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## INTERNATIONAL EXPERIENCES OF INFORMAL SECTOR ACTIVITY AND THE LESSONS FOR SOUTH AFRICA

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### Introduction

During the last few years in South Africa we have witnessed a growing interest in the activities of what has come to be known as the 'informal sector'.<sup>1</sup> Progressive intellectuals' initial response to this phenomenon was to ignore it, dismissing it as a marginal element to the development of capitalism in South Africa. Later, however, it was with some scepticism and suspicion that the discussion of the informal sector was greeted, mainly because the promotion of the informal sector was perceived to be a strategy employed by capital to rid itself of its social and economic responsibilities. By glorifying the informal sector as a creator of jobs for countless numbers of blacks, big business was able to offload its responsibility to provide stable and secure jobs onto the impoverished blacks in the informal sector.

Yet it has been precisely the failure of big business to provide stable employment that has caused developmentalists to re-examine our position on the informal sector. Whatever the accurate unemployment rate is - ranging from conservative estimates of 18% to suggestions of nearly 50% - most analysts agree that the unemployment problem is a real and increasing one. Whilst the majority of new entrants to the labour market were able to be absorbed into the economy in the 1960s, it is estimated that currently the economy has the capacity to employ only 10% of new entrants onto the labour market. Given this serious inability of the economy to create new employment or maintain current employment, large numbers of people are entering the informal sector, either in self-employment, with a few hired workers, or by hiring their labour to others in the informal sector. Kirsten (1991) estimates that an average of 23% of the economically active black population makes a living solely from the informal sector, and that the informal economy's contribution to GDP in 1985 was around 5.1%.

It is clear that the real causes of this country's economic crisis must be addressed, and a viable strategy developed if sustainable growth is to be effected. Yet the sheer number of people dependent on the informal sector for their livelihood compels us to examine this phenomenon in more detail, and further, to develop a clear set of policy responses which democratic state institutions can implement.

These issues have been the focus of attention in the international development field for over two decades. Since the 1972 ILO Mission to Kenya on employment and growth first raised the issue of the informal sector as a significant employment generator, policy-makers world-wide have sought to analyse the characteristics and development potential of informal economic activities. By reviewing international experiences of the informal sector, this article attempts to throw some light on the process of policy formulation for the informal sector in South Africa. This will be done in two parts: firstly, we highlight some of the main characteristics which have emerged from various studies into the nature of the informal sector in the developing world; and, secondly, we evaluate some of the lessons that emerge from the experience of policy implementation for the informal sector.

However, before beginning this review, we briefly introduce the debate which pervades all discussions on the informal sector, that of the role of the informal sector in the process of development.

### **Developmental Potential of the Informal Sector**

Throughout the developing world, and even in South Africa in recent years, one finds a growing enthusiasm of the role that the informal sector can play in economic regeneration and growth. Indeed, one observes a growing belief that entrepreneurship, especially amongst black small-business people, will prove to be the panacea for South Africa's economic ills. Yet sceptics have questioned the effectiveness of a development strategy which accords the informal sector the role of employment generator - it has been argued that informal enterprises occupy a highly vulnerable position relative to large firms, casting doubt on the security of jobs in the informal sector.

In the international literature, it is common to find two broad positions on this issue: firstly, that which is optimistic of the potential that the informal sector offers to solve economic problems; and, secondly, that which denies that any developmental role can be played by the informal sector, arguing that it represents that part of the economy which perpetuates poverty and vulnerability.

Adherents to the first position stem from two distinct schools; the first from the neo-liberal tradition, best articulated by Hernando de Soto in his work, *The Other Path* (1986), in which he presents the informal sector as a revolutionary development, offering the potential for developing countries to resolve the macro-economic problems plaguing them (such as the debt problem). De Soto portrays participants in the informal sector as victims of excessive government regulation, who have rebelled against the mercantilist system which excluded most Peruvians from business opportunities. According to this position, the retreat of the state from economic activities will free the informal sector from

the restrictions it faces, allow the vast entrepreneurial reserves of the country to be tapped, and promote growth and dynamism in the informal sector, in a genuinely *laissez faire* system of capitalism, free from market imperfections.<sup>2</sup>

It is from a very different position that other proponents of the developmental potential of the informal sector emerge. Best exemplified by the position adopted in the numerous ILO studies on the informal sector, the starting point of this position lies in the crisis of the economy, which is argued to be structurally incapable of absorbing large sections of the labour force.<sup>3</sup> Whilst this position starts by recognising that the origins of the informal sector lie in economic crisis, it perceives the informal sector as having the potential to temper this crisis, by creating jobs, increasing output, and thus facilitating the more efficient use of the economy's human and physical resources.

