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A Thematic Literature Review on the Concept of Informal Sector

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Introduction

Informal sector is an undeniable entity which has come to captivate policy makers and researchers around the globe. The relevance of informal sector (IS) in today's economic scenario cannot be ignored as it is a source of livelihood to a majority of the poor, unskilled, socially marginalised and female population. It is an important means of survival for people in countries lacking proper social safety nets and unemployment insurance and especially for those who lack adequate skills to enter formal sector jobs. People from rural areas move out to urban dwellings looking for employment due to their impoverishment and the lack of income generating sources. Since majority of the migrants do not possess the skills or the education, they are barred from entering lucrative and secure jobs in the formal sector, and they ultimately have to settle for work in the informal sector. The share of the informal economy ranged from over 55 percent in Latin America to 45-85 percent in different parts of Asia to nearly 80 percent in Africa (Charmes, 1998).

The word "Informal Sector" came into the scene of development literature in the early 1970s, which explained the dualism that existed in the production process. During this period most of the newly developing countries experienced urbanisation and development of the economy. Most of the economic structuring was around urban areas, thus attracting labourers from the rural areas. With the increase in economic development, capital intensive mode of production was employed leading to a vast reserve of unemployed labourers. Since the formal sector could not generate enough job opportunities, the informal sector accommodated this excess labour. After the Second World War, the successful recovery of Japan and Europe instilled confidence that even the newly decolonized third world countries would achieve similar progress if adequate economic effort were undertaken. Many observers in the seventies believed that the informal sector in the developing countries was ephemeral and marginal and would fade away once these economies attain high economic growth. Far from fading away, today the informal sector has grown to be the largest vestibule for employment in most of the developing countries.

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The Theory and the Origin of the Concept of Informal Sector

Keith Hart an anthropologist first introduced the term “Informal Sector” in 1971 in a conference at the Institute of Development Studies in Sussex on the theme urban unemployment in Africa. He delivered a paper on the Informal sector on the basis of a study he did in southern Ghana (the paper was published in periodicals only in 1973). He depicts that in the informal sector a part of the urban labour force worked outside the formal labour market. Even though the paper received severe criticism, it acted as a starting point for introducing the concept into more extensive areas for further deliberations. Within a year, the International Labour Organisation (ILO) incorporated the concept in a substantially revised form in its World Employment Programme (WEP)[1] to Kenya in a report titled “Employment, incomes and equality” in 1972. Despite the fact that Keith Hart first used the term “Informal Sector” in 1971, it was the ILOs World Employment Programme to Kenya that accelerated and made it known. Hart himself writes that there have been reports of the “economy of the street” before (Hart, 1987). The informal sector may be seen as a “spin-off of the dual economy” literature starting with Lewis (1954) and Hirschmann (1958) whose theories gestated economic growth as the transfer of labour from agriculture (the traditional sector) to the manufacturing sector (the modern sector) with the development of the economy.

Different schools of thought have been propounded to try to understand the informal sector in a better light. The dualist school, propagated by the ILO in the 1970s, explains informal sector as “marginal activities” undertaken by workers which is distinct and different from the formal sector. It acts as a safety net and source of income for the poor (ILO, 1972; Sethuraman, 1976; Tokman, 1978). The existence of the informal sector according to this school is due to the lack of jobs in the formal sector and the inability of the formal sector to generate adequate job opportunities to contain the excess labour. Most researchers have conceptualised these differences of opinion in terms of a duality. Geertz (1963) divides it in terms of a `bazaar' sector and a`firm-centred' sector. Reynolds (1969) has also brought distinction between modern sector and traditional sector in an urban economy. Dependency theorists and Marxists, such as Gerry (1979), describe the informal sector as `petty commodity production. The dualist school subscribes to the view that the informal sector would shrink once the economy develops and attains high growth rate as informal sector was thought to be “peripheral to capitalist production systems” (Chen, 2004).

According to the structuralist school, whose main proponents were Caroline Moser and Alejandro Portes looked at the informal sector as a complementary unit of the formal sector. These two sectors are not rivals but grow in tandem with the formal sector subcontracting jobs to the informal sector while the informal sector providing

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the output at a lower cost thus benefitting each other. In this model unlike the dualist model, the two sectors are seen not only to co-exist but also to be inextricably linked and interdependent (Moser, 1978: Castells and Portes, 1989).

