

October 05

**The Business Environment and the Informal Economy:
Creating Conditions for Poverty Reduction**

Martha Chen
Harvard University
WIEGO

Draft Paper for
Committee of Donor Agencies for Small Enterprise Development
Conference on
“Reforming the Business Environment”
November 2005
Cairo, Egypt

Table of Contents

1.	Introduction	1
	<i>The Context</i>	1
	<i>This Paper</i>	2
2.	The Private Sector and the Informal Economy	4
	<i>The Formal and Informal Economies</i>	5
	<i>The Formal Private Sector</i>	7
	<i>The Informal Private Sector</i>	8
3.	Costs and Benefits of Informal Self-Employment	11
	<i>The Nature of Informal Self-Employment</i>	11
	<i>Benefits of Informal Self-Employment</i>	14
	<i>Costs of Informal Self-Employment</i>	16
	<i>Informality and Poverty</i>	19
4.	The Business Environment, Formal Enterprises, and Informal Enterprises	26
	<i>Formal Enterprises</i>	27
	<i>The Business Environment</i>	28
5.	Promoting a Pro-Poor Business Environment	31
	<i>Strategies</i>	32
	<i>Interventions</i>	36
	<i>Concluding Thoughts</i>	37

I. Introduction

Over the past decade, the donor community has expressed increasing interest in making economic growth – and globalization - pro-poor. The underlying concern is to identify and promote “strategies and policies... that connect poor people to self-sustaining economic growth and to the benefits of globalization” (OECD DAC Poverty Network). Pro-poor private sector development is seen as one of the key pathways through which this can take place: other pathways identified include infrastructure and agricultural development. Further, a pro-poor business environment is seen as essential to pro-poor private sector development.

However, there is an unresolved debate within the donor community and the international development community more generally on the relationship of the business environment to micro-enterprises and to the informal economy, where most of the poor are employed. This is reflected in that fact that out of seven topical and controversial issues identified for this conference, two are:

- Why should enterprise size matter?
- What is the connection between the informal economy and the business environment?

This paper will provide recent statistical data and research findings that should help the donor community come up with informed answers to these questions. It will also provide a strategic framework with promising examples for promoting a more favorable business environment for informal enterprises of the poor.

The Context

The persistence of poverty worldwide is a major challenge of the 21st. century. More than 1 billion people struggle to survive on less than \$1 a day (UN 2005). Of these, roughly half – 550 million – are working (ILO 2005). By definition, these working poor cannot work their way out of extreme poverty. They simply do not earn enough to feed themselves and their families, much less to deal with the economic risks and uncertainty they face. Given this reality, more and better employment opportunities are a key pathway to poverty reduction.

Underlying the work of many donor agencies today is the vision of a world free from want and fear as outlined in the 2000 UN Millennium Declaration (United Nations 2000) and translated into the eight time-bound Millennium Development Goals (MDGs). Eradicating extreme hunger and poverty is the first major Millennium Development Goal. Yet employment is neither a target nor an indicator under Millennium Development Goal # 1; and employment is an explicit target in only a handful of Poverty Reduction Strategy Papers.¹

¹ In collaboration with UNIFEM, James Heintz reviewed 41 PRSPs for the *Progress of the World's Women 2005*. Of these 41 PRSPs, only 5 set any kind of explicit target for employment and only 23 incorporated some form of employment indicators as part of the monitoring and evaluation process (Chen et al. 2005).

2005 is a benchmark year for the MDGs. There are signs that employment has emerged as a priority concern in the UN-led review of progress made towards the MDGs over the past five years. The International Labour Organization has promoted the goal of ‘decent work for all’ as a global priority. The 2004 Extraordinary Summit of Heads of State and Government of the African Union (held in Burkina Faso) adopted a declaration and plan of action calling for employment to be placed at the centre of poverty reduction strategies. The Inter-Agency and Expert Group (IAEG) on MDG indicators is actively considering new employment and earnings indicators that would distinguish between formal and informal employment. And, most recently, the 2005 World Summit held at the United Nations in September 2005 included the goals of “full and productive employment and decent work for all” in paragraph 47 of its Declaration.²

Also, as the topic of this conference highlights, many donor agencies have come to recognize that reforms to the business environment to make them pro-poor can be a crucial ingredient to achieving the MDGs. For this reason, as the organizers of this conference have noted, “reforms to business environments that improve the conditions for poverty reduction are likely to be given greater attention in the coming years”.

This Paper

The central concern of this paper is how to promote a *pro-poor business environment* for the *enterprises of the poor*.³ As the evidence presented in this paper will show, most of the enterprises of the poor are very small in size, often with no hired workers.⁴ Also, in most contexts, the existing business environment is *biased towards larger more formal enterprises* to the disadvantage of small and medium enterprises and, more so, of the very small informal enterprises of the poor.

The paper will present recent statistical data and research findings that indicate:

- where the working poor are situated in the economy/workforce
- what constraints, costs, and risks they face
- how the enterprises of the poor are affected by the business environment, legislation, and policies

² Para 47 of the 2005 World Summit Declaration reads: “We strongly support fair globalization and resolve to make the goals of full and productive employment and decent work for all, including for women and young people, a central objective of our relevant national and international policies as well as national development strategies, including poverty reduction strategies, as part of our efforts to achieve the Millennium Development Goals. These measures should also encompass the elimination of the worst forms of child labour, as defined in the ILO Convention No. 182, and forced labour. We also resolve to ensure full respect for the Fundamental Principles and Rights at Work.”

³ The focus will be on non-agricultural enterprises of the poor to the exclusion of the concerns of a) informal wage workers and b) small and marginal farmers and others who live off natural products. However, it should be noted that most of the extremely poor people in the world live in rural areas and survive on the consumption and sale of natural products (UN 2005).

⁴ A pro-poor business environment should also enable *enterprises that employ the poor* and protect the workers in them: but this paper will not address this dimension of a pro-poor business environment. For a parallel assessment and policy framework (with promising examples) of how to protect informal wage workers, in both formal and informal enterprises, see Chen et al. 2004 and 2005.

In so doing, it will illustrate the need for more and better data in order to design a pro-poor business environment.

This paper will also make the case that:

- the private sector is predominantly informal (nor formal or corporate)
- the majority of enterprises of the poor are family businesses or single person operations
- targeting the smallest enterprises matters, if the donor community wants to reach the poor and to reduce poverty
- what is needed, in addition to expanding wage employment opportunities by helping small and medium enterprises to grow, is to a) increase incentives for informal enterprises to formalize and b) improve the terms of doing business and increase the returns of informal enterprises

The structure of the paper is as follows. The next section will present data on the size and composition of the private sector with a particular focus on the informal part of the private sector. Section III will discuss the costs and risks of operating informal enterprises, and the link between informality and poverty. Section IV will discuss the relationship between informal enterprises, formal enterprises, and the business environment. And the concluding section will provide a strategic framework for creating a more favorable economic policy and business environment for informal enterprises and for targeting supportive interventions to them. The Annex contains a set of good practice examples for each of the strategies in the framework, illustrating their feasibility.

Most of the statistical evidence presented in this paper is drawn from three recent sets of analyses of national data from a cross-section of countries:

1. The first set is an analysis of national statistics on non-agricultural informal employment (25 countries) and non-agricultural self-employment (30 developed countries and 70 developing countries) compiled by Jacques Charmes for a statistical publication commissioned by the International Labour Office (ILO) for the International Labour Conference 2002 General Discussion on “Decent Work and the Informal Economy”.⁵

2. The second set is the analysis of national data in five countries – Egypt, El Salvador, India, Russia and South Africa⁶ - commissioned by the Economic Policy Institute-Global Policy Network (EPI-GPN) for a comparative workforce development project funded by the Ford Foundation. Following a common framework of questions, these EPI-GPN analyses all studied the links between macroeconomic processes and labor force development (though they varied in the measures used). Most importantly, for our

⁵ This ILO publication entitled *Women and Men in the Informal Economy: A Statistical Picture* (ILO 2002b) was written by Martha Chen and Joann Vanek.

⁶ These studies have been published in a volume called *Good Jobs, Bad Jobs, and No Jobs: Labor Markets and Informal Work in Egypt, El Salvador, India, Russia and South Africa* edited by Tony Avirgan with L. Josh Bivens and Sarah Gammage (Avirgan et al. 2005).

purposes here, they also disaggregated the total labor force by formal and informal employment, the formal labor force by public and private sectors, and all categories by sex.

3. The third set is the analysis of national data in five countries – Costa Rica, Egypt, El Salvador, Ghana, and South Africa - commissioned for the 2005 issue of UNIFEM’s flagship publication *Progress of the World’s Women* by the WIEGO network in consultation with the ILO.⁷ Following a common data tabulation plan, these analyses were designed to a) distinguish workers not only by the main categories – formal and informal, agricultural and non-agricultural – but also by the employment statuses within them; and b) link employment data with earnings data and, for some of the countries, household income data.

Most of the analysis and recommendations presented in sections III-V of this paper have been presented earlier by members of the WIEGO network, including the author of this paper, notably in two recent publications: *Mainstreaming Informal Employment and Gender in Poverty Reduction: A Handbook for Policy-Makers and Other Stakeholders* (Chen et al. 2004), the third in a series of Commonwealth Secretariat publications on gender mainstreaming in critical development issues; and *Progress of the World’s Women 2005: Women, Work and Poverty* (Chen et al. 2005), the third issue of UNIFEM’s biennial flagship publication. To conform to the theme of this conference, the focus has been narrowed to informal self-employment, to the exclusion of the concerns of informal wage workers.

II. The Private Sector and the Informal Economy

According to the Concise Oxford Dictionary (1995 edition), the private sector is “the part of the economy not under direct state control”. Common sense would tell us that the private sector is comprised all economic units, activities, and agents that are not part of the public sector (i.e., the government bureaucracy and public enterprises). The private sector so defined would include *formal* economic units, activities, and agents that are under *indirect* state control in the form of registration, regulations, and taxation; as well as *informal* economic units, activities, and agents that are largely (but often not totally) free of both direct and indirect state control. However, it is not always clear when donor agencies and other observers refer to the “private sector” whether they include a) both formal and informal private economic activities and b) both agricultural and non-agricultural private economic activities.

