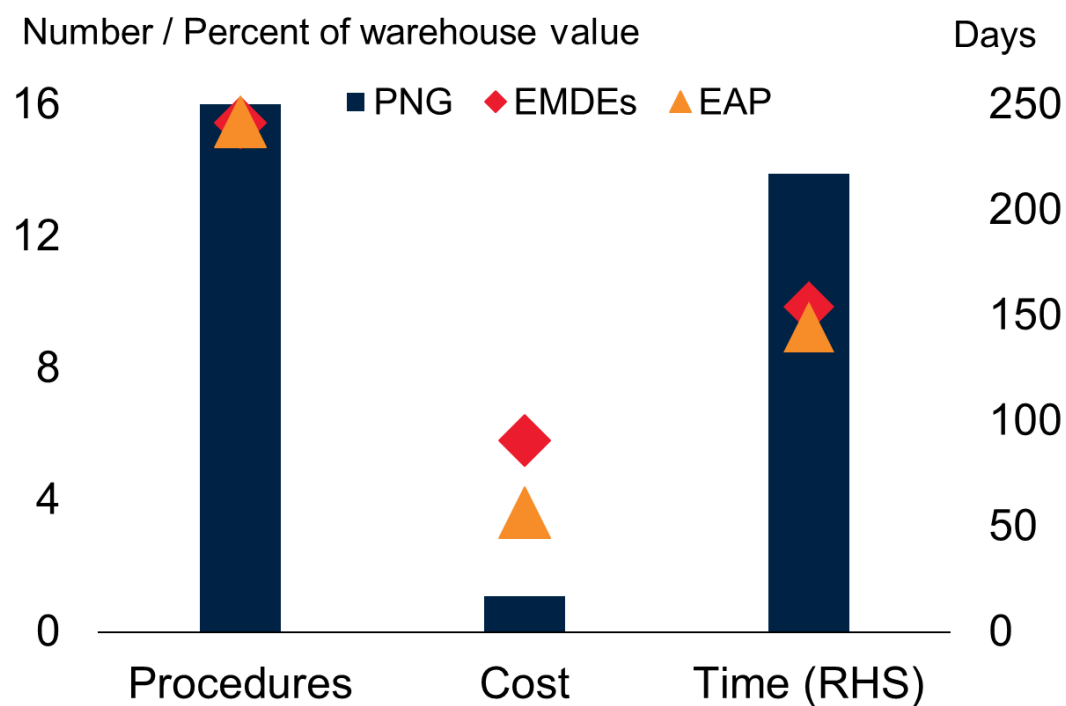
Unfriendly Business Climate

An unfriendly business climate makes “being formal” more costly and less beneficial for firms in PNG.

A. Cost of business startup procedures



B. Cost of obtaining a building permit



Notes: World Bank World Development Indicators, GEM, World Bank Enterprise Surveys, World Bank Doing Business reports, and staff estimates. Data are from 2019 or the latest available year. Diamonds for "EMDEs" are simple averages for emerging market and developing economies excluding PNG. Triangles for "EAP" are simple averages for EMDEs in East Asia and Pacific region excl. PNG.