The main advocate of the legalist school was Hernando de Soto during the 1980s and 1990s. According to this school the informal sector consists of "plucky micro-entrepreneurs" who prefers to function informally so as to avoid the expenses, time and effort of formal registration (De Soto, 1989). People chose to work informally since government regulations are lengthy and complicated. This trend is mostly observed in developed nations and in Latin America.

According to the Illigalist School, popularized by neo-classical and neo-liberal economists the informal entrepreneurs deliberately seek to avoid regulations and taxation and, in some cases, to deal in illegal goods and services. This perspective is associated with the notion that the informal economy is an underground or black economy. According to Maloney (2004), informal entrepreneurs choose to operate illegally – or even criminally - in order to avoiding taxation, commercial regulations, electricity and rental fees, and other costs of operating formally.

Definition of the Informal Sector

The concept of informal sector is so diverse that it is difficult to give one conclusive definition that will be applicable universally since every country has different characteristics and traits. Different writers have termed informal sector by various names as underground economy, subterranean economy, shadow economy, informal economy, hidden economy, parallel economy, clandestine economy, second or household economy. Hernando de Soto, likens the informal sector to "an elephant we may not quite be able to exactly characterize its true nature but once we see it, we have no doubt what is in front of us" (Mead and Morrison, 1996). Although there is a variety of definition on the informal sector or also called as the unorganised sector, common to all definitions is that these are economic activities which are relatively small scale and eludes certain government requirements such as registration, tax and social security obligations and health and safety regulations for workers. Informal sector embraces an assortment of activities ranging from cart pulling, street vending, rickshaw and other manual jobs which requires little or no skill.

The ILO (1972) describes informal sector as "Informal activities are the way of doing things, characterised by (a) ease of entry, (b) reliance on indigenous resources (c) family ownership of enterprises, (d) small scale of operations, (e) labour-intensive and adapted technology, (f) skills acquired outside the formal sector system and (g) unregulated and competitive markets". The informal sector is characterised by small-scale, labour-intensive, largely unregulated and unregistered, low-technology manufacturing or provision of services.

Sethuraman (1976) defined informal sector as: (a) All unregistered commercial enterprises and (b) all noncommercial enterprises that have no formal structure in terms of organisation and operation. He gave the following criteria to identify the informal sector enterprises: it employs 10 persons or less; it operates on an illegal basis, contrary to the government regulations; members of the household of the head of the enterprise work in it; it does not observe fixed hours/days of operation; it does not depend on formal financial institutions for its credit needs; its output is normally distributed directly to the final consumer; almost all those working in it have fewer than six years of schooling and for certain activities it operate in semi-permanent or temporary premises, or in a shifting location and it does not use mechanical and electrical energy. The informal sector consists of small-scale units engaged in the production and distribution of goods and services with primary objective of generating employment and income to their participants notwithstanding the constraints on capital, both physical and human and know-how. According to this definition, the size of the informal sector is small, they are more labour-intensive as they have little capital to work with and they use relatively simple technologies.

Davis (1979) distinguishes the two sectors exclusively on the basis of mode of production and opines that in the formal sector, the mode of production determines the superstructure, whereas the reverse is true for the informal sector. To Davies, highly developed division of labour characterises the formal sector whereas the informal sector exhibits scant division of labour or if there is at all any division of labour, it is only rudimentary and horizontal in nature.

Tokman (1992) and Portes (1994) define IS on the basis of characteristics. According to them IS is the collection of marginal enterprises characterised by- (i) low entry barriers in terms of skills, capital and organisation (ii) family ownership enterprises (iii) small scale of operation (iv) labour intensive production with outdated technology (v) unregulated and competitive markets (vi) low levels of productivity and (vii) Low levels of capacity for accumulation.

Farrel (2000) defines the IS as one which consists of economic activities which are not recorded in the Gross Domestic Product (GDP) or the national income accounts.

Chandra and Pratap (2001) describes IS as the non-factory sector, which includes those employed in small establishments, the self employed, the casual labour and home-workers. It is characterised by ill-defined employer-employee relationship, acute incidence of underemployment, scattered nature of work place and low wages.