In this paper, the term “private sector” is used to refer to non-agricultural private economic activities, both formal and informal. But what share of all non-agricultural economic units, activities, and agents are private in developing countries? And what

⁷ Members of the WIEGO network, including the author of this paper, designed the common data tabulation plan and commissioned the national data analyses for the *Progress of the World’s Women 2005* in consultation with the ILO Statistics Bureau and with financial support from UNIFEM and UNDP, and the ILO funded a synthesis analysis of the findings by James Heintz (Heintz 2005). The findings have been published in summary form in Chapter 3 of Chen et al. 2005.

share of these are formal versus informal? What, in brief, does the non-agricultural private sector actually look like in developing countries?

Ideally, national labor force data (as well as enterprise and output data) should be collected and tabulated as follows:

- Total employment (all types)
 - Agricultural employment (1)
 - Non-agricultural wage employment (2)
of which: Informal wage employment (3)
 - Non-agricultural self-employment (4)
of which: Informal self-employment (5)
 - Formal non-agricultural self-employment (6)
of which: Private sector (7)
 - Formal non-agricultural wage employment (8)
of which: Private sector (9)

If data so tabulated were available, the size of the non-agricultural private sector could be estimated as the sum of components # 3, 5, 7, and 9 above. However, national data are seldom tabulated or presented in this way. What follows is a summary of relevant data (from the three sources outlined above as well as related analysis of national labor force data) which provides an admittedly sketchy overview of the non-agricultural private sector – both formal and informal – in developing countries.

The Formal and Informal Economies

Labour markets in *developing* countries have been characterized as dualistic, including a small formal/regulated segment and a large informal/unregulated segment in which workers, excluded from formal jobs, are employed. Recent compilations of national data indicate that, in developing countries, informal employment comprises one-half to three-quarters of non-agricultural employment: specifically, 48 per cent in Northern Africa; 51 per cent in Latin America; 65 per cent in Asia; and 72 per cent in sub-Saharan Africa. If South Africa is excluded, the share of informal employment in non-agricultural employment rises to 78 per cent in sub-Saharan Africa (ILO 2002b). If comparable data were available for other countries in Southern Asia in addition to India, the regional average for Asia would likely be much higher (*ibid.*).

While data on the share of informal employment in total *employment* are available, data on the share of informal enterprises in total *enterprises* or of the informal economy in total *output* are less readily available. For the 2002 ILO statistics book on the informal economy, Jacques Charmes compiled estimates of the contribution of informal enterprises to GDP in 26 developing countries (3 in Northern Africa, 16 in Sub-Saharan Africa, 3 in Latin America, and 4 in Asia). These estimates show a wide variation in (unweighted) averages between regions (27% in Northern Africa, 29% in Latin America, 31% in Asia, and 41% in Sub-Saharan Africa) and countries (from 13% in Mexico to 58% in Ghana) (*ibid.*). Another recent estimate found that in South Africa, at current prices for 1999, the informal enterprises contributed an estimated 26 per cent of the value

added in trade, the highest for any sector, followed by 18 per cent of value added in both construction and community services (Budlender et al. 2004).⁸

A recent compilation of national data in nine countries where data were available - six in Africa, three in Asia – found that informal traders, mainly street vendors, represent a very high proportion (73 to 99 per cent) of *employment* in trade and a significant share (50 to 90 per cent) of *gross domestic product* (GDP) from trade (see Table 1). In most of the countries, women accounted for between 50 and 90 per cent of informal traders and between 20 and 65 per cent of the value added in informal trade. The notable exceptions were two countries - India and Tunisia - where social norms restrict women’s mobility outside the home: the share of women among informal traders in these countries was 12 and 8 per cent, respectively (see Table 1).

These figures reflect the predominance of women in trade in Africa and Southeast Asia and the restrictions on women’s mobility in North Africa, Middle East, and South Asia. Consider the case of Benin. A 1992 survey of ten major cities in that country found that street trade constituted 81 per cent of all economic units, 64 per cent of total employment, and 69 per cent of urban informal sector employment. This survey found that women represented 75 per cent of street vendors in these cities; and that women street vendors accounted for 26 per cent of those in the urban informal sector and 24 per cent of the total urban workforce (data compiled by Charmes, presented in ILO 2002b).

Table 1
Size and Contribution of Informal Enterprises in Trade and Women Traders in Informal Trade

	Informal Enterprises as a Share of:		Female Informal Traders as a Share of:	
	Total Trade Employment	Total Trade Value Added	Total Informal Trade Employment	Total Informal Trade Value Added
AFRICA				
Benin	99	70	92	64
Burkina Faso	95	46	66	30
Chad	99	67	62	41
Kenya	85	62	50	27
Mali	98	57	81	46
Tunisia	88	56	8	4
ASIA				
India	96.	90	12	11

⁸ These GDP estimates do not include the contribution of informal wage employment in formal enterprises or informal domestic work.

Indonesia	93	77	49	38
Philippines	73	52	72	22

Source: Charmes, Jacques (personal compilation of the author on the basis of official labor force statistics and national account), published in ILO 2002b.

The Formal Private Sector

If the formal part of the economy – both public and private - represents only one-quarter to one-half of non-agricultural employment in developing countries, the *formal private sector* would represent an even smaller share of non-agricultural employment. However, many analyses of national labor force data do not distinguish between formal employment in the private and public sectors: so it is difficult to compile a statistical profile of the private sector, both formal and informal. An exception is a recent compilation of national data for Egypt which shows that, in 1998, 29 per cent of total employment was in the public sector, 39 per cent in private agricultural activities, and 32 per cent in private non-agricultural activities (El-Mahdi and Amer 2005).

However, there is a wide variation between developing countries in the share of total employment that is in the public sector and in agriculture as the following data suggest:

1. Government employment as percentage of total employment (1990s)

Asia	6%
Sub-Saharan Africa	> 6 %
Latin America	> 8%
Eastern Europe/ Former-USSR	16%
OECD	~17%
Middle East/ North Africa	>17%

Source: Schiavo-Campo et al. 2003, cited in Yousef 2004

2. Agricultural employment as percentage of total employment (1990s)

Middle East/ North Africa	27%
Low- and Middle-Income Developing Countries	46%

Source: World Development Indicators 2003, cited in Yousef 2004

Note: the Middle East and Northern Africa (MENA) is one of the most urbanized regions of the developing world.

Despite the variation in the relative sizes of these basic components of the labor force, available evidence suggests three common employment trends across developing countries. First, the shares of both public sector and agricultural employment in total employment are declining. Second, the growth of formal private sector employment is not keeping pace with the growth of the labor force. And, third, employment relations in formal enterprises – both public and private - are being informalized. The net result is a growth in informal employment in most developing countries. In most developing

countries, the major employment challenge is underemployment in the informal sector, not open unemployment.

In sum, in most developing countries, the formal part of the private sector represents less than half of all workers and an even smaller share of enterprises in the total private sector. **In other words, over half of the workforce and a major share of enterprises in the private sector are informal.** What, then, does the informal part of the private sector look like?

The Informal Private Sector

The informal workforce is large and heterogeneous, comprised of both the self-employed in informal (i.e. unregulated and small) enterprises and waged workers in informal (i.e. unregulated and unprotected) jobs. The focus of this paper is on the *self-employed in informal enterprises*. It is important to note, to begin with, that self-employment comprises a greater share of *total* employment in the developing world (32-48 % depending on the region) than in developed regions (12 %) (data prepared by Charmes, presented in ILO 2002b). Further, in developing countries, self-employment comprises a larger share of *informal* employment (outside of agriculture) than does wage employment, ranging from 60 to 70 per cent of non-agricultural informal employment, depending on the region (see Table 2).

Table 2
Wage and Self-Employment in
Non-Agricultural Informal Employment, by Sex (1994/2000)

Country/Region	Self-employment as a percentage of non-agricultural informal employment			Wage employment as a percentage of non-agricultural informal employment		
	Total	Women	Men	Total	Women	Men
North Africa	62	72	60	38	28	40
Algeria	67	81	64	33	19	36
Egypt	50	67	47	50	33	53
Morocco	81	89	78	19	11	22
Tunisia	52	51	52	48	49	48
Sub-Saharan Africa	70	71	70	30	29	30
Benin	95	98	91	5	2	9
Chad	93	99	86	7	1	14
Guinea	95	98	94	5	2	6
Kenya	42	33	56	58	67	44
South Africa	25	27	23	75	73	77
Latin America	60	58	61	40	42	39
Bolivia	81	91	71	19	9	29
Brazil	41	32	50	59	68	50
Chile	52	39	64	48	61	36
Colombia	38	36	40	62	64	60

Costa Rica	55	49	59	45	51	41
Dominican Rep.	74	63	80	26	37	20
El Salvador	65	71	57	35	29	43
Guatemala	60	65	55	40	35	45
Honduras	72	77	65	28	23	35
Mexico	54	53	54	46	47	46
Venezuela	69	66	70	31	34	30
Asia	59	63	55	41	37	45
India	52	57	51	48	43	49
Indonesia	63	70	59	37	30	41
Philippines	48	63	36	52	37	64
Syria	65	57	67	35	43	33
Thailand	66	68	64	34	32	36

Source: ILO 2002b. Data prepared by Jacques Charmes from official national statistics.

Reflecting its size, informal self-employment is itself a heterogeneous category, including:

- *employers*: owner operators of informal enterprises who hire others, contributed their own capital, but may (or may not) contribute their own labour;
- *own account operators*: owner operators of single-person units or heads of family businesses or farms who do not hire others and contribute both their own capital and labour;
- *unpaid contributing family workers*: family workers who work in family businesses or farms without pay and are unlikely, therefore, to have personal capital to contribute; and
- *paid contributing members of cooperatives or producer groups* who contribute both their own capital and labour.

Other categories of informal workers, who are often classified as self-employed in labour statistics and under labour law although they are not fully independent operators, include:

- *industrial outworkers*: sub-contracted workers who produce from their homes or a small workshop who contribute their own labour and have to pay for many of the non-wage costs of production (space, utilities); and
- *dependent contractors* such as commission agents who sell goods on a commission for others or taxi- and truck-drivers who work for a company that owns the vehicles they drive.

Data on the composition of informal self-employment are not readily available.

However, a recent analysis of national data in India illustrates the kind of data analysis that would be useful. This analysis looked at the distribution of informal enterprises and workers in the manufacturing sector by size of enterprise (see Table 3). What this analysis indicates is that 86 per cent of all enterprises and 68 per cent of the workforce in the informal part of the manufacturing sector were in single person operations or family businesses (in which there were no hired workers); and only 4 per cent of all enterprises had six or more workers and only 17 per cent of the workforce were in enterprises with six or more workers.

