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The Informal Sector Revisited: A Synthesis Across Space and Time

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Abstract

The concept of the informal sector (IS) has recently received widespread and growing attention. Indeed, it may be fair to talk about a re-emergence of the concept in the debate related to social protection and poverty reduction. We argue that with this new found prominence, it is even more important that we better understand the IS. Only with an improved understanding of the issues and dimensions of the IS can we design policies and programs which effectively address the needs of workers engaged in informal sector activities. This paper is an attempt to contribute to such an increased understanding by highlighting important pieces in understanding the concept of the IS across (1) time, briefly discussing how our view of the concept of the IS has evolved over time and (2) space, presenting empirical evidence and stylized features across regions. After presenting the current state of knowledge of the IS, we distill key aspects and issues of the IS and discuss their implications for policy design and implementation, especially in the context of fighting poverty and improving livelihoods of the poor in developing countries.

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The Informal Sector Revisited: A Synthesis Across Space and Time[†]

1. Introduction

The concept of the IS was first introduced by Hart (1971). But by its very nature, the IS precludes a clear articulation of itself – though not for the lack of trying by researchers. The traditional sector, the "survival" sector, the unregulated sector are all terms that are used to describe it. Indeed, one study, quoting 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 Morrisson 1996). While the informal sector is highly heterogeneous, to provide some semblance of order, we classify the sector into two broad groups: non-wage employment and wage employment. Under non-wage employment, you find the self employed (both micro-enterprises and own account) and work in family businesses; under wage-employment, you find regular and casual workers which include sub-contract workers and home-based workers. Closely related to the ambiguity in its definition is a disagreement on the degree of significance that should be attributed to the IS in policy discussions - despite recent empirical evidence suggesting the economic importance of the sector (Charmes 2000).

Clearly, an improved understanding of the IS is needed in order to achieve agreement on this issue and others. A synthesis of the theoretical and empirical literature on the subject facilitates this endeavor. We see this task as not merely as an intellectual exercise, but one that has practical benefits: an improved understanding of the phenomenon is the basis for appropriate interventions. While the informal sector has generally been considered a residual sector, the "formalization" of which would come in due time, this prediction has, thus far, proved not to hold. Indeed, on the contrary, the informal sector of most developing countries has grown considerably over the past two decades and contributes significantly to output and employment as we show later.

The informal sector in developing countries has received increased attention over the last couple of decades. However, most of this attention has been directed at the fact that often the earnings and employment situation of IS workers is inferior to that of the formal sector (FS) workers. This contrasts the tendencies of developed countries, where recent years have seen an emergence of labor which, by one or more of the previously discussed definitions, could be termed "informal". Specifically, rather than traditional street traders and vendors, which are well-known from developed and developing countries alike, we refer to the emergence of more flexible forms of employment in the putative "New Economy". In essence, we see an increased informalization of the formal sector of developed countries, wherein new breeds of workers allow greater flexibility in production at the expense of job stability and social security benefits, which were standard in the archetypal employer-employee relationship in the formal sector.[1] One of the forces at play in precipitating this transformation in the nature of employment is increasing market competition stemming from globalization (greater economic integration). It is interesting to note how this directly opposes the notion of how (developing) countries "should" move towards greater formalization of the labor force, which was traditionally considered the preferred goal by development practitioners and policy makers.

These observations beg a more nuanced debate of issues related to the informal sector. In particular, great strides in improving the conditions and circumstances of informal sector workers can be only achieved with greater recognition of their economic contributions and potential as well as with removal of long-standing policy biases against them. Indeed, the IS is often, by far, the most important source of employment in many developing economies as the formal sector – both private and public - has struggled to generate sufficient employment. Moreover, the growth of the informal sector may not be entirely undesirable as it plays an important role in the growth and development of the overall economy.

[†] We would like to thank Shantayanan Devarajan and Salem Sethuraman for helpful comments and suggestions. Remaining errors are our own. The views expressed here are solely those of the authors and should not be attributed to the World Bank or any of its member countries.

[1] A closely related issue is the widespread use of home-based workers, i.e. workers working from home and being connected to the firm's network via a personal computer. By allowing the firms to free costly office space, this allows for a major cut in firms' expenditures, while at the same time allowing for a more flexible work force in terms of the possibility of quick adjustments of labor capacity. Indeed, it has been claimed that the widespread displacement of office work to homework has provided a more flexible - but also more exploited - workforce in the tradition of the Japanese practice of the so called "Just-in-time" inventory principle, Christensen et al. (1988).

This paper, taking as a starting point the importance of the IS as an engine of economic growth and job creation, seeks to glean key conclusions from the theoretical and empirical literature related to the concept of the informal sector with the aim of discussing their policy implications. In order to fully exploit the potential gains of the informal sector, we need to take into account both the multi-faceted dimensions of the concept, as well as the regional experiences over time. A case in point is that the informal sector is very much demand driven, the skills that are demanded are directly linked to the activities to be undertaken.

This contrasts to the formal sector, where, to some extent, skills acquisition is supply driven, with education, for example, often serving as a signal and/or a screening device without necessarily being productivity-enhancing to the same degree it is wage-enhancing (if the latter was the case, skills acquisition would instead be demand driven). Hence, rather than trying to merely "formalize" the informal sector, one needs to realize that the most significant obstacle to growth in informal sector employment is the lack of access to markets and resources, most notably, factor and financial markets.

With a main objective of providing a coherent framework that may enable sound policy design and implementation, the target audience of this paper is policymakers and development practitioners. The paper is structured as follows. The next section focuses on the concept of the IS across time, tracing its origins, changes and developments. Section three presents the evidence on the IS across space, reviewing the empirical evidence on the IS across geographical regions. The fourth section, based on the preceding two sections, explores the implications for policies and programs with respect to the IS.

