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V-Goods and the Role of the Urban Informal Sector in Development

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V-GOODS AND THE ROLE OF THE
URBAN INFORMAL SECTOR IN DEVELOPMENT

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Abstract

This paper analyzes the role of the urban informal sector in a developing country in relation to the performance of agriculture and other rural activities, on the one hand, and that of urban formal sector activities, on the other. It decomposes the sectors into traditional and modernizing components, traceable to production and consumption linkages with the rest of the economy as well as the character of government interventions over time. The paper contrasts success cases á la Taiwan in which the overall size of the urban informal sector remains modest, the modernizing sub-sector grows in relative importance and the end of overall labor surplus is reached rather early, with non-success cases á la the Philippines in which rapid rural-urban migration enhances the overall size of the urban informal sector, the traditional sub-sector grows relatively and the end of the labor surplus condition is substantially delayed.

V-goods and the Role of the Urban Informal Sector in Development

Gustav Ranis and Frances Stewart[1]

INTRODUCTION

The informal sector typically accounts for a high proportion of the workforce in developing countries. It is often described as a low productivity backwater 'sponge' which absorbs those who can't find productive employment in the rural areas or in formal urban activities.[2] In contrast, others suggest that the sector can make an important and indeed increasing contribution to production and income generation.[3] The purpose of this paper is to advance this debate by taking a closer look at the sector itself and analyzing its relationships with the rest of the economy.

There is, of course, a vast literature on the urban informal sector, much of it devoted to the question of how to define the animal. Some define it with reference to its legal status -- i.e. the informal sector comprises all activities which fall outside the reach of government regulations.[4] Others define it mainly in terms of the size of establishments, broadly covering micro-enterprises of less than 10 workers. Still others emphasize the use of simple, traditional technology. Many, including the ILO Report on Kenya, adopt elements of each of these definitions. In this paper we shall spend little energy on definitions. Our main focus will be on establishments of 10 (mainly family) workers or less; although, in some contexts, some of these establishments might well be classified as formal by some of the above criteria, the pursuit of very precise definitions is not critical to our

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[2] Most influential in this regard was the ILO's 1972 report on Kenya.

[3] See e.g. Turnham, D., Salome, B. and A. Schwarz, eds., 1990. For a most useful recent survey of this literature see Lubell, 1991.

[4] For example, Hernando de Soto, 1988.

analysis and would not be particularly productive.

In section I we analyze the determinants of the overall size of the informal sector at any point in time in a macro-economic context. In section II we elucidate some important features of the urban informal sector, dividing it into a traditional component, providing a living for those not absorbed elsewhere, and a modern component, which is largely demand-pulled via links with the formal sector. Section III provides the basic analytic framework for the paper, showing the functioning of the two components of the informal sector in relation to the rest of the economy. Section IV considers alternative dynamic paths and outcomes. The concluding section (V) provides some relevant empirical findings and conclusions.

I.   Determinants of the Size of the Urban Informal Sector

The size of the urban informal sector labor force is the cumulative outcome of a number of interactions within the economy as a whole. These include the extent to which the rural sector is able to absorb labor in relation to initial population pressure and population growth and the employment opportunities presented by the growth of the urban formal sector. Although the Harris-Todaro model[5] ignores the informal sector, their approach provides powerful insights into the determinants of its size. As they put it, relative employment opportunities and wage gaps between the rural economy and the urban formal sector explain the rate of rural/urban migration. Open urban unemployment is the outcome of this process. But, as has been widely noted, in the presence of an informal urban or V-sector, rural/urban migration also feeds it. Indeed, for very poor people, joining the V-sector is nearly always preferable to open unemployment, as it provides some income without preventing continued search for a formal sector job.

To consider these relationships more fully, labor can be divided into three

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[5] Harris and Todaro, 1970.

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groups: rural labor, employees in the urban formal sector and workers in the urban informal sector. In seeking to maximize income, rural workers will migrate to urban areas as long as the life-time wage they expect to earn in urban employment exceeds their lifetime income in rural employment.

For simplicity, we make certain assumptions, some of which will be relaxed later on. First, it is assumed that rural employment in agriculture and non-agriculture generates a wage (however determined) which is below that of the urban formal sector wage; secondly, that individuals move from rural areas to urban when they believe they can increase their life-time incomes by doing so; thirdly, that the informal sector is homogeneous and has zero costs of entry and exit; fourthly, that the marginal product of additional workers entering the informal sector is positive, but low; fifthly, that there is no involuntary open urban unemployment; sixthly, that search and migration costs are negligible.