The approach referred to as the 'petty-commodity production theorists' (Moser, 1984), also see the informal sector as a structural problem, rooted in macro-economic failure, but fails to detect any potential for the informal sector to grow or make a significant contribution to the development process. For them, the dependence of the informal sector on the capitalist system is so strong as to rule out all possibilities of growth within this part of the economy. For these theorists, the surplus gained by the informal sector is extracted by firms in the rest of the economy - particularly large firms - using the following mechanism: informal enterprises pay higher prices for the purchase of goods, inputs, etc, from larger firms, and receive lower prices for the sale of its goods; the difference in these prices represents the extraction of surplus by big capital. Thus, control by large firms of the sources of supply and markets needed by the informal sector entrenches the subordination of the informal enterprises. This subordination may take different forms, including: the provision by the informal sector of cheap wage goods; the process of big firms sub-contracting out certain stages in the production process to small informal enterprises, and so on. The subordination of the informal sector implies that those operating within the informal sector are tied into stagnant, vulnerable occupations, and continually face the possibility of poverty - the main avenue they have to compete with large firms is through lowering prices, which they do by reducing wages and profits.

In a useful comment on this debate over the growth potential of small enterprises, Schmitz (1992) recently observed that the current 'state of the art' of research into small-scale industry may be summarised in two points: one is that contrary to earlier expectations that these firms would diminish with time (due to their lesser efficiency), small-scale industry continues to be present in both industrialised and developing countries, surviving competition from large firms. His second observation is that research has demonstrated that generalisations about the viability of small enterprises are not reliable, and that sufficient

evidence exists showing that firms of all sizes may be economically viable.

Certainly, a survey of international evidence will reveal both institutional and macroeconomic biases operating against small businesses, which inhibit their potential to grow and develop,<sup>4</sup> yet the survival of small firms in most economies - including those in which the most virulent forms of monopolisation exists - suggests that small firms may have the capacity to survive tough conditions. We suggest that rather than re-opening the endless debate on the viability of small firms, this debate is best taken forward by examining questions such as: the conditions under which small and informal firms operate - the nature of the operation (scale, capital investment, skill composition), who their competitors are, etc - to determine whether they have the potential to grow. In the South African context this issue presents itself as an important one since it has become accepted in the ranks of the democratic movement that for equity reasons, small - and black - businesses must be promoted. Yet the question which this raises is whether these businesses are potentially viable, or whether they are destined to remain marginal to the rest of the economy, collapsing once state support is withdrawn. The approach which we adopt is one which recognises the limitations of small firms - and their vulnerability in relation to big business - but also acknowledges small firms' potential to contribute towards the regeneration process by utilising available labour, albeit at less than desirable wages and working conditions.

### **Profile of the Informal Sector in Some Developing Countries**

Part of the dispute over the developmental role of the informal sectors is rooted in the tendency for observers to homogenise the diverse range of activities found in the informal sector. Thus, in discussions on the informal sector, segments of the informal sector characterised by extreme vulnerability are conflated with relatively efficient activities, resulting in inappropriate policies toward the informal sector. Whilst we argue that there is 'something out there' which justifies using the concept of the informal sector to embrace such a wide range of activities, we would caution observers to remain conscious of the diversity of activities to be found in the informal sector, and of the differences in the potential for different segments of the informal sector to contribute towards employment, output and growth. Recognition of these differences will contribute towards more appropriate policy-making, so that we can promote those parts of the informal sector which appear to have a greater developmental impact. In this section, we briefly review some of the evidence showing the characteristics of the informal sector, whilst attempting to distinguish differences within it.<sup>5</sup>

Most of the data suggests that between 10% and 50% of the labour force in most developing countries are engaged in informal economic activities. In many

African and Asian economies, informal employment is said to be between 40% and 50% (ILO, 1972; Tokman, 1989).<sup>6</sup>

Compared to the sluggish record of growth of employment in the 'formal' sectors of most Latin American countries in the 1980s (the average annual growth of employment in the 'modern sector' for Latin America was 3.2%), the growth of informal employment was significantly higher, namely 6.8% (Charmes, 1990).

Kenyan figures on the distribution of employment between the informal and modern sector show that in 1987 the modern sector was responsible for approximately 16.4% of urban employment (of which 15.9% was wage employment and 0.5% self-employment), whilst the urban informal sector accounted for 4.9% of urban employment (rural employment accounted for approximately 78.7% of total employment in Kenya) (House, et al, 1990). What is striking is the predictions that are made about the growth of each sector's contribution to employment - whilst modern sector wage employment is estimated to grow by 4.1% between 1987-1993, modern sector self-employment is expected to increase by 8.3%. Urban informal employment is predicted to grow at the even faster rate of 10.6%. What these figures suggest is that the urban informal sector will become responsible for a much larger share of employment during the 1990s.

