


Annex I

ROLE OF THE INFORMAL SECTOR

A. Background

1. Role and challenges of the informal sector during economic downturns

Chapter I discusses in detail the increase in unemployment as a direct result of the Asian economic crisis. Loss of employment in the affected sectors, as businesses closed down and GDP contracted, was considered to be the most important social consequence of the crisis. But the unemployment figures told just one part of the story. The bulk of the job losses was concentrated in modern sectors that depended on institutional finances, the lack of which resulted in the closures. As a result, many skilled workers were pushed into taking relatively inferior jobs in the informal sector. Flexible labour markets in many of the affected countries allowed the affected employees to be reallocated from the formal sector to the informal sector, thus moderating the impact of the recession. According to one report, many of Indonesia's unemployed in 1999 moved into low-paying urban and rural informal sector work rather than into open unemployment.¹

Against this background, a brief discussion of this sector is necessary. The need for such a discussion is further strengthened by the country survey reported in this document, from which the importance of the informal sector has emerged. The experts who attended the regional seminar where the survey results were discussed also recognized that the informal sector ought to be an important element of the Asian social protection framework.

¹ "Poverty in East Asia, the challenges of social policy and governance", at <http://www.worldbank.org/eapsocial/sector/poverty/povcwp3.htm>.

The informal sector refers to the part of the economy that does not fall under the purview of organized economic activities. The concept has a very interesting and chequered history. As the concern of the world community increased over the lack of economic growth and perpetuation of poverty in the developing countries, policy makers began looking for a solution to ease the situation. The traditional wisdom of economic development represented by Prebisch's doctrine of post-Keynesian developments suggested that what was needed was appropriate macroeconomic policies and institutions together with the availability of sufficient funds.² A planned promotion of growth in selected leading sectors of the economy would then lead to the overall growth of the economy. Thus, the primary problems were perceived to be the identification of the target sectors with maximum linkages to the rest of the economy, and the mobilization of enough finance to enhance the growth rate of the target sectors.

The growth that was visualized by those early development economists was essentially the growth of organized economic activities through rapid industrialization via capital formation and the expansion of domestic and export demand. The reality that a large section of the population was earning a daily living by participating in activities that fell outside the orbit of the organized sector was summarily ignored as it was considered to be a temporary phenomenon. It was expected that those activities would disappear with the growth of the economy. In other words, the idea was that once the take-off in economic growth was accomplished, with the growth of the organized economy the demand for, and returns to labour would increase. Consequently, the need to participate in activities outside the organized economy was expected to gradually disappear.

That optimistic vision of economic transition did not match what was actually happening in the world. In the late 1960s and 1970s, a large section of the population in the developing countries was still suffering from poverty and still working outside the organized sector in activities that were later broadly termed as "informal". Economic growth was not percolating down to the masses fast enough. Due to population growth and urban migration, the active labour force was growing at a much faster rate than the availability of jobs in the organized sector. The focus of development policies was gradually shifting from pure economic growth to growth with

² Osvaldo Sunkel, "Past, present and future of the international economic crisis", *New World Series: One Economic Theory and New World Order* (New Delhi, Ashish Publishing House).

equity and the eradication of poverty. Interest was thus generated in sectors outside the organized economy that was providing a livelihood to a large section of the poor. Hence, the concept of the informal sector was born.

In analysing the contribution of the informal sector, emphasis is placed on the pervasive importance of the link between formal and informal activities that are not confined to particular occupations or even economic activities. Rather, informal activities are the way of doing things, characterized by:

- Ease of entry;
- Reliance on indigenous resources;
- Family ownership of enterprises;
- The small scale of operation;
- Labour-intensive and adapted technology;
- Skills acquired outside the formal school system;
- Unregulated and competitive markets.

In addition to the above characteristics, the following are sometimes included:

- Units work outside the formal administrative networks that cover the formal sector;
- A relatively low level of capital requirement.

B. Some country experiences

Given the above background, a discussion of the nature and size of the informal sector in the three countries (Indonesia, the Republic of Korea and Thailand) is in order.

Several studies on the informal sector in Thailand throw some light on this sector. A summary of the studies by Allal gives a very comprehensive picture of the informal sector activities in Thailand.³

Identification of the informal sector has always been a problem when carrying out comprehensive fact-based studies. In 1994, the National Statistical Office (NSO) of Thailand carried out a national survey of the

³ Maurice Allal, 1999, *Micro and Small Enterprises in Thailand: Definitions and Contributions*, Working Paper No. 6, Micro and Small Enterprise Development and Poverty Alleviation in Thailand Project, (ILO/UNDP:THA/99/003).

informal sector in all economic spheres, including agriculture, manufacturing, trade and service. Definitions used by NSO were:

- (a) The formal sector: Organizations that have defined management and administrative systems, including government and private agencies that employ at least 10 persons;
- (b) The informal sector: Enterprises typically operating on a small scale with a low level of organization, low and uncertain wages, and no social welfare and security.