Given these assumptions, we can derive an expression for the determinants of migration and, implicitly, for the size of the urban informal sector. Let the worker's actual (and expected) rural wage be equal to $E(W_r)$; if risk-neutral, the worker will migrate if expected urban income, $E(w_u)$, exceeds this value. Expected urban income is assumed to be calculated on the basis of the incomes anticipated from various types of urban employment and the probability of acquiring each type. Expected urban income is assumed to be equal to the formal sector wage multiplied by the probability of obtaining a formal sector job plus informal sector earnings multiplied by the probability of being employed in that sector.

Let the probability of obtaining a formal sector job in a particular period be P_f; it is assumed that $P_f = F_E/[F_E + V_E]$, or the ratio of formal sector

employment to total urban employment.[6] Let the formal sector wage be set

exogenously at w_f. Since there are assumed to be zero entry costs into at

least a part of the informal sector, all urban labor can be assured of some

sort of employment, either in the formal or informal sub-sectors. The

probability of some form of urban employment is, therefore, 1, and, by

deduction, the probability of informal sector work is $(1-P_f)$. (In this model,

open unemployment is assumed to be non-existent and the V-sector takes its

place as an equilibrating variable.) Let the wage in the informal sector be

equal to w_v. As in the rural areas, the more people are engaged in that

sector, the lower the wage is likely to be.

In equilibrium, the expected urban wage is equivalent to the expected rural

wage (both expressed as the present value of the discounted future stream of

expected earnings), i.e.

$E(w_r) = E(w_u)$, where

$E(w_u) = P_f \cdot w_f + (1-P_f)w_v$, or

$= [F_E/(F_E + V_E)]w_f + [1 - F_E/(F_E + V_E)]w_v$

For equilibrium $w_v < w_r$; otherwise, given free entry into the V-sector and no

relocation cost, migration would continue indefinitely.

Assume the economy is expanding, with no change in the formal sector wage but

an increase in formal sector employment. P_f rises, leading to an immediate

increase in expected urban income. With no change in the rural wage, this

induces additional migration, but how much? Migration will not be unlimited

because the labor inflow itself will produce two effects to counteract the one

mentioned above. First, the inflow will raise numbers in the informal sector,

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[6] A common criticism of the Harris-Todaro model, also relevant here, is
the simplistic view of workers' estimates of the probabilities of acquiring
formal sector employment, which have been shown to be incorrect in empirical
work. It has been argued (e.g. by Kannappan, 1989) that there are 'clan
corridors' giving special access to jobs to some groups. This is probably
true for each of our urban subsectors. Accounting for such specialized
corridors would enrich our analysis, but not affect it fundamentally.

V_E, so reducing the probability of additional formal sector employment, $F_E/[F_E +V_E]$. Second, as V_E rises, income per person to be earned in the informal sector, w_v, will fall since marginal and average product decline. The migration process and the expansion of the informal sector continue until expected urban and rural incomes are equalized.

In summary, adopting the approach to migration discussed above, the equilibrium size of V at any point in time will depend on: i) labor absorption in agriculture relative to population pressure, which determine productivity and incomes in agriculture; ii) income-earning opportunities in rural non-agriculture, arising chiefly from linkages with agriculture; iii) the rate of growth of formal sector employment; iv) wages in the urban formal and informal sectors relative to rural alternatives.

It follows that the V-sector can grow rapidly in a number of different circumstances: for example, where rural growth is low and fails to absorb significant additions to its labor force, even a small rise in urban formal sector employment can lead to rapid rural-urban migration, as for example in Mexico. Alternatively, even where rural growth is high, if employment in the urban formal sector is growing fast, rural migrants may still be attracted in excess of formal sector employment opportunities, as in China today. In contrast, where urban formal sector employment is actually contracting, as in some African countries, the model would predict, *ceteris paribus*, a reverse flow of migration to rural areas and/or an increase in the size of the urban informal sector.

The overall employment size of V may thus be viewed largely as a residual, depending on population pressures, wages, and employment opportunities elsewhere in the economy.

II. A Subclassification of the V-Sector

So far, like most of the literature, we have treated the V-sector as an undifferentiated whole. However, we think it important to distinguish between a more productive and dynamic component and a traditional, relatively stagnant part of the sector, which more closely fits the customary image of the sector.[7] We then have two major types of activity: those we describe as 'traditional' (V_T) which have very low capitalization, low labor productivity and incomes, very small size (three or less workers) and static technology, often organized within the home. The second component of V, V_M, consists of 'modernizing' activities, often linked to the urban formal (or F) sector. These typically are more capital-intensive, sometimes larger in size (up to ten workers), and more dynamic in technology. This sub-sector tends to use more skills, partly generated through learning and training activities; its labor productivity is higher, and some incomes, especially entrepreneurial incomes, can be substantial.

