The Impact of Globalization on the Informal Sector in Africa

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Abstract

Contrary to the expectations of much of the early development literature, the informal sector has not only persisted but actually grown in many developing countries, particularly in Africa where it dominates the economy both in terms of output and employment. This growth has occurred in conjunction with increasing globalization and opening up of economies, which has provoked a debate about the impact of these processes on the informal sector. In this debate it is often argued that the poor, usually women, lose out in a globalized world as multinationals seek to exploit low labour costs in developing countries. The empirical evidence suggests that there are in fact both winners and losers in a globalized economy. Given the importance of informalization in African economies, this paper sets out to summarise the nature of the informal sector in Africa and how globalization affects its development. Based on the issues discussed in the paper, a number of policy recommendations are proposed. The ultimate aim of any African government must be job creation and poverty alleviation, and the policy response for this objective has to address both the removal of the barriers that constrain the participation of enterprises and workers in the formal economy, as well as extending assistance to those in the informal sector. However, this poses a particular challenge for policymakers, namely the trade-off between the ability of the sector to generate jobs and the level of benefits and protection provided for informal workers.

Keywords: globalization, labour markets, informal sector, Africa

1. Introduction

Globalization through trade, foreign direct investment (FDI), capital, technology and migration flows can stimulate demand and productivity, resulting in higher incomes and job creation, and hence, a reduction in poverty. Using cross-country data, most of the empirical evidence presented during the 1990s indicated that openness to trade has a positive effect on economic growth (see, for example, Winters (2004) and the references quoted therein). In addition to other factors, this implies that the labour market plays an essential role in the link between globalization, growth and poverty. However, understanding these linkages has proven to be challenging in both theoretical and empirical terms.

For some decades the Stopler-Samuelson theorem, one of the central results of the Heckscher-Ohlin (HO) model of trade, has provided a theoretical framework that explains how trade impacts employment and wages. The basic prediction of this model is that trade liberalisation leads to an increase in demand for labour-intensive goods produced in developing countries (conversely, an increase in the demand for capital-intensive goods in the developed world). This subsequently pushes up the real return to labour (wages) and decreases the return to capital. In most developing countries the abundant factor is unskilled labour, and therefore, trade liberalisation is expected to increase the returns to these workers, leading to a reduction in inequality. These predictions, however, rely on a set of strict assumptions, and once any of these often-unrealistic theoretical conjectures are dropped, the predictions of the theorem become more ambiguous.

In the African context these predictions are especially incongruous with the structure and characteristics of the labour market. One of the most important characteristics of the labour market in Africa is the prevalence of informal employment, which according to some figures now accounts for 72 percent of non-agriculture employment in sub-Saharan Africa, 78 percent if South Africa is excluded (ILO 2002c). Other studies claim that a vast majority of jobs created in the 1990s were outside the formal sector.

Lewis (1954) proposed a theoretical model of economic development where there is an unlimited supply of labour in the informal sector or in subsistence agriculture. The model implies that as the formal sector develops, its demand for labour increases, absorbing this excess labour, which subsequently leads to a shrinking informal sector. The Lewis model dominated the development discourse during the 1950s and 1960s as Europe and Japan rebuilt their economies (Chen et al. 2002). However, in recent decades, the growth of the informal sector in developing countries has precipitated a rethinking of its role in the economy, particularly by the International Labour Organisation (ILO) in the early 1970s. The main question raised by these explorations is why did informal employment not only continue to exist but actually grow, while the formal sector declined? What role did globalization have in this process?

Another issue is that the informal sector by definition does not provide the same benefits and protection to workers and businesses as found in the formal economy. Therefore, since the informal sector has been growing in recent decades in Africa, this suggests that there is a potential trade-off between job creation and employment conditions. This is a particular challenge for policymakers who strive on the one hand to promote economic growth and job creation, and at the same time improve the situation of workers in Africa. This challenge raises a number of questions: should African governments aim to integrate the informal sector into the formal economy in order to extend benefits to this sector, though this may hamper growth and job creation?; or should they instead focus on deregulating the formal sector to remove the barriers to workers and enterprises from participating in the formal segment of the economy?

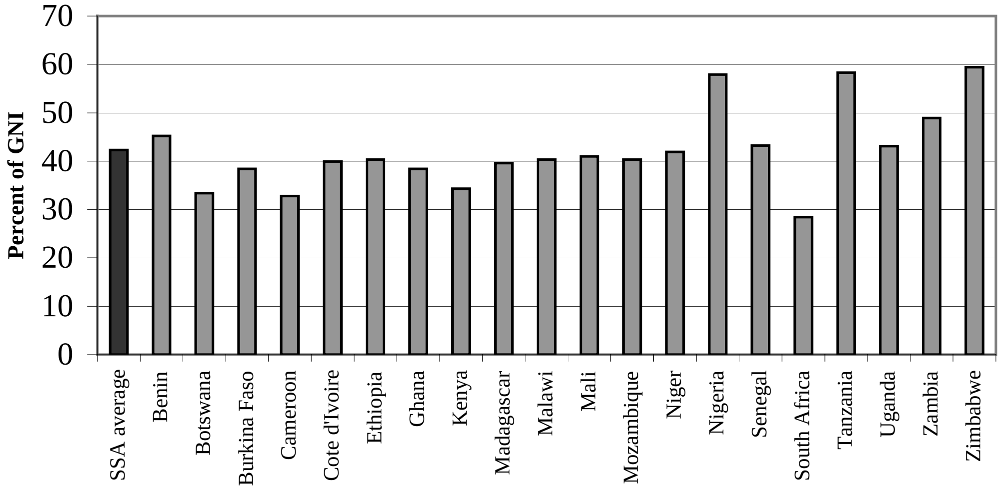
Little is known, however, about the effects of globalization on the informal economy and how changes in trade and FDI affect employment in this sector. For this reason, the main contribution of this paper is furthering our understanding of the informal sector in African countries and the effects of globalization on this aspect of the labour market. The paper consists of two parts. The first part is made up of two sections (Sections 2 and 3) covering the conceptual and theoretical background in addition to the empirical evidence. In Section 2 we review the trends and the characteristics of the informal sector in Africa. Section 3 goes into more detail about the relationship between globalization, particularly trade, and the informalization of the economy. The second part of this paper (Section 4) addresses these issues in terms of policy recommendations.