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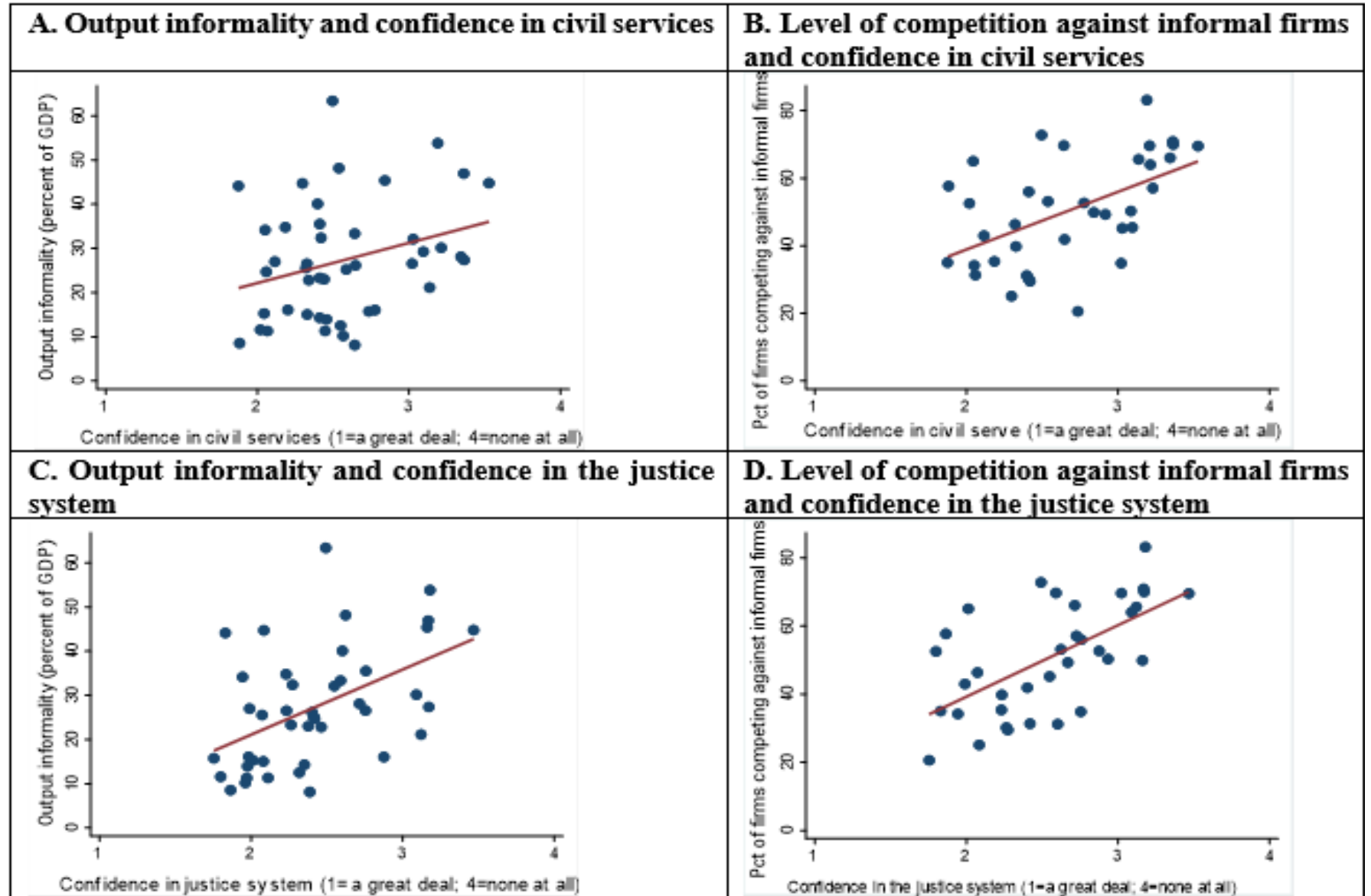
Perception of Trust and Corruption

Corruption and rent-seeking behavior by government officials are among the reasons firms and workers engage in informal economic activities.

PNG ranks 133rd out of 180 countries on the Corruption Perceptions Index 2023 (CPI).

