

Developing the informal sector for inclusive growth

The informal economy, providing jobs (often self-employed) and income to most of Africa's poor households, has only recently gained increasing attention from policymakers (see e.g. the [African Development Bank](#)). Despite large economic growth in Africa in the past decade, the informal sector remains huge. This is often attributed to Africa's explosive population growth ('youth bulges'), which cannot be absorbed by the formal sector. Youth and women are overrepresented in an informal sector that is frequently associated with increasing poverty, irregularity, lack of social protection and poor working conditions. Lack of prospects for large numbers of young urban men in particular, may lead to frustrations and even social and political instability ('ticking time bomb'). Engaging the informal sector to achieve more inclusive growth is, therefore, considered crucial.

The question is, how can the informal sector be developed from a sector entered by young workers due to an absence of formal employment (brain-drain), into an attractive sector that offers career opportunities and decent work (brain-gain). In other words, how can the informal sector create productive jobs and offer decent working conditions to the large numbers of Africa's youth that are currently crowding the labour market?

This note identifies a number of recent conferences and studies that are relevant for policymakers understanding and development of the informal sector. A separate [one-pager](#) has been drafted on youth employment in Sub-Saharan Africa.

What is informality?

A first conceptual question is, what does informality actually entail? However, a clear definition does not exist. There are different perspectives on the informal side of the economy, which are examined in some overview papers.

- A starting point is Ernest Aryeetey's [framework paper](#) for AERC (n.d.) on informality in relation to economic growth and poverty. He describes the evolution of the concept of informality, dating back to the early 1970s, which loosely refers to a wide range of "activities that have less form and structure; that operate away from bureaucratic controls, and which are likely to be more precarious and not so stable." After the [ILO](#) introduced a statistical definition of informal economy in 1993 (which was adopted in 2002), the [ICLS](#) defined informal employment more broadly in 2003. In recent years, the definition of informal activity has been further expanded and includes "small-scale low income activities, whether in employment or self-employment, whether linked to registered firms or not."

Informality is often associated with poverty. Opposing views exist, however, on the relationship between poverty and informality. Some consider the link as a vicious circle: poverty forces people to engage in informality, but working in the informal sector also means poverty as jobs are of lower quality and working conditions are poor. By contrast, others view informality as a transitory stage for those workers with the ambition to move higher up the ladder financially at a later stage.

- In his [paper](#) for IDRC on informality and inclusive growth, James Heintz (2012) reviews three different approaches to informality, which, as he emphasizes, importantly have different policy implications:
 - 1) enterprise-based approaches that try to distinguish informal from formal enterprises. Indicators used include: size; registration status; employer/enterprise social security contributions; legal form of organization and character of financial accounts; and legal entitlements and property rights.

- 2) employment-based approaches that combine an enterprise- and jobs-based definition, recognizing that there can be formal employees in informal enterprises (i.e. self-employed) and informal employees in formal enterprises (i.e. lacking social protection).
- 3) focus on illegal activities: individuals and enterprises that operate outside the law through, for example, tax evasion; violation of labour standards and laws; or trade and production of illicit goods and services.

It is apparent that a clear-cut distinction cannot be made between the formal and informal economy in Africa. Elements of informality are found in official enterprises and vice versa; an informal-formal continuum exists with intrinsic linkages between informal and formal enterprises, workers and activities. Consequently, measuring the size of the informal economy in terms of employment and production and its contribution to economic growth, which is already difficult because of its nature and composition, is complicated.

How to develop the informal sector?

In his [paper](#) for AERC, Aryeetey details various strategic options for engaging the informal economy:

- Policies are needed to deal with high unemployment, lawlessness and tax evasion, all of which are often associated with the informal economy. Countries must adopt explicit policies that encourage the development of the informal sector.
- Private sector development is crucial for growth and employment creation in Africa, also through tax revenues that enable more and better public services.
- Promotion of informal-formal economy linkages.
- Provision of safety nets for informal workers.
- Better measurement of informal production and employment and its contribution to economic growth.

Studies often focus on different aspects of improving the informal sector. These aspects can be grouped in two (connected) categories. The first one expects the informal sector to be an important driver of economic growth that generates jobs (including entrepreneurship), while the second approach focuses on improving rights and working conditions (including social protection) of informal workers.

1. The informal sector as a driver of economic growth and job creation

Taxation

- CISLAC (with support from Oxfam) produced a [policy brief](#) that explores a number of approaches and makes recommendations regarding expanding the tax base in the informal sector in Nigeria, specifically targeting companies that deliberately evade taxes. More tax revenues enable more and better public services.

Use of ICT

- ICT is considered vital to enabling new business models and formalizing traditionally informal activities, as Julius Gatune from ACET argued during his [presentation](#) at the 2015 World Economic Forum.
- Likewise, an [INCLUDE research project](#) led by Harry Barkema (EUR) focuses on the conditions under which small IT firms in Kenya, which typically start in the informal sector, take off, generate organisational growth and become formal-sector employers of women and youth.
- A [study](#) in Nigeria aims to find innovative ways to make the agricultural sector more attractive for young workers through the use of ICT.