2. Trends in the Africa informal sector

Following the current conceptualisation, this paper restricts the informal sector to the urban context. ILO (2002a) provides a more detailed discussion on the interaction between the status of the enterprise and employment, resulting in a number of different variations of informalization in the economy. Since many African countries either don’t collect data on the informal sector or they use different definitions, it is difficult to make strict comparisons within and between countries. Nonetheless, the available data clearly indicates that the informal sector represents both a significant component of gross domestic product and employment in most African countries.

The World Bank as part of its work on benchmarking business regulations has developed a measure of the size of the informal economy. The methodology for estimating this indicator is based on the study by Schneider (2002). Using this data, Figure 1 graphs the size of the informal economy as a percentage of gross national income (GNI), which ranges from under 30 percent in South Africa, the continent’s largest economy, to almost 60 percent in Nigeria, Tanzania and Zimbabwe. The average in sub-Saharan Africa (SSA) is 42.3 percent.

Figure 1 – Size of the informal sector in sub-Saharan Africa (ratio of GNI in 2003)



Source: World Bank Doing Business database. This indicator measures output in the informal economy as a share of gross national product (%GNP, 1999/2000) sourced from the study by Schneider (2002)

Turning to the labour market, based on figures reported in ILO (2002a) the informal sector in SSA is estimated to represent around three-quarters of non-agricultural employment. According to ILO (2002c), the sector amounts to 72 percent of employment in sub-Saharan Africa, 78 percent if South Africa is excluded. Statistics reported in Chen (2001) suggest that 93 percent of new jobs created in Africa during the 1990s were in the informal sector, reflecting the impact of globalization, economic reforms and competitive pressures on the labour market in recent years.

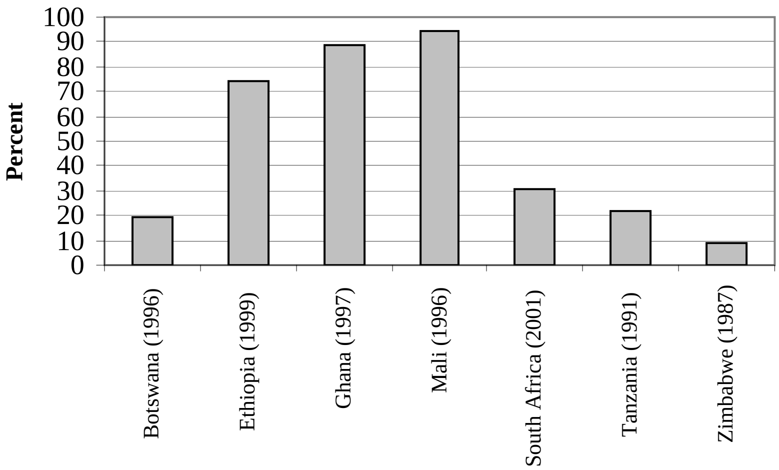
Xaba et al. (2002) summarises the experience of a number of African countries, which shows that there has been a decline or stagnation in employment growth in the formal sector, while the informal sector on the continent has been growing in terms of both its share of output and employment. For example, informal employment in Kenya and Uganda exceeds employment in the formal sector. In terms of Southern Africa, in Zambia 43 percent of urban employment is in the informal economy, while in Mozambique evidence suggests that 30-40 percent of urban households were dependent on the informal economy in the 1990s. As also reported in Xaba et al. (ibid), 89 percent of the labour force in Ghana is employed in the informal sector.

ILO (2002b) reports on the share of employment in the informal sector for a number of African countries based on the harmonised and national definitions.[1] Figure 2 presents the share of total employment in the informal sector using the national definition for a

[1] The differences in the definitions do have a considerable impact on the final aggregate statistic. For example, 50.2 percent of total employment in Ethiopia is in the formal sector according to the harmonised definition, while the national definition suggests a much higher share of 74.2 percent.

number of African countries. Though the figures are for different years, it is clear that the share of informal employment varies considerably within Africa, ranging from 8.8 percent in Zimbabwe to 94.1 percent in Mali.[2]

Figure 2 – Share of total employment in the informal sector



Source: ILO (2002b)

The informal sector in Africa is dominated by trade-related activities, with services and manufacturing accounting for only a small percentage of this sector (UN 1996). For example, in Angola, Nigeria, South Africa and Uganda, a majority of informal sector workers are active in retail trade (ILO 2002a). Most of these workers are self-employed, which accounts for 70 percent of workers in this sector in SSA, with the remainder in wage employment (ILO 2002c). Street vending is one particular informal activity that is prevalent on the continent. According to 1992 figures quoted in Charmes (1998a), street vendors represented 80.7 percent of all economic units surveyed in urban areas in Benin, with women making up over 75 percent of vendors.

Characteristics of informal employment

Informal employment in developing regions such as Africa is characterised by a number of traits (see, for example, Vishwanath (2001) and Avirgan et al. (2005)). Besides the high proportion of women and self-employment, there are also a number of other defining characteristics of informal workers in terms of education levels, wages (and hence, poverty), hours worked and overall employment conditions. In particular, informal employment is characterised by the lack of decent work or deficits in comparison with employment in the formal segment of the economy.

[2] The share for Zimbabwe has increased in recent years as a result of economic stagnation, which is reflected in Figure 1.

Firstly, workers have lower levels of education and rates of literacy compared with the formal sector, reflecting that poor human capital increases the probability of participation in the informal sector. As reported in Braude (2005), there is a stark difference in the education levels of workers in the South African informal and formal sectors – 37 percent of workers in the informal economy in South Africa have not completed primary school education compared to only 16 percent for the formal sector. Related to low education is the phenomenon of skill mismatch, which occurs when job seekers lack the skills demanded by employers. This problem is evident in the urban labour markets of many African countries where school leavers seek a job in the public sector, but as a consequence of downsizing and retrenchments, there are few opportunities. At the same time, these youths do not have appropriate skills for other forms of formal sector employment in industry or service activities (the mismatch). These youths, therefore, end up unemployed or working in the informal sector, with many of them still "queuing" or waiting for a job in the public sector.

Secondly, given that wages are usually much lower in the informal sector, rates of poverty are subsequently higher amongst workers and families who rely on informal employment. According to the ILO, wages are on average 44 percent lower in the informal sector (ILO 2002a). El Mahdi and Amer (2005) find that informal workers in Egypt earn approximately 84 percent on average of what workers receive in the formal sector. Similar results were also found for South Africa (Braude 2005). However, such estimates do not control for occupation, which has been found in the gender wage gap literature to have a large impact on the disparity between female and male wages.