An analysis of the sectoral composition of informal employment reveals the dominance of the service sector in employment creation. In Columbia in 1984 approximately 42.4% of all informal employment was in the service sector, whilst the Mexican informal service sector was responsible for 48.7% of informal employment. The commerce or trade sector follows services as the biggest informal employer, whilst production and manufacturing appears to provide the least employment. The composition of the South African informal sector appears to be similar to this pattern, although recent studies have pointed to the disproportionately small presence of manufacturing activities in the informal sector in this country, compared to other cases (Mashigo, 1992; Rogerson, 1992).

This data suggests that the informal sector does provide incomes for a significant share of the labour force throughout developing countries, and most studies indicate the tendency for informal employment to grow proportionately more than formal employment.

Let us now examine the evidence about the nature of the employment created by the informal sector.

One of the most commonly cited criticisms of the informal sector is that wages for both the self-employed and employees are lower than in the formal sector. Most of the studies cited below have used the minimum wage as a measure of the lowest income received in the formal or modern economy,<sup>7</sup> and have compared informal sector wages with this guaranteed minimum. This has been

done across sectors and across different categories of workers. The following evidence has surfaced: informal self-employed in several African cities appear to receive an income above the minimum wage, with those in the production and service sectors receiving incomes at least 3-8 times higher than the minimum wage (see Table 1). In most of the cases cited in Table 1, entrepreneurs in trade sectors were receiving incomes very close to the minimum wage, much less than incomes in the production and service sectors. This appears to confirm the trend that incomes from production and manufacturing activities are higher than that from other activities.

**TABLE ONE**  
**INCOME OF ENTREPRENEURS IN THE INFORMAL SECTOR**  
**IN SELECTED AFRICAN COUNTRIES**  
 (as a multiple of the guaranteed minimum wage)

Country	City	Year	Production	Trade	Services
Cameroon	Yaounde	1978	5.5		5.0
Central Africa	Bangui	1982	4.3	1.3	2.7
Niger	Niamey	1982	8.8	6.2	8.7
Sierra Leone	Freetown	1978	2.5	1.9	2.3
Togo	Lome	1977	3.6		2.9
Tunisia		1982	5.1	4.4	8.9

Source: Chames, 1990:35.

However, wages paid to employees of informal enterprises are significantly lower than the income earned by self-employed entrepreneurs.<sup>8</sup> Kenya represents one exception to this trend - Aboagye (1988:79), in his study into the Kenyan informal sector, compared the earnings of the self-employed and employees in three Kenyan cities, and came up with evidence that employees in informal enterprises earned between 47.9% and 54.8% of their employers incomes - that is, around half of what their employers were earning. He explained this relatively high wage earned by employees (in relation to other African countries) by referring to the large numbers of skilled workers who choose to remain as employees in the Kenyan informal sector, earning higher than average incomes.

Yet another determinant of wages or income in the informal sector is gender. Studies done on informal enterprises throughout the developing world show that in general female-owned informal enterprises generate less income than male-owned enterprises. This appears to be related to two factors: firstly, enterprises

run by women tend to be located in sectors which allow easy access - that is, where the skill, capital or other barriers to entry are low. Thus many women occupy vulnerable positions within the informal sector - they are located in the lowest-paying sectors of the informal sector, such as hawking, low-paying services, and the lower end of the manufacturing sector, such as garment manufacturing, needle-working, candle-making. The large number of individuals which consequently enter these sectors makes for highly competitive market conditions, undermining potential profits for the entrepreneur. The second factor reducing the profits of female-run enterprises is the entrepreneurs' responsibility for daily domestic chores, limiting her time for business activities.

The data presented in this section has illustrated the point that there are wide differences in the earning capacity of skilled workers and entrepreneurs, compared to those of unskilled workers and apprentices and many women in the informal sector. What this suggests is that conditions in the informal sector may be relatively attractive for some categories of workers in the formal economy. Indeed, the evidence on labour movements into and out of the informal sector supports this analysis. In his paper, Charmes (1990) reports the findings of a study into the informal sectors of four African cities which emerged with evidence that almost 47% of informal employers had worked in the formal economy, and had left that for the informal sector. Abuodha and King (1991:46), in their study on Kenya's informal manufacturers, found that an average of only 10% of entrepreneurs would choose to give up their work in preference for formal employment or further training. During our research in Nairobi, Durban, Johannesburg and Cape Town, we found that several workers had resigned from their formal sector jobs in large factories, in preference to an informal sector job. The main reason cited in explanation for this action was the potential to earn higher wages in the informal job. Our research was conducted only on the informal *manufacturing* sector, thus most of the workers we interviewed were skilled craftspeople, who stood to benefit from the relatively higher wages paid to skilled workers (especially in the manufacturing sector).

