

Informal economic activities predominate in many LDCs. Should strategies for economic development be based on them?

Ranabir Chanda

Introduction

Urbanisation has been defined as the relative increase in the urban population as a proportion of the total population. In the past two decades, there has been a significant acceleration in the growth of the urban population and the greatest increase has been in developing countries. This growth is expected to continue over the next 20 years leading to an explosive growth in cities in the Less Developed Countries (LDCs).

One of the major consequences of rapid urbanisation, in LDCs, has been a burgeoning supply of job – seekers, fuelled by migration from rural areas. Various studies show that 45% - 50% of the increase in cities has been due to rural migration and that these migrants form about 50% of the workforce. Other studies show that rural unemployment is a lot lower than urban unemployment

The main fuel of urbanisation has been and remains rural – urban migration induced by lack of access to productive resources, hence an over stressed labour market in the rural economy. Investment is attracted to the major cities because of the diversity of the internal market, the strength of purchasing power among its population and its array of facilities and services. All this means that migrants are attracted to the cities under the impression that their living prospects will be enhanced.

The strength and pattern of urban growth, over the last 25 years, has led to a number of problems :

- a) Extreme urban poverty
- b) Spatial imbalance in the distribution of urban population represents opportunities already forgone to distribute the pattern of value – added more widely
- c) Land use planning has hardly been recognised as an important tool in urban development
- d) Urban management and administrative structures and systems are fundamentally weak
- e) Infrastructure and services in urban areas show massive backlogs in provision

Historically, rural migration has been viewed positively in economic terms. It has been thought of as a natural process in which the supply of surplus labour from the rural areas was withdrawn to provide the manpower for urban industrial growth.

It is abundantly clear that this is not happening in LDCs. The capacity of industry, to create jobs to absorb the massive rural migration, is not there. Migration is now a major factor contributing to urban surplus labour, exacerbating urban unemployment and causing infrastructure failure.

The structural adjustment policies imposed by the World Bank, hits hardest at the urban poor. This is because the poor are dependent on their labour rather than on asset – ownership. In the developed countries one outcome of the phenomenon of deindustrialization has been the growth of the informal sector or the hidden economy.

The informal sector (IS) has been defined as that part of the urban economy of LDCs characterised by small competitive individual or family firms, petty retail trade and services, labour-intensive methods of doing things, free entry and market – determined factor and product

prices. It often provides a major source of urban employment and economic activity. It is often considered to be the disadvantaged sector of a dualistic labour market segmented by excessive formal sector remuneration, benefits and regulations.

The Report of the Director – General of the ILO (1991) referred to the informal sector as

“ ---- very small – scale units producing and distributing goods and services, and consisting largely of independent self - employed producers in urban areas of developing countries, some of whom also employ family labour and / or a few hired workers or apprentices; which operate with very little capital or none at all; which utilise a low level of technology and skills; which therefore operate at a low level of productivity; and which generally provide very low and irregular incomes and highly unstable employment to those who work in it”.

Outside the ILO, the term is used increasingly to describe a general informalisation of the modern economy that is taking place in the developing and industrialised countries, and involves the growth of casual, part – time, contract and other forms of precarious work which is undertaken by workers for operating in and outside the formal economy.

Informal sector activity is that which occurs outside of structured employment, and is usually outside government control and taxation. It is often intermittent and irregular. It is a world of interpersonal cash transactions or payment in kind for services rendered. This is a world much of which borders on the illegal and some of, which is transparently criminal. In many countries through the expansion of the informal sector, people build their lives on two pillars : one in the formal and the other in the informal sector.¹

The informal sector is characterised by small units that produce, repair or render services to other sectors, to other units within the sector itself, or directly to other households. The lines of demarcation are blurred upwards to the organised economy and downwards to community work and domestic work. A combination of subsistence production, petty commodity production, small –scale trading, services and other forms of unregistered, informal activities have become more important sources of income for a fast growing number of households.²

The informal sector has, also, developed its own links with the formal sector (FS). The productivity and low costs of large companies depend on the possibilities of securing supplies from producers and service providers in the informal sector.