Thirdly, informal sector workers typically work longer hours in the week; results for Egypt suggest that the average number of hours worked in the informal economy was 51.6 in 1998, while it was only 44.6 in the formal segment of the economy (El Mahdi and Amer 2005). Other decent work deficits that are more prominent in the informal economy vis-à-vis the formal sector include poor health and safety, high job insecurity, no worker representation and few opportunities for skill enhancement (ILO 2002a). Finally, child labour is a persistent problem in the African informal sector, an issue addressed in Xaba et al. (2002).

Characteristics of enterprises in the informal sector

Looking at the enterprise side, there are also a number of defining features, which characterise these businesses in Africa (see Becker (2004)). These include:

- There are low set up costs and entry requirements, which are presented above as key factors behind informalization.
- Operations are typically on a small scale with only a few workers.
- Skills required for the business activities are usually gained outside formal education.
- The production of goods and services is labour intensive.

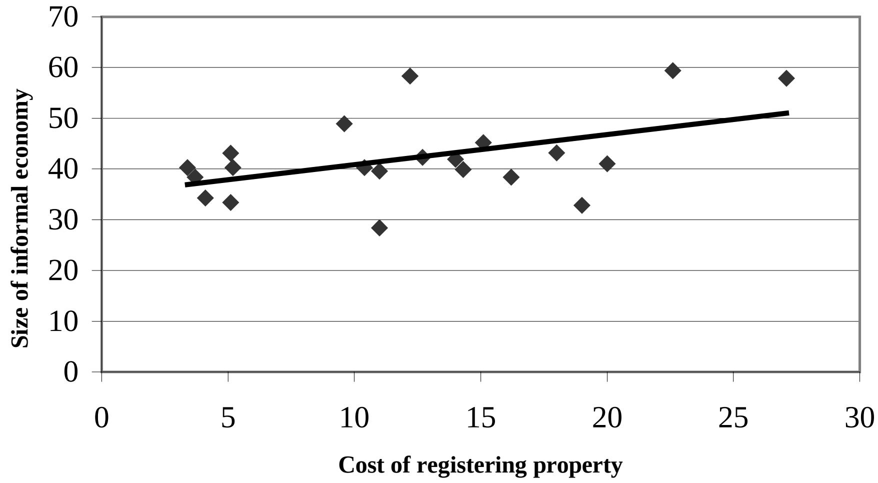
Again turning to the Doing Business Database compiled by the World Bank, it is interesting to consider the heterogeneity in some of the key business factors behind the development of the sector in Africa. The database contains figures for various indicators representing the ease of starting up a business, hiring and firing workers, registering property, getting credit, protecting investors, enforcing contracts, licensing requirements and closing a business.[3] For example, based on certain assumptions regarding the nature and location of the business, sub-Saharan enterprises are required to complete 11 procedures on average in order to establish a new business, the equal highest amongst all regions. This process takes over 63 days in sub-Saharan Africa, the longest of any region. The cost of starting a business in SSA represents 215.3 percent of GNI per capita, which is over three times higher than the next most expensive region (Middle East and North Africa). This figure, however, masks the heterogeneity in SSA: the percentage ranges in fact from 8.6 percent of per capita GNI in South Africa to 1,442.5 percent in Zimbabwe. Overall, these figures show that establishing a business in the formal sector in SSA is a complex, lengthy and costly undertaking, which are all reasons for enterprises to remain informal.

Another barrier for enterprises to operate in the formal economy is licensing. In sub-Saharan Africa there are on average 20.1 licensing procedures for a business in the construction industry to build a standardized warehouse. These procedures include obtaining licenses and permits, completing notifications, inspections and submitting the necessary documents (see www.doingbusiness.org). The figure for SSA varies from 11 in Kenya and Namibia to 48 in Sierra Leone. The only region that has more licensing procedures than SSA is Europe and Central Asia (21.4). These procedures take approximately 251.8 days in sub-Saharan Africa, ranging from 127 in Ghana to 569 in Cote d'Ivoire. On average the cost of registration amounts to 1,597.3 percent of GNI per capita, with a minimum in Mauritius of 16.7 percent and maximum of over 10,000 percent for Burundi. This cost illustrates another barrier enterprises face when undertaking such an investment.

The different dimensions covered by the World Bank's Doing Business database allows for a more detailed empirical country-level analysis of the most important factors determining the size of the informal economy. A first look at the correlations between the size variable and other characteristics reveals that the following factors are positively and significantly correlated with the size of the informal economy: time to get a license; cost of registering a property; and the number of documents required for exporting. The relationship between the size and the cost of property registration is illustrated in Figure 3 above. This graph shows that an increase in the cost of registration by 1 percentage point is associated with an increase in the size of the informal economy by 0.6 of a percentage point. While there are many potential variables that influence the formation and growth of the informal economy, this preliminary analysis indicates that these barriers and costs to doing business are important factors behind this phenomenon.

[3] See the World Bank's Doing Business website and online database: www.doingbusiness.org

Figure 3 – The relationship between the size of the informal economy and the costs of setting up a business in Africa



Notes: The size of the informal economy is the percentage of this sector in terms of gross national income (GNI) (as of 2003). The cost of registering property is stated as a percentage of the property value (as of January 2005).

Source: World Bank Doing Business Database (www.doingbusiness.org)

Gender dimensions of the African informal sector

An important aspect of informalization is the significant representation of women in informal employment in Africa, where most women are normally self-employed or unpaid home-based workers (Chen 2001). Figures presented in Charmes (1998b), which are reproduced in Table 1, illustrate the important role of women in informal activities in Africa. According to these statistics, the share of women in total non-agricultural informal employment ranges from 5.0 percent in Tunisia, which is the result of the traditional role of women in this country and their low labour force participation rate (around 27 percent in Tunisia (1997)), to 71.9 percent in Mali. In informal trade, the share in employment is even higher, reaching 92.2 percent in Benin and 81.3 percent in Mali. The highest share in informal industrial employment amongst these selected countries is 88.5 percent in Burkina Faso. Participation of women in the informal service sector is not so evident with the share only reaching 48.5 percent of employment in Mali.

In terms of aggregate output in the informal segment, it is estimated that the contribution of women is larger on average than of men, except for Tunisia where it accounts for a minor 3.2 percent of informal sector GDP. These percentages reveal that though women clearly play a dominant role in the African informal sector, there is also considerable heterogeneity in terms of sectors and countries.