The difference between wage levels in the formal and informal sector is interesting since it helps us to establish the direction of labour force movements between the formal and informal sector. Thus significantly higher average wages in the formal sector suggests that the general tendency will be for labour to move from the informal sector to the formal sector, chasing higher wages. This movement of labour assists us in understanding whether the informal sector is simply a last-resort option for workers who would prefer to be in the formal economy, or whether informal employment represents a viable option for workers.

Most research findings cited here suggest that informal employment may



represent a viable source of jobs for some types of labour. This assertion challenges the characterisation of the informal sector as a last-resort option, since it suggests that it may be the first choice of certain types of workers, in certain types of economic conditions. On the other hand, the evidence does show that unskilled workers, women workers and apprentices occupy much more vulnerable positions in the informal sector.

### **Growth Performance of Informal Manufacturers**

Whilst most observers acknowledge that the informal sector has been growing in developing countries, studies have shown that this is due to the aggregate growth of the sectors in the informal sector, rather than to growth of individual enterprises. Livingstone (1991) finds that this is the case for the Kenyan informal sector, where large numbers of people take up self-employment, entering sectors in which the informal sector is already established. This is growth through replication, or 'extensive' growth, rather than growth through 'intensification' or capital/skill/technology deepening. The distinction between these two growth paths is a useful one, for it exposes the limits to growth through 'extensive' means, and points to the potential benefits of 'intensive' paths to growth.<sup>9</sup> Showing the effects of extensive growth paths on informal enterprises, Livingstone cites evidence from Kenya showing that the intense competition in the tailoring sector - brought on by ever-increasing numbers of enterprises springing up in the tailoring informal sector - has substantially reduced the level of earnings of those engaged in the sector.

There is consensus in the literature that manufacturers in the informal sector exhibit significantly greater capacity to grow than do other sectors, particularly trade. Sethuraman (1985, cited in House et al, 1990) contends that the manufacturing, construction and transport sectors of the informal sector are more likely to grow in an evolutionary way, because of the nature of competition within these sectors. He argues that these sectors are more likely to be characterised by growth which is more productivity enhancing, through innovation, adoption of more appropriate technology, as opposed to growth via the multiplication of enterprises, in which a larger number of enterprises squeeze into the same restricted markets. House et al (1990) make the point that those in such sectors as manufacturing are protected from excess competition by the higher capital and skill requirements for entry into the manufacturing, construction and auto-repair sectors. Whilst these requirements may protect informal manufacturers from intense competition from others in the informal sector, competition from large firm competitors remains real<sup>10</sup> - they are in a much stronger position to undercut informal producers' prices, forcing the informal producers to narrow their profit margins drastically. However, international evidence shows that

informal producers do not simply fold in the face of such competition - rather, one finds globally the presence of large and informal producers co-existing, often in different segments of the same market. The basis of their competitiveness lies not only in their preparedness to accept lower profit margins, their practice of paying lower wages, and in their lower overheads, but also in their success in capturing niche markets, adopting new technology, and producing high value, high cost goods. Those small firms which have become successful on the basis of the latter approach are to be found in areas such as northern Italy, Spain, Hong Kong. Most explanations of these firms' success point to two phenomena: the co-operative networks of small firms, which serve to reduce the diseconomies of scale arising from the small size of individual firms; and the role of public institutions in creating a supportive environment for the successful functioning of small firms.

It is important, however, to remain aware of the tough competitive environment that most informal manufacturers (especially those in poverty-stricken developing countries) face. Our fieldwork amongst the informal furniture, metal and clothing manufacturers in Nairobi as well as in South Africa illustrated the fierce nature of competition in many segments of these markets, contrasting sharply with the experience of small firms in places like Italy and Spain.<sup>11</sup> Thus, informal manufacturers competing in markets for low value-added products will be confronted with a harsher competitive environment than those in the more protected markets.

### **Policy Responses to the Informal Sector**

It has sometimes been asserted that despite two decades of informal sector promotion, there is very little evidence of improvement in the conditions of the poor to be found in the informal sector. In this part of the paper, we examine the extent to which policies aimed at supporting the informal sector have been successful.<sup>12</sup>

International evidence indicates that there are four objectives towards which policy for the informal sector may be aimed - creating employment; promoting increased output and greater productivity of activities in the informal sector; generating more stable and better working conditions for workers in the informal sector; and, finally, reducing the vulnerability of the poor found in the informal sector. Three types of policy may be formulated to address these objectives: (i) productivity-enhancing policies; (ii) policies which seek to improve the legal/institutional environment of the informal sector; and (iii) welfare-type policies.