In most developing countries, the informal sector is vast, heterogeneous in terms of activities and occupations and expanding rapidly. At times the sector is characterised as innovative, dynamic and a provider of opportunity for those with entrepreneurial spirit. There is an assumption that informal firms have dynamics similar to those in industrialised countries and that formality can be thought of as a decision to participate in societal institutions.³

Initially, it was believed that growth in IS activity was due to the incapacity of the formal public and private sectors to generate employment, a situation that worsened when economic reform conditionalities (structural adjustment policies) required massive reductions in public sector employment. The increase in microenterprises was seen as a survival strategy for the “new

¹ Szalai, J & Orosz, E (1992) “Social Policy in Hungary” in B Deacon(ed) *The New Eastern Europe: Social Policy Past, Present and Future*. London Sage

² Kongstad, P & Monsted, M (1980) – *Family, Labour & Trade in Western Kenya*, Uppsala, Scandinavian Institute of African Studies

³ Levenson, A R & Maloney, W F (1998) – *The Informal Sector, Firm Dynamics & Institutional Participation*, Miliken Institute for Job & Capital Formation, Santa Monica, California & WB, Washington, USA

poor". However, studies appear to show that the ability to move in and out of employment, engage in a number of economic activities, simultaneously, choose hours and locations are some of the reasons as to why people choose to work in the informal sector. Ease of entry, use of skills acquired outside the formal system of education and training, low or little overhead costs, small scale of operations, servicing a particular niche and non-compliance with regulations are the reasons why individuals and firms choose to stay informal.⁴

Each of the activities performed in the urban economy have distinct levels of requirements of resources – human and capital – which allow only a certain scale of operations. Activities demanding a high level of investment in the form of skill and education dominate the upper end of the continuum, whilst the reverse is true for those at the lower end. Trading as an activity allows operations at any level within the economy because the characteristics are such that it fixes no minimum level of investment. This allows vast number of people with no skills and no capital to participate in the urban economy.

The IS provides the means of livelihood to migrants and unemployed urban residents and supports the bulk of its workers at or marginally above the poverty line. The survival strategies and the income generating capacity of the worker attempt to reduce the pressures created by production relations over which there is little control.

The system of activities in any urban setting reflects the role and position of that urban centre in the hierarchy of the national urban system and the prevailing power structure. The national urban system is the spatial manifestation of the pattern of capital accumulation and disparity. The emerging or the present power structure parallels these centres of accumulation, which in turn control the subsequent movement of capital and labour. It is the direction and flow of capital and labour, which are the crucial underlying factors.

There is general consensus that investment patterns in most Third World countries have tended to reinforce patterns of capital accumulation, which produce urban enclaves of accumulation and consumption. These urban centres dominate and expand as they continue to attract capital and labour. Capital finds lucrative investment in the capitalist sector and excess labour finds its place in small-scale activities

The various modernisation theories perceived the informal sector as part of the traditional society, which should be developed and ultimately will be replaced by modern institutions and practices. The Neo – Marxist approaches perceived it, basically, in a similar way, based on the expectation that the sector in the course of time, would become integrated in the capitalist production and market economy. Gradually it has become evident that that these expectations were not being fulfilled in the vast majority of the developing countries.

The informal micro-firm sector is believed to be large, accounting for between 20% - 40% of employment in many developing countries. Paul Streeten (1994) makes the interesting observation that the activity in the informal sector grows with a decline in aggregate demand and declines with its growth. It increases during recessions, thus providing a safety net for many poor people. However a blueprint for developing the informal sector is not available.

The operation of the IS and the attitudes of the governments in a few countries and regions will now be considered. The paper will look at governmental attitudes towards the sector, consider the implications of it for the economy of LDCs and try to come to some conclusions about its implication for strategies of industrialisation for economic development and growth.

⁴ The Informal Sector, the Micro, Small and Medium-sized Enterprises and Job Creation in the Caribbean – SP/RDCTI98/DT No 2/2 : 22 – 24 June 1998

Country Survey

South Africa's Informal Economy

The majority of ordinary South Africans have at some time or other been in touch with the informal economy. Many millions of people, particularly black South Africans work and the income received from this sector has shaped the course of their working lives. The informal economy has been both a potential source of opportunity and upward mobility for some households and individuals, and a sinkhole of exploitation for many others. The ambiguity persists with the occasional self – made Horatio Alger being juxtaposed against the common situations of bare survival, desperation and drudgery.