96% of people in PNG believe that corruption in government is a big problem

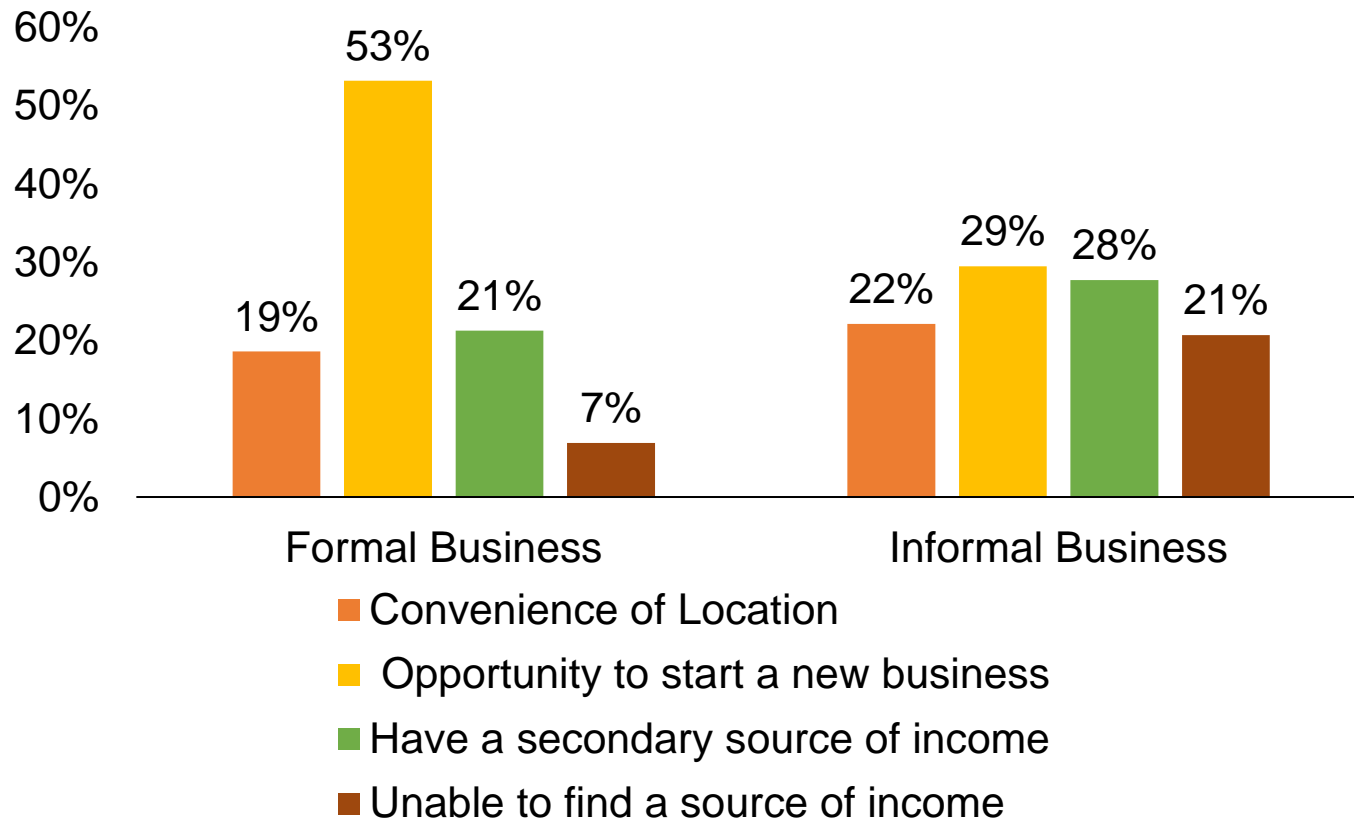
54% of public service users claimed to have paid a bribe in the last 12 months



Source: Elgin et al. (2021); World Bank Enterprise Surveys (2020); World Value Survey (2021).

Opportunity and Incentive to Start a Business

The difference in motivation between formal and informal firms:



Evidence from existing research and literature also signals the necessity to generate income as the biggest factor for informal firms to start business activity (*The National Research Institute, 2017*)

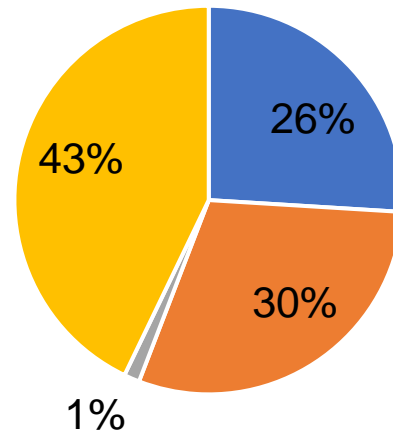
Estimated from 2024 PNG National Capital District Informal Business Survey

Constraints to Starting a Business

Fifty-three percent of informal businesses are located on household premises in comparison to 23 percent of formal ones.