Upadhyay (2007) defines IS as that sector which consists of the Own Account Enterprise (OAE) or an establishment where 9 or less number of workers work. The enterprise operates at low level of organization, with little or no division between labour and capital as factors of production and on a small scale. Labour relations where they exist are based mostly on casual employment, kinship or personal or social relation rather than contractual arrangement with formal guarantees.

Philip C.C. Huang’s (2009) study on china’s informal economy defined “the informal economy as workers who have no security of employment, receive few or no benefits, and are often unprotected by labour laws”.

Structure and Operations

Aziz (1984) in a study in the city of Bangalore on the waste recycle industry discusses the informality of this industry in terms of organisational and production characteristics. It explains the structure and organisation, income, employment, output, levels of living and earning differentials of the participants. Aziz concludes that, urban IS is a permanent organic element of the process of urban growth.

National Institute of Urban Affairs (NIUA) (1987) in a study undertaken in four cities of India – wardha, Ghaziabad, Allahabad and Jaipur on cross sector informal activities finds that (i) the IS occupies a predominant position in the urban economics of all the case study cities and its size in terms of total number of enterprises is estimated at above 95 percent of all the economic establishments in the four cities, (ii) there exists heterogeneity in the cross sector informal activities in terms of structural attributes, nature of production, employment generation potential, technology and productivity patterns and levels of income, (iii) they are having small capital base and low employment per unit. On an average they possessed a capital base ranging between Rs. 5000 and Rs. 10000, (iv) despite low income levels, informal enterprises account for a substantial part of aggregate savings of the urban economy, (v) this sector faces constraints of finance and marketing, (vi) despite all these, the future of the urban IS is bright in India because of its very favorable capital output ratio and labour intensive nature.

Panda (1998) studied about Informal Manufacturing sector (IMS) in class-I town of Cuttack in Orissa and throws considerable light on issues of structure and productivity, size and growth, socio-economic profile and linkages in respect of the urban IMS. The main findings of his study are: (i) the fixed capital required to create a job in the IMS is 11 times less than that of the FS. (ii) Gross value added per employee in the IMS is much lower than that of the formal manufacturing sector (FMS) but gross value added per rupee of fixed assets is 7 times higher in the IMS than that in the FMS. (iii) Presence of child labour in the IMS (iv) Earning level of the entrepreneurs is positively governed by their education levels. (v) Majority of the IMS firms are indebted. (vi) Average size of employment in IMS is 3.43 persons. (vii) Informal sources of finance dominated by money lenders play a significant part in providing credit to IMS units for meeting their working capital requirements. (viii) Direct forward linkages of IMS units with the FS are very weak; the direct backward linkages between the two sectors are not very strong.

Vishwanathan (2002) describes that the informal sectors of West Africa identifies IS as the smallest enterprises, typically those with ten or fewer employees, the vast majority of which are one-person businesses with few wage workers. The enterprises are home based and involve agro-processing or petty trade in the rural area, while urban enterprises engage in trade or services and the use of paid employees is rare. Apart from family members, apprentices also work for little account for the bulk of workers in the IS businesses. Due to ease of entry and consequent large number of participants and the small size of markets served by the IS enterprises, competition is fierce in most IS markets. Lack of specialized skills leads micro enterprises to become concentrated in smaller activities which hastens the market saturation.

Cling Jean-Pierre, et al. (2010) made a comparative study in the informal sector of Vietnam and Africa where informal sector is the major source of employment in both the African and Vietnamese labour market. Even though both these country differ in terms of economic development and economic structure, they have many similarities when it comes to the informal sector. The study compares the socio-demographic characteristics of the labour force and the characteristics of jobs (status, income, etc.). In Vietnam, the proportion of young workers (less than 25 years old) is smaller in the informal sector than in the formal sector, while the opposite is true in Africa where the formal/informal ratio is 1 to 3-4 (except in Madagascar where the ratio is lower). This trend can be understood by the fact that the formal sector (especially domestic and foreign enterprises) provides employment to many young people entering the labour market, which is not the case in Africa. On the whole, there are much fewer young people working in the informal sector in Vietnam than in Africa because the proportion of young people aged 15 to 24 is lower in the Vietnamese labour force than in the African labour force.