The 1995 Household Survey estimated that 17% of the workers were active in the informal sector. The SA Revenue Service, through door – to – door surveys have come up with a figure of 30% of businesses and workers who were not registered as taxpayers. Apart from criminals, domestic workers, shabeen queens, hawkers and more recently, the practitioners of traditional medicine or urban herbalist, form the majority of the informal sector workers. The importance of the vital income – earning opportunity of the shabeen is starkly posed in Sepamla's poem, *Queens / Kings* (1977). It tells of a meeting called by Soweto students to request the closure of shabeens in observance of mourning for the dead of the 1976 riots. One queen responded: " I am not mad, I must pay rent, I must pay school fees, I have no husband " .⁵

Popular writings on the informal economy follow a naively simplistic line, celebrating the energy, initiative and entrepreneurship of the self – made person while conveniently ignoring the numerous men, women and children, whose energy and labour laid the foundation for this success (Bromley, 1985).⁶

Policy and planning for the informal economy in SA is an issue of recent origin. Informality is often perceived through the lens of licensing, regulation, tax and criminal law. Trying to assess the contribution of the informal sector to GDP and job creation is a difficult task. However, Marie Kirsten (1991) tried to determine the extent of such contribution to the economy. She found that, overall, 23% of the black labour force were making a living out of the informal sector. Whilst there were wide variations in the incomes earned, a weighted average income of R3228, per capita was arrived at. This gave a contribution of R6billion or 5.1% of the GDP.

Helmo Preuss, an economist, says that the IS is important for job creation, acknowledging its contribution will ease deficit restrictions and allow for a more relaxed monetary policy by the Reserve Bank as its inflationary concerns would be allayed.⁷

The Congress of South African Trade Union (COSATU) found that the workers are intensely exploited and their vulnerability used by employers as a bargaining chip against regular workers. Due to lack of job security casual and temporary workers are pliable, working conditions are usually oppressive and very often unsafe; the incomes of unregulated wage earners and the self – employed are usually at or below the poverty line, access to any form of state – provided social protection, training and social services are severely restricted; exploitation and infringement of workers' rights are common. For the vast majority of dependent and own – account workers the IS is not a stepping – stone out of poverty into

⁵ Sepamla, S. S. (1977) – *The Soweto I Love*, Rex Collings, London

⁶ Bromley, R (1985) - ed. *Planning for Small Enterprises in Third World Cities*, Pergamon, Oxford

⁷ Preuss, H (1998) - *The Informal Sector – Is It Important?*, Financial Mail, 7 August 1998

improvement or the path to formal employment, but a means to survival. It also found that, generally, unions have failed to develop clear policies for drawing these workers to its fold.

COSATU recommends that the definition of “employees”, as covered by the present labour legislation, should be broadened, that the Basic Conditions of Employment Act should apply to workers in the informal sector and that unions should adopt various organising strategies to attract these workers. One method may be to organise these workers into co-operatives.⁸

The Caribbean

Although it operates outside of formal legal framework and economic institutions, the informal sector is an integral part of Caribbean economies, particularly due to its absorption of large numbers of the unemployed and because of the goods and services it provides. In recent years there has been an increasing effort on the part of the Caribbean governments to strengthen their economies and stimulate economic growth and development in the face recent trends towards globalisation and increased competition on the international market.

Small and Medium Enterprises (SMEs) have been targeted as the driver for economic and social development in the 1990s. Channelling the activities of the informal sector implies the transformation of the units in this sector into micro, small and medium enterprises in the formal sector. This would enable the informal sector to respond more effectively to opportunities arising out of the development process.

Attempts to achieve this would involve not only overcoming constraints to expansion in the informal sector such as low income, lack of access to resources e.g. credit and training, limited access to markets, but also the reason why many participants choose to operate in this sector in the first place. The gradual integration of the informal sector into the formal would have the effect of strengthening the latter as the workers would have greater productivity and higher incomes leading to a general improvement in economic prosperity and quality of life.

One of the ways of encouraging movement away from the informal sector is to enable home-based workers and petty traders to rent premises and eventually expand operations. The view is that with economic growth the significance of the informal sector will decline over time. Rising real incomes will lead to a decrease in the demand for goods from the informal sector.

It is the intention of the various countries to form regional alliances, which would include SME development across the region so that each country could benefit from the experiences of the other. The countries have called for a review to determine the key drivers of each national economy based on the economic theory of “competitive advantage”. New business creation and the development of sustainable enterprises is vital if the countries of the Caribbean region are to have a meaningful future in the, emerging, global system. A comprehensive and integrated strategy for the development of SMEs within the context of larger developmental concerns is matter requiring urgent attention. An example of such an integrated strategy would be to invest in training to develop entrepreneurs, attract new foreign direct investment, assess the growth and sustainability of SMEs, developing a comprehensive support mechanism for start up and growth and considering linkages on a cross – border intra regional basis.⁹ The establishment and operation of the Free Trade Area of the Americas by 2005, is seen as an opportunity to gain access to a new and very large market place.