Table 1 – The role of women in informal employment in selected African countries

Indicator	Benin (1992)	Mali (1989)	Chad (1993)	Burkina Faso (1992)	Tunisia (1994-1996)
Share of informal employment (%)					
Total non-agricultural	59.7	71.9	53.4	41.9	5.0
Industry	42.8	73.2	24.5	88.5	4.4
Trade	92.2	81.3	61.8	65.9	2.4
Services	20.5	48.5	47.1	10.7	3.6
Contribution to informal sector GDP (%)	51.1	68.2	62.3	61.4	3.2

Source: Charmes (1998b)

As discussed in Chen et al. (1999), a neglected aspect of the contribution of women to the informal sector is home-based work, which accounts for over 50 percent of enterprises in many African countries, varying from 32 percent in Kenya to 77 percent in Botswana and Zimbabwe. Women in the informal sector in Africa are typically self-employed and often home-based. For example, in Benin, Guinea and Chad, self-employment accounts for almost 100 percent of informal female employment.

3. The impact of globalization on the African informal sector

This section explores the main theme of this paper – the role of globalization in the development of the informal economy. Although globalization can have different meanings, it normally refers to new patterns of global trade, FDI, capital flows, diffusion of technology and international migration of workers. These processes all have substantial implications for the structure of an economy and allocation of resources. Though it is worthwhile and informative to investigate the impact of these different dimensions of globalization on the informal sector, most of the literature addresses trade liberalisation and associated reforms (though mostly in general terms rather than concentrating on the informal sector). Thus, the primary focus in this section will be on the impact of trade.

At this point it is important to remember that Africa remains a small player in the global economy, with trade and FDI flows only accounting for less than 3 percent of total world flows (UNECA 2004). However, the ratio of trade to GDP in African countries is high indicating that these economies are nonetheless dependent and integrated with the world economy. Therefore, it is important for policymakers to appreciate the potential impact of globalization on labour markets, and in this case the informal economy, especially with the view that these effects are only likely to increase over coming decades.

Trade and the informal sector

As mentioned in the Introduction, the main approach to analyse the impact of trade on employment has been the Stopler-Samuelson Theorem/Heckscher-Ohlin (HO) model. This key contribution to neoclassical trade theory predicts that trade liberalisation – a major component of the globalization process – leads to an increase in demand for labour-intensive exportable goods in developing countries (assuming that this is the relatively abundant factor), resulting in an increase in its price and wages for those employed in this sector. The growth of employment in exporting industries depends on the elasticity of demand for labour in this sector, which in turn is conditional on the supply elasticity.

However, this is a simple 2x2x2 macro-economic model – two goods, two factors, and only two countries, and there is, therefore, no distinction between the informal and formal sectors. Moreover, once the main assumptions, notably perfect factor mobility and no externalities or other market imperfections, are violated, the predictive power of this theoretical approach begins to become more complex (see Fosu (2002) and Winters (2002)). In this respect, the labour markets present in Africa are clearly not consistent with the strict assumptions of the HO model. For example, the above result assumes perfect labour mobility between sectors (but not between countries). This raises the importance of short versus long-term adjustment (the predictions of the HO model are long-run in nature) as a consequence of globalization. If adjustment is costly due to labour market imperfections stemming from such factors as minimum wages, unionisation and dismissal protection, unemployment will increase in the short-term. This type of transitional unemployment is subsequently likely to force retrenched workers and their families into other forms of employment in the informal sector, to cope with new situation. Ultimately, the effects of trade and other forms of globalization on employment will depend on how the labour market functions.

A more theoretical consistent framework has to take into account these issues. Edwards (1988), for example, proposes a model of a small open economy with two factors (labour and capital) and three goods (exportables, importables, non-tradables) (see also Fosu (2002)). The model of Edwards (ibid) yields different predictions for the impact of trade on employment and wages in the three different sectors in the short and long-run and also shows how these findings differ when employment in the importable sector is subject to a minimum wage. Based on Edwards (1988), more relevant predictions for the impact of trade on the informal economy can be proposed.

Prior to liberalisation, import-competing capital-intensive industries in developing countries typically operated in the formal (private and public) sector. After reducing barriers to trade, we would expect, therefore, that there is a fall in demand for goods produced in the formal sector, resulting in a drop in employment in this sector in the short and long-run. Employment in the exportable sector is predicted to increase in any case, while the effect on wages in this sector depends on the assumption regarding wage rigidities. The response of the informal sector hinges on whether it specialises in the production of tradeables or non-tradeables. Assuming that informal enterprises manufacture exportable goods, then the demand for these products would also increase after liberalisation, leading to an increase in employment. If the informal sector produces mainly non-tradables (services), as often observed in developing countries, the impact of trade liberalisation on employment will be indeterminate.

However, if wage-rigidities are present in the importable sector, employment in the non-tradable sector is predicted by the model in Edwards (ibid) to rise in the long-run as capital is reallocated from the importable sector. The problem is that enterprises in the informal sector face many credit-constraints as the consequence of asymmetric information, lack of credit history, property rights and collateral. This implies that capital is not fully reallocated to the informal sector and thus employment in the long-run will not necessarily increase in the long-run.

Another argument that is relevant to this paper is that trade reforms result in a reallocation from the formal to the informal sector along the lines cited in Goldberg and Pavcnik (2003). As a consequence of global forces, businesses are forced to reduce labour costs to remain competitive. To achieve this, employers can cut workers' benefits in the form of leave, overtime payments, social security contributions and employment protection (severance payments). Alternatively, the enterprise can lay-off these more expensive employees and replace them with workers without these benefits, such as those on temporary contracts who are not afforded the protection of labour laws and union coverage. This type of response implies that informal sector workers increase their representation in the formal sector. As a final step, businesses may sub-contract the work entirely to the informal sector, including home-based workers and the self-employed (Goldberg and Pavcnik ibid).

Marjit (2003) argues that the informal sector has in fact two roles in a globalized economy: firstly, as a supplier of intermediary goods to the formal sector; and secondly, as producer of final goods. In this study, a theoretical model is proposed where the informal sector consists of both capital-intensive (producer of intermediary goods) and labour-intensive segments (producer of final goods). In such a framework, trade reforms lead to a contraction in the formal sector, which in turn adversely affects the informal capital-segment. Capital in the informal economy is as a consequence reallocated to the informal labour-intensive segment, which produces final goods and is therefore not directly linked as a supplier of goods to the formal sector. Marjit (ibid) outlines conditions where the wage in this segment increases as a result of this process. Note that in this study it is assumed that capital can be reallocated from one segment of the informal sector to another, but not from the formal sector.