We assume that V_T produces only consumer goods which are sold to low income urban consumers. V_M produces both consumer goods, V_{MC}, and producer goods V_{MP}. The modern V-sector's consumer goods, V_{MC}, serve both low-income and middle-income urban consumers (e.g. the households of formal sector workers) and are likely to compete with consumer goods produced by the formal sector. The modern V-sector's producer goods, V_{MP}, consist of intermediate products and simple capital goods which partly address the V-sector's own needs and partly respond to the demands of the F-sector.

V_M production may thus be complementary as well as competitive with production in F. The sub-sector can make an important contribution to development; it offers opportunities for reasonable incomes, growing over time, while contributing to the growth of output in the economy as a whole. In contrast,

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[7] A somewhat similar distinction has been made by Nihan, Denal and Comlan, 1979, and by Fields in Turnham et al. (1990) op. cit. who differentiates between "easy entry" and "upper tier" components.

V_T acts as a 'sponge' absorbing that portion of the total work force in V which can't find a place in V_M, while providing very low incomes.

Given this decomposition of the V-sector, our earlier migration equilibrium formula needs to be modified to allow for the probability of obtaining employment in each of the sub-sectors, weighted by the wage in each. The wages in the two sub-sectors, V_M and V_T, are then defined respectively as w_{VM} and w_{VT}; the probability of getting employment in the modernizing sub-sector, P_{VM}, is assumed to be the ratio of employment in that sector to total urban employment, i.e. $V_{EM}/[F_E + V_E]$; we continue to assume that there is open entry into V_T, so that the probability of obtaining employment there is $[1 - (P_f + P_{VM})]$.

Hence, in equilibrium,

$E(w_r) = E(w_u)$; where

$E(w_u) = P_f \cdot w_f + P_{VM} \cdot w_{VM} + [1-(P_f + P_{VM})]w_{VT}$, or

$\qquad = [F_E/(F_E + V_E)]w_f + [V_{EM}/(F_E + V_E)] \cdot w_{VM} + [1 - \{F_E/(F_E + V_E)$

$\qquad\qquad + V_{EM}/(F_E + V_E)\}]w_{VT}$;

$\qquad = [F_E/(F_E + V_E)]w_f + [V_{EM}/(F_E + V_E)] \cdot w_{VM} +$

$\qquad\qquad [1 - (V_{EM} + F_E)/(F_E + V_E)]w_{VT}$

With free entry now only into V_T, equilibrium requires $w_{VT} < w_r$.

III. <u>Analysis of the Functioning of the V-Sector in a Developing Economy</u>

To understand the size and functioning of the two components of the V-sector, they need to be analyzed within a general equilibrium context. We have already discussed the determinants of the total employment size of V. As pointed out above, the critical issue from a development perspective is the size of the modern sub-sector, V_M, relative to V_T. This is in large part determined by the nature of the relationship of V_M with the formal sector, both on the production and consumption sides.

On the production side, the crucial issue is the strength of the demand from formal sector enterprises for intermediate and capital goods in V_M. The strength of this demand depends mainly on the size and character of the formal sector. The larger and the more competitive the F-sector, for example, the more likely it is to seek subcontracting relationships with V_M and consequently the stronger the demand for V_{MP}.

On the consumption side, incomes generated in the formal sector are partly spent on goods produced by the modernizing informal sector, V_{MC}, as well as on its own output. The strength of these consumption linkages between the two sectors again depends on the character of the formal sector, including the distribution of income generated. Given that, for the most part, consumer goods produced in V_M have low-income characteristics, a more egalitarian distribution of income within the formal sector will generate greater demand for these goods.

The strength of these linkages on both the production and consumption sides also, of course, depends on the vitality of the modernizing informal sector and its ability to respond to these potential demands.

It should be noted that V_M also meets some of its own capital and intermediate goods needs, as well as the more limited demands emanating from V_T. On the consumption side, some V_{MC} goods are bought by low-income households, themselves working in the informal sector, in competition with goods produced by V_T, on the one hand, and also by F, on the other.

The major components of this system merit further discussion. The most important issue is the strength of production linkages between F and V_M. Given the potential supply of V_{MP} goods, both in quantity and quality, formal sector demand for them depends not only on the size and composition of the formal sector itself but also on the environment in which it operates. The

more competitive that environment the stronger the linkages with the informal sector can be expected to be as formal sector enterprises search for cost-cutting opportunities. Some formal sector firms organize themselves largely through vertical integration, while others subcontract extensively in the Japanese style, including to households through the putting out system. Moreover, some industries are technologically more suitable for subcontracting than others. Government interventions, such as health and safety standards and minimum wage legislation can also affect the strength of these linkages, i.e. unduly high standards tend to diminish the procurement of intermediate products from the informal sector. In contrast, when minimum wages are enforced in the formal sector, this usually provides an additional encouragement for subcontracting to the informal sector.