Informal Sector and Productivity

Study undertaken by Sharma and Abraham (2004) on labour productivity in the informal service sector in the Indian economy based on the National Sample Survey (NSS) data of the 57^{th} round found that the average labour productivity in the unorganised service sector, measured as average gross value added per worker was Rs. 28160 in 2001-02. Among all the service sectors, storage and warehousing reports the highest labour productivity at Rs. 86074 per worker per annum. Storage and warehousing operations consists of operations of storages and warehouses on hire to the farm producer, dealer or trader, processor and manufacturing. While the lowest labour productivity was reported in other community social & personal service activities at Rs. 16698 per annum. This sector consists of diverse activities like sewage and refuse disposal, washing and cleaning of textiles, hair dressing, beauty parlours, shoe shiners, porters, car parkers, astrologers, palmists etc.

Taymaz (2009) research in Turkey discovered that there is tremendous potential to increase productivity in the informal sector. This can be realized by reducing the size of the informal sector by compelling the informal units to operate formally. By adopting this policy, many informal units in the manufacturing sector will probably decease from engaging in this sector as they would find it difficult to increase their productivity if they operate formally.

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Asian Development Bank and BPS-Statistics Indonesia. (2011) study in Yogyakarta revealed that labour productivity for the informal sector in real estate, renting and business activities showed the highest figure of Rp 68.46 million. The lowest labor productivity is in finance, which recorded a figure of Rp0.07 million. The informal sector industry, such as real estate and other business activities, had the highest labor productivity in Banten.

Falco (2011) studies the returns to workers' productive assets, in the form of physical capital, human capital and labour, in an African labour market. The findings show that physical capital and labour market play the most significant role in generating income for the self-employed and productivity appears to be paltry for the self employed with formal education. While education may allow workers to get access to the formal sector, its effectiveness to increase productivity in the informal sector is trammeled.

Informal Sector and Linkages

Operational Research Group (1980) undertook a survey of two types of enterprises: (i) slum-based (ii) bank assisted in the city of Madras. Ease of entry and limited access to capital were the essential features of the slum-based enterprises. Twenty-five percent of the respondents in this enterprise considered the present enterprise to be an occupation of last resort. Most of such enterprises were tiny, employing one person and started with non-institutional finances. The bank assisted units on an average were larger than slum enterprises and had a greater degree of linkage with the organized sector.

In an important study in the city of Calcutta, Shaw (1985) explains the presence of significant levels of linkages (both backward and forward) between the formal and informal sectors and this presence of linkages becomes instrumental in transferring substantially the value surplus of wage and non-wage goods produced in the IS to the FS.

The United Nation report titled "Informal Sector Development in Africa" suggests five major linkages:

i. *Forward linkages*: where firms in the formal sector buy inputs from those produced in the informal sector.

ii. *Backward linkages*: where formal sector firms supply inputs to those in the informal sector (e.g., communications technology).

iii. *Technology linkages*: transferring technology from one sector to the other.

iv. *Consumer linkages*: people from all sectors buy final products (goods and services) from the informal sector.

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v. *Credit linkages*: Often the informal sector obtains credit from the formal sector.

Menyah's (2009) study of Gaborone, the capital city of Botswana show that only 26.3% of enterprises obtain a greater proportion of their inputs directly from formal sector enterprises i.e. large scale manufacturing firms, while 73.7% of enterprises obtain their inputs from informal sector intermediaries and other retail outlets. Thus, in terms of material inputs, the informal sector is ultimately the major source of materials inputs. This situation arises from the fact that most informal sector operators are unable to purchase inputs in bulk and therefore are unable to take advantage of discount prices associated with bulk purchase. Concomitantly, micro-enterprises are unable to deal directly with formal large scale enterprises which offer such possibilities. The results therefore indicate strong and direct backward linkages between informal enterprises especially in the retail sub-sector in Gaborone's urban economy.