- 77 percent cite 'lesser cost of running a business from home',
- 85 percent cite 'safety' as the reason why they operate from household premises

Most informal businesses did not access any grant or loan from any government scheme developed to support the growth and/or productivity of informal businesses

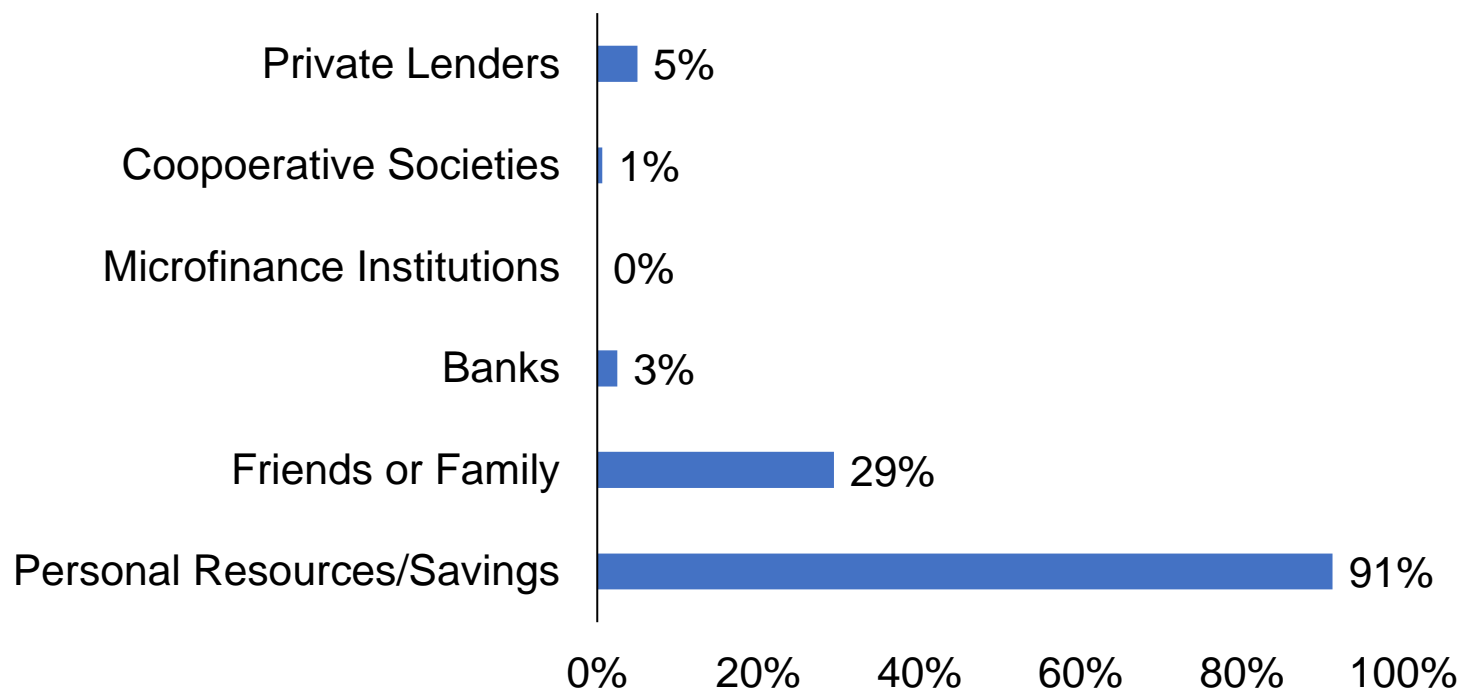


■ Not Eligible ■ Not Aware ■ Applied, but Did Not Receive ■ Did Not Apply

Lack of Access to Credit Inhibits Business Growth & Formalization

Many informal businesses struggle to access formal financial services, such as bank loans and credit facilities.