2. The informal sector across time: origins, changes, and developments

In this section the changes and developments in the understanding of the concept of the "informal sector" over the last decades will be reviewed. We will do so by presenting ten specific areas or points (for the sake of exposition) where the understanding of the concept of the informal sector has changed over time, either due to new evidence or methodological or theoretical reconsiderations. First, however, we briefly trace the origins of the concept..

The informal sector as a concept was first introduced by Hart (1971), according to Bekkers and Stoffers (1995). However, some claim (for example, Kabra 1995) that the concept really builds upon the earlier concept of the "unorganized sector", which encompasses production units of small size, including handicrafts, which have a “domestic or unorganized character” and may also be part of the “non-monetary” sector of the economy (for example, GOI; 1951). As claimed by Bromley (1978), it may equally well be seen as a spin-off of the dual economy literature, originating with Lewis (1954) and Hirschmann (1958), which conceptualized economic development as the emergence and growth of manufacturing sector (the “modern” sector) through the absorption of labor being freed from agriculture (the “traditional” sector), due to the more efficient means of production in the former. Whereas the dual economy (the “modern-traditional” dichotomy) literature mainly addressed the sectoral differences in terms of the *technology* applied, a somewhat later related literature focused more on the *organization* of the sectors (Sethuraman 1976). An example of the latter literature is Geertz (1963) who examined the informal sector in Indonesia.

The concept of the informal sector is a fuzzy one. Indeed, Kabra (1995) states that some thirty terms including the survival sector, non-structured sector, and transitional activities have been and/or are currently used to describe the IS.

The understanding of this concept has changed over time in several dimensions:

(1) Marginal or basic sector: The initial view of the informal sector was that it was a marginal sector in terms of its place in and contribution to the overall economy. It has later been conjectured and substantiated, however, that rather than marginal, the informal sector is basic, contributing significantly to employment and output mainly through the proliferation of labor-intensive undertakings, some of which are considered unprofitable for larger (formal) enterprises (Williams and Tumusiime-Mutebile 1978).

(2*) Short- or long term phenomenon*: the IS was traditionally viewed as a transitional phenomenon but has recently come to be accepted as a more permanent phenomenon (Bekkers and Stoffers 1995). Relatedly, recent evidence that – contrary to what one might hypothesize under the abovementioned more “traditional” view – the informal sector did not contract following economic reforms. On the contrary, the evidence suggests that – at least in Africa and Latin America – the informal sector actually shows expansionary tendencies following adjustment and reform policies (Tokman 1990).

(3) Type of labor employed: The first official report to apply this concept, ILO (1972), proved somewhat successful in contrasting the characteristics of the informal and formal sectors, the former being characterized by ease of entry, low resource-base, family ownership, small-scale, labor-intensive, adapted technology, unregulated but competitive markets, and informal processes of acquiring skills. However, it failed to adequately recognize that in addition to self-employment and family labor in various guises, wage labor (regular as well as casual) and apprentices, for example, were also a very important component of the IS.

(4) Linkages to the formal sector: Another issue typically absent in the earlier literature, for example, the ILO-study just mentioned, was the general lack of recognition of linkages between the formal and the informal sectors, or, at a minimum, of the character and basis of these linkages, for example, subordination or superordination, Sethuraman (1981), Hugon (1991), were not even raised (see Kabra 1995). Recent evidence shows that in some countries, linkages between the formal and informal sectors can often be quite dense and extensive, particularly in urban areas.

(5) Productivity and contribution to GDP: While initially the informal sector was viewed as more or less a "residual sector", a source of employment for those who were unable to find employment in the formal sector, and the informal sector worker, correspondingly, being regarded a low productivity worker, recent empirical research has shown this not to be true. For example, Charmes (1990) finds evidence that the informal sector worker generally contributes to GDP over and beyond the minimum wage. Furthermore, Charmes (1990) suggests that generally, productivity in the sector is much higher than average per capita GNP in the economy. Another important fact which has not received attention until recently is that there are non-trivial numbers of households engaging in both informal and formal sector activities (King 1990).

(6) Geography: The term also came to have a geographical dimension in that the notion of the informal sector was implicitly linked to the urban economy, a tendency which has continued to persist (Todaro, 1987). However, recent studies find evidence of the informal sector is far more pervasive, applying equally to urban and rural areas. For example, King (1990, p. 95) states that "in the 1980s, there seem to be some point in re-conceptualizing the

informal sector as the ordinary economy cutting across rural and urban areas, agriculture and commerce, across survival skills and income-generating strategies".

(7) Importance of context: While initially the term "informal sector" was entirely descriptive and somewhat decontextualized, recently, increased attention has been directed towards understanding the informal sector in the context of the specific historical, political and social aspects of the country or region in question. For example, Kabra (1995, p. 200) stresses the importance of applying a historical framework, since "any ahistorical approach to the informal sector would hardly be able to capture its diversity, varying degrees of cohesion, linkages with the rest of the economy and future directions...".

(8) Technological base: Another area where the understanding of the informal sector has undergone change is with respect to the technological base of the informal sector. Where it was initially generally supposed that the technological base of the informal sector was traditional – hence, practically static, recent empirical evidence seems to show that this view does not hold uniformly. Although IS enterprises tend to use simple technology and have low capital intensity, some are highly dynamic, with innovations taking place in inputs, processes, and output, allowing them to adapt to new circumstances and exploit market opportunities (Arye 1981).

(9) The informal sector – or informal sectors? Dividing economic activities into two mutually exclusive formal and informal sectors, though perhaps desirable on analytical grounds is clearly an over-simplification. Some establishments may be characterized by elements from both sectors, complicating their proper classification. Hence, as an alternative, it has been suggested that enterprises be classified on a *continuum* between the two extreme and opposite poles of formal and informal. This alternative representation improves upon the earlier and more crude dual sector depiction by allowing intermediate categories and movements along the overall continuum (Bromley 1978).