Table 3
Distribution of Informal Enterprises and Workers in Manufacturing
by Size of Enterprise: India (2000)

	Rural	Urban	All
Enterprises			
No hired workers	93	71	86
< 6 workers	5	21	10
≥ 6 workers	2	8	4
Workers			
No hired workers	80	45	68
< 6 workers	8	28	15
≥ 6 workers	12	27	17
Notes: 1. no hired workers = own account operations 2. about 40% of own account operations have unpaid family workers Source: Unni 2005			

Gender and Informal Self-Employment

In Northern Africa and Asia and at least half of the countries of sub-Saharan Africa and Latin America, more women in informal employment (outside agriculture) are in self-employment than in wage employment. By contrast informal wage employment is more important for women in Kenya, South Africa and four countries in the Latin America and Caribbean region (Brazil, Chile, Columbia and Costa Rica). In these countries more than half of women in informal employment are wage workers. Moreover, in all but one of these countries – South Africa – women are more likely to be informal wage workers than are men. In explaining these patterns, it is important to recognize that paid domestic work is an important category of informal employment for women in all Latin American countries as well as in South Africa (ILO 2002b).⁹

⁹ In South Africa, the Unemployment Insurance Act has recently been extended to cover domestic workers: so increasing numbers of domestic workers are receiving unemployment insurance thus blurring the dividing line between formal and informal wage employment (see Chen et al. 2005).

Within the informal economy, as has been noted, there are five basic categories of self-employed: employers who hired others (called micro-entrepreneurs in this paper); two categories of own account operators (i.e., heads of family businesses and single person operators); unpaid contributing family workers; and industrial outworkers. Available data suggest that women are under-represented among employers and heads of family businesses and over-represented among single person operators, unpaid contributing family workers, and industrial outworkers. As will be show below, this gendered segmentation within informal self-employment contributes to a gender gap in average earnings and poverty risk within informal self-employment.

III. Costs and Benefits of Informal Self-Employment

It is often assumed that those who work informally choose – or volunteer - to do so because of the advantages it offers compared to working formally (Maloney 2004). But those who share this assumption tend to focus on the more entrepreneurial among the informal self-employed. They also tend to overlook the negative aspects of informal self-employment and downplay the fact that the informal self-employed do not enjoy many of the positive aspects of formal self-employment because they are not registered and are not recognized by the state. In short, they tend to overstate the benefits - and understate the costs - of informal self-employment. What follows is an analysis of the costs and benefits of informal self-employment from the perspective of the working poor, especially women, based on recent research findings.¹⁰

Nature of Informal Self-Employment

Understanding the costs and benefits of informal self-employment requires first of all understanding the nature of informal self-employment, which is complex and changing. In many developing countries especially, different systems of production and exchange operate side-by-side. Manufacturing takes place in modern factories or in small workshops, on sidewalks and at home. Goods are bought and sold in private homes, street markets, kiosks and small shops, as well as modern supermarkets and shopping plazas. The expanding service sector includes personal services as well as data entry and call centres for airlines, hospitals and other service industries.

Adding to this diversity, production is increasingly global as firms move to or outsource production to countries all over the world. Computers and related technologies facilitate all aspects of production and exchange from product design to production to marketing. The bar code helps retail firms respond quickly to shifts in consumer demand; and digital graphics technology helps them transfer designs to their suppliers. In order to respond quickly, lead firms seek flexibility by sub-contracting out production to suppliers around the world, often under repeat short-term contracts rather than more long-term commercial relationships.

¹⁰ The research and statistical findings in this section draw heavily from Chapters 4 and 3, respectively, of Chen et al. 2005.

Three dimensions of work arrangements are useful in determining the nature, costs and benefits of informal self-employment: place of work, commercial relations, and production system.

Place of Work - Some informal economic activities are located in conventional workplaces such as registered shops or offices. But, typically, informal activities are located in non-conventional places, including private homes, streets, other open spaces, and unregistered shops and workshops.

Each place of work is associated with specific risks, and thus different degrees of security or insecurity, for those who work in them. The relevant factors include:

- ownership and security of tenure of the site;
- relationships of control at the work site: with fellow self-employed, with dominant commercial counterparts, with other interest groups, with public authorities and/or with family members;
- costs of securing the site (and especially entry costs for poorer women);
- the access to infrastructure needed for work, such as electricity (for light and power), water, toilets, garbage removal, storage of goods;
- access to customers and suppliers;
- potential for upgrading the conditions at the worksite;
- ability of informal self-employed to organize at the site or away from it in order to secure representation of their interests;
- different risks and hazards associated with the site.

Private homes – Significant numbers of people, especially women, work from their own homes, including own account operators, unpaid contributing family members and industrial outworkers. Among the benefits of working at home, often mentioned by women, is the ability to carry out both paid work and housework or child or elder care. This multi-tasking, which may be seen as a ‘benefit’ in terms of enabling women to fulfil multiple expectations, also imposes concrete costs. When a home-based worker stops work in order to care for a child or cook a meal, her productivity drops – and so does her income.

In some circumstances, working from home may be more physically safe for women. In others, it can increase their vulnerability – as they are less visible and less likely to be legally recognized as workers – and limit their access to social protection measures, chances to upgrade their skills or opportunities to organize collectively. Also, those who work at home are less likely than those who work in a workplace outside the home to develop social ties outside the family.

Those who work at home may also be limited in the kind of work they can do and how productive they are by such things as the amount of space available for work and storage, or whether there is electricity and water supply. In Ahmedabad City, India, poor women who live in dilapidated shelters on the streets report that no one is willing to sub-contract piece-rated garment work to them because of the poor conditions of their homes and lack of clean storage space. In spite of having the necessary sewing skills, they have resorted

to work as casual labourers or waste pickers (Rani and Unni 2000).

Finally, home-based workers may work with toxic substances, putting children especially at risk. They may be unable to read warnings about safe handling and storage, or their homes may not be equipped for proper storage or ventilation. In the case of industrial subcontracting, this is one very concrete way in which some lead firms shift risk down the supply chain.

Public places – Streets, sidewalks and traffic intersections are the place of work for many traders, along with parks, fairgrounds and municipal markets. The same public spot may be used for different purposes at different times of day: in the mornings and afternoons it might be used to trade consumer goods such as cosmetics, while in the evenings it converts to a sidewalk café run as a small family enterprise.

Despite exposure to pollution, noise and weather, the benefit of working in public spaces is evidenced by the demand for them. In the competitive jostle for sites close to transport and commuter nodes, city authorities respond in different ways, ranging from outright prohibition of street trade to regulated and negotiated use. Harassment, confiscation of goods, imposition of fines, physical assault and time spent in court – all of these affect the bottom line for traders. Given these costs of operating informally, some traders may wish to pay site licenses and other levies, but often the costs of regulation in both time and money are too high in relation to the tiny size of their enterprises and incomes.

Other open spaces – Other common places of work are agricultural land, including pastures and forests, and fishing areas, including ponds, rivers and oceans. Construction sites are not only places of work for construction workers but also for suppliers and transporters of materials, and these sites may attract other informal providers of goods and services – such as street food vendors – while building is taking place.

In many countries, there is a marked gender pattern to the place of work. A recent random-sample survey of both formal and informal workers in Ahmedabad City, India found that less than 25 per cent of the female workforce worked in factories, offices or shops compared to nearly 60 per cent of the male workforce, while nearly 70 per cent of the female workforce worked in their own or other homes, compared to less than 10 per cent of the male workforce (Unni 2000).

Commercial Relationships - Self-employment ranges from fully-dependent arrangements in which the owner operator controls the process and outcomes of work and absorbs the risks, to semi-dependent arrangements in which the operator does not control the entire process or outcome of her work but may still absorb all of the risks involved. And, as noted earlier, some self-employed persons are dependent on one or two clients or contractors, including newspaper distribution workers, commission agents for brand-name goods, taxi-drivers and skilled homeworkers involved in information communication technology.

Also, industrial outworkers who work from their homes are neither self-employed nor wage-employed. They work under sub-contracts for a piece rate without secure contracts or any real bargaining power. The small amount and insecurity of their income is exacerbated by the fact that they have to pay for many of the non-wage costs of production, such as workplace, equipment and utilities. They have little control over the volume or timing of work orders, the quality of raw material supplied to them or when they are paid. Some industrial out workers produce goods for major firms abroad. In today's global economy, there may be no greater distance – physical and psychological – or greater imbalance in terms of power, profit and life-style than that between the woman who stitches garments or soccer balls from her home in Pakistan for a brand-name retailer in Europe or North America and the chief executive officer (CEO) of that brand-name corporation (Chen et al. 2005).

System of Production -To fully understand the nature of informal work today, it is also important to look beyond commercial relationships to uncover the underlying system of production and exchange (du Toit and Ewert 2002). In most developing economies today, a complex mix of traditional, industrial and global modes of production and exchange co-exist as parallel or linked systems. In many developing countries, artisanal and agricultural modes of production have not changed significantly over the past century, and industrialization has not expanded as rapidly or as fully as in developed countries. Self-employment remains a large share of total employment and industrial production takes place in micro and small units, in family businesses or in single person units.

The global system of production – facilitated by digital technologies – involves dispersed production coordinated through networks or chains of firms. Authority and power tend to get concentrated in the top links of value chains or diffused across firms in complex networks, making it difficult for micro-entrepreneurs to gain access, compete and bargain for improved terms of production and exchange or for wage worker to bargain for better wages and working conditions. Highly competitive conditions among small-scale suppliers and the significant market power of transnational corporations mean that the lion's share of the value produced across these value chains is captured by the most powerful players. Some small and micro-entrepreneurs become suppliers in these chains or networks, others become subcontractors or subcontracted workers, while yet others lose out all together.

What this complex reality suggests is that the costs and benefits of different types of informal self-employment are a function of the specific place of work, commercial relations and production system under which the work is carried out – each of which serves to determine the conditions and outcomes of work. Making the link between informal employment, poverty and gender inequality means assessing the costs and benefits associated with different informal work arrangements against the location of women and men within them.