Sources of Funding - Informal Business



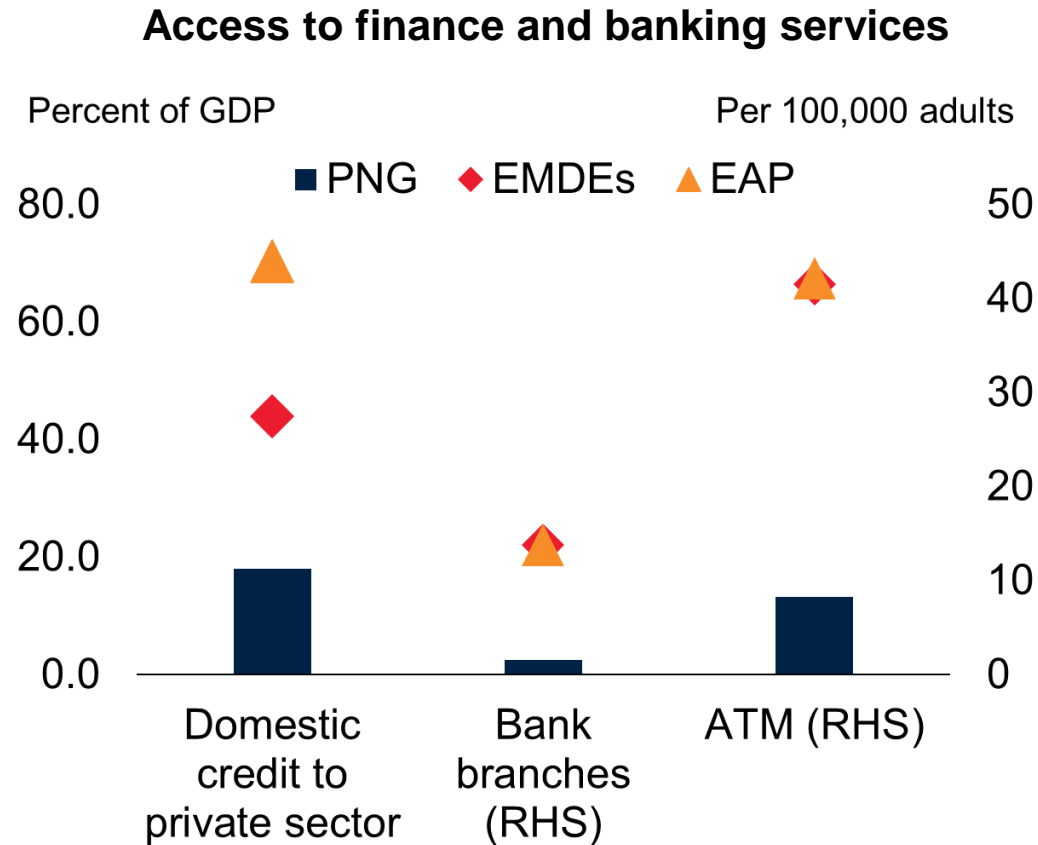
Estimated from 2024 PNG National Capital District Informal Business Survey

Multiple factors limit firms' access to financial services in PNG:

- Difficult terrain and infrastructure gaps
- Prevalence of traditional banking models
- Limited development and reach of digital platforms
- Low financial literacy
- High volume of cash economy
- Complicated application procedures

Lack of Access to Credit Inhibits Business Growth & Formalization

PNG has one of the lowest rates of access to finance among EMDEs and regional peers



Notes: World Bank World Development Indicators, GEM, World Bank Enterprise Surveys, World Bank Doing Business reports, and staff estimates. Data are from 2019 or the latest available year. Diamonds for "EMDEs" are simple averages for emerging market and developing economies excluding PNG. Triangles for "EAP" are simple averages for EMDEs in East Asia and Pacific region excl. PNG.

Constraints Inhibiting Growth and Formalization

Informal firms are constrained by limited access to markets. Lack of access is due to:

- Exclusion from formal market networks such as business councils and chambers, and government programs
- Lack of finance, knowledge, and skills, or even materials and technology

Over 93% of informal firms state that access to markets would improve if they formally register.

85% of informal firms do not have linkages with formal firms, further impedes market access.

Insurance:

90% of informal firms do not have any form of insurance or insurance products that could safeguard or protect their businesses in case of emergencies or unforeseen disruptions.

Figures estimated from 2024 PNG National Capital District Informal Business Survey

Tax Structure and Regulations

PNG's tax system is perceived to be complex, with no simplified arrangements for micro, small, and medium enterprises (MSMEs)

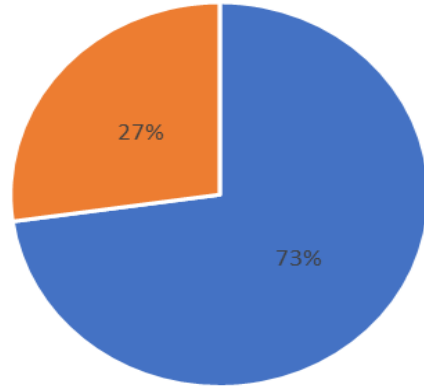
Tax structures translate into high compliance costs and low levels of engagement and outreach.