(10) Policy intervention: An outcome of the previously discussed sharp dichotomy between the formal and the informal sector was the perception that a single policy prescription can be applied to the entire informal sector, without consideration for the specific circumstances of individual establishments. Consistent with this view, "governments should adopt similar programs towards artisans making furniture, artisans illegally manufacturing fireworks,

towards sellers of basic food-stuffs, and towards prostitutes and drug-peddlers", as put provocatively but enlighteningly by Bromley (1978, pp. 1035). However, given growing recognition of the wide diversity of activities, occupations, and individuals in the informal sector, rather than a single uniform policy, a wide range of policies and programs are argued for – one size does *not* fit all. Policy instruments need to be fine tuned to the particular conditions and circumstances of a given segment of the IS in a given economy.

In the following section, the understanding of the informal sector as it relates to the above mentioned points will be (further) substantiated in a regional context to the extent that empirical evidence makes possible.

3. The informal sector across space: regional evidence

This section complements the previous one by delineating the salient features of the informal sector across space based on an extensive review of the empirical literature on the subject. The issues brought to light here – together with those that emerged from the previous section – will form the basis of the policy discussion in section four.

Contribution to employment

The notion of the informal sector being basic as discussed in the previous section is clearly reinforced by the size and pervasiveness of the phenomenon in the developing world. In many countries, it is *the* primary source of employment for workers, particularly for those that are relatively disadvantaged in the labor market (e.g., unskilled or low-skilled, female, disabled, and older workers). Available evidence suggests that the informal sector is larger in sub-Saharan Africa than in other parts of the developing world, generally accounting for 60-80 percent of total non-agricultural employment (Charmes 2000). In Asia, the informal sectors in South and Southeast Asia are also considered to be equally large. Evidence for these regions are not as extensive as for sub-Saharan Africa, but recent estimates for India (73.7 percent of non-agricultural employment), Indonesia (77.9 percent of non-agricultural employment), Pakistan (67.1 percent of urban employment), the Philippines (66.9 percent of non-agricultural employment) and Thailand (51.4 percent of non-agricultural employment) lend strong support to this view (Charmes 2000, ILO 2000). In comparison, the informal sectors in Latin America and North Africa appear to be somewhat smaller, generally between 30 and 60 percent of non-agricultural employment (Charmes 1998, Charmes 2000). The limited evidence for Eastern Europe and Central Asia shows that the informal sector generally constitutes only about 5-20 percent of non-agricultural employment; however, the shares exhibit a strong upward trend given weak employment creation and income generation in its nascent private sector (ILO 2000).

Across the developing world, the informal sector continues to expand in absolute and relative terms (see Charmes 1998). Its perpetuation and growth has been largely due to the weak capacity of the formal private sector to generate adequate employment and incomes, in many countries, in the face of high rates of labor force growth and rural-urban migration (Sethuraman 1997, Tokman 1990, Charmes 1998). Conversely, informal sector employment (growth) has declined in countries that have experienced periods of robust *and* sustained economic growth (Charmes 1998). For example, in pre-crisis Southeast Asia, on account of strong export-led growth and industrialization, the formal sector was able to absorb informal sector workers and new labor force entrants in increasing numbers, resulting in a marked deceleration in the growth of the informal sector (see Alonzo 1991, Lubell 1993, Poapongsakorn 1991). The complementary empirical accounts of employment expansion during economic downturns and employment contraction during robust economic recoveries appear to testify to the counter-cyclical character of the informal sector argued by many researchers of the phenomenon, East Asia being a case in point.

Contribution to output

For obvious reasons, empirical evidence on the contribution of the informal sector to GDP is scarce; however, where estimated, the figures suggest that the informal sector contributes significantly to GDP. For example, Charmes (2000) determines that in sub-Saharan Africa (excluding South Africa), the informal sector contributes between 20-50 percent of non-agricultural GDP. His estimates for few countries in South and Southeast Asia, and Latin America mostly fall within the same range.[2]

Activities and enterprises

The preponderance of evidence suggests that the informal sector is highly heterogeneous in terms of the types of activities and encompasses a range of sub-sectors including manufacturing, trade, services, construction, and transport. The relative distribution of these

[2] Corroborated by, for example, Sanderatne (1991); Alonzo (1991); and Poapongsakorn (1991).

activities shows wide variation between countries, but by and large, trade and services tend to dominate followed by manufacturing. Construction and transport are less prevalent.[3] Typically, informal sector enterprises are small-scale, labor-intensive operations.[4] Tokman (1990) describes these enterprises as characterized by ". . .a low level of technology, few capital requirements, a simple division of labor, and little differentiation in the ownership of means of production (p. 1069)." There is also overwhelming evidence that informal sector participants face a variety of constraints including limited or lack of access to resources and markets as well as to land and physical infrastructure (see Sethuraman 1997, Tokman 1990).

Employment

Non-wage employment is the norm. For example, Charmes (1990) reports that non-wage employment in the form of self-employment, family labor, and apprenticeships accounts for more than 80 percent of informal sector employment in urban areas in sub-Saharan Africa, while wage employment accounted for only about 10 percent. Similarly, Sethuraman (1997) claims that two-thirds or more of informal sector enterprises are either single-person (i.e., self-employed) or family operations. Wage labor appears to be more common in manufacturing, transport, and construction activities, in larger informal sector enterprises, and in urban areas. Among wage-earners, regular wage labor is typical; however, casual wage labor is substantial. In addition, work intensity (hours of work) in the informal sector also appears to be higher than in the formal sector.[5] Working and workplace conditions in the informal sector are also often a cause for concern as legislated standards and regulations are generally not applied.

Skills and human capital

The majority of informal sector workers are low-skilled or unskilled.[6] Formal education levels tend to be lower than in the formal sector.[7] A large share of informal sector

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[3] The ILO-PREALC studies reveal that the urban informal sector in Latin America was composed as follows: 37.5 percent services; 20.4 percent trade; 18.6 percent manufacturing; 6.3 percent construction; and 3.3 percent transport (Lubell 1991).