The effects of other dimensions – FDI and immigration

Although there has also been very little research on the impact of other aspects of globalization on the informal sector, it is still worth reflecting on the potential effects of different dimensions such as foreign direct investment (FDI) and immigration.

Similar to the effects of trade, if foreign direct investment is concentrated in the labour-intensive sector, there will be a positive impact on employment and potentially wages. However, the majority of FDI flows in Africa have been in the extractive sector, which are capital-intensive (UNECA 2004). Therefore, such investments are unlikely to have a significant direct impact on employment in general and in the informal segment of the economy in particular.

The impact of FDI on informal employment will also depend on the type of linkages the investment will have with other sectors. An example of this situation is if a foreign company undertakes an investment that requires considerable backward linkages with suppliers, and in order to keep costs low and operations flexible, the company subsequently taps into the informal sector. This implies that such FDI flows would result in growth of the informal sector employment. However, it is also plausible that foreign companies only sub-contract to domestic enterprises in the formal sector, reflecting their desire to reduce risk and uncertainty in a long-term business relationship, or perhaps as a result of foreign investment regulations. In this case, employment is likely to rise in the formal sector.

Recent financial crises in Asia, Russia and Latin America demonstrate the mobility of capital in a globalized world. In contrast, labour in the international context remains relatively immobile. Nonetheless, large flows of migrants can have substantial implications for labour markets in both the source and receiving countries. A good illustration of this process is the United States, which has received over the last few decades millions of migrants, mostly illegal, from Mexico and other parts of Latin America (Canales 2003). The illegal migrants usually end up in informal employment such as on construction sites, factories and home-based work. These workers are attractive to employers because they are not subject to labour laws and union coverage, which makes them cheaper to hire and fire than locals. This suggests that these large inflows of migrants contribute to a rise in the informal sector in the US, but not necessarily at the cost of local jobs.

In the African context, there are considerable intra-continent migrant flows. For example, South Africa attracts many migrants from neighbouring countries who participate in informal cross-border trade. Many of them are female street traders who return to their country of origin such as Zimbabwe to sell goods purchased in South Africa (Xaba et al. 2002). Rural-urban migration is another aspect of labour mobility that is especially relevant for African countries. Underemployed rural workers, particularly the youth, migrate to urban areas seeking employment, but as a result of poor job opportunities in the formal sector, many of them end up as informal workers. As reported in Sethuraman (1997), there were considerable flows from rural regions to urban centres in Angola and Mozambique as a consequence of political turmoil, civil war, lack of infrastructure and displacement.

A further dimension of immigration that has a potential role to play in the development of the informal economy is remittances, which are sent by the African Diaspora to family and friends in their countries of origin. These much-needed funds are typically used for consumption and educational investments, but increasingly also for investments of other forms including helping relatives set up businesses in the informal sector.

Impact of trade, economic reforms and structural adjustment policies: empirical evidence

There are few empirical studies that have estimated the impact of globalization on the informal sector. Therefore, to supplement these limited resources, findings from the much larger class of studies that have investigated the effect of related economic reforms on employment are also considered.

In terms of the specific impact on the informal sector, there is one study on Latin America by Goldberg and Pavcnik (2003), in which the informal sector is defined as the part of the economy that does not comply with labour laws and does not provide workers with the benefits mentioned above. With this definition, the study investigates the impact of trade liberalization in two Latin American countries, Brazil and Colombia, on the probability of employment in the informal sector. Using individual labour force data, the empirical analysis suggests that trade policy and changes to tariffs had little impact on the informal economy. The only significant result is for Colombia prior to the introduction of major labour market reforms, which the authors argue indicates that trade policy effects are a “second-order concern compared to labor market legislation” (ibid, p.466). Reforms to the labour market actually work in the opposite direction: by reducing employment protection, workers’ benefits and other provisions, costs of labour in the formal sector are reduced, which acts as an incentive for businesses to operate in the formal economy (ibid). This result highlights the difficulties in empirically identifying the impact of trade liberalization, or globalization in general, on the economy as reforms are usually enacted concurrently, rather than in an isolated manner.

There are even fewer rigorous empirical studies on the effects of globalization on the informal sector in African countries. One illustration of the potential negative effects resulting from international competition is the production of sisal bags in Kenya. Women who traditionally produced these bags informally now face stiff competition in the form of cheaper imitations from South-East Asia, to whom they are losing market share, and as a result, suffering a loss of income (Carr and Chen 2002). Another example quoted in Carr and Chen (ibid) is the impact of the fish processing factories, which export fish from Lake Victoria to Europe, on the women in Kenya, Uganda and Tanzania who traditionally derived an income from smoking and selling fish. While these case studies are illustrative, more research is ultimately needed to improve our understanding of the relationship between globalization and informalization in Africa.

Another approach to analysing the impact of globalization on the informal sector is to consider the evidence for the effects of economic reforms and structural adjustment policies (SAPs), which were adopted in many African countries in the 1980s and 1990s. These economic policies are very much related to the overall globalization process, particularly the attempts to liberalise trade, FDI and capital flows. The main SAPs in Africa and other developing regions during this period were tighter monetary policy, fiscal constraint, an exchange rate depreciation, privatisation, capital market and external trade liberalisation. It has been widely argued that the SAPs of the 1980s and 1990s led to a growing informal sector in Africa. One often-cited example of this relationship in another region is the explosion in the sector following the Asian financial crisis and the subsequent imposition of such policies following IMF lending to stabilise the economies (ILO 2002a). The impact of such policies on employment and wages, and in particular on poverty, has been extensively discussed in the literature (see Lee and Vivarelli (2004) and references cited therein).

Kenya was one of the first countries in Africa to turn to the IMF and the World Bank in the 1980s after a period of economic crisis following the two oil shocks. Ikiara and Ndung'u (1999) present detailed statistics on the impact of the SAPs on the Kenyan labour market. The figures in this study clearly show the growth in the informal sector starting off in the 1970s: in 1972 the informal sector represented 4.2 percent of total employment, increasing rapidly to 10.3 percent in 1980 and 15.2 percent in 1985. From 1990 the figures are significantly larger: 39.1 percent in 1990 and 53.4 percent in 1994, though this increase is also due to a change in the definition of the informal sector, which broadened the scope of the series in the national statistics. Regression results presented in this study imply that growth in domestic output, (interestingly) growth in formal sector employment, and the size of the import surplus all have a positive effect on the growth in informal sector employment. There is also evidence of dynamics in the relationship between the growth in the informal sector and the covariates. The only variable with a negative impact on employment in the informal sector is the growth in public expenditure. The relative formal/informal real wage in Kenya actually declined during the 1990s (Ikiara and Ndung'u ibid).