The extent and character of demands for V_{MC} and V_{MP} depends also, of course, on the characteristics of the modernizing V-sector, in both its qualitative and quantitative dimensions. The potential output of V_{MP}, for example, depends on the resources available to that sub-sector, including the education, training and skills incorporated in its labor force, its technological and entrepreneurial capacities, as well as its access to appropriate institutions, information, infrastructure and informal sources of finance. At any point in time, the accumulation of capital and skills in the sector is, of course, the product of historical developments. Where structures and policies have favored the sector over a longish period, a strong supply potential will have developed, facilitating its response to new demands.

Where the V-sector is largely traditional there will be relatively little V_{MP} produced, and the sector will be heavily concentrated on consumer goods, as the informal sector is generally depicted. As indicated earlier, however, within V there are not only the traditional, low-technology consumer goods produced by V_T, but also increasingly modern consumer goods produced by V_M. In essence there thus exists a continuum of consumer goods of varying
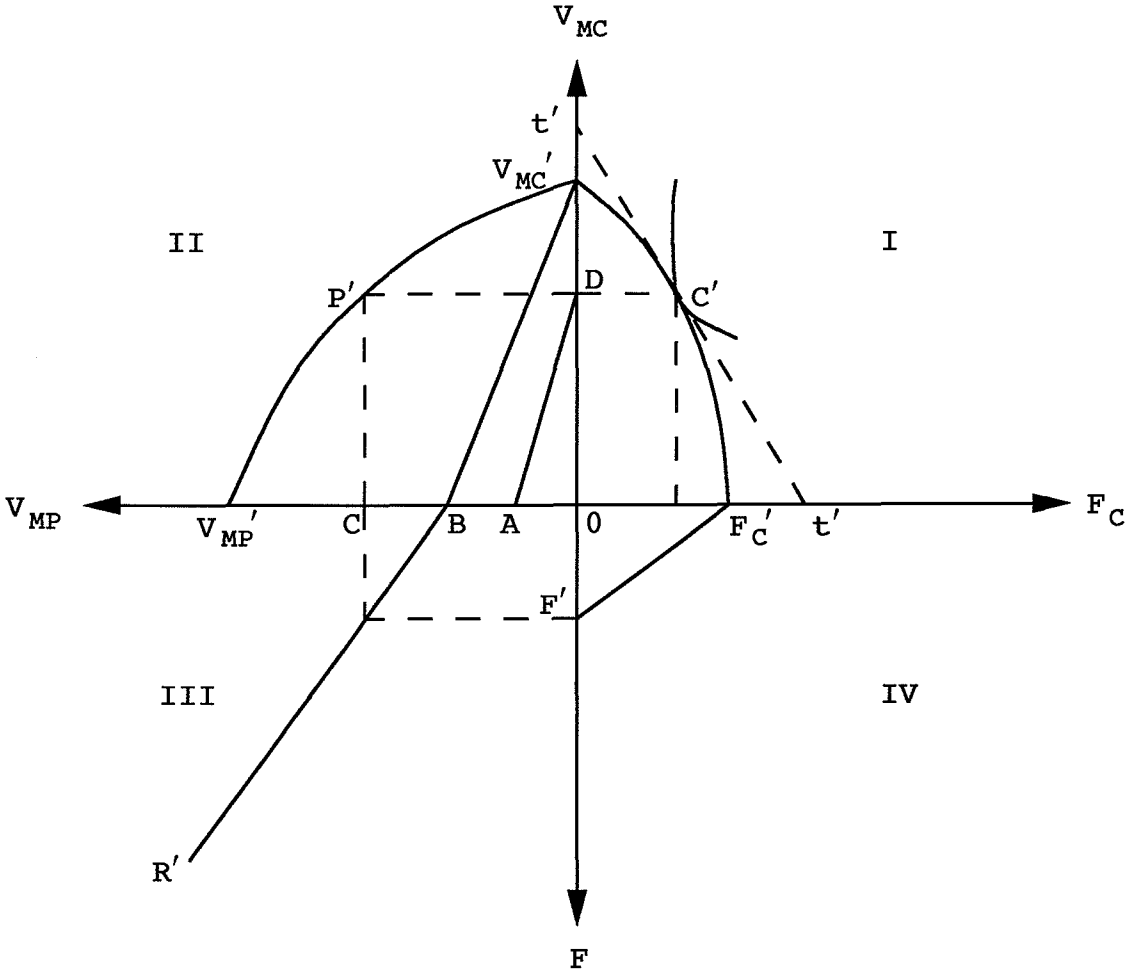
Diagram I
Consumption Equilibria