**Productivity enhancing policies:***Credit for the informal sector*

As we noted above, one of the most common policy prescriptions for assisting the informal sector is to improve its access to credit. Evaluations of the effectiveness of such programmes have thrown up three issues: firstly, that subsidised credit is often 'hijacked' by the more prosperous sections of the informal sector instead of reaching the poorest entrepreneurs. If policy-makers see the need to allocate subsidised credit to the poorest parts of the informal sector (those who may not be able to afford market interest rates), then methods must be sought to discourage the better-off from joining the programme (such as compulsory solidarity meetings and other collective activities which the better off are likely to find unattractive).

A second lesson which emerges from the international experience of policy-making for the informal sector concerns the riskiness of lending to the informal sector - although the conventional view has been that lending to the informal sector is a high-risk activity, substantial evidence has emerged which challenges this assertion, demonstrating relatively high repayment rates. Costs of administering such small loans are admittedly still high, especially since the most successful experiences of repayment have taken place in the context of solidarity groups (which have associated administration costs). However, the recognition that the poor have a relatively acceptable record of repayment has helped to instil more confidence amongst the financial institutions about lending to the informal sector.<sup>13</sup>

The final point which is more frequently being made is over the bias towards credit programmes over other types of assistance. It is argued that institutions dealing with the informal sector find credit an attractive method of assisting the informal sector, since it requires less administrative effort than other types of support. This is criticised as being too mechanistic, since the particular needs of the individual enterprise may warrant some other type of support.

*Technical and management training*

Like credit programmes, courses on business management have gained enormous popularity in institutions dealing with the informal sector. However, these have been criticised as often being inappropriate to the needs of the individual enterprise, and sometimes forced on entrepreneurs by a programme which ties credit support with business training. McLaughlin (1990) makes the point that one of the most important determinants of the success of any training programme is the degree of demand for the skill. What this implies is that if training programmes are to be effective, it should be responding to a real demand or need for training. Sanyal and Pradhan (1990) cite a case of successful training in India,

where women garment manufacturers were experiencing problems with the dyeing process. The organisation to which they belong, SEWA (Self-Employed Women's Organisation) arranged for a textile specialist to visit them at the site at which they were producing, to give them advice. Three lessons emerge from this experience: training must be oriented towards a perceived need (which suggests that mechanisms for identifying needs should be integrated into policy); training is most effective when delivered on site; and for new skills to be most effectively used, the training must involve a limited amount of changes to a known skill, rather than dramatic changes in technology.

### *Technology*

An abundant literature exists on the issue of appropriate technology for the informal sector - how existing technologies (both human - the methods people use to do things - and physical) can be adapted and new technologies introduced which will improve the productivity and efficiency of small and informal producers. However, thus far, there is little evidence demonstrating the success of these innovations. The problem appears to lie in dissemination of innovations - whilst institutions develop new technologies, they experience problems in disseminating them to scattered enterprises, thus the new innovations are imbibed by only a small number of enterprises. This evidence suggests that much more effort needs to be placed on the dissemination of newly developed technologies to the informal sector than is currently the case.

### *Organisation of informal manufacturers*

Recent studies have placed increasing attention on policy promoting greater organisation of informal sector enterprises. The flexible specialisation literature<sup>14</sup> has devoted much attention to the role of small firms in the industrialisation process, especially in industrially-advanced economies. One of the tenets of the flexible specialisation theory is that the organisation of small firms into networks and associations may be an important factor stimulating their growth and competitiveness, contributing towards their 'collective efficiency' (Schmitz, 1990).<sup>15</sup> Some of the other benefits assumed to accrue to informal enterprises from associational activity (see Sanyal and Pradhan, 1990; Livingstone, 1991) include: reducing costs through bulk-buying; increasing the scale of production through the establishment of production lines by groups of producers; facilitating price-setting, through co-operation about optimum prices amongst entrepreneurs; creating the conditions for small informal firms to reap the benefits from economies of scale, through joint R&D, adoption and innovation of new technologies; providing an institutional base which facilitates governments and NGOs easier access to the informal sector; stimulating political

networking of individuals in the informal sector, and reducing the isolation which reinforces the vulnerability of large parts of the informal sector.