Mupedziswa and Gumbo (2001) provide an illustration of the impact of structural adjustment policies in Zimbabwe on women informal traders working in Harare. Prior to the economic reforms and crisis in the early 1990s, many women in this country were already employed in the informal sector as unpaid family and own account workers. In 1984, for example, women accounted for 64 percent of employment in the informal sector compared with only 25 percent in the formal sector. The first phase of economic reforms in Zimbabwe occurred from 1990 to 1996, which included reducing the fiscal deficit, tightening monetary policy, domestic deregulation, and trade and exchange rate liberalisation. This longitudinal study presents evidence that women were the most negatively affected by these reforms. One particular outcome of the policies was an increase in the competition amongst informal traders, which resulted from the influx of retrenched workers and those who had to acquire a second job to offset declining real wages. By 1996 there were 1.56 million workers in the informal sector compared with only 1.26 million in the formal sector. Cross-border trading with other Southern African countries witnessed the strongest growth, increasing from 5.4 percent of all informal trading activities in 1992/1993 to 19.5 percent in 1998 (Mupedziswa and Gumbo ibid).

As discussed above, labour force participation of women in the informal sector has increased in many African countries in conjunction with liberalisation and economic reforms. One reason is that many men were retrenched as a consequence of competition or through public-sector downsizing. Though not directly related to globalization and its effects on the tradable sectors, public sector downsizing has been an integral part of economic reforms conducted in Africa in the 1980s and 1990s as part of structural adjustment policies. After such measures, women (and men) have sought to supplement household income by finding employment and often a second or third job in the informal sector. Inflation and a cutback in publicly funded services also exacerbated the negative effects of liberalisation on incomes (Carr and Chen 2002).

For example, the Ethiopian government demobilised over 541,000 soldiers between 1991 and 1995 (Haltiwanger and Singh 1999). During the same period, the government of Ethiopia retrenched public sector workers, reduced new hires, and abandoned the job guarantee for tertiary graduates, an institution which was very widespread in Africa. The youth were the most adversely affected by these policy changes, and the evidence indicates that rather than entering the informal sector, many of them remained unemployed after graduation (Krishnan et al. 1998). This is an illustration of when the informal sector does not absorb excess labour supply, though the causes of this outcome have not been identified or well researched.

Benefiting from a globalized economy

Contrary to popular perceptions about the impact of globalization, there are also positive effects through the opening up of new markets for goods produced by the informal sector. An example of this positive outcome of globalization is discussed in Box 1 in relation to the production of shea butter in Burkina Faso. A fundamental message from this illustration is that it is, however, not enough to rely on market forces to help the poor in the informal sector. Assistance in the form of education and training, the development of other relevant skills, and importantly, access to credit, are also essential for such workers to benefit from the global economy. These issues are expanded upon in the next section, which highlights key policy areas.

Box 1 – The production of Shea butter in Burkina Faso

The collection of the nuts from the shea tree to produce a vegetable fat or shea butter has been a traditional activity of women throughout rural areas in the Sahel region of West Africa, particularly in Burkina Faso. Shea nuts in an unprocessed form have been exported to Europe for some decades to be used in the production of chocolate. However, during the 1990s, a period of structural adjustment and liberalization, the export focus shifted to cotton. More recently, with the help of bilateral donors and NGOs, women were supported to develop the production of shea butter as opposed to only collecting the nuts. Now a number of multinational cosmetic companies purchase shea butter from Burkina Faso to be used in the production of a range of beauty products. Women in the informal sector and their families have benefited from these trade opportunities. Engagement with the global economy required learning a range of technical and organisational skills, which would not have been possible without the help of NGOs and donors. In recent years, the shea butter producers in the informal sector are facing more direct competition from the formal sector and multinational companies. Therefore, it is likely that this informal activity will continue to require assistance in order to be able to remain competitive in the global market.

Source: Harsch (2001)

The study by Boateng (1998) provides an insight into the development of the labour market in Ghana after the implementation of structural adjustment policies during the early 1990s. Prior to the SAPs, formal sector employment in Ghana grew from 337,000 in 1980 to 464,000 workers in 1985, an average annual rate of growth of 7.5 percent. After the imposition of economic reforms and SAPs during the period 1991 to 1996, the employment levels in the formal sector dropped from 414,000 to 186,000. Nonetheless, the average real formal wage increased by 27 percent per annum. Boateng (ibid) argues that this reflects the shift from mass employment to quality jobs, which suggests a potential positive outcome resulting from structural adjustment in Ghana. As a consequence of an exchange-rate adjustment and import liberalisation, there was a decline in the import sector, and a subsequent growth in exportables (natural resources) and non-tradeables (banking/finance and services). An interesting finding in Boateng (ibid) is that the decline in employment was larger in firms that had collective bargaining agreements, which illustrates how labour market institutions can constrain labour mobility during periods of adjustment. Overall, there was a shift in demand from low-skill to high-skill labour, reflecting the importance of developing curricula and training to match the type of skills required in the new economy.

There is also some empirical evidence that the formal sector can actually grow and absorb workers from the informal sector after trade liberalisation. This was apparent in the formal manufacturing sector in South Asia where growth increased from 3.8 percent per annum to 9.4 percent after liberalisation, creating many jobs for informal sector workers (World Bank 2001). This result is more consistent with the predictions of Lewis (1954) where the formal sector absorbs excess labour from the subsistence and informal segments of the economy. For this to be achieved, however, economic policies and the institutional environment have to deliver the right incentives for the formal sector to create jobs.

4. Policy recommendations - integrate or deregulate?

In the first half of this paper, in Sections 2 and 3, the main conceptual, theoretical and empirical issues relating to the informal sector in Africa have been explored. In this section, policy recommendations are proposed in light of this discussion.