The definition implied that enterprises in the informal sector employed one to nine workers. The definition did not refer to the legal status of an enterprise, that is, whether they were registered or unregistered. However, the census survey was very useful from many points of view and it yielded a wealth of information.

According to the survey of Thailand undertaken in 1994 by NSO, which was a boom year for the economy with a GDP growth rate of more than 8 per cent, over 75 per cent of the total employed workforce was in the informal sector. The latter figure reached 97 per cent in the agricultural sector. The informal sector accounted for 51 per cent of all enterprises in the manufacturing, trade and service sectors. It also accounted for 22.7 per cent of all employed labour in the non-agricultural sectors compared with 20.7 per cent for the formal sector. NSO statistics for 1997 on industrial and business establishments showed that employment generated by the informal sector in the manufacturing, trade and service sectors was approximately 3.5 times that in the same for the formal sector. The contributions of informal sector enterprises involved in trading to employment were much more important than those of enterprises in the manufacturing and service sectors. Women found employment more in the informal than the formal sector.

Contrary to expectations, competition among the enterprises covered by the 1994 NSO survey was not strong in most sectors where a large variety of products and services were offered. Competition was more intense in the garment, jewellery and artificial flowers groups, which were dominated by subcontracting activities and which produced for the export market where some type of product standardization was required.

The NSO survey also yielded useful information on the use of capital by micro- and small-scale enterprises. In most cases, it was found out that an informal micro-enterprise in the manufacturing sector required a substantial amount of capital. Thus, the argument of easy entry into the informal sector was not supported by the facts for a number of production sectors. Also, graduation from an informal micro- to a small-scale formal enterprise required substantial additional investment; the capital requirement for setting up a small-scale enterprise was 2 to 14 times the requirement for a micro-enterprise. In most cases, the formal small-scale enterprises had started as formal enterprises. The evidence was clear that even in the boom period, the informal sector in Thailand was important both in terms of the number of enterprises and the contribution of the sector to employment. These contributions provide ample justification for stronger support to be provided to the informal sector with a view to further increasing its contribution to employment, as well as to improving its overall competitiveness.

In the Republic of Korea, the term “informal sector” is not used. In defining the informal sector to include the self-employed with or without family labour and micro-enterprises with less than five workers, it was estimated that in 1985 there were 13.37 million employed (about 42 per cent) in this sector in urban areas compared with 5.57 million in the mid-1970s.

In Indonesia, the informal sector accounts for a large share of the total workforce. However, recent data are difficult to come by. According to a World Bank report, in 1993 the formal sector accounted for less than 32 per cent of the working population.⁴ The remaining 68 per cent were working in the informal sector. Sethuraman also provided a comprehensive study of the informal sector in Indonesia.⁵ According to the study, in the early 1980s the informal sector’s share of employment in manufacturing was 48 per cent and in trade and restaurants, 90 per cent. Overall employment in the informal sector was found to be 53.8 per cent of total employment. This finding was corroborated by an even earlier study, which reported that

⁴ Franck Wiebe, 1996, *Income Insecurity and Underemployment in Indonesia’s Informal Sector*, Policy Research Working Paper No. 1639 (Washington, DC, World Bank East Asia and Pacific Country Department III, Indonesia Policy and Operations Division), pp. 2-3.

⁵ S.V. Sethuraman, 1997, *Urban Poverty and the Informal Sector: A Critical Assessment of Current Strategies* (Geneva, International Labour Organization).

as early as 1980, 53.4 per cent of the workers engaged in non-agricultural employment were in informal sector.⁶

In terms of employment, the informal sector has been as important as the formal sector. According to an ILO study on urban Indonesia, employment in the informal sector was estimated to have risen from 6.1 million in 1986 to 8.1 million in 1990, which was about 42 per cent of total urban employment.⁷

C. Informal sector and the economic crisis

Workers employed in the informal sector were at least as equally affected by the economic crisis. Price increases that followed the crisis resulted in cost of living increases. The impact was likely greater in the case of informal sector workers. Being poorer, they had fewer buffers available to them in the form of savings and suffered from greater income uncertainty. The informal producers usually maintained a lower level of stocks and hence were also adversely affected by increases in input prices. However, the impact of the crisis on the demand for informal sector products was ambiguous. To the extent that cheaper products produced by the informal sector were substitutes for more expensive formal sector products, demand increased. On the other hand, to the extent that certain goods and services produced by the informal sector were considered to be non-essential (for example, handicraft products) with high income elasticities, demand could be expected to have fallen.