Benefits of Informal Self-Employment

The most widely cited benefits of operating informally include tax avoidance, illegal occupation of premises and illegal tapping of electricity, all of which are seen to lower the costs of informal enterprises and to give them a competitive advantage over formal firms that pay taxes, rent and utility bills. A second set of benefits, thought to favour women in particular, are the flexibility of work hours and the convenience of working from home or another convenient location. A further derived benefit is the opportunity that might not otherwise be available for generating wealth (if a person is entrepreneurial) or for making ends meet (if a person is poor). And for those who might not be able to seek a formal job, such as women whose physical mobility is constrained by social norms, informal work is seen to offer a chance to earn an independent income.

Tax Avoidance and Competitive Advantage - Informal entrepreneurs are thought to avoid the various taxes paid by formal enterprises, including registration fees, corporate income tax and payroll taxes. However, the reality is not so straightforward. Although informal enterprises are not formally registered at the national level, they may be registered at a local municipal level and pay registration fees as well as operating fees for the use of urban space. Moreover, they often pay indirect taxes or fees in the form of bribes, fees to recover confiscated goods and relocation costs in cases of eviction. Street vendors are particularly liable to indirect taxes. Some also pay nearby storekeepers for the use of toilets or space to store goods.¹¹

With regard to corporate income taxes, many micro-enterprises and own account operators are not subject to these since they are not incorporated or do not generate enough profit to fall into existing corporate tax brackets. However, they may still pay taxes because of reporting business profits as personal income due to the difficulty of separating household and business accounts. On the other hand, micro-enterprises and own account units do not benefit when governments lower corporate income tax rates as part of export-promotion incentive packages. There is no parallel tax incentive for micro-enterprises or own account operators that are not incorporated.

With regard to payroll taxes, micro-enterprises that hire others are legally liable to submit these but, by not registering, often avoid them. However, own account operators, who represent a large share of informal enterprises in many developing countries, are not subject to payroll taxes as they do not (by definition) hire workers. In India, as reported earlier, own account operations represent over 85 per cent of all informal enterprises in manufacturing (Unni 2005).

Finally, with regard to value-added taxes, informal producers and traders often find it difficult to 'pass' these on to their customers because they operate in such highly competitive and price-sensitive markets. And they cannot claim back the VAT that they pay on inputs because they are not legally registered. Further, a flat rate value-added tax – especially on foodstuffs – can prove regressive for informal workers *as consumers*.

¹¹ A recent study in Ahmedabad City, India estimated that the *legal fines* paid to the municipality – for traffic violations or release of confiscated goods – totaled nearly 8 million rupees (US \$175,000 at the prevailing exchange rate) while the *illegal bribes* paid to the police, city officials, and others totaled another 35.5 million rupees (US\$775,000) (Unni and Rani 2000).

This is because low-income households spend a larger proportion of their income on food than higher-income households and informal workers are more likely to be from poor households than are formal workers.

In 2004, the World Bank extended its Investment Climate Surveys in 11 countries to cover micro and informal firms. These extended surveys found that, compared to all sizes of formal firms (small, medium and large), informal firms:

- pay relatively high bribes (using bribe payments as a share of sales as the measure);
- have less access to formal finance;
- experience more frequent electricity outages; and
- find government services less efficient.

The surveys also found that non-compliance with taxes and regulations leaves informal firms vulnerable to being evicted or shut down, and makes them easy targets for bribes or bureaucratic harassment from officials (Hallward-Driemeier and Stone 2004).

Flexibility and Convenience - Some forms of informal work are associated with flexible work hours and other forms of convenience such as working at or near one's own home. And, undoubtedly, some women 'prefer' flexible work hours and working from home due to competing time pressures owing to their responsibility for both paid and unpaid work. But other women have little choice, are conditioned to prefer or are forced into these arrangements. The flip-side of flexibility is uncertainty, including uncertain volume and quality of production due to unpredictable work orders, interrupted work schedules and poor working conditions; and uncertain commercial contracts and payments due to limited market knowledge and bargaining power. This applies in particular to the many home-based producers who are industrial outworkers – also known as homeworkers.

Industrial outworkers are completely dependent on others for the supply of raw materials and the sale of finished goods and remain isolated from other women doing the same type of work. This dependence, combined with the isolation that makes organizing with others difficult if not impossible, undermines their ability to bargain for higher piece-rates, timely payments or overtime pay. Finally, working at home can represent a cost in terms of bargaining power not just in the market but within the household, because it does not provide women with a viable fall-back position.

Costs of Informal Self-Employment

While informal work does offer positive opportunities and benefits, the benefits are not sufficient and the costs are often too high for most of those who work informally to achieve an adequate standard of living over their working lives (see Box 1). Some costs are *direct* in the form of 'out of pocket' expenses needed to run an informal business or otherwise work informally; others are *indirect*, reflecting the more general conditions under which the working poor live and work. Some of these can be rather high over the long-term, such as when an informal operator has to sacrifice access to health and education (or training) for herself or family members. Also, there are psychological and emotional costs – in terms of a worker's self-esteem and dignity – associated with many forms of informal work.

Box 1
Costs of Informal Self-Employment

Direct Costs

1. High costs of running informal businesses, including direct and indirect taxes
2. High costs of accessing capital in informal financial markets and high indebtedness
3. High costs associated with periodic economic 'shocks' to specific trades/occupations or to the economy as a whole

Indirect Costs

1. Lack of secure work and income
 - greater insecurity of work
 - variability and volatility of income
2. Lack of social protection
 - few (if any) rights such as paid sick leave, overtime compensation or severance pay
 - no childcare provisions
 - no health, disability, property, unemployment or life insurance
3. Lack of training and career prospects
4. Lack of capital and other assets
 - lack of/vulnerability of productive assets
 - limited (if any) access to formal financial services, for loans and savings
5. Lack of legal status, organization and voice
 - uncertain legal status
 - lack of organization and voice

Source: Chen et al. 2005.

Consider, for example, the issue of occupational health and safety. Many informal self-employed persons face significant occupational hazards in the workplace yet are not covered by occupational health and safety (OHS) regulatory and compensatory mechanisms, both because they are self-employed and because they are not legally recognized by the state. For unprotected informal self-employed persons, exposure to toxic chemicals, repetitive strain and muscular-skeletal injuries, poor sanitation, excessive working hours and structurally unsafe workplaces not only threaten personal health and safety but can also impact on productivity and income (see Box 2).

Box 2

Occupational Health and Safety Hazards of Common Informal Occupations

Problems associated with poor health and safety in the workplace vary from occupation to occupation and are also heavily dependent on the environment in which each occupation is undertaken. Some of the common problems associated with common types of informal occupations include:

1. Garment makers

- neck and back ache
- pain in limbs and joints
- poor vision resulting from eye strain
- headaches, dizziness and fatigue
- respiratory problems associated with dust and textile fibres

2. Street vendors

- exposure to weather – extreme temperatures, wind, rain and sun
- poor access to clean water
- poor sanitation from dirty streets and poor drainage, as well as waste produce from other vendors
- diseases transmitted by vermin
- lead poisoning and respiratory problems from vehicle fumes
- musculoskeletal problems associated with ergonomic hazards at workstations and static postures
- risk of physical harm from both authorities, members of the public or other traders

3. Waste pickers

- exposure to weather – extreme temperatures, wind, rain and sun
- poor sanitation and limited or no access to clean water
- exposure to dangerous domestic and industrial waste, including toxic substances such as lead and asbestos
- exposure to other dangerous matter, including blood, faecal matter, broken glass, needles, sharp metal objects, flies, mosquitoes, stray animals and animal carcasses
- back and limb pain, itchy skin/rashes
- diseases transmitted by vermin
- specific high risk of tuberculosis, bronchitis, asthma, pneumonia, dysentery and parasites

Source: Lund and Marriott 2005, cited in Chen et al. 2005.

In addition to the costs of working informally, informal workers often have to forego the benefits associated with working formally and being legally recognized by the state. Formal enterprises are more likely to have access to financial resources and market information, and to be able to secure written and enforceable commercial contracts. Formal entrepreneurs are entitled to join registered business associations through which they gain information about market trends and bargaining power.

In addition, depending on the country, the state may contribute to unemployment funds, maternity benefits, health insurance and retirement savings, all of which are forms of risk management and means of smoothing incomes over a lifetime. In many cases, the informal self-employed are excluded from such schemes. Finally, to promote exports and

competitiveness in specific sectors, the state may offer subsidies and incentives to businesses, including tax rebates, business training, export licenses, export promotion through trade fairs, outright subsidies (e.g. agriculture) and other means.

Finally, as *citizens*, both formal and informal workers are entitled to benefits from the state that can directly and indirectly contribute to their ability to work productively: for example, health, education and welfare services, infrastructure for residential areas and support for care of elderly people, children and people with disabilities. However, in many countries, there are systematic biases against *poorer people* either in accessing state-provided services such as health and education or in the quality of services received.

In brief, competitive market pressures and related corporate practices, a decline in state social spending and legal protections and various forms of discrimination in the broader society – by class, gender, race/ethnicity and geography – reinforce each other to generate significant costs for the working poor in the informal economy.

Together these costs take a huge toll on the financial, physical and psychological well-being of many informal workers, eroding the benefits earned through employment. In the short term, the working poor in the informal economy often have to ‘over-work’ to cover these costs and still make ends meet. In the long-term, the cumulative toll of being over-worked, under-compensated and under-protected on the informal self-employed, their families and their societies undermines human capital and depletes physical capital. All of these costs, both direct and indirect – as well as foregone benefits – must be addressed if the poor are to be able to work their way out of poverty.

In brief, the benefits of informal self-employment are often not sufficient and the costs are often too high for those who work informally to achieve an adequate standard of living over their working lives. In general, only one category of the informal self-employed - the *informal employers* who hire others - earns enough to predictably rise above the poverty threshold.

Informality and Poverty

Making the link between informality and poverty means assessing the costs and benefits associated with different segments of informal employment against the location of the working poor, both women and men, within them. Statistical data on associated costs and benefits are limited: so testing these linkages statistically is very difficult. However, several recent sets of national data analyses have considered the *average earnings* and/or the *poverty risk* of different segments of the labor force, both formal and informal. These include the three sets of statistical analyses summarized earlier as well as a compilation of data for 14 countries by Jacques Charmes (presented in Chen et al. 2004). For all countries, Charmes compares data on the average monthly income of micro-entrepreneurs (i.e., informal employers who hire others) and the average monthly wage of employees of micro-enterprises, both expressed as multiples of the legal minimum wage

level in those countries.¹² What follows is a summary of the main findings of these different sets of data analyses in multiple countries as well as recent analyses of national data from Tunisia (Charmes and Lakepal n.d.) and India (Sastry 2004, Dubey et al. 2001).