⁸ COSATU (2000) – 7th National Congress : Strategy to Organise the Informal Sector and Atypical Workers

⁹ SELA (1998) – The Informal Sector, the Micro, Small & Medium – sized Enterprises and Job Creation in the Caribbean, Technical Paper : Chaps 2 - 5

The main aim of the countries in the Caribbean would appear to be the integration of the informal sector into mainstream economic activity in order to strengthen the formal sector.

Pacific Island Countries

Formal paid jobs occupy about 22% of the labour force in Pacific island countries. In several countries the gap between the demand and availability of paid employment is widening. Conventional labour statistics paint a picture of large-scale economic inactivity through under representing the productivity of the semi – subsistence sector.

Economic and demographic trends suggest that formal employment will not catch up with the growing demand for work in the foreseeable future. In the light of this shortfall, the only way to meet the material aspirations of the people is to stimulate the informal sector and increase opportunities for self-employment.

Most Pacific island governments see the informal sector as a potential source of dynamism, a breeding ground for entrepreneurs, a possible source of employment for displaced public sector employees and potential impetus to private sector expansion. However, the large rural informal sector has been viewed as traditionalist, anti-entrepreneurial and static.

The informal sector is large and a critically important source of livelihood in the Pacific. Households and families depend on multiple sources of income – some cash, some subsistence production, some traditional exchange or other small-scale trading. It is only through increasing the productivity of the semi-subsistence sector that their incomes can increase.

A number of barriers must be removed if informal sector activities are to grow in size and productivity. The conditions that would enable small enterprises to succeed are adequate transport and communications infrastructure, access to resources, access to credit and the removal of legal restrictions and non-supportive government policies.

One way to bolster the informal sector is through non- formal education programmes that teach basic education skills. Another way is to create a supportive environment through community development, entrepreneurial training and micro-credit schemes.

Considering the narrow range of economic resources in the region, promoting sustainable resource use and increasing the added value of local products would appear to be the surest basis for creating job-rich economies. The many linkages between formal and informal sector activity are particularly evident in the potential for employment growth in the fishing industry and agriculture. Plant based-biotechnology is a new area of development, offering opportunities for both formal and informal types of commercial ventures.

The prediction that labour force growth will almost certainly outstrip formal sector jobs reinforces the need to sustain and develop the semi-subsistence or informal sector as the main source of employment in the Pacific islands.¹⁰

Evaluation

It would appear that governments consider the existence of the IS as an important part of their economy. Its growth is recognised as playing a major role in absorbing labour that cannot find employment in the FS and providing a level of income to the poorest members of society. It

¹⁰ UNDP (1997)

Report : Sustaining Livelihoods : Promoting Informal Sector Growth in Pacific Island Countries, Suva, Fiji

plays an essential role in the provision of goods and services thus making a contribution to the economic development of the country. The sector is seen as a potential source of dynamism, a seedbed of indigenous entrepreneurs, contributing to independent economic development.

Opinions diverge as to what should be done about the growth in the sector and its future in a developing economy. The Caribbean countries seek to integrate it within the formal economy, seeing its natural demise following the Harriss and Todaro model, where the expansion of the formal sector supplants informal activities.¹¹ The Caribbean, being close to the United States of America, is also very much influenced by its economic theories and model of development.

In contrast to the Caribbean, South Africa sees the IS as the survival strategy adopted by the marginalised, a dumping ground for unemployed labour, particularly during periods of severe economic crisis. It recognises the importance and contribution of the sector, acknowledges its inevitable growth and seeks to reform it by granting the rights, privileges and protection enjoyed by the FS to the workers in it.

The Pacific countries sees the IS as an integral part of its development strategies and actively seeks ways and means of increasing its contribution to the economy.

Conclusion

Discussion of the IS is and continues to be controversial. This is partly due to the nature of the sector and the expectations of analysts and policy makers about it. Different contributions in the literature view compliance with or participation in the institutions in seemingly inconsistent ways (Levenson & Maloney, 1998). Some emphasise the desire to evade taxes, regulations or state controls “ The informal economy arises when excessive taxes and regulations are imposed by governments... ” (Loayaz, 1995). Others see the inability to access institutions, such as securing property rights, as hampering growth (de Soto, 1989). There is, also, a tendency to view formality as an all or nothing state.

A few decades ago the popular view was that the informal sector reflected the transition from an agrarian society to an industrialised, modern economy. The predominant model of economic development was accelerated industrialisation increasing national growth and leading to the expansion of per capita income throughout the population. Within this model, economic activity and employment were seen as divided into two broad sectors: the modern industrial wage sector and traditional non-wage sector. The activities of what is now known as the IS were part of traditional, backward and unproductive activities carried out at the margins of society. According to this view, solutions to the IS poverty and problems lay in intensified development of the FS, population control, and strategies to control rural-urban migration. Programmes to develop and upgrade the IS activities formed no part of this thinking.