Access to finance

- Informal businesses often have problems accessing finance, such as micro-credit. The [study](#) by I. Decardi-Nelson et al. (2012) looks for innovative mortgages for the informal sector in Ghana.

Access to markets

- IIED and HIVOS jointly published a [report](#) on how small-scale producers use formal and informal markets. It suggests, among other things, that inclusive formalisation builds the benefits of informality - access, flexibility, resilience - into policy and business frameworks.

Bottom-of-the-pyramid approach

- The bottom-of-the-pyramid approach (BoP) is a market-based approach for poverty reduction that considers the four million poorest people in Sub-Saharan Africa resilient entrepreneurs and value-conscious consumers (see [C.K. Prahalad and Stuart L. Hart](#)). The central idea is that the poverty of the poorest can be reduced by providing them with much-needed products and services and generating employment opportunities for informal workers.
- Critical scholars, such as [Aneel Karnani](#) consider the BoP approach a romanticized and harmful view of the poor that, among other things, minimizes the role and responsibility of the state in poverty reduction.
- The BoP approach and other new business models were also the focus of a panel during the [Africa Works conference](#), jointly organized by the African Studies Centre (ASC) and the Netherlands-Africa Business Council (NABC) in October 2014. Specific attention was paid to the impact these efforts are having on African workers and entrepreneurs: are inclusive markets helping to make poverty history, or are they just making poverty business? Catherine Dolan, one of the panel members, wrote a [critical analysis](#) (together with Kate Roll) on market-based development to engaging informal economies.

Skills improvement

- Skills improvement (training, vocational training, education) was one of the central themes in [ACET's 2014 African Transformation Report "Growth with Depth"](#). It is believed that many informal workers cannot find jobs in the formal sector due to a skills mismatch with the needs of business.
- The [study](#) by IRD economist Laure Pasquier-Doumer (2012) is interesting in terms of understanding the transmission of skills within families and the impact of entrepreneurial familial background on informal business outcomes in West Africa. Family networks are a central theme in her [research](#).

2. Improving rights and working conditions of informal workers

Another approach to the informal sector focuses on key actors to improve the rights and working conditions of informal workers (including informal entrepreneurs), such as trade unions and innovative partnerships.

Access to social protection

- Informal workers are not usually involved in social protection schemes (safety nets) relating to, e.g. health insurance and pensions. The ASC and CNV International (both based in the Netherlands) jointly initiated a [mapping](#) of the accessibility of social protection for informal workers in five West African countries (Guinea, Niger, Senegal, Togo and Benin). It was found that change goes slowly and political commitment is crucial to establishing an effective and coherent social protection structure that also includes informal workers. But it also requires actions in other policy areas too, e.g. a well-functioning health care system. There is a need to look for innovative, alternative schemes for informal workers, e.g. without state involvement but by other stakeholders within an economic sector or among a specific group of workers.
- Related to this, in an ongoing [PEP research project](#) that studies the willingness of Togolese informal workers to pay for formal social security.

Promoting decent work

- The ILO published a [paper](#) on poverty reduction and decent work in 2001.
- "To promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all" is one of the 17 [proposed](#) Sustainable Development Goals (SDGs), which are guiding the UN Post-2015 development agenda. The SDGs will be adopted during the [United Nations Summit](#) that will take place in New York from 25 to 27 September 2015.
- The question of how to create sufficient, productive and decent jobs was central at the [PEGNet conference 2014](#).

- An [INCLUDE research project](#) led by Mayke Kaag (ASC) investigates the role and impact of trade unions and informal workers' organisations in Ghana and Benin in promoting decent work for informal workers.
- Matteo Rizzo (2013) carried out a [study](#) on political organisation among informal transport workers in Dar es Salaam (Tanzania) in which he challenged the influential view that, due to widespread economic informalisation, trade unions are not a viable option for defending workers' interests.
- Gunilla Andrae & Björn Beckman's (2013) [study](#) on the organisation of self-employed tailors in Lagos (Nigeria) highlights their struggle to improve their working and living conditions.

Need for knowledge

Several policymakers and think tanks have argued for a better understanding of the informal activities and the environment in which these take place.

- James Heintz identifies knowledge gaps in four areas in his [paper](#) for IDRC: the relationship between economic growth, economic development, and informality; barriers to mobility facing individuals and enterprises; understanding formal/informal linkages; and public goods, informality, and the quality of employment
- Ernest Aryeetey argues in his [framework paper](#) for AERC that lack of information and understanding of socio-economic issues related to informality (such as lack of social protection, limited access to credit, training, and markets; and differentials in wages and working conditions) hinders policymakers' ability to design and implement effective measures for poverty reduction.
- The [African Development Bank](#) pleads for more awareness among African policymakers on the importance of the informal sector for the economy, better access to financing (such as micro-credit), and improving access to information about the informal sector.

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Weblink: <http://includeplatform.net/downloads/developing-the-informal-sector-for-inclusive-growth/>