Sherifat (2011) opines that there are two central points' that should not be lost in the complexities of formal-informal sector linkages. The first point is that, in contrast to the findings in Latin America and the developed countries, the type of linkages that are developing between the formal and informal sectors in African countries do little to include the informal sector at the level of production. The forward linkages that have developed since the onset of crisis rest largely at the level of services and trade, which suggests little scope for the development of the light manufacturing sector beyond the level of low income consumer demand. The second point is that the lucrativeness of these linkages emerges not because of more efficiency and 'appropriateness' of informal activity, but because informal sector workers are willing to operate in poor working conditions and the existence of cheap labour. The reality is that informal workers work longer hours, demand no formal wages, and have minimal overhead that makes them an attractive option to formal sector firms.

Informal Sector and Employment

Charmes (1990) study of informal sector employment in urban areas of sub-Saharan Africa reveals that non-wage employment in the form of self-employment, family labour and apprenticeships accounts for more than 80 percent of informal sector employment and wage employment accounted for only about 10 percent.

According to Fidler and Webster (1996), the urban informal sector is one of the largest providers of income and employment to three categories of socio-economic groups in urban areas. The three categories are: (i) the survivalist i.e. the very poor people who work part-time for generating income. (ii) The self-employed who produce goods for sale, purchase goods for resale or offer services (iii) the tiny business units or micro enterprises that usually operate from a fixed location with more or less regular hours.

Xaba et al. (2002) summarizes the trend occurring in a number of African nations which revealed that there has been a reduction in the growth of employment in the formal sector, while on the other hand the informal sector has been increasing both in terms of employment and share of output. For instance, informal employment in Kenya and Uganda exceeds employment in the formal sector. In terms of Southern Africa, in Zambia 43 percent of urban employment is in the informal economy, while in Mozambique evidence suggests that 30-40 percent of urban households were dependent on the informal economy in the 1990s.

Brown (2005) revealed that the informal sector and street vending is the major source of employment in most of the underdeveloped nations. The informal sector has proved to be invaluable source for economic growth and development.

According to Devey, Skinner and Valodia (2006) South Africa‘s informal employment as a proportion of non-agricultural employment reaches 72 percent, with 47 percent of informal enterprise workers in the trade sector.

Krstić and Sanfey’s (2010) study of Serbia’s informal economy found that the informal sector in the Serbian labour market have grown substantially during 2002-2007. Nearly 28 per cent of total employment (aged 15-64) was in the informal sector in 2002, and this percentage increased to 35 per cent in 2007. One reason for the growth in informal activity is due to the regressiveness of the wage taxation system that was present since 2001 until 1 January 2007. The existence of social benefits also contributed to the increase in informal sector as a worker can register himself as unemployed in the employment service to enjoy the benefits while in reality he works in the informal sector.

Timalsina’s (2011) study of street vendors in Kathmandu found that 30,000 street vendors earned their livelihood on the street. Street vending is an important feature of an urban economy as it is a source of employment and income generation for the urban poor

Informal Sector and Earnings

Burki and Ubaidullah’s (1992) study of Gujranwala urban informal sector in Pakistan found that earnings in the informal sector were not as low as usually thought to be. His study points to the fact that earnings in the informal sector were as high that it could be compared with the earnings in the formal sector. The average monthly earnings of self-employed and workers shows that average earnings of self-employed and workers are Rs.2741, and Rs. 617, respectively. The earnings of self-employed are more than four times higher than the earnings of workers. Out of 138 self-employed more than 78 percent are earning Rs.1500 or more, about 36 percent are earning Rs. 2500 or more, and about 25 percent are earning more than Rs. 3000.

Das (2001) made a case study of the ceramic-ware industry in Gujarat and found that monthly earnings ranged from Rs.1200 to Rs.1800 for adult workers and Rs.600

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for child workers. It was also found that 88 per cent of the informal-sector units used the piece-rate payment system.

Suharto's (2002) study of Pedagang kakilima in Bandung revealed that the average household income of street vendors was found to be Rp. 32,454 (Rp= Rupiah, currency of Indonesia) or about NZ$8 per day. It was found that bulk of the street traders had very low working capital of no more than Rp. 200,000. The wide range of household incomes as illustrated by interval figures shows that most street traders (42 percent) obtain daily revenues of between Rp. 10,000 and 20,000 and more than 20 percent of the traders earn less than Rp. 10,000 a day.