The International Labour Organisation’s (ILO) report on Kenya in 1972 and the 1973 study carried out by Keith Hart on the Accra urban poor produced a different perspective of the IS. These studies were conducted through recognition of the failure of the accelerated growth model to generate adequate employment. The studies, however, remained constrained by their adherence to the overall model and focused on a series of structural imbalances within the model. Emerging from this was attention to the IS as a distinct socio-economic group with the capacity for labour absorption and income generation. The IS activities came to be viewed as economically efficient, technologically adaptable and socially useful in the provision of services to the urban population, which have no access to the benefits of formal development. The

¹¹ Harris, J & Todaro, M (1970) – Migration, Unemployment & Development : A two-sector analysis. American Economic Review, vol. 60, Pp 109 – 122 & 126 - 142

persistent poverty of the IS was not seen as embedded in the sector and its activities but as a result of inappropriate state policy which failed to provide the environment for its growth.

Recognition of the capability of the IS led to two different policy approaches. One, represented by the ILO, recognises the poverty and low productivity of the IS. It requires governmental intervention in the areas of skill development, technical support and the provision of credit and infrastructure, for growth. The other, typified by the World Bank, assumes that the sector possesses the prerequisites for growth, having survived under hostile legal restrictions and market distortions caused by government interventions. The solution is not state support but deregulation and the free interplay of market forces.

This conception and approach led to the structural adjustment policies of the World Bank / International Monetary Fund and rigid adherence to the application of free market principles. A fundamental aspect of this policy is the informalisation of the economy and production relations. This involves the restructuring of the production process to take advantage of the reduced labour costs available in the informal sector. Over a decade and many devastated lives later, recognition of the failure of this policy has been, grudgingly, admitted.

The fundamental problem with the definition of the informal sector lies in the nature of the concept. Using the term informal implies comparison with activities in another sector, which is seen as separate. A more fruitful approach would be to see it as part of the processes and relations and chain of productive and distributive activities of the broader economy. This definition includes the presence of complex relationships with the FS and market-based production, generally.

It is essential for the state and metropolitan authorities to recognise that the rise of the IS is a consequence of the total socio-economic processes affecting LDCs. Further that its significance is heightened by the absence of any significant growth in the capitalist, formal, sector. To quote a few statistics : 85% of the jobs created in Latin America, during 1990 – 95, 90% of the work force in India, (Asia – 50%, before the 1997 financial crisis), 61% of the urban labour force in Africa were in the IS. Additionally, it is expected that most of the jobs created over the next decade will be in the informal sector.¹² Even developed countries have seen widespread growth in the IS with about 30% of the national income in some countries coming from this sector. Recently, in order to comply with the EU requirements for economic integration, Italy increased its GDP by about 30% to allow for the contribution from the IS.

Questioning the development of LDCs is essential before answers can be postulated. Most LDCs were colonies and secured their independence through the intervention of urban elites, mostly educated in western thought and philosophy. It was, therefore, in their interest to gear development towards the needs of the urban sector at the expense of the rural areas. The rural areas provided the teachers, doctors and servants to tender to the needs of the urban population.

Mainstream and (its off – spring) neo – classical economic theories evolved to explain industrialisation and economic growth of west European countries. The historical conditions under which this growth took place – will never be repeated. The protectionism, guaranteed by force of arms, is not available to LDCs. These economic policies, therefore, do not have the answer to the problems faced by LDCs. The political science and structures that developed to explain these economic theories consequently do not have the answers – they are best consigned to the museum of history.

¹² ILO (1999)

– Key Indicators of the Labour Market (KILM)

The inability of the capitalist economy to address the fundamental requirements of the needs of LDCs and the rise of the informal economy leads to the conclusion that strategies for economic development must take into account the enormous contribution of the IS. This will allow for state investment in skills and training, infrastructure eg transport, access to finance, particularly micro credit, and recognising the IS and FS as two facets of the same economy through granting the same rights and legal protection to workers in both sectors. Trade Unions should develop innovative forms of organisation to ensure that workers rights are maintained and enhanced, taking care that particular sections eg. women, disabled, do not lose out in the process.

“ (it is) ... the failures of past conceptions and the changes in the world that lead to the necessity of a new conception ” (Joseph Stiglitz, Chief Economist, World Bank).¹³

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¹³ Stiglitz, J (1998)

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