[4] The average informal sector firm size in selected countries/cities are as follows: 3.3 in Pakistan (Kemal and Mahmood 1998); 1.6 in Bangladesh (Quasem et al 1998); 3.3 in Jakarta, Indonesia (Lubell 1991); 3.5 in Bangkok (Lubell 1993); 2.2 in Lusaka (Lubell 1991); 1.9 in Nairobi (Lubell 1991).

[5] For example, Kemal and Mahmood (1998) report that informal sector workers worked on average 15 hours more than their counterparts in the formal sector. Quasem et al (1998) find similar evidence for Bangladesh.

[6] It is important to note that, although to a much lesser extent, the informal sector also includes highly skilled workers involved in artisanal activities, either independently or in small groups. These workers possess

participants have not received any formal education; of those who have, the vast majority have only obtained some basic or primary education. However, it appears that this general characterization is less applicable to Southeast Asia: the limited available evidence on this aspect suggests that informal sector participants in Southeast Asia tend to be better educated than their counterparts in South Asia, Africa, and Latin America, with sizeable shares of workers having received secondary, even tertiary education (see Lubell 1991). On the job training is the norm and usually considered sufficient to obtain the knowledge and skills required for undertaking various economic activities in the informal sector. Typically, investments in human capital take the form of apprenticeships under informal arrangements. Given limited access, training from formal institutions is extremely rare.[8] Some evidence from Southeast Asia shows that when formal vocational training is acquired, it is usually in repair work related to electrical appliances, automobiles, electronics, and the like (Lubell 1993).

Earnings

Wages tend to be very low in the informal sector, typically markedly below those offered in the formal sector, and often below legislated minimum wage levels.[9] Notwithstanding, the earnings profiles of informal sector participants differ both considerably and systematically by occupational status. In general, the self-employed have the highest earnings followed, in descending order, by regular wage earners, casual wage earners, and lastly, apprentices. This order holds true regardless of the branch of informal activity. Moreover, there appears to be a significant gap in the earnings of the self-employed compared to wage earners in the

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substantial, often unique human capital usually acquired through several years of intensive apprenticeships (Mead and Morrisson 1996).

[7] For example, Funkhouser (1996) finds for a sample of five Central American countries, that the mean levels of education was higher (often substantially) in the formal sector than in the informal sector. The mean education levels were also generally lower than that required for completion of primary education.

[8] Burki and Abbas (1991) find, for example, that less than 10 percent of workers in the urban informal sector in Pakistan received formal training.

[9] For example, Mesa-Lago (1992) reports ILO-PREALC findings which show that the average wages in the informal sector were 51.3 percent of average wages in the formal sector in Costa Rica, 46.6 percent in Mexico, 44.4 percent in Lima, and 36 percent in Chile. In Brazil, 66 percent of informal sector participants earned below the officially stipulated minimum wage. Quasem et al (1998) find for Bangladesh that the average wage rate for informal sector workers is 26.2 percent lower than the minimum wage rate for the formal private sector.

informal sector.[10] For example, in the urban informal sectors of Costa Rica, Colombia, and Peru, micro-enterprise owners make 2.5 to 3 times the earnings of their employees, while the self-employed (with no hired workers) make 50 percent more than wage-earners (Tokman 1990).[11]

Survey findings also suggest that the earnings of the self-employed in the informal sector compare favorably with wage-earners in the formal sector, often being considerably higher than legislated minimum wage levels, while the earnings of wage-earners tend to be near or below them.[12] For example, across countries in Africa, the average earnings of the self-employed ranged from 1.5 to 5.8 times the minimum wage level, compared to 0.6 to 1.7 times for wage earners (Charmes 1998). Wages are particularly low for apprentices, if they are paid at all. Again, in Africa, the average wages of apprentices range from 0.2 to 0.4 times the minimum wage level across countries (Charmes 1990).

Capital and credit

Given its relative scarcity, financial capital investments in the informal sector tend to be low. However, there is significant variation in the use of capital by type (manufacturing and transport activities tend to be relatively more capital intensive) and scale of informal activity. Most informal sector entrepreneurs rely on their own personal savings or equity as their primary source of start-up capital, followed by credit from family and/or friends. For example, 82 percent of informal sector entrepreneurs in Bangkok used their own funds as start-up capital (Lubell 1993). Similarly, in New Delhi, 84 percent of informal sector entrepreneurs used either their personal savings or borrowings from family or friends to set-up their businesses (Lubell 1991). Borrowing from other sources is minimal; when resorted to, it is usually from non-institutional sources such as professional money lenders rather than formal financial institutions. There is some evidence that non-institutional sources of credit are more important as a source of working capital (for example, see Quasem et al 1998 for Bangladesh).

[10] Tokman (1990) and others argue that the earnings disparity between the self-employed and wage-earners is perhaps not as wide as implied by the data as adjustments have not been made for the use of unpaid family labor by the self-employed and for remuneration in kind for wage-earners at the bottom of the earnings distribution (e.g., domestic servants).
[11] For other countries and regions, see, for example, Burki and Abbas (1991) for Pakistan; Huq and Sultan (1991) for Bangladesh; Charmes (1998) for Africa; Lubell (1991) for Southeast Asia.

Duality within the informal sector

Although low productivity, subsistence activities typify the informal sector, there is mounting evidence that there is also a dynamic, productive, and lucrative segment. Termed the "upper-tier informal sector" by Fields (1990), this segment is comprised largely of small-scale or micro-enterprises. The degree of capitalization is usually higher and workers tend to be more educated and skilled than in the informal sector at large. As described above, their earnings reflect this more favorable state.[13] Furthermore, unlike for the informal sector generally, this segment appears to be pro-cyclical in character, growing when the economy grows. We also see that if the micro-enterprise segment is used as a proxy for the "upper-tier", it is generally larger in Latin America and Southeast Asia than in sub-Saharan Africa and South Asia. For example, the micro-enterprise segment constituted between 30-50 percent of informal sector employment in Latin America compared to between 5-20 percent in sub-Saharan Africa (Charmes 1998).