Several analysts (Schmitz, 1990, 1992; Livingstone, 1991; Dawson, 1992) have attempted to test whether there is any evidence supporting the 'collective efficiency' thesis in developing countries. Livingstone cites a study into Kebuye estate in Kenya which showed the existence of cooperation over the use of machinery and tools; subcontracting to other informal enterprises if large orders came in; jointly developing ideas for new products; and joint marketing strategies. Several studies in Kumasi in Ghana (Riedel and Schmitz, 1990; Dawson, 1992) have also suggested that clustering of small firms has contributed towards increasing their competitiveness.

Whilst the issue of whether collective organisation can contribute directly to productivity enhancement continues to be debated, the effectiveness of such organisations in advancing the broader interests of their members is widely acknowledged. Sanyal and Pradhan (1990) argue that many organisations of women in the informal sector gave members access to child care, group health, etc. instead of directly enhancing their productivity or income. Another example of support which may be derived from organising within the informal sector is the practice in some developing countries of individuals (usually in the economic sector) forming themselves into groups such as burial societies, pension schemes.

This issue of the gains to be made from clustering of informal firms has important implications for policy - namely, how policy can promote co-operation and collective efficiency. Here the question of the role of public and private institutions in creating the appropriate environment for supporting these small firms becomes critical. The evidence from Europe, especially Italy, suggests that local and regional public bodies may be instrumental in providing small firms with back-up to increase their competitiveness - setting up R&D and training facilities, increasing information about international market trends, and so on. The Indian government, too, has played an important role in providing services to small firms - industrial estates, marketing services, technology development, extension and training. In their evaluation of the effectiveness of these programmes in India, Little et al (1987) note that despite the costliness of providing such an institutional framework for small firms, 'its actual assistance to small scale units is of uncertain efficiency' (1987:30).

#### **Policy addressing the legal and institutional environment:**

A recent study for the ILO (Teshfashew, 1992) outlined a number of ways in which government policy may discriminate against the informal sector - trade policies; tax policy; government regulations concerning land allocation, infrastructure development, industrial sites, health and licensing requirements;

public spending patterns. According to Tesfashew, governments concerned with promoting the informal sector will need to consider orienting the macro-economic environment to become more favourable to the informal sector.

Reconciling the needs of the informal sector with the needs of other sectors of the economy and society into one policy framework is no easy task - promoting the informal sector may involve compromising the interests of other sectors of the economy. The issue of regulation, for example, is treated by most governments with a considerable degree of caution - whilst their rhetoric often dwells on their reluctance to compromise the rights of workers, it is more likely to be the case that they are deflecting pressure from big business who are concerned about the discriminatory impact of selective deregulation. Thus, even in a country like Kenya, which government has long articulated a commitment to promoting the informal sector, one finds very little evidence of changes in the regulatory environment in support of the informal sector.

#### **Welfare measures:**

Two groups are targeted by policy promoting welfare support for the informal sector: the less productive, more vulnerable informal units, who may not qualify for productive assistance; and workers in informal enterprises. It is these two groups which tend to be excluded from the benefits of productive support. Tokman (1989) thus recommends that broad welfare policy be devised to raise the welfare levels of these sections of the informal sector.

Policies which may be implemented should be aimed at social infrastructure development, credit delivery (micro-loans) to the poor, low-level technical assistance, education (such as literacy), and other 'basic needs' requirements, which improve basic nutrition, health and housing of the poor.

In evaluating the effectiveness of these programmes, Farberman and Lessik acknowledge that in narrow economic or business terms, there is little evidence pointing to their success. However, they contend that such programmes were 'not insubstantial in social and economic terms for the participants' (1989:112). Evidence seems to suggest that whilst micro-loans may not necessarily improve the output of an informal enterprise, it may be used on other income generating activities to improve the welfare of the family. These policies may also indirectly raise productivity levels, argues Tokman (1989), in that improvements in the welfare of the poorer parts of the informal sector (especially health and education) may free them to compete for better jobs.

Clearly serious difficulties will be encountered in trying to promote such programmes - by definition they are not directed at narrow economic objectives, thus a conventional cost-benefit analysis will not justify spending large sums of money on programmes to reduce poverty in the informal sector, when this money

could be more 'efficiently' used for productivity enhancing programmes.

The discussion on policy in this section of the paper has highlighted the following two points: firstly, that support programmes must necessarily be directed at all three constraining factors: the institutional and regulatory environment, low levels of productivity and efficiency, and the socio-economic depression which motivates large numbers of people into the informal sector. Secondly, that despite rational arguments favouring the implementation of certain policies, governments are ultimately influenced by political factors. Policies which favour the informal sector at the expense of other sectors - especially those that are politically more powerful - are rarely implemented.

This suggests that more effective organisation of enterprises in the informal sector may serve to advance their collective interests.