The overriding objective of African governments has to be to develop policies that promote job creation. Macroeconomic policies such as prudent fiscal management, appropriate monetary and exchange rate policies are key elements to accelerating economic and job growth. However, with the dominance of informalization in these economies, policymakers have to also consider the trade-off between jobs and employment conditions. In this regard, informal workers and enterprises need assistance to participate in a global economy, but if the regulations and benefits provided in the formal sector are extended to informal workers and enterprises, their advantage vis-à-vis the formal sector in terms of labour costs and flexibility may be lost. This outcome will lead to unemployment and an increase in poverty. Ultimately, the informal/formal dualism in the labour market has negative implications for both equity (protection for workers) and efficiency (allocation of resources). Thus, the goal should also be to provide a level playing field such that there is no need to distinguish between the informal and formal sectors. In order to address these points, we consider two sets of policy objectives:

- ♦ Assist the informal sector in taking advantage of opportunities in a global market
- ♦ Stimulate job creation in the formal sector

Policies to assist integration with the global economy

While globalization creates opportunities for the informal sector, workers and enterprises will often require assistance to reap these rewards. The main policy areas to target are:

- ♦ Access to credit and insurance for businesses
- ♦ Secure property rights
- ♦ Improve flows of information and technology to the informal sector
- ♦ Provide measures and incentives for training
- ♦ Develop worker representation
- ♦ Extend worker benefits such as health insurance and social security

Access to credit and insurance for businesses

As a consequence of informality, and in particular due to the lack of property rights and hence collateral, businesses in the informal sector are constrained in their ability to access credit in the formal sector. Facing this constraint, the poor in developing countries typically turn to family, or more likely to the local moneylender for credit. The latter source charges exorbitant interest rates, which cripple borrowers and keep them in a cycle of debt. For example, the founder of the well-known and much lauded Grameen Bank, Professor Yunus witnessed that an unskilled woman was in effect paying 3,000 percent per annum on a loan from a moneylender needed for raw materials to produce bamboo furniture.[4] Moreover, the objective has to be not only to improve access to credit for informal sector workers and enterprises, but also other banking facilities such as savings accounts, which in turn improves liquidity in times of necessity.

The lack of information and appropriate policies also creates barriers for informal enterprises in accessing insurance. Without the ability to mitigate economic and natural risk, these businesses are as a result subject to volatile incomes and the vagrancies of the market and weather. Again similar to the situation for access to credit, insurance policies for the informal sector have to be tailored to the conditions, taking into account the lower contributory capacity of employers, in addition to the volatility of their earnings. The scheme offered by the Self-Employed Women's Association (SEWA) in India is an example of one approach (World Bank 2001). Many insurance schemes in the informal sector in developing countries have been self-financed, but others continue to require assistance from the government or donors.

Extending secure and enforceable property rights

As discussed in Rodrik (2000), and earlier in North and Thomas (1973) and North and Weingast (1989), the establishment of secure and enforceable property rights was one of the fundamental factors in the development of capitalist economies in the West. Property rights enable individuals and businesses to use assets as formal collateral in order to raise capital from financial institutions, which charge lower rates of interest than informal lenders. Moreover, as argued by de Soto (2000), property rights also generate a positive externality in the economy by providing information, which can be used by all sides of the market. The challenge is, however, to extend property rights to those in the informal sector who have been outside the scope of the legal system. De Soto (ibid) argues that to achieve this, the ownership of assets, including land, property, and businesses, needs to be assigned through titling. With the assignment of legally recognised property rights, the poor in the informal sector are subsequently able to participate in the formal economy.

Bridging the digital divide

Information technology provides an opportunity for informal workers and businesses to engage with the formal sector in both the domestic and global markets. IT can be particularly useful for receiving the latest information on prices and market conditions, which helps enterprises in adjusting their production to new trends and demands. Telecommunications, such as mobile telephony, also assists in keeping in touch with customers and developing distributional and informational networks. Costs of traditional services such as fixed-lines can, however, be prohibitively expensive, while new forms of technology can reduce these costs and improve access for even the rural poor. Examples of overcoming this hurdle include Grameen Telecom, a subsidiary of the Grameen Bank, which leases mobile phones to bank members, who are poor rural women (Vishwanath 2001). The worldwide web is also delivering many opportunities for informal businesses

[4] See information on the Grameen Bank's website: www.grameen-info.org.

to sell their products in an international market. Of course, other forms of infrastructure are also essential for businesses to set up and operate in the global economy, such as utilities and roads.

Worker representation and organisation

An important factor that contributes to the development of these constraints in accessing credit, insurance, training and ICT, is the lack of information on both sides of the market. Worker representation is one approach that can help overcome this barrier, in addition to facilitating the expansion of informal workers' rights and benefits. Contrary to the common perception about the informal sector, it is indeed feasible to organise workers and enterprises in this sector. However, the form of representation is unlikely to be a traditional union, who are often reluctant to engage with the informal sector, but rather grassroots organisations that provide support to members and a voice in lobbying with policymakers. The Self-Employed Women's Association (SEWA) mentioned above is an example of establishing such an organisation. Purchasing associations are another form of organisation that can employ their bargaining power to ensure that rents are fairly distributed between the informal sellers and buyers (ILO 2002a). In general, policymakers have to also be aware that unionisation can result in unemployment and should not become a vehicle for rent seeking.

Extending social protection

A large proportion of workers in the informal sector do not pay taxes or contributions, which in turn leaves them ineligible for social security benefits. Moreover, in many African countries, there are often no public forms of social insurance or protection. In order to extend social protection, it is, therefore, important that additional institutions be developed for informal sector workers, which are able to spread the benefits and protection afforded to those in the formal sector, without acting as a dampener on business activity. Box 2 provides an illustration of two approaches, one in Senegal and the other in Tanzania. The key objective of these schemes is to help members with unexpected health expenses, without providing comprehensive medical insurance, which would be too expensive for most informal sector workers. Even with the growing number of schemes, the proportion of informal workers covered by any form of social protection remains very small in African countries (ILO 2002a), which needs to be addressed by policymakers on the continent. Again, governments have to keep in mind that social protection can potentially act as brake on job creation, as discussed above in terms of European countries.

Box 2 – Extending social security to the informal sector – experiences in Senegal and Tanzania

Senegal

The Senegalese Ministry of Labour and Employment together with the Senegal Old-Age Pension Insurance Institution and the Social Security Fund (CSS) set up a social security scheme for the informal sector. This sector accounted for 58.7 percent of the employed urban population in 1991, with a growth rate 1.8 times the formal sector. The main causes behind the growth in the Senegalese informal sector were an economic crisis and the macroeconomic adjustment policies that followed. This social security scheme targeted the self-employed and offered a range of benefits such as a prenatal allowance, maternity allowance, family allowances, accident and health insurance. Lécuyer (2002) reports that in the Dakar region alone some 1,000 craftspeople were registered with the scheme, with most taking up accident insurance and family allowances.