Legality

Informal sector enterprises are considered (often by definition) to operate outside of the institutional and regulatory framework. However, this notion does not hold uniformly, graying the area once thought to represent a distinct line between informal and formal activity. This variation in compliance represents one of the main elements in the informality-formality continuum discussed in the previous section. There is scattered evidence from different parts of the developing world that show that a significant share of informal sector enterprises really operate on the margins of legality, that is, they comply with some regulations but not with others. The extent of compliance with various *applicable* legal requirements appears to be positively correlated with firm size and age. Furthermore, informal sector firms in cities are more likely to comply with various regulations than those in smaller towns or rural areas, as are those that in certain sub-sectors of informal sector (Mead and Morrisson 1996, Tokman 1996). Obviously, the degree of enforcement rigor by authorities also affects the degree of compliance – in particular, the capacity for law

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[12] See, for example, Tokman (1990) for Latin America.

[13] For example, Evers and Mehmet (1994) report that more than half of Indonesian informal sector enterprises in trade generated earnings that were substantially higher than the minimum wage. Similar findings are reported for informal sector enterprises in Bangkok (Lubell 1993).

enforcement tend to be concentrated in cities, which is one important explanation of the above mentioned duality. However, in many countries, the majority of informal sector activities are considered *alegal*, in other words, tolerated by government authorities.

Poverty

There is growing evidence that poverty is a key characteristic of the informal sector,[14] and that there is an association between the incidence of poverty and participation in the informal sector. Measured on the basis of consumption expenditure, evidence from India shows that 43 percent of informal sector participants to be poor compared to only 6 percent in the formal sector (Pradhan et al 1999). Sethuraman (1997) reports extensive evidence for urban centers in Latin America which clearly shows that, in general, the majority of the working poor are in informal sector (e.g., 66.2 percent in Bolivia, 66.4 percent in Brazil, 87.1 percent in Panama, 57.4 percent in Venezuela). He also shows that the incidence of extreme poverty is higher in the informal sector (see also Mesa-Lago 1992). However, the association between poverty and participation in the informal sector does not hold uniformly across all types of workers. As discussed before, the self-employed, particularly micro-enterprise owners, are found to have average earnings several times the minimum wage, allowing us to infer a lower likelihood of poverty among them. Consequently, in many cases, it might be incorrect to claim that poverty is a defining characteristic of the informal sector as a whole.

Female workers

Given the disadvantaged position of women in the labor market in most parts of the developing world -- the result of long-standing societal norms which discourage the social and economic integration and advancement of women -- the majority of female workers are in the informal sector. This is especially true for sub-Saharan Africa and South Asia (UN 2000, Sethuraman 1998). It is also evident that female workers rely more on the informal sector than men -- the shares of female non-agricultural employment in the informal sector are generally (and often substantially) higher than those for male workers. But women's participation in terms of their share of informal sector employment is more mixed. Recent evidence shows extremely low shares in North Africa (for example, Tunisia: 18.1 percent)

[14] See, for example, Alonzo (1991) for the Philippines, Quasem, Mondal and Mahmud (1998) for Bangladesh, Charmes (1990) for selected countries in Latin America.

and South Asia (for example, India: 22.7 percent) and near even shares in Southeast Asia (e.g., Thailand: 48 percent; Philippines: 52 percent). No pattern was apparent for sub-Saharan Africa and Latin America; there is, however, some evidence of very large female shares in informal employment in sub-Saharan Africa (Benin: 62 percent; Kenya: 60 percent; South Africa: 61 percent) (Sethuraman 1998, Charmes 2000, UN 2000). Notwithstanding, there is strong evidence that, in most countries, women are over-represented in the informal sector, that is, their share in informal sector employment is higher than their share in total labor force (Sethuraman 1998). This is in stark contrast to women's extreme under-representation in the formal sector employment.

In terms of occupational distribution within the informal sector, women are more likely to be employed in manufacturing, trade, and services than in construction and transport. Women tend to dominate trade, and, depending on the country, sometimes even manufacturing and services. Furthermore, even within a given sub-sector, there can be a sharp difference in the types of activities women and men are engaged in. For example, in the informal manufacturing sub-sector of Southeast Asia, women were more numerous in garment manufacturing and leather working than men, while the opposite was true for metal- and wood-working (Lubell 1993).

Scattered evidence shows that the women are more likely to be in non-wage employment (own account or unpaid family worker). When in wage employment, they tend to be disproportionately more at the bottom of the earnings distribution. Furthermore, female workers tend to earn less than male workers irrespective of occupational category or economic activity in the informal sector. This gender disparity in earnings is often markedly wide (see Sethuraman 1998 for cross-country evidence on female employment and earnings in the informal sector).[15] This evidence implies a higher incidence of poverty for female workers in the informal sector.

4. Policy discussion: a synthesis across space and time

The above discussion has clearly demonstrated how the concept of the informal sector has undergone significant change in the last few decades and how its character differs from one part of the world to the next. This has pertinent implications for policy interventions which seek to address the needs and circumstances of informal sector workers. In this section, using the main points raised in the previous two sections, we explore the implications for policy and program interventions.

One recurring theme across space and time is the heterogeneity in several dimensions – degree of legality, the education and productivity of workers to name but a few - of the informal sector. Consequently, this fact needs to be factored into policy discussions. For instance, programs which have been introduced in order to address the needs of one segment of the IS may be at odds – or, at least, not relevant and/or unnecessary - with another segment. As an example, if the female part of the relevant segment of the IS in a given region or country for instance mainly face a lack of relevant skills, addressing the main obstacle of the male segment which, say, is a general lack of access to credit does not address the problems of the IS *as a whole,* but merely those of smaller *segment(s)* of the IS. In addition, measures which work for the one IS segment may not be relevant for the same segment in another region or country depending on the factors which underlie them. Clearly, there is no "cookie cut" approach in the policy realm with respect to the IS. The challenge for policy makers and development practitioners is how to address informal sector needs in view of its inherent heterogeneity and dynamism.