Approximately 45 percent of surveyed businesses admitted to not paying taxes. The primary reasons for not paying taxes include:

- High tax rates
- Complicated tax filing procedures
- Lack of trust in how tax revenues are used

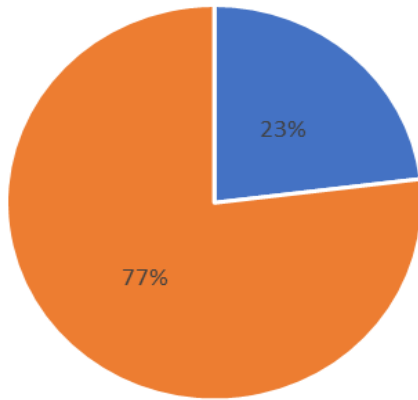
Difference in Formal and Informal Business Practices

Digital Payments, Formal Business



■ Yes ■ No

Digital Payments, Informal Business



■ Yes ■ No

Book-keeping

- 66% of informal businesses do not keep accounting records such as those related to sales and purchase transactions, income or cash flow statements, budgeting, etc.
- 68% of informal business owners do not have a bank account dedicated exclusively to managing the business
- In comparison, 91% of formal firms do keep accounting records, and almost all formal firms have a bank account

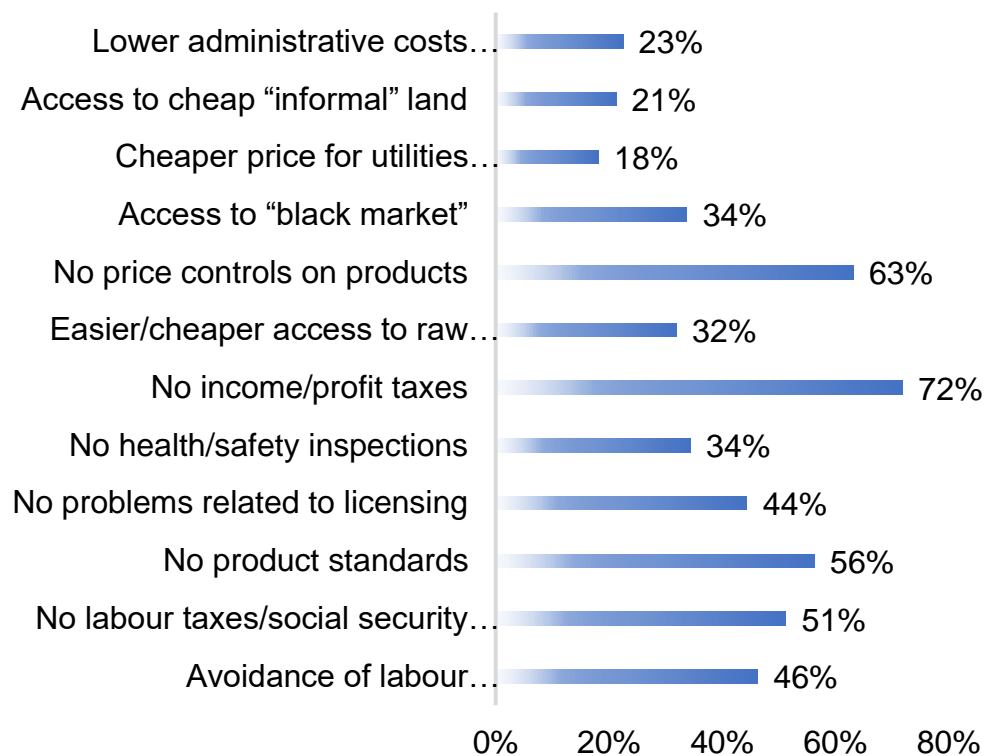
75 percent of informal businesses do not use digital payments or technology-driven platforms for receiving payments from customers or paying their suppliers

Notes: Estimated from 2024 PNG National Capital District Informal Business Survey.