The economic crisis also had a direct impact on the informal labour market. The workers who lost jobs in the formal sector entered the informal sector, increasing the competitiveness within the sector and reducing profit margins. The existing workers in that sector also suffered on this count. Among the countries that are the focus of the present study, the increase in open unemployment was less in Indonesia and Thailand as the informal sector absorbed a large part of the unemployed labour force. In contrast, the increase in open unemployment was greater in the

⁶ J.S. Uppal, 1988, "Informal sector in Jakarta", in *The Asian Economic Review*, Indian Institute of Economics, vol. XXX, No. 2, pp. 230-245.

⁷ International Labour Organization, 1994, *The Urban Informal Sector in Asia: Policies and Strategies*, (Geneva).

Republic of Korea where the informal sector, which is very small, could not absorb the unemployed labour force to any significant extent.

The survey conducted in Indonesia, the Republic of Korea and Thailand provided evidence that the informal economy had been significantly affected by the crisis. Annex table 1 shows the extent of participation in the public works programmes and microcredit programmes by self-employed persons who were among the informal sector workers. The results indicate that the majority of the self-employed persons who participated in the assistance programmes lost a substantial amount of income as a result of the economic crisis.

Annex table 1. Participation by the informal sector in public works and microcredit programmes by income drop groups

<i>Programme</i>	<i>Country</i>	<i>No drop</i>	<i>0-50 per cent</i>	<i>> 50 per cent</i>	<i>Self-employed participants suffering income loss (per cent)</i>
Public works programmes					
Self-employed	Indonesia	12	72	46	91
	Thailand	49	37	59	66
Microcredit programmes					
Self-employed	Indonesia	68	87	63	69
	Thailand	23	66	55	84

Note: Income drop groups refer to income losses suffered by the participants. For example, the first row of the table can be interpreted as follows: among 130 participants from the self-employed group in public works programmes in Indonesia, 12 did not suffer any income loss, 72 suffered less than 50 per cent loss and 46 experienced a loss of more than 50 per cent. In total, 91 per cent of the participants from the group suffered a loss of income.

The above data highlight the need to provide proper protection for informal sector workers during economic downturns; if social protection (safety nets) is inadequate for workers in the formal sector, it is virtually non-existent for informal sector workers. Thus, designing social safety nets

only for the openly unemployed would be a gross injustice to workers in the informal sector. This need for strengthening the informal sector is adequately addressed in the Copenhagen Declaration:⁸

“In many developed countries, growth in employment is currently great in small and medium-sized enterprises and in self-employment. In many developing countries, informal sector activities are often the leading source of employment opportunities for people with limited access to formal-sector wage employment, in particular for women. The removal of obstacles to the operation of such enterprises and the provision of support for their creation and expansion must be accompanied by protection of the basic rights, health and safety of workers and the progressive improvement of overall working conditions, together with the strengthening of efforts to make some enterprises part of the formal sector ... Governments should enhance the quality of work and employment by: ... (b) improving health policies that reduce, with a view to eliminating, environmental health hazards and provide for occupational health and safety, in conformity with the relevant Conventions, and providing informal sector enterprises and all workers with accessible information and guidance on how to enhance occupational safety and reduce health risks”.

However, the question remains as to what would be the best way of providing social safety nets for people working in the informal sector. Given the nature of the sector, it is very difficult to implement programmes such as contributory unemployment benefits. The other question to be considered is whether or not the extension, to informal units, of labour protection measures similar to those for the formal sector will result in the sector losing its competitive edge. A detailed discussion on this issue is, however, beyond the scope of the present exercise.

Thus, policies that promote the efficiency of informal units and make them more competitive by providing greater access to investment funds and markets for output are likely to be effective. Microcredit and special credit programmes such as the SME credit programme in the Republic Korea could be appropriate for the informal sector. A detailed discussion on possible modalities for improving the efficiency of the informal sector can

⁸ United Nations, 1995, *The Copenhagen Declaration and Programme of Action*, World Summit for Social Development, 6-12 March 1995, chapter 3.

be found in an ESCAP report that documents the results on an informal sector survey.⁹

Evidence suggests that the informal sector is very much a reality not only in developing countries but also in newly industrialized countries. Evidence also suggests that in times of economic distress this sector works as a buffer and provides a livelihood for the impoverished masses even if the level might be somewhat inadequate. In a sense, the sector itself works as a type of social safety net. In view of the role of the sector, leaving it unassisted in times of economic distress would be doing a grave injustice to a large section of poor people who, rather than depend on government support, are brave enough to fight their way forward when faced by an unfavourable economic environment.

⁹ Economic and Social Commission for Asia and the Pacific, 1996, *Role of the Informal Service Sector in Urban Poverty Alleviation* (United Nations publication, sales No. E.96.II.F.18).