The discussion in this paper has also underscored the variety of constraints (for example, technology, credit, capital, and education and training) that the informal sector faces. Interestingly, the challenge for policy makers is how to design polices which can systematically and consistently address these issues. One fact which is clear is that there are very few interventions which can address all or most of them at the same time. Also, if there are linkages between certain constraints, for example, access to credit, capital and technology, then they need to be dealt with together. The few state interventions that exist have been disappointing because they did not take into account constraints holistically and hence having realized little, if any, improvement in the IS after they were introduced. This also shows the complexity of designing policies for the IS as they have to address different

[15] Charmes (1998) however asserts that the gender disparity in earnings is not as wide as suggested by the data as within the various broad occupational and sub-sectoral categories, women and men are engaged in different activities.

constraints depending on the sector or locality. Also, the importance and linkages are more nuanced depending on their differences. This calls for a multi-sectoral approach to policy interventions which is extremely challenging in most developing countries where individual policy "silos" seldom collaborate in designing and implementing policies and programs.

This paper also argues that the linkages between the formal and informal sectors form an important part of their character. [16] The literature discusses the linkages as important for understanding the issues of the IS. Historically, these relationships have not been explored or formed an integral part of policy discussions regarding the IS. Studies have revealed the "derived demand" character of some informal sector activities and how a downturn in the overall economy and weak formal sector demand can adversely affect the IS. Thus, policy interventions need to be cognizant of the inter linkages when they consider IS needs. Pre-crisis East Asia, for example, has clearly shown how the lack of policies and programs for the IS can be detrimental when a shock hits. In fact, as a result of this neglect, these economies had to pay a heavy price. It is surprising that policy discussions have not taken into account formal-informal sector linkages despite their close connection. One could argue that the entrepreneurs in the informal sector face the same challenges as those in the formal sector, but on a somewhat larger scale or with differing depth. Recent discussions in expanding social protection to the IS has brought to light many opportunities and challenges given the close linkages between these two sectors. It is clear from the literature there is very little disagreement on the existence of these linkages in academic circles, however there are wide ranging views on what these linkages mean for policy. Indeed, the very first step forward would be for policy makers to *acknowledge* the existence and importance of these linkages in the first place, thus enabling the initiation of the natural next step, namely to *address and utilize* the FS-IS linkages in policy. Until policy makers fully realize and acknowledge the FS-IS linkages, these linkage cannot fully be exploited.

Another conundrum in the economics literature has been the persistence of the IS. Although the literature shows how some of the features of the IS have undergone change

[16] While one may distinguish between several types of linkages, interfirm, intersectoral, forward and backwards, to name but a few, such a classification is beyond the scope of this paper. The important insight in this discussion is that important linkages, or, similarly, spill-over mechanisms or externalities, exist between the FS and the IS.

there are many other features which have persisted over time. Hence, the economic theories which predict the decline of the IS with economic growth have become less convincing. Of course there is a potential for increasing the degree of "formality" in the IS. There is growing evidence that even in developed economies there has been a resurgence in IS activities. This gives credence to the hypothesis that there is actually a continuum of informality among enterprises. Some are more formal than others. The theoretical artifact of a dichotomous classification has proven to be far from reality. This also gives less credibility to policies which relentlessly attempt to "formalize" the IS by collecting taxes or register them forcefully. Therefore, future polices and programs should take into account this feature. If not, we will have policies which are based on the wrong premises and also have the wrong objectives as their targets. For instance, in many countries, policies which have sought to "formalize" the IS have failed because they did not recognize the fact that "informalization" is part of an *economic process*[17] and not due to the deliberate act of those who are in the IS.

One of the myths of the IS is that it does not account for a large share of employment, output, or incomes. As this paper shows, recent work shows unequivocally that the IS is a significant part of the economy. In fact, there are detailed studies which estimate that as much as 50 percent of non-agricultural GDP can be attributed to the IS in sub-Saharan Africa, Asia and Latin America, Charmes (2000). There are also some evidence to show that the poor in most developing countries resort to IS activities as an escape route out of poverty, Alonzo (1991), Charmes (1990), Quasem, Mondal and Mahmud (1998). Hence, the IS is far too important to be left to itself or for governments and donors to downplay. Thus, development practitioners and governments should strive to find policies and programs which harness the potential this sector. However, the challenge is how to do this given the complexity of this sector. One framework which can be useful in this context is the Social Risk management (SRM) which, among other things, argues that risks and opportunities are two sides of the same coin and depending on how effective one is in dealing with risk, it can turn into a great opportunity. Thus, governments should focus on developing sustainable and

[17] For example, recall the discussion in the introduction on the increased degree of informalization in many developed economies in recent years.

meaningful risk management strategies which can enable the IS to realize its potential. Many governments today are beginning to realize the importance of such an approach but have a long way to go in terms of developing appropriate policy responses for the IS.

As mentioned in the previous sections, the IS is heterogeneous also in terms of employer-employee relationships. There are many employer-employee relationships which, on the one hand, give this sector its rich character but on the other, contributes to complexities and problems. For instance, micro entrepreneurs, self employed workers, home-based workers, unpaid wage workers, apprentices and wage workers belong to this sector. The degrees of informality that characterize each of these groups differs. Thus, it is extremely difficult to have a single policy intervention which can address all of the needs of this sector. Evidence shows that labor standards and labor codes are inadequate to deal with the complexities generated by the various labor relationships in the IS. Thus, one approach is to use the SRM approach and understand the risks these workers face and based on the common sources of these risks develop appropriate policy interventions. Although this is challenging and probably difficult, it will lead to solutions which address the root causes of the risks they face rather than their symptoms. In fact, the need to deal with numerous activities and labor relations can lead to a plethora of programs and policies, some of which can be at odds with others. One example was the case of addressing a need of increased access to credit, when skills acquisition was the more important issue, as discussed earlier.