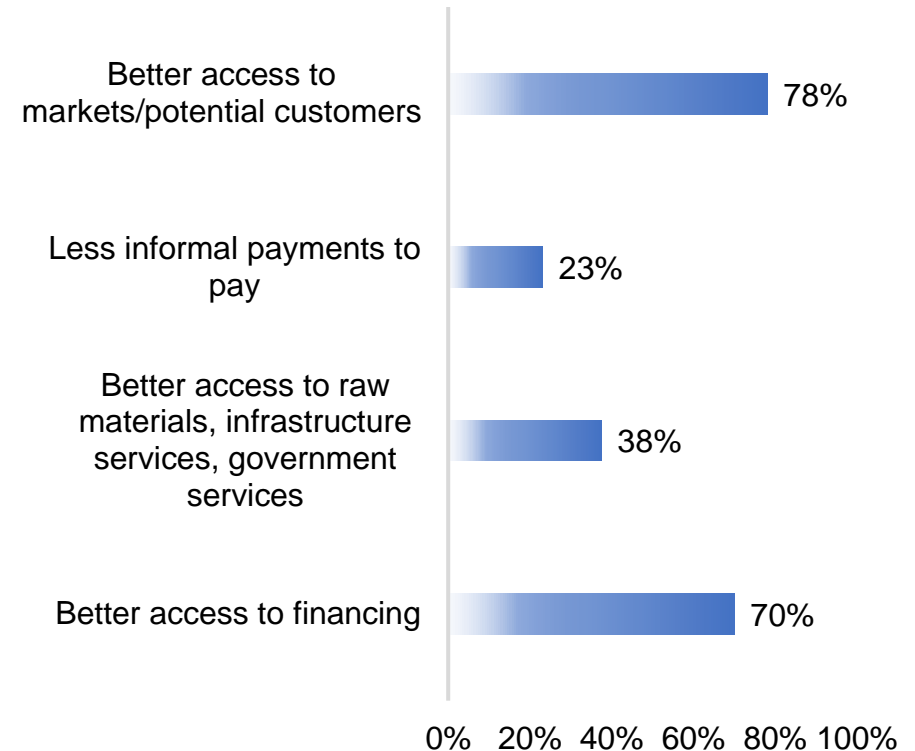
Cost-Benefit Equation to Formalization

While informal firms have perceived benefits of remaining informal, informal business owners or managers also acknowledge the benefits of formalization, which can be further solidified if government support is extended.