1. Employment and Earnings

The links between employment, gender, and poverty can be seen by comparing a) average earnings in formal and informal employment and b) average earnings of different categories of informal employment.

Average Earnings in Formal and Informal Employment - A first comparison is the contrast between average wages or earnings in formal and informal employment, taken as a whole. The results confirm that, on average, wages or earnings are higher in formal than in informal employment. However, in two countries for which data were analyzed - Costa Rica and El Salvador - average earnings for *informal employers* are equal to or higher than average earnings in formal employment; Similarly, an analysis of 1997 data on employment in the informal sector (small unregistered enterprises) in Tunisia found that the employers who hired others – the micro-entrepreneurs – were not poor. Indeed, the average income of micro-entrepreneurs was found to be four times as high as the legal minimum salary and 2.2 times the average salary in the formal sector (Charmes and Lakepal n.d.).

In another two countries for which data were analyzed - Ghana and South Africa - average earnings of *informal public sector employees* are higher than those of *formal private-sector employees* (Chen et al. 2005). In general, wage employment in the public sector, both formal and informal, has higher average earnings than wage employment in the private sector.¹³

Comparative Earnings within Informal Employment – A second comparison is the difference in average earnings *within* informal employment. As noted earlier, the informal economy is diverse and segmented. The different segments are associated with different earning potentials that would be concealed by the average for the informal economy as a whole.

Agricultural vs. non-agricultural and rural vs. urban informal employment: To begin with, in all countries for which data were available, average incomes in informal employment in agricultural or rural activities are lower than for informal employment in non-agricultural or urban activities.

¹² The 14 countries whose national data was compiled by Charmes include: Morocco and Tunisia in Northern Africa; Benin, Burkina Faso (street vendors only), Chad, Ethiopia (urban), Gabon, Kenya, Mali, and Niger in Sub-Saharan Africa; Brazil, Colombia, and Mexico (all urban) in Latin America; and India and Indonesia in Asia. All of the data was from the late-1990s with the exception of Morocco where the data was from 1992 (Charmes n.d.).

¹³ See Chapter 3 of Chen et al. 2005 for more details.

Informal employers versus own account operators: Notably for our purposes here, in all countries for which data were available, the average incomes of informal employers were uniformly higher than for own account operators. In a cross-section of countries for which data were available - Columbia, India, Tunisia, - informal employers were not poor and/or earned multiples of the national minimum wage (Chen et al. 2004, Charmes and Lakepal n.d.).

Own account operators versus informal wage workers: The results in regard to this comparison are mixed. In many countries for which data are available, the *informal employees* of both formal and informal enterprises earn, on average, about the same or slightly more than own account operators; but casual wage workers and domestic workers earn less on average than own account operators. However, in South Africa, employees in informal/unregistered enterprises earn somewhat less than own-account workers, while informal employees in registered enterprises earn more than own-account workers.¹⁴ Therefore, in South Africa, informal employees in unregistered enterprises would be more closely linked with ‘casual wage workers’ (Chen et al. 2005). In Egypt, enterprise survey data indicate that the average wage of employees increases with firm size (ibid.).

Informal wage workers versus industrial outworkers: In the one country where random-sample survey data were available – Tunisia – industrial outworkers earned, on average, only 30 per cent of the minimum wage and 60 per cent of what the employees of informal enterprises earn (Charmes and Lakepal n.d.). Other field surveys have found that industrial outworkers tend to earn the lowest earnings/wages of all categories of informal workers plus they have to cover many of the non-wage costs of production (Chen and Snodgrass 2001, Carr et al. 2000).

Within informal employment, in all five countries in the UNIFEM-WIEGO-ILO set of analyses, women’s hourly earnings uniformly fall below those of men in identical employment statuses. The gender gap in earnings is particularly pronounced among own-account workers – both agricultural and non-agricultural. This gender gap in earnings is compounded by the gendered segmentation of informal employment, as women are more likely to be own account workers than employers or regular wage workers.

2. Employment and Poverty

Household Poverty - Data on the linkages between employment and household poverty are more limited. However, recent national surveys in two countries – the 2002 Labour Force Survey in South Africa and several rounds of the National Sample Survey of India – provide unique data that begin to answer questions regarding the relationship between employment and household poverty. Findings from different analyses of these national data are summarized below:

South Africa Analysis # 1: The higher the monthly expenditure category, the higher the percentage of households with persons in permanent employment. Moving down the expenditure categories, the percentage of households with persons in informal

¹⁴ This category, relatively small, represents the high-end of informal wage employment.

employment (including domestic services) increases. Not surprisingly, the lowest expenditure category had the highest percentage of households with an unemployed person or persons (using an expanded definition of unemployment) (Braude 2005).

South Africa Analysis # 2: Households that depend primarily on informal employment income have significantly higher poverty rates than households with a majority of income coming from formal employment. Because women are less likely than men to be formally employed, female-headed households have significantly higher poverty rates than male-headed households. Similarly, households whose primary earner is female have significantly higher poverty rates than households in which the primary earner is male. However, these gender differentials are much less pronounced when households have access to formal employment (Chen et al. 2005).

India Analysis # 1 (National Sample Survey 1987/88 and 1993/94 rounds): For cities or towns of all sizes and both points in time, households with regular salaried employees (both formal and informal) have the lowest probability of being poor, while those that depend on casual day labor have the highest probability, and households that depend on self-employment falling roughly half-way in between.¹⁵ All employment groups fared better in larger cities. And, between the two rounds of the survey, the probability of being poor declined for all groups.

India Analysis # 2 (National Sample Survey 1999/2000 round): Among *urban* Indian households that sustain themselves on informal employment,¹⁶ households that depend on 'regular' (as opposed to casual) informal wage employment have lower poverty rates relative to households that rely on self-employment, and households that depend on casual labor as their primary source of income are the most likely to be poor. This hierarchy of poverty risk within the informal economy – households depending on 'regular' informal wage employment having the lowest, self-employment the next highest, and casual wage employment the highest risk – is robust across industrial sectors in urban India.

Individual Poverty – The UNIFEM-WIEGO-ILO set of country studies used an innovative technique for measuring the risk of poverty among employed persons. According to this technique, the “poverty risk” associated with different employment statuses is defined as the share of all persons employed in a given status who live in households whose incomes place them below the national poverty line. This technique connects the type of employment, measured at the *individual* level, to the risk of poverty, measured at the *household* level. As such, it is only feasible in those countries where national data on employment and household income are linked. The hierarchy of poverty risk so defined is the reverse of the hierarchy of earnings detailed above: informal agricultural workers have the highest risk of poverty and, among the non-

¹⁵ While the findings of both studies may not be surprising, there are very few empirical analyses linking household poverty and employment in this way.

¹⁶ In this study, households classified as sustaining themselves on informal employment income are households with at least one person employed as an informal worker and no household member employed outside of the informal economy.

agricultural informally employed, informal employers have the lowest risk of poverty, own account workers have a higher risk of poverty, while casual wage workers and domestic workers have the highest risk (Chen et al. 2005). Since the UNIFEM-WIEGO-ILO country studies did not separate out employees of informal enterprises or industrial outworkers it was not possible to measure the poverty risk of these groups.

In all five UNIFEM-WIEGO-ILO study countries, gender-based differences in poverty risk are associated with the multi-segmented character of the labour force, as women are concentrated in forms of employment with low earnings and higher poverty rates. However, no systematic pattern emerged in the country case studies in terms of differences between men's and women's poverty rates *within* a particular employment status. One possible explanation is that households in which women are engaged in remunerative work might have lower poverty rates relative to households in which women do not allocate time to income-generating activities. If this is the case, a household's poverty status can be determined by women's access to paid employment, no matter how low their earnings.

3. Hierarchies of Earnings and Poverty Risk

In sum, the statistical evidence presented in this paper suggests a hierarchy of earnings and poverty risk across the various segments of the labor force, as illustrated in figures 1-3. While average earnings are higher in formal employment than in informal, there is also a hierarchy of earnings within the informal economy. Informal employers have the highest average earnings followed by their employees and other 'regular' informal employees, then own account workers, followed by casual wage workers and domestic workers, and finally industrial outworkers. Within this hierarchy, women are disproportionately represented in segments of the informal labor force with low earnings (see figure 1). The fact that women tend to be under-represented among informal employers and 'regular' informal wage workers and over-represented among own account operators and industrial outworkers leads to a *gender gap in average earnings and in poverty risk* within the informal economy: average earnings are lower and the risk of poverty is higher among all women workers in the informal economy compared to all men workers within the informal economy.

The hierarchy of poverty risk among households depends on whether households have some formal sources of employment income or only informal sources (figure 2) and also on what type of employment is the *primary* source of employment income (figure 3). Figure 2 illustrates that households which rely primarily on informal sources of employment income face higher poverty risk than those that rely on formal sources. Figure 3 illustrates that households which depend on the most precarious forms of informal employment as their primary source of income are likely to have substantially higher poverty risk than those that have access to more stable and better quality employment.