The development community has been preoccupied with the challenge of poverty reduction for some time. The link between the IS and the poverty reduction challenge is more than a coincidence. Evidence seems to show that there is a strong association between the incidence of poverty and participation in the IS. Hence, poverty reduction, which most developing country governments grapple with, cannot be achieved without having a comprehensive policy for the IS. In most cases in SSA and South Asia, addressing the needs of the IS can result in dealing with two issues at the same time – on the one hand, the needs of the informal sector, and on the other, the needs of the poor. Given the substantial overlap between these two, most strategies can be jointly developed and implemented. Also given donor commitment to such a strategy, it is certain that both the technical and financial resources to support such an approach will be more than forthcoming.

It is a well established fact that there is a majority of women in the informal sector. The numbers also indicate that female employment in the IS results in a significant augmentation of family income. Thus, policy design and interventions need to ensure that women can take advantage of employment opportunities as they arise. The literature indicates that women are predominantly found in unpaid or home based work. As a result, the needs of these women cannot be easily addressed through formal policy measures as they tend to be beyond the domain of government interventions and enforcement. This clearly highlights the need to collaborate with NGOs and community based organizations (CBOs) in finding lasting solutions to the needs of those in the IS, especially women. One observation which seems fairly consistent both across space and time is lower earnings of women compared to men. This issue has posed a formidable challenge for policy decisions even in the formal sector for a long time and need government intervention. The important issue to note here is that legislative reform alone may not work as most segments of the IS are beyond the domain of the state. Hence, the challenge is to design innovative programs which seek to address regulatory and institutional reforms which affect the IS.

The notion that the IS is less productive, inefficient, and so on are not true of many activities. Although there are activities which are less productive and possess low returns, there are also many activities which are more productive and very lucrative. Here, again, the notion of a "continuum" applies. Thus, activities in the IS cover the entire spectrum of less to highly productive and profitable activities. Policies in the past which have focused on the "traditional" notion that the IS is a low productive sector have ended up being largely irrelevant. Thus, policy interventions need to take into account the reality of the spectrum of activities to ensure they are relevant for the IS. Also, measures which seek to enhance their productivity through subsidies and assistance packages (for example, training and credit) are not relevant for all firms.

Also, it is not always true that all those in the IS are there involuntarily; some voluntarily choose to participate in the sector, Maloney (2001). There are several reasons why participation in the IS may be voluntary. During recessions, for example, IS workers may index their wages daily, while FS workers are locked in their wage contracts. Also, the existence of a ceiling on mobility opportunities for manual workers makes self-employment one of the only, if not *the*, remaining outlet for further advancement. So, those who voluntarily join the IS and are involved in potentially highly productive activities may not need such assistance, as discussed above. Indeed, providing certain kinds of assistance packages may lead to unnecessary subsidies being given to certain groups within the IS. Hence, government assistance needs to target those who need such assistance rather than providing it to all, an unnecessary fiscal cost.

The informal sector when first discussed in the early seventies was concerned with mainly with urban informal activities. Over time, the literature has recognized that the IS is much more vibrant and larger in the rural areas than previously thought. However, programs are still designed with the urban IS in mind. As discussed in this paper a significant segment of the labor market is in the rural informal sector in terms of employment and output. Hence, policies which address the needs of the informal sector needs to be cognizant of this, otherwise they will not be able to address many of the IS needs which have a rural bent to them. In addition, macro policy biases lead to asymmetric adverse effects on certain IS activities, for example food processing, petty trading, handicrafts, small scale manufacturing of household items and so on, and can be avoided if their character, both in rural and urban areas, are considered jointly.

In addition, the recent changes in the landscape of most economies – greater vulnerability to external economic and financial shocks, the role of information technology in driving the economy - are leading to many changes in economic activities and labor relations, all with implications for the IS. The "new economy", apart from holding great promise, also entails risks which have implications for the IS. Therefore, policy discussions need to take account of these nuances as this debate continues. In addition, economic liberalization and globalization has resulted in enhanced opportunities and in some cases increased insecurity. Therefore, policies and programs need to take into account the effects of these interventions. The WDR2000/1 provides us with a useful framework to address IS needs in this context – promoting opportunities, facilitating empowerment, and enhancing security.

5. Conclusion

The concept of the informal sector (IS) – originating three decades ago with Hart (1971) - has recently received widespread and growing attention in the development community. Indeed, it may be fair to talk about a re-emergence of the concept in the debate related to social protection and poverty reduction. We suggest that with the re-emergence of the concept in recent years, it is even more important that we conceptualize and formalize the notion of the IS. Only when a thorough understanding of the issues and dimensions of the IS has been obtained can we design policy packages which help address the needs of workers engaged in the informal sector.

This paper is an attempt to bring about such an increased understanding by synthesizing the developments of the understanding of the concept of the informal sector (IS) as it has been conceptualized and analyzed in scholarly journals and research over the past three decades with the empirical evidence available. The aim of this exercise is an increased understanding of the concept of the IS, enabling development practitioners and policy makers to design and implement policy packages which satisfactorily address key issues, needs and concerns of IS workers.

This paper clearly shows the paucity of empirical evidence, hence, one important conclusion reached is that more emphasis needs to be placed on the collection of high quality data. This work is very cautious in its nature and, hence, is likely to be improved and/or corroborated, as the amount of high quality data available for empirical analysis of IS related issues increases in the future.