### **Implications for South Africa**

One of the great difficulties with discussing the informal sector is the vagueness of the concept. Lumped together into one category are a wide range of activities - emerging, potentially viable businesses in a range of economic sectors, alongside subsistence activities initiated simply for the survival of impoverished individuals. Further, policy is expected to address the full scope of the informal sector. By illustrating the wide range of activities, as well as the varying growth potential of informal enterprises, this paper has attempted to highlight the diversity of the informal sector. The question which emerges at this point concerns the appropriate form of policy intervention required to support the informal sector to increase its output and incomes. Given such diversity in characteristics, how can policy address the diverse needs of individual enterprises? In an attempt to explain the need for policy formulation which takes into account the diversity within the informal sector, several analysts have stressed the need to develop a clearer classification of the informal sector. In one of these contributions, Farbman and Lessik (1989) came up with three categories within the informal sector:

- survival activities - driven purely by the poverty of individuals;
- microenterprises - characterised by viable activities with have some growth potential;
- small-scale enterprises - small entrepreneurial firms engaged in non-traditional economic activities (often manufacturing), which tend to be economically more efficient than the second type, and who demonstrate a greater capacity to grow.<sup>16</sup>

Thus what Farbman and Lessik advocate is to identify the objective behind each enterprise - desperation, survival, or entrepreneurship - and to formulate

policy which is more appropriate to the type of enterprise. In this way, the vulnerable groups to which we referred earlier in the paper will not be ignored.

As has been pointed out above, the motivation for the emergence of a very large segment of the informal sector is poverty and vulnerability, rather than any entrepreneurial zeal. In South Africa, this phenomenon is easily confirmed by the vast numbers of people engaged in petty trading activities in the streets of the towns. It therefore seems inappropriate to use conventional business standards to evaluate the performance of these enterprises, and to use such standards as criteria for deciding on whether to support them. Clearly, enterprises in this mould require welfare and social support, in the form of the extension of social security, better access to health and education facilities, and so on. If support programmes for the informal sector are biased towards productivity-enhancing measures only, large segments of the informal sector will not be able to qualify for assistance, and will be neglected.

The existence of vibrant and dynamic small and informal enterprises throughout the developing world and in this country - especially in the manufacturing and service sectors - points to the potential for such informal enterprises to grow and to become competitive. An important policy issue that needs to be confronted is the need for growth-enhancing support measures for such enterprises. Manufacturers in the informal sector have been systematically disadvantaged by a whole barrage of apartheid policies, which have effectively prevented blacks from engaging in manufacturing activities. Those that are now attempting to enter these activities are in critical need of support measures which attempts to redress this disprivilege. However, the support environment presently obtaining in this country is still lacking - the major financial institutions are reluctant to deal with micro-enterprises, leaving small, resource-poor enterprises neglected. NGOs are the sole institutions willing to provide affordable assistance.<sup>17</sup>

Lack of clear policy guidelines, as well as co-ordination between the various institutions allocating assistance results in these institutions having a less than optimal impact on informal enterprises in this country.

The international evidence surveyed in this paper shows that small manufacturers exhibit a substantially greater capacity to grow and to contribute towards the development process than do other segments of the informal sector. The dearth of informal manufacturing in South Africa, therefore, represents cause for concern amongst developmentalists - if the informal sector continues to be characterised by unproductive, relatively inefficient traders and vendors of services, this does not bode well for the development of these enterprises into dynamic and competitive ones. This suggests the need for policy to target manufacturing activities for promotion.



It has been suggested in this review of other countries' experiences that effective organisation of enterprises in the informal sector has served to advance the interests of informal entrepreneurs. Organisation may attempt to directly increase members' productivity and income, or it may serve to grant marginalised elements of society a stronger political voice.

There has been much talk of the need for affirmative action and the restructuring of the social structure of the South African economy. In terms of this discussion, it has been argued that the need exists for the nurturing of a class of emerging black business-people. Clearly, the informal sector presents itself as a suitable candidate for promotion of this type, since it is from the ranks of such businesses that dynamic entrepreneurs will emerge. Certainly the danger exists that the creation of such a class may result in adverse distributional effects, yet concern over income distribution changes within the black community does not justify leaving untouched the racially-skewed nature of the South African economy.

## Conclusions

The argument offered in this paper is not that informal or small firms are a desirable characteristic of any economy. Rather, we suggest that in conditions of high unemployment and escalating poverty - such as that currently prevailing in South Africa - the informal sector presents itself as an effective vehicle of income generation, notwithstanding the high social costs associated with it - poverty wages and working condition reminiscent of the Industrial Revolution.