Figure 1

Segmentation of Informal Employment by Average Earnings and Sex

Average Earnings

Segmentation by Sex

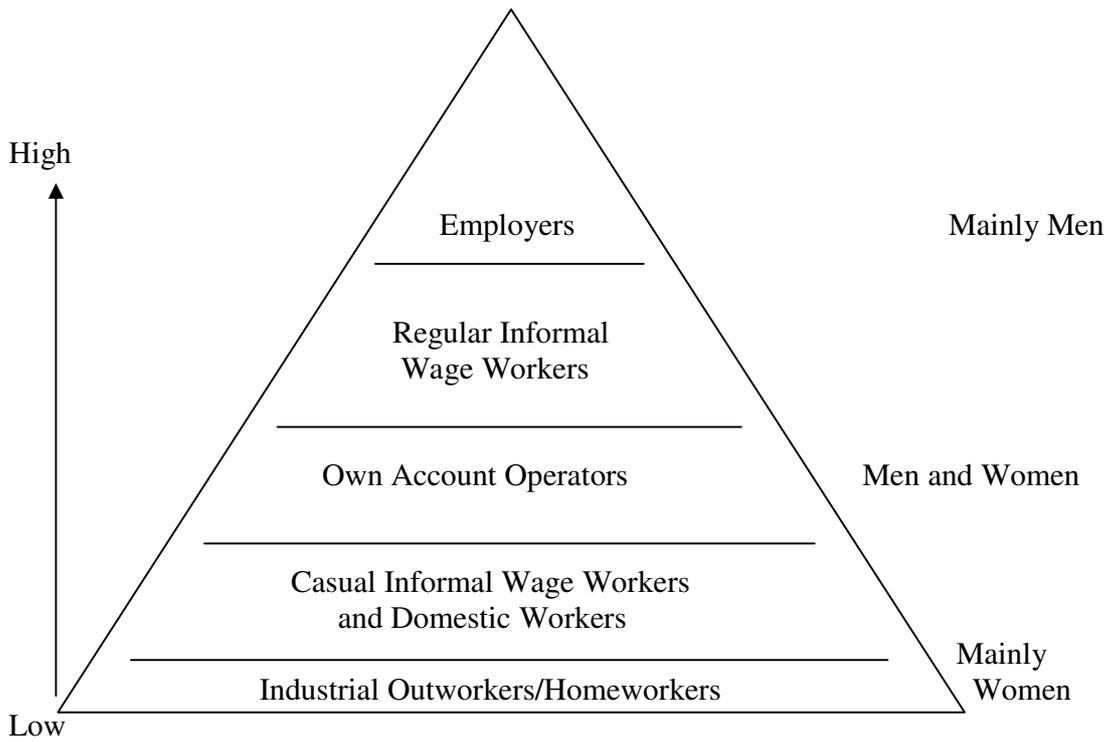


Figure 2
Poverty Risk of Households by Sources of Income

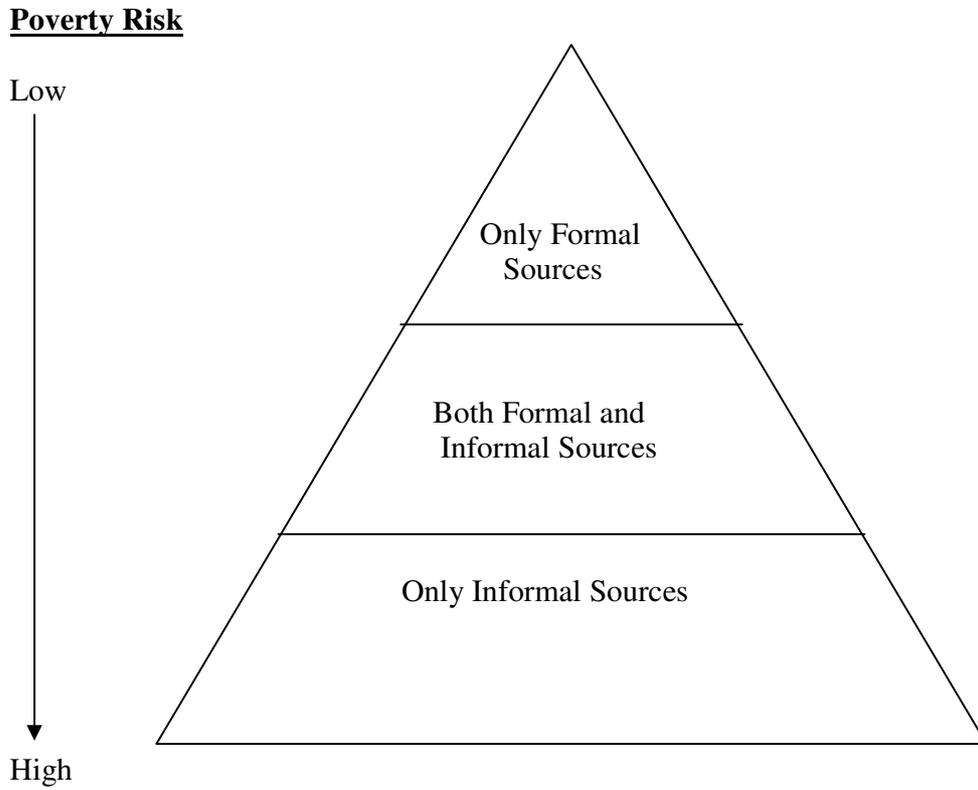
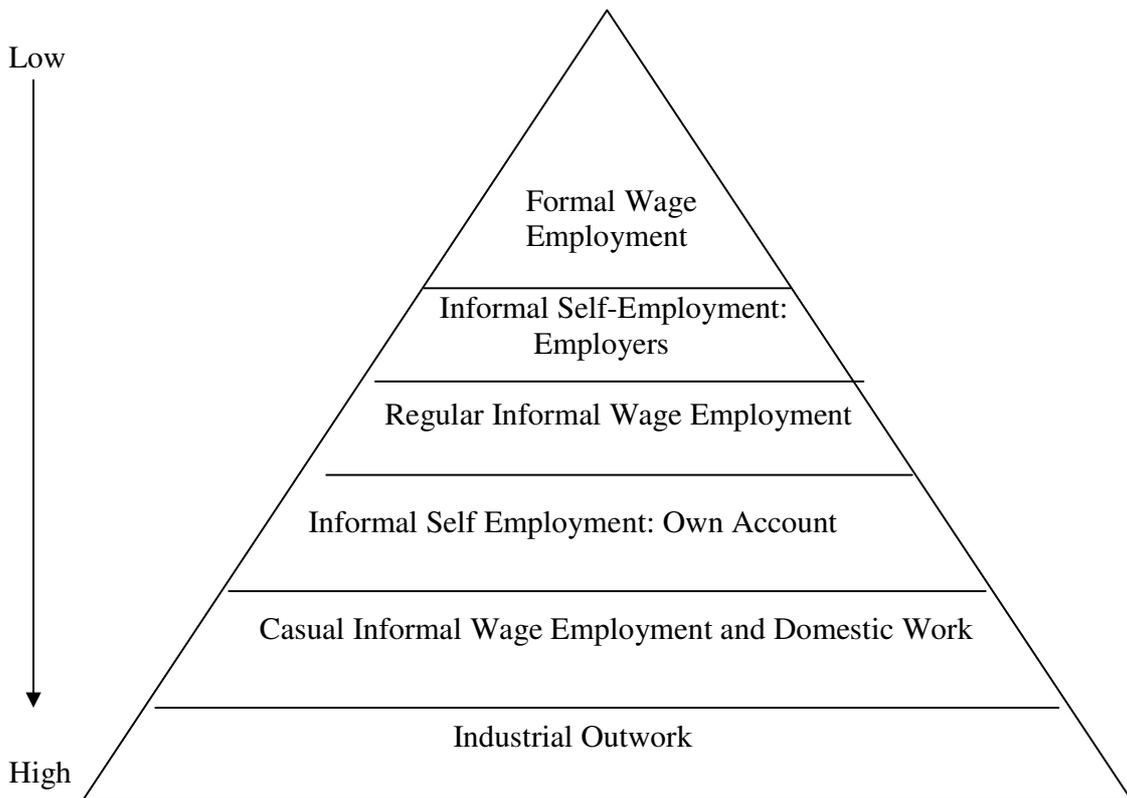


Figure 3
Poverty Risk of Households by Primary Source of Income

Poverty Risk



For our purposes here, it is important to highlight the hierarchy of earnings and poverty risk *within informal self-employment*:

- informal employers have the highest average earnings and the lowest poverty risk
- own account operators have a middle-range of earnings and poverty risk
- industrial outworkers have the lowest average earnings and the highest poverty risk

Since women are under-represented among informal employers and over-represented among own account operators and industrial outworkers, there is a significant gender gap in average earnings and poverty risk among the informal self-employed.

IV. The Business Environment, Formal Enterprises, and Informal Enterprises

A key issue in the debates on the informal economy is whether and how the informal economy and formal economy are linked. However, these debates have tended to blur the

distinction between the formal economy and the formal regulatory environment. But it is important to distinguish between the:

- *formal economy*: comprised of regulated enterprises and protected workers
- *formal regulatory environment*: comprised of government policies, laws, and regulations

This section of the paper discusses the linkages between informal enterprises and, respectively, formal enterprises and the formal regulatory environment.¹⁷ In real life, of course, it is often hard to know what is driving what: as large formal registered enterprises are often involved in ‘setting’ formal policies and regulations; and formal policies and regulations are often biased towards formal registered firms to the disadvantage of informal enterprises.

Formal Enterprises

Over the years, the debates on the informal economy crystallized into three dominant schools of thought regarding the informal economy: dualism, structuralism, and legalism. Each of these has a different perspective on how the informal and formal economies are linked. The dualists argue that informal units and activities have few (if any) linkages to the formal economy but, rather, operate as a distinct separate sector of the economy; and that informal workers comprise the less-advantaged sector of a dualistic labor market (Sethuraman 1976, Tokman 1978). Unlike the dualists, structuralists see the informal and formal economies as intrinsically linked. To increase competitiveness, capitalist firms in the formal economy are seen to reduce their input costs, including labor costs, by promoting informal production and employment relationships with subordinated economic units and workers. According to structuralists, both informal enterprises and informal wage workers are subordinated to the interests of capitalist development, providing cheap goods and services (Moser 1978, Portes et al. 1989). The legalists focus on the relationship between informal entrepreneurs/enterprises and the formal regulatory environment, not formal firms. But they acknowledge that capitalist interests – what Hernando de Soto calls ‘mercantilist’ interests – collude with government to set the bureaucratic ‘rules of the game’ (de Soto 1989).

Given the heterogeneity of the informal economy, there is some truth to each of these perspectives. But the reality of informal employment is more complex than these perspectives would suggest. What follows is a summary of various ways in which informal enterprises are linked to formal firms.

Few informal enterprises, except perhaps some survival activities, operate in total isolation from formal firms. Most source raw materials from and/or supply finished goods to formal firms either directly or through intermediate (often informal) firms. Sourcing and supplying of goods or services can take place through *individual*

¹⁷ This section of the paper draws heavily on an earlier paper written by the author for the September 2004 EGD-WIDER conference “Unleashing Human Potential: Linking the Informal and Formal Sectors”. This earlier paper was also summarized in the concluding chapter of Chen et al. 2005.

transactions but are more likely to take place through a *sub-sector network* of commercial relationships or a *value chain* of sub-contracted relationships.