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APPENDIX

Table 1: Size of the informal sector in developing countries

Country	As a percent of the labor force				As a percent of GDP		
	Year	Total	Male	Female	Year	Total	Non-agricultural
Africa							
Benin[5]	1992	47.9	52.5	41.1	1993	27.3	42.7
Botswana[1]	1985	27.0	--	--	--	--	--
Burkina Faso[4]	1992	77.0	--	--	1992	24.5	36.2
Burundi[4]	--	--	--	--	1996	25.7	43.7
Cameroon[6]	1993	57.3	--	--	--	--	--
Chad[4]	1993	74.2	--	--	1993	31.0	44.7
Côte d'Ivoire[7]	1996	52.7	37.3	73.3	--	--	--
Ethiopia[1]	1996	33.0	19.3	53.4	--	--	--
Gambia[2]	1993	72.4	66.1	82.7	--	--	--
Ghana[1]	1997	78.5	--	--	1988	31.4	58.3
Kenya[4]	1995	58.1	--	--	1999	18.4	25.0
Madagascar[8]	1995	57.5	--	--	--	--	--
Mali[2]	1996	71.0	--	--	1989	23.0	41.7
Mauritania[4]	1989	75.3	--	--	1989	10.2	14.4
Mauritius[4]	1992	24.0	--	--	--	--	--
Mozambique[4]	1994	73.5	--	--	1994	38.9	44.8
Níger[2]	1995	35.2	--	--	1995	37.6	58.5
Senegal[4]	1991	76.0	--	--	1991	33.0	40.9
South Africa[4]	1996	19.3	12.3	27.6	1995	6.9	7.2
Tanzania[9]	1995	67.0	59.7	85.3	--	--	--
Uganda[10]	1993	83.7	67.6	80.5	--	--	--
Zambia[3]	1993	80.7	--	--	1998	14.7	20.2
East Asia and the Pacific							
Indonesia[11]	1995	20.6	19.1	22.7	1998	25.2	31.4
Fiji[12]	1990	43.0	--	--	--	--	--
Myanmar[13]	1996	54.2	52.6	56.9	--	--	--
Philippines[3]	1988	25.6	--	--	--	--	--
Philippines[14]	1995	17.0	15.8	19.4	1995	25.4	32.5
Thailand[3]	1994	76.8	75.3	78.6	--	--	--
Thailand[1]	1994	47.6	46.1	49.4	--	--	--
South Korea	--	--	--	--	1995	15.9	16.9
East Europe and Central Asia							
Croatia[1]	1997	6.2	5.9	6.6	--	--	--
Kazakhstan[15]	1996	17.3	--	--	--	--	--
Kyrgyz Republic[10]	1994	11.9	--	--	--	--	--
Latvia[1]	1996	9.1	--	--	--	--	--
Lithuania[1]	1997	8.5	11.9	4.8	--	--	--
Poland[1]	1995	12.8	14.3	11.0	--	--	--

Table 1: Size of the informal sector in developing countries							
Country	**As a percent of the labor force**				**As a percent of GDP**		
	Year	**Total**	**Male**	**Female**	**Year**	**Total**	**Non-agricultural**
Slovakia[4]	1996	19.2	25.0	10.9	--	--	--
Ukraine[1]	1997	4.9	4.5	5.3	--	--	--
Latin America and the Caribbean							
Argentina[4]	1995	45.7	--	--	--	--	--
Bolivia[2]	1996	58.5	54.0	63.8	--	--	--
Brazil[4]	1995	48.2	--	--	--	--	--
Chile[2]	1997	30.3	31.9	27.4	--	--	--
Colombia[4]	1995	51.5	--	--	--	--	--
Colombia[16]	1996	53.4	53.5	53.4	--	--	--
Costa Rica[4]	1995	39.6	--	--	--	--	--
Ecuador[4]	1995	47.6	--	--	--	--	--
Ecuador[2]	1997	40.0	39.0	41.6	--	--	--
Guatemala[3]	1989	53.5	--	--	--	--	--
Honduras[4]	1995	49.0	--	--	--	--	--
Jamaica[4]	1996	74.5	23.5	26.2	--	--	--
México[4]	1995	54.0	--	--	--	--	--
México[17]	1996	27.4	28.1	26.2	1998	12.7	13.4
Panama[4]	1995	33.7	--	--	--	--	--
Paraguay[2]	1996	46.4	47.0	46.0	--	--	--
Peru[2]	1997	51.9	47.7	57.5	--	--	--
Uruguay[1]	1997	30.1	32.8	26.8	--	--	--
Venezuela[4]	1997	42.4	44.2	39.5	--	--	--
Middle East and North Africa							
Iran[18]	1996	17.9	3.4	89.5	--	--	--
Morocco[18]	1988	28.2	--	--	1986	24.9	30.7
Tunisia[19]	1981	38.6	--	--	1995	20.3	22.9
South Asia							
Bangladesh[18]	1993	10.0	10.0	16.0	--	--	--
India[2]	1993	44.2	--	--	1990-91	32.4	48.1
Pakistan[20]	1992	67.1	65.9	80.6	--	--	--

Notes: *Applicable only to employment figures*.
[1] Urban areas only
[2] Urban areas only; agriculture excluded.
[3] Urban and rural areas.
[4] Urban and rural areas; agricultural excluded.
[5] Urban areas; manufacturing, trade, transport, and services only.
[6] Yaounde only.
[7] Abidjan only.
[8] Antananarivo only; agricultural excluded.
[9] Dar es Salaam only; agriculture included unless primary source of household income.
[10] Urban areas; utilities excluded.
[11] Urban and rural areas in 27 provinces; manufacturing only.

[12] Urban and rural areas in Central, Western, Eastern, and Northern divisions only.
[13] Urban areas only; agricultural, mining, trade, and selected services excluded.
[14] National Capital Region.
[15] Urban areas; mining, utilities, and selected services exc luded.
[16] Ten metropolitan areas.
[17] Cities with over 100,000 inhabitants; agriculture excluded.
[18] Urban areas; manufacturing, trade, and services only.
[19] Urban and rural areas; manufacturing, trade, and services only.
[20] Urban areas of Punjab and North West Frontier provinces; agriculture excluded.

Sources: Compiled from statistical tables in ILO (2000) and Charmes (2000).