A. Perceived benefits of remaining informal



B. Perceived benefits of formalization for informal businesses

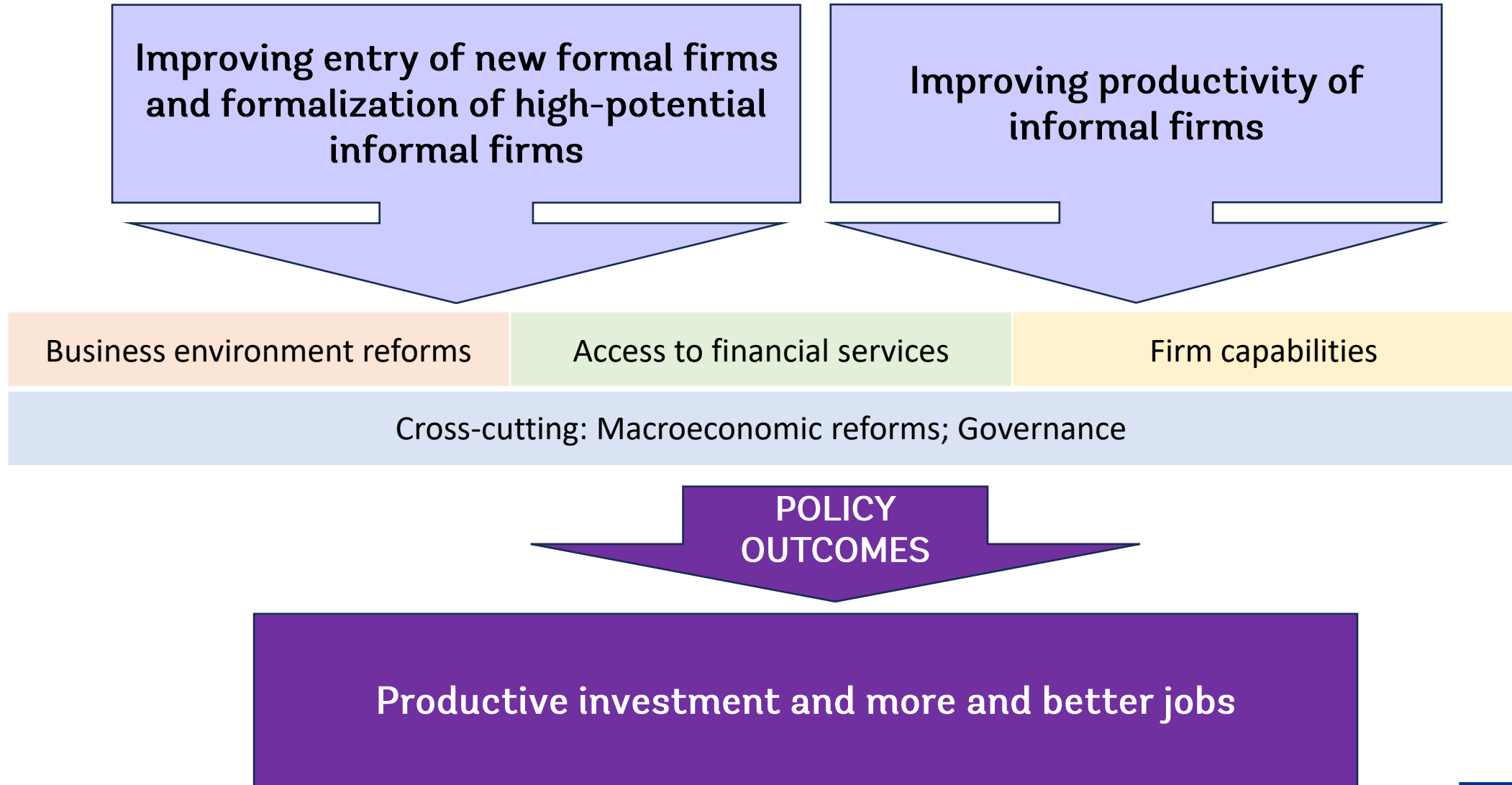




Policy Recommendations



Policy Framework



Policy Recommendations

Business environment reforms

Continue to streamline business procedures and consolidate them in a one-stop shop

Consider simplified legal forms and temporary or intermediate status to facilitate transition from informal to formal firms with growth orientation

Promote the establishment of cooperatives as bridges b/w customary approaches to ownership & modern business operation models

Simplify and facilitate compliance with tax regulations using a combination of interventions to improve tax morale; learn lessons of implementation of the Small Business Tax

Clarify and review regulatory thresholds; remove potential disincentives for firms to grow and formalize

Expand digitalization of government services (including enablers such as digital ID and combine with awareness/education campaigns to raise uptake

Build trust through stakeholder engagements, building on previous experiences

Access to financial services

Promote financial inclusion, leveraging digital technologies

Expand credit guarantees and design related interventions to increase access to finance

Firm capabilities

Consider interventions to improve skills of informal entrepreneurs to improve productivity

Identify and support informal clusters to facilitate their eventual transition to more formal legal status

Cross-cutting

MACROECONOMIC REFORMS: Maintain macroeconomic stability and boost long-run (productivity) growth

GOVERNANCE: Improve accountability & reduce rent-seeking behaviors

Questions for Discussion

1. Do the proposed recommendations resonate? What would you see as the highest priorities?
2. Are there successful examples of policy initiatives in the areas identified that could be scaled up?
3. What reforms in the business environment would be more critical to encourage more productive firms in the informal sector to operate formally?
4. Do you have any suggestions on how to bridge the gap between customary practices and modern business operations?
5. Are there good examples of initiatives to promote digital literacy and awareness that benefit informal firms?
6. To what extent do clusters of informal firms exist and could be leveraged for support policies?