To understand the linkages between informal enterprises and formal firms it is important to consider the nature of the production system through which they are linked. This is because the nature of the linkage – specifically, the allocation of authority and risk between the informal and formal firm - varies according to the nature of the production system. For instance, a garment maker might produce for the open market (with some authority and all of the risk) or for a supply firm linked to a multinational company (with little authority but much of the risk in the form of non-wage costs, rejected goods, and delayed payments). Types of production systems include:

- *individual transactions*: some micro-entrepreneurs and own account operators exchange goods and services with formal firms in what might be characterized as open or pure market exchange (in the sense of independent units transacting with each other). In such cases, the dominant firm in terms of market knowledge and power – usually the formal firm - controls the exchange or transaction.
- *sub-sectors*: many micro-entrepreneurs and own account operators produce (or exchange) goods and services for (or with) formal firms in what are called sub-sectors, networks of independent units involved in the production and distribution of a product or commodity. In such networks, individual units are involved in transactions with multiple suppliers and customers. The terms and conditions of these transactions are governed largely by the dominant firm in specific transactions (as above) but also by the ‘rules of the game’ for the sub-sector as a whole, which typically are determined by dominant firms in the sub-sector.
- *value chains*: some micro-entrepreneurs and own account operators and, by definition, all industrial outworkers produce goods within a value chain. The terms and conditions of production in value chains are determined largely by the lead firm: a large national firm in most domestic chains and a large trans-national corporation in most global value chains. However, the major suppliers to whom the lead firm sub-contracts work – also often formal firms - also help determine the terms and conditions of work that they sub-contract to informal firms and workers down the chain.

In sum, informal enterprises are quite likely to have linkages with formal firms. But the commercial relationship between informal enterprises and formal firms is likely to be imbalanced and unregulated, although this differs context to context.

The Business Environment

The three dominant schools of thought on the informal economy view the relationship between informal enterprises and the business or regulatory environment in different ways. In regard to informal enterprises, dualists pay relatively little attention to government regulations per se but focus instead on government provision of necessary support services: notably, credit and business development services. The legalists believe

that government deregulation would lead to increased economic freedom and entrepreneurship among working people, especially in developing countries (de Soto 1989). However, the founder of the legalist school - Hernando de Soto - recently advocated one form of regulation: namely, the *formalization* of property rights for the informal workforce to help them convert their informally-held assets into real assets (de Soto 2000). In marked contrast, the structuralists see a role for government in regulating the unequal relationships between 'big businesses' and subordinated informal producers and workers: they advocate the regulation of commercial relations in the case of informal producers and the regulation of employment relations in the case of informal wage workers (Castells and Portes 1989).

Over-Regulation - As noted earlier, the legalists have focused on excessive regulations that create barriers to working formally. However, over-regulation may raise barriers and costs not only to operating formally but also to operating informally. Consider the case of government monopoly of forest products in India. Following the nationalization of the forests in India, gum, salt, and other forest products came under the control of the National and State Forest Departments with the result that trading these products requires a government license.

- *gum collectors*: Although there is a thriving open market for gum that includes textile and pharmaceutical companies, those who collect gum must sell gum to the Forest Development Corporation; to sell in the open market requires a special license. Most gum collectors – except those who can afford to obtain a license - must sell to the Forest Development Corporation for below market prices (Crowell 2003).
- *salt makers*: The cheapest way to transport salt within India is via railway. Historically, small salt producers have not been able to transport their salt by train because of a long-standing government regulation that stipulates that salt farmers need to own a minimum of 90 acres of land to be eligible to book a train wagon. Given that most small salt farmers lease land from the government or local landlords, most small salt farmers are not eligible to use rail transport. Because they have to use private transport, small salt farmers face high transportation costs and, therefore, remain less competitive than larger salt farmers (ibid.).

Deregulation - As part of economic restructuring and liberalization, there has been a fair amount of *deregulation*, particularly of financial and labour markets. Deregulation is associated with the rise of volatility within financial markets.

Lack of Regulation - The regulatory environment often overlooks whole categories of the informal economy. A *missing* regulatory environment can be as costly to informal operators as an *excessive* regulatory environment. For example, city governments tend to adopt either of two stances towards street trade: trying to eliminate it or turning a 'blind eye' to it. Either stance has a punitive effect: eviction, harassment, and the demand for bribes by police, municipal officials and other vested interests. Few cities have adopted a coherent policy – or set of regulations – towards street trade. Rather, most cities assign

the ‘handling’ of street traders to those departments – such as the police – that deal with law and order (Bhowmik 2004, Mitullah 2004).

The different perspectives on regulation outlined above are appropriate for the specific components of the informal economy to which they refer: the legalists focus on informal *enterprises* (and informal *commercial* relationships); and those concerned about street vendors focus on the regulation of *urban space* and *informal trade*.¹⁸ Arguably, for each component of the informal economy, what is needed is *appropriate regulation*, not complete deregulation or the lack of regulation.

To Formalize or Not To Formalize?

More recently, the debate on the informal economy has focused on the question of whether to ‘formalize’ the informal economy. However, it is not clear what is meant by ‘formalization’. To many policy-makers, formalization means that informal enterprises should obtain a license, register their accounts, and pay taxes. But to the self-employed these represent the *costs of entry into the formal economy*. What they would like is to receive the *benefits of operating formally* in return for paying these costs, including: enforceable commercial contracts; legal ownership of their place of business and means of production; tax breaks and incentive packages to increase their competitiveness; membership in trade associations; and statutory social protection.¹⁹

Taking into account the different meanings of formalization, the feasibility of formalizing the informal economy is unclear. Firstly, most bureaucracies would not be able to handle the volume of license applications and tax forms if all informal businesses formalized. Secondly, most bureaucracies would claim that they cannot afford to offer informal businesses the incentives and benefits that formal businesses receive. Thirdly, recent trends suggest that employment growth is not keeping pace with the demand for jobs – there simply are not enough jobs to go around so that informal self-employment is likely to grow.

The formalization debate should be turned on its head by recognizing, first, that formalization has different meanings for different segments of the informal economy and, second, that it is unlikely that most informal producers and workers can be formalized – although efforts should be made to do so. Further, the formalization debate needs to take into account the benefits due to informal enterprises if they operate formally and to wage workers if they get a formal job; and the costs of working informally for both the self-employed and the wage employed. The policy challenge is to decrease the costs of working informally and to increase the benefits of working formally.

Finally, those of us who work on the informal economy are often asked two additional questions. First, do you promote informal employment, despite its consequences? Our answer is that informal employment is a widespread feature of today’s global economy

¹⁸ In a parallel strand of analysis, labor advocates focus on informal wage workers and informal employment relations (see Chen et al. 2004 and 2005).

¹⁹ To informal wage workers, formalization means obtaining a formal wage job – or converting their current job into a formal job - with secure contract, worker benefits, and social protection.

that needs to be upgraded: the goal is to reduce the costs and increase the benefits of working informally. Second, are there any ‘magic bullets’ for improving conditions of informal employment? Our answer is that while some interventions (such as microfinance) are often seen as magic bullets to improve conditions in some cases, no single intervention can address all of the constraints and needs faced by the working poor in the informal economy. What is needed is a context-specific mix of interventions, developed in consultation with working poor women and men and informed by an understanding of their significance in the labour force and their contribution to the economy.

V. Promoting a Pro-Poor Business Environment

The overarching goals of a pro-poor business environment should be:

- to expand formal employment opportunities – by putting employment creation and decent work at the centre of macroeconomic policy, and by promoting the growth of micro-, small, and medium enterprises;
- to formalize informal enterprises – by creating incentives and simplifying procedures for entrepreneurs to register;²⁰ and
- to help the working poor in informal enterprises, especially women, get higher returns to their labor and capital – by increasing their assets and competitiveness and by assuring better terms and conditions of trade (Diez de Medina 2005).

To achieve these goals requires a favourable economic policy and business environment as well as targeted interventions, reflected in the following set of six strategic priorities:²¹

#1 – To Create a Favourable Policy Environment

The economic policy environment needs to be supportive of the working poor, rather than blind to them or biased against them. This requires addressing biases in general policies and regulations as well as designing and implementing targeted policies and regulations.

#2 - To Increase Assets and Access

For the working poor to be able to take advantage of the opportunities offered by a more favourable policy regulatory environment, they need greater market access as well as the relevant assets and skills with which to better compete in markets.

#3 – To Improve Terms of Doing Business

To compete effectively in markets, in addition to having the requisite resources and skills the working poor need to be able to negotiate favourable prices and wages for the goods and services they sell, relative to their cost of inputs and their cost of living.

#4 – To Secure Appropriate Legal Frameworks

²⁰ To reduce poverty, efforts to formalize informal wage jobs are also needed. This will require persuading employers, in both formal and informal enterprises, to provide more benefits and protections to their workers.

²¹ This section of the paper draws heavily on the concluding chapter of Chen et al. 2005.

The working poor in the informal economy need new or expanded legal frameworks to protect their rights and entitlements as economic agents, including the right to work (e.g. the right to vend) , the right to use public resources, and rights to private property.

#5 – To Address Risk and Uncertainty

The working poor need protection against the risks and uncertainties associated with their work as well as the common contingencies of property loss, illness, disability and death.

#6 – To Strengthen Representative Voice and Increase Visibility

To demand their rights and make claims, and to influence the policy decisions that shape their lives, the working poor need stronger organizations and a voice in policy-making as well as greater visibility in national data and statistics.

Strategies

Strategies for each of these strategic priorities are outlined below; promising examples illustrating the feasibility of these strategies are presented in the Annex.

Strategy #1 – To Create a Favourable Policy Environment

Most if not all economic and social policies – both macro and micro – affect the lives and work of the working poor in various direct ways.

As workers: government policies and regulations influence training and long-term prospects of informal workers; create incentives and benefits for enterprises of different sizes; and determine whether the working poor have the right to organize and be represented in collective bargaining negotiations or rule-setting institutions such as business associations.

As consumers: government policies affect the accessibility, variety and costs of goods and services, including those consumed by the working poor.

As users of infrastructure, finance and property, including urban space, and natural resources: government policies regarding infrastructure investments, financial markets, property rights and the use of urban space, utilities and natural resources all affect the economic opportunities available to the working poor and their ability to take advantage of them.