This focus on the informal sector, however, ought not to detract attention from the main engine of growth in our economy - the formally-organised sectors of the economy, notably industry, on which great expectations of employment generation and growth are placed. As Tokman points out,

The development of Latin American countries is and will continue to be, determined outside the informal sector where most of the accumulation takes place. Support for the informal sector could contribute to better efficiency and distribution, but growth will mostly depend on adequate development and macro-economic policies (1989:14).

## NOTES

1. Conceptual and definitional problems: despite years of debate over the informal sector, it is perhaps surprising to find the complete absence of consensus on what it is that is being referred to by the concept. Recognising the limitations and problems with this definition - but lacking time to discuss these - we use the standard ILO definition of the informal sector: those that are characterised by: ease of entry; reliance on indigenous resources; family ownership of enterprises; small scale of enterprises; labour-intensive and adapted technology; skills acquired outside the formal school system.
2. It is out of a similar ideological belief in the potential of the free market which many South African enthusiasts on the informal sector emerge. Like De Soto (1989), they assume that the absence of regulation is a sufficient condition to guarantee the growth and prospering of the informal sector.
3. This position differs from De Soto's (1989), since, for De Soto, the main problem giving rise to the informal sector is an excessively interventionist state, rather than macro-economic problems. For De Soto, the informal sector offers the most potential to resolve macro-economic crises, and to achieve full employment (albeit at lower wage levels).
4. The high levels of concentration of South African capital has long been argued to limit competition in South Africa, reducing the space for small and medium firms to compete with the large monopolies.
5. Methodological problems with data collection seriously hamper attempts to establish a profile of the informal sector. Whilst some writers use size of enterprise to denote an informal enterprise, others use indicators such as capital stock, poverty levels of individuals, and so on, making cross-study comparisons very difficult and unreliable.
6. These may not necessarily be full-time activities, as evidence exists pointing to individuals simultaneously operating in informal and modern sectors.
7. It should be kept in mind that minimum wages have been steadily falling throughout the developing world, thus they may not represent a living wage at all.
8. One ILO survey of four African countries 1985 found that between 92% and 100% of apprentices employed by entrepreneurs earned less than the minimum wage, although the study pointed out the clear non-wage benefits enjoyed by apprentices, such as own-account work.
9. 'Extensive' growth refers to the process of a sector growing not through dynamism of individual enterprises, but through an ever-increasing number of firms springing up in the sector. Thus, whilst individual firms may remain relatively stagnant, more enterprises enter the same market, making competition much more fierce. 'Intensive' growth, on the other hand, refers to the process of growth whereby individual firms accumulate and reinvesting profit, begin to innovate, adopt new technologies, and expand. Whereas extensive growth paths increases the ferocity of competition within the informal sector, intensive growth allows individual firms to become more competitive..
10. This highlights another point - that of the monopolisation of markets which is so prevalent in many developing countries (including South Africa), excluding small businesses from competing. This calls for policy to be implemented which contains such practices.
11. Research amongst pinafore producers in Durban demonstrated this point explicitly: in order to maintain prices at a level which was profitable for the producers, several dozen women - selling virtually identical products alongside each other - attempted to set a price floor, yet within a short while the agreement was abandoned, and the practice of undercutting each other resumed.
12. Evaluating the international experience of policy implementation is an enormous task which cannot be accomplished in a few pages. All that we propose to do here is to highlight some of the most salient points which may help to inform policy-making in South Africa.
13. The excellent repayment record of informal entrepreneurs in South Africa - evidenced by the high repayment rates reported by several loan-giving NGOs - has yet to convince the major financial institutions of the credit-worthiness of these entrepreneurs. Consequently, South African financial institutions display extreme reluctance to support small or informal businesses, and when they do, often give credit at prohibitively high interest rates.
14. For a more thorough reading of the flexible specialisation literature, the reader is referred to Piore and Sabel (1984), Best (1990), Schmitz (1992); *IDS Bulletin*, 23(3) (1992). Space constraints prevent us from discussing the flexible specialisation thesis, except insofar as it

concerns the institutional environment for small and informal firms.

15. Schmitz's (1990) argument is that small firms' capacity for growth cannot be achieved individually, but is enhanced by the efficiency and flexibility derived from the division of labour and geographical clustering of firms.
16. This type of enterprise may certainly fall into the category of 'formal', since they would comply with many of the stipulated regulations.
17. One of the measures that have been relatively effective in other developing countries is the establishment of credit guarantee funds, which allow institutions to grant loans to microenterprises without requiring substantial collateral. Discussions are underway - between the government and the SBDC - about the establishment of such a fund in South Africa.

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