Source: Lécuyer (2002)

Tanzania

In 1995 the ILO helped establish an umbrella organization for the informal sector in Tanzania, known as the UMASIDA (Mutual Society for Health Care in the Informal Sector). By 1999, the organisation had 1,800 contributing members, who each pay less than US$2 per month into a centralised account. UMASIDA provides for members some coverage of the costs of primary health care. The scheme is successful because the contributions are not high, though there are problems with the irregularity of payments made by members.

Source: ILO (2002a)

Policies to create jobs in the formal sector

To stimulate job creation and to improve equity in the labour market, African policymakers need to remove the very causes of informalization. In spite of the controversy over the linkages between openness and growth/poverty, liberalisation of trade, FDI and capital flows remains a vital step towards enhancing job growth in a developing country. However, as discussed in Fosu (2004), policies need to also encourage the expansion of the export sector, specifically in industries that are labour-intensive. This will involve removing barriers for the export sector such as poor infrastructure, export taxation, and over regulation. It will also include reducing labour mobility costs through better transport links, training to reduce skill obsolescence, access to capital, and improved facilitation of migrant labour and flows of information (Fosu ibid).

The barriers imposed by government policies, such as the tax burden, labour laws and licensing procedures, have been identified as an important factor in the informalization of labour markets. One aspect of these issues, the inefficiencies caused by labour market regulations, has been a prominent topic of debate in developed countries, above all in Europe. A good illustration of this is the effect of dismissal protection. As discussed in OECD (1999, 2004), firing costs resulting from dismissal protection theoretically reduce incentives for employers to hire new workers since they have to take into account the costs of dismissing them at a later date (with some probability). Another example is a minimum wage, which can also deter employers from taking on unskilled workers if they are less productive than the wage set by this law. Theoretically wage rigidity and other labour market imperfections result in unemployment, and removing such barriers should help create jobs in the formal sector.

Another relevant issue in Africa is compliance with labour laws, which is typically weak in Africa as it is often straightforward for employers to avoid the constraints imposed by such institutions. Consequently, the key predictions discussed in the literature may not be so relevant. Nonetheless, a lack of labour mobility prevents workers from being reallocated to the expanding export sector, and therefore, improving labour market flexibility must still be an integral component of any reform package that aims to stimulate job creation. However, this again reveals the efficiency-equity trade-off present in the labour market. On one side, governments want to create jobs by improving the functioning of the labour market (efficiency dimension). At the same time, policymakers may wish to increase social protection and other dimensions of employment (equity dimension), which could, however, indirectly hinder employment creation.

Moreover, African governments need to also tailor education policy to improve the match between graduates and job opportunities in the formal economy. A shift in demand for skills, from low-skill to high-skill, means that curricula and training have to keep up with what is required in the labour market. This would also address the problem of youth unemployment, which is very high in Africa (at around 21 percent) (UNECA 2005). Retraining for retrenched workers is another key measure that would assist these individuals to find decent employment in a growing economy.

By improving the incentives, informal workers and enterprises will be able to take up opportunities in the formal sector, thereby leading to a reduction in the size of the informal sector. This development will also contribute to improving tax revenue, which is particularly undeveloped in Africa.

Statistical analysis and data collection

An accurate picture of the informal sector and its different elements and characteristics is crucial for policymakers. Without this information, predictions for the impact of policy changes and globalization are likely to be imprecise in regions like Africa where the informal sector plays such an important role in the economy. However, due to the very nature of the informal sector, the collection of data on employment and output that is generated outside the formal economy is difficult. Therefore, an important objective is to improve the capacity of national statistical offices in African countries. To address these deficiencies, the ILO has been instrumental in recent years in improving the definition and collection of data in developing countries. Specific issues that need to be tackled include the contribution of women to home-based and often unpaid activities, and other workers such as street vendors that are missed by labour force surveys and population censuses. Key references for this agenda are Charmes (1998a), Chen et al. (1999), and the report by the ILO (2002c).

Given that the informal sector is so heterogeneous in terms of characteristics, the whole objective of quantifying the informal sector raises the question of whether or not any aggregate statistic can be useful to policymakers. The main issues of concern are how workers and enterprises can benefit from globalization, or whether the exploitation of vulnerable groups such as women and children increases with openness. Evidence mentioned above and cited in the literature indicates that there are both winners and losers in a globalized economy. Therefore, the agenda must focus instead on identifying these groups and the links between globalization and the labour market. This will indeed require the collection of data at the household and individual-level, but the focus of the analysis must go beyond just the development of an aggregate statistic representing the informal sector. In this regard, a database that contains aggregate and microdata on the informal sector in Africa would serve to help governments make appropriate decisions regarding economic growth, job creation and welfare. With this information at hand, research in African countries can expand, addressing the impact of globalization in all its forms on employment in the informal sector.

5. Summary

Contrary to the expectations of much of the early development literature, the informal sector has not only persisted but also grown in many developing countries, particularly in Africa. This growth has occurred in conjunction with increasing globalization and opening up of economies, which has provoked a debate about the link between these processes and the informal sector. In this debate it is often argued that the poor, usually women, lose out in a globalized world as multinationals seek to exploit low labour costs in developing countries. The empirical evidence, though incomplete, suggests that there are in fact both winners and losers as a consequence of these forces.

Rather than targeting one specific sector, the primary goal of policymakers in Africa must be to remove the barriers that prevent the reallocation of resources and mobility of labour between the formal and informal sectors, and particularly between the import competing and export industries. These barriers include labour market rigidities, over regulation of businesses, taxation, and the lack of appropriate training. By removing these constraints, the informal/formal dualism in the labour market will cease to exist, thereby rendering the debate not one about the differences between sectors, but rather about the need to promote economic growth and job creation in the economy, while at the same time extending worker protection, social security and benefits to mitigate any short-term episodes of unemployment and earnings volatility.

A key component of this agenda in Africa will be to improve the collection and analysis of data on the informal sector. Given that the informal sector is so heterogeneous in nature, the objective, however, cannot be to find an aggregate statistic for its own sake but to identify those segments in the labour market that are the most vulnerable, such as women, children, the disabled, and the elderly, and then target these groups with appropriate policies.

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