As potential recipients of tax-funded services or transfers: whether or not the working poor, especially women, receive public services (e.g., health, education and childcare) or public transfers – as well as the quality of the services and the amount of transfers received – depends in large part on whether these services and transfers are targeted to specific groups of the working poor, the particular locations where the working poor live and the particular activities from which they earn their livelihoods (World Bank 2005).

Creating a favourable policy environment involves both addressing biases in existing policies that work to the disadvantage of the working poor and developing new policies targeted to them. Economic policies that are ‘blind’ to how the private sector is actually structured and functions cannot be assumed to be ‘neutral’ towards informal enterprises. Economic planners should take into account the size, composition and contribution of

both the formal and informal enterprises in different countries, and recognize that their policies are likely to have differential impacts on informal and formal enterprises, and on enterprises run by women and men. To assess and address how economic policies affect the working poor, both men and women, it is important to analyse how class, gender and other biases intersect in the policy and business environment.

A recent seven-country study sponsored by the ILO identified biases against micro- and small enterprises (MSEs) and made a set of recommendations as to how to address them, including setting up lines of credit for MSEs, streamlining licensing arrangements and simplifying taxation policies (Reinecke and White 2004). Ideally, such an analysis should look at the inter-section of different biases, including: those that favour formal over informal enterprises, and enterprises run by men over those run by women.

A new tool is Informal Economy Budget Analysis which views budget allocations (or the lack thereof) as an expression of policy approaches to the informal economy. Informal economy budgets are designed to do three things. First, they examine the extent to which the state budget shows an awareness of the existence and situation of informal operators and their enterprises. Second, they identify measures of direct and indirect state support, and thus have the potential to raise the visibility of informal operators and their enterprises and encourage advocacy for greater support. Third, they can be used to assess the gap between policies, budget allocations, and policy implementation.

Two pioneering initiatives in South Africa (Budlender 2000; Budlender, Skinner and Valodia 2004) showed the need to analyse budget allocations across all government agencies, not just those dealing with 'economic development' or 'support for small businesses' (see Box 3).

Box 3

Multi-Sectoral Approach to Informal Economy Budget Analysis

Statistics: Good data is a first step at improving policies for these workers and enterprises. Time and money invested in data collection that focuses on the size, composition and contribution of informal workers and enterprises will increase visibility.

Economic policy and employment creation: Informal workers will benefit from policies and allocations that support smaller rather than larger business. Special attention to and support for very small enterprises will reach poorer people and especially women.

Land entitlements: Budgetary allocations to land reform that are redistributive, and in which women have entitlements in their own right, will be of direct benefit to women informal workers.

Agricultural support: Support for informal and poorer workers will be reflected in budget allocations to extension officers with an orientation to very small producers, in employment of women extension officers and in training in methods of reaching women producers.

Communications: A telecommunications policy that supports cheaper telecommunications will give informal workers easier access to information about markets and prices, and can specifically address the exclusion of women from the informal circuits of information-sharing and price-setting that are dominated by men.

Education: Informal workers benefit from policies that allocate resources to literacy, to adult and further education and to primary and secondary education geared to the real world of work. Resources for affordable early childhood education can enable the mothers of young children to work, and can create significant (albeit low-waged) employment opportunities for women.

Health: Informal women workers are assisted by health services that emphasize reproductive health and are alert to occupational health and safety issues, and by services that are safe, affordable and near the place of work.

Housing: Private homes are used by millions of people, especially women, as places to earn a living. Allocations of land for housing development that are near markets and industrial nodes, and housing subsidies for poorer people will directly benefit informal women workers.

Infrastructure: Water, sanitation and electricity are essential for most informal as well as formal work activities, and policies should ensure quality, accessibility and affordability.

Transport: Governments should support affordable and accessible public and private transport so workers and their products can reach markets and work sites.

The safety and protection services: National and local policing policies that see informal and formal business as linked, and that are funded in a way which enables their safety, will help improve the general investment or business environment.

Source: Budlender 2000; Budlender, Skinner and Valodia 2004 as summarized by Francie Lund in Chen et al. 2005.

Some policies or regulations that may have benefits and/or costs to informal workers are not found in budgets themselves. For example, zoning policies can restrict or promote the accommodation of economic activities in residential areas; urban planning can integrate or restrict sites for informal operators in urban renewal plans, or exclude them altogether; and municipal and national governments can design tendering and procurement policies (which will be reflected in budgets) to include or exclude very small businesses.

In brief, Informal Economy Budget Analysis links the rhetoric of policy to the allocation of resources, enabling us to see assessments of the costs and benefits of policy decisions for informal enterprises.

In addition to a favourable policy environment, targeted interventions are required to address the costs of informal self-employment. These should aim:

Strategy # 2 - To increase the assets, access and competitiveness of the working poor, both women and men, in informal enterprises

For the working poor to be able to take advantage of the opportunities offered by a more favourable policy environment, they need greater market access as well as the relevant resources and skills with which to better compete in the markets. Over the past three decades, there has been a proliferation of projects designed to provide micro-finance and/or business development services to micro-enterprises. While the vast majority of the clients of micro-finance are working poor women, business development services are not typically targeted at the smallest enterprises, particularly those run by women. Future micro-finance and business development services need to target more explicitly, and with context-specific and user-friendly services, the enterprises of the poor, especially those run by women.

Strategy # 3 - To improve the terms of doing business for the working poor, both women and men, in informal enterprises

To compete effectively in the markets, in addition to having the requisite resources and skills the working poor need to be able to negotiate favorable terms of trade. This involves changing government policies, government-set prices or institutional arrangements as well as the balance of power within markets or value chains. This requires that the working poor, especially women, have bargaining power and are able to participate in the negotiations that determine the terms of trade in the sectors within which they work. Often what is effective in this regard is joint action by organizations of the working poor and like-minded allies who can leverage access to government policy makers and to rule-setting institutions.

Strategy # 4 - To secure appropriate legal frameworks for the working poor, both women and men, in informal enterprises

The informal self-employed need legal recognition as economic operators and for their enterprises, and the legal entitlements that come with that recognition, including the right to work, rights to use of public resources (e.g. to vend in public spaces), and rights to private property.

Strategy # 5 - To address risk and uncertainty faced by the working poor, both women and men, in informal enterprises

The informal self-employed need protection against the risks and uncertainties associated with their work as well as the common contingencies of illness, property loss, disability and death. Providing needed protections requires a variety of interventions, including different safety nets (relief payments, cash transfers, public works); insurance coverage of various kinds (health, property, disability, life); and pensions or long-term savings schemes. Governments, the private sector, non-governmental organizations, business associations and other membership-based organizations can all play active roles in providing social protection to informal self-employed.

Strategy # 6 – To support organizations of women informal workers and to increase their voice

To hold other players accountable to these strategic priorities, the working poor need to be able to organize and have representative voice in policy-making processes and institutions. The informal self-employed, especially women, cannot count on other actors to represent their interests in policy-making or programme planning processes, including national Millennium Development Goals reports and the Poverty Reduction Strategy Papers (PRSPs). Securing this seat at the decision-making table requires supporting and strengthening organizations of informal producers and traders, with a special focus on women's organizations and women's leadership.

Interventions

These broad strategies require a series of interventions. First, *policy reforms* are needed to correct for biases in existing policies against the working poor, especially women, in informal enterprises and to develop targeted policies in support of enterprises of the poor. Second, *institutional reforms* are needed to make relevant policy-making and rule-setting bodies (e.g. business associations) more inclusive of the informal workforce and to develop and strengthen organizations of informal producers and traders to have effective representative voice. Third, a *range of services* need to be delivered including microfinance, business development, infrastructure, social (health, education, and childcare), occupational health and safety, and social protection (insurance, safety nets, disability and pensions).

Past efforts to support micro-enterprises and the informal economy have focused primarily on micro-financial and/or business development services. Such efforts need to be maintained, expanded, and improved upon. But the fuller range of services as well as policy and institutional reforms, as outlined above, are required to reduce poverty.

To successfully pursue these broad strategies and implement the necessary interventions requires the concerted action of a range of players. International trade and financial institutions, inter-governmental agencies, the private sector, consumers and the public, business associations, and NGOs all have a role to play, along with governments. Donor agencies can play a lead role in motivating the various players and in helping to coordinate their various interventions.

Concluding Thoughts

The evidence presented in this paper suggests answers to the two questions posed by the conference organizers related to enterprise size and the informal economy:

1. Why should enterprise size matter?

The evidence presented in this paper suggests that a major share of private enterprises is comprised of micro-enterprises with a few hired workers, family businesses, or single person operations. And that the vast majority of enterprises of the poor tend to be family businesses or single person operations with no hired workers. Targeting these *mini-enterprises* matters for poverty reduction, and yet the business environment is often biased against small and medium enterprises and, more so, the very smallest enterprises, and business development services seldom reach even micro-enterprises. Targeting the mini-enterprises of the poor also matters for growth because, if these very small enterprises are not supported, they cannot grow and will remain a drag on the economy.

Targeting the enterprises of the poor does not necessarily mean setting up a separate system of regulations and services. Correcting for biases that favor larger formal firms in existing regulations and services is a major first step. Extending the coverage and more effectively targeting existing regulations and services is a second major step. In addition, special targeted policies and interventions may need to be introduced, depending on the type of informal enterprise and the context.

2. What is the connection between the informal economy and the business environment?

As the evidence presented in this paper suggests, the informal economy is often affected – either directly or indirectly - by the existing business environment. Existing biases in the business, legal, policy, and market environment which favor larger and more formal businesses often pose indirect costs to the smallest informal firms, including the lack of access to a) financial services and market information; b) written and enforceable commercial contracts; c) membership in registered business associations through which they could gain information about market trends and forge market contacts; and d) incentive packages and subsidies to businesses to help make them more competitive. Making the situation more unequal still, many informal operators pay direct or indirect taxes to the government but do not enjoy the benefits of formalization.

This paper has provided a rationale and a framework for creating a more favourable economic and policy environment for the enterprises of the poor as an essential pre-condition for poverty reduction. To effectively reduce poverty, the donor community needs to work with nation states and civil society to put more emphasis on expanding formal employment opportunities, formalizing informal enterprises, and increasing returns to the enterprises of the working poor. At a minimum, this requires reducing systemic biases in existing policies and interventions to extend their coverage to the working poor and their enterprises. Ideally, this also requires introducing targeted policies and interventions in support of the working poor and their enterprises.