Bargain and Kwenda (2011) using panel datasets studied the male earnings structure in Brazil, South Africa and Mexico. The study was on the estimation of conditional earning gaps between formal and informal wage earners differentiating between wage earners and the informal self-employed. The study revealed that informal sector workers were underpaid compared to formal sector and because of the heterogeneous activities in the informal sector the earnings of the self employed were more dispersed.

Informal Sector and Migration

The study on migration, the urban informal sector and earnings in Philippines by Koo and Smith (1983) found that migrant workers enter into the labour market employment first through the informal sector. The study also dispelled the widely held notion that identified informal sector with poverty, as it was found that informal sector offered a wide variety of income opportunities. The incomes of formal and informal sector workers were found to be more or less similar.

Ming's (2001) study on informal sector and rural-urban migration in China differentiates between the wage earner and self employed in the informal sector and looks at the separate roles they play. The study found that workers with better human capital and those who have worked in the city for a longer period are most likely to take up a job as self employed in the informal sector and those who worked as self employed were found to be the most satisfied with their jobs than those who worked as wage earners or migrants employed in the formal sector.

Timalsina's (2007) study on rural urban migration and livelihood in the informal sector in Kathmandu city, Nepal found that informal sector activity particularly street vending was significantly related to rural-urban migration in Nepal. Street vending had a positive effect on the economy as it opened up avenues for employment and sustained the urban poor. The composition of workers in street vending in Kathmandu were internal migrants who moved to the city due to the hard life in the rural areas, lack of jobs and especially due to the constant conflicts in the country side. The migrants who come to the city see work in the informal sector as a way out for them from their poverty and as a source of livelihood. Most of the workers in the informal sector were found to be possessing very low or semi skilled capabilities.

Kainth (2009) undertook a study on the push and pull factors of migration on the brick kiln industry of Punjab state. The study found that most of the migrant workers were young in age, illiterate and had low level of education. Among the various pull factors, better employment opportunities was the most significant reason for migration whereas lack of job opportunities at home was the reason to leave their native place. Remittances were also practiced by the migrants as the study found that 75 percent sent money to their families back home and all the migrant respondents maintained links with their families back home.

Conclusion

Since the inception of the term informal sector in the 1970s, various researchers have defined it according to its occurrence in different regions of the world both in developed and underdeveloped countries. The dualist or the marginalist perceived this sector as a temporary phenomenon or a transit point which would eventually fade once the economy develops. The International Labour Organisation (ILO) through its World Employment Programme saw the informal sector as a fertile segment with tremendous potential for employment generation and propelling the growth process. The structuralists argued that the formal and informal sector co-exists together and they foster each other's growth. Hernando De Soto and his followers subscribes to the legalistic view that informal sector is an outcome of people operating in this sector to avoid or escape the legal process involved in running an enterprise. Though various definitions have been attached to this sector, one area where all converge is the heterogeneity of the informal sector. Studies conducted on the structure and operation of this sector have shown that units are normally small and labour intensive, usually operated on an individual basis without partnership. Most often the employees are family members or apprentices. There is substantial linkage between the formal and informal sector often in the form of subcontracting. This validates the structuralists proposition in a sense that there exists a symbiotic relation between the formal and informal sector, though other researchers have differed on this view. In contrast, sherifat (ibid) study on formal-informal linkages observed that informal sector workers willingness to operate in poor working conditions with minimal wages makes them attractive to formal sector firms, thus taking advantage in the process and maximizing its gains. Numerous findings have expressed the informal sector's capacity to generate employment and thereby sustaining the livelihoods of workers in developing countries especially in African and Asian countries. Informal sector has been defined according to size, characteristics, legality, number of workers employed thus inheriting a heterogeneous outlook in its operation, yet its dominance in employing million of workers globally indeed points out to its existence as vital for sustaining livelihoods. Provided adequate impetus, the growth of this sector will enhance the development process considerably.

End Notes

[1]WEP (World Employment Programme) was launched by ILO in its 1969 session. Since then the ILO has conducted a large number of country and city studies in 1970s, 1980s and

early 1990s. All these studies primarily aim at creating an employment centered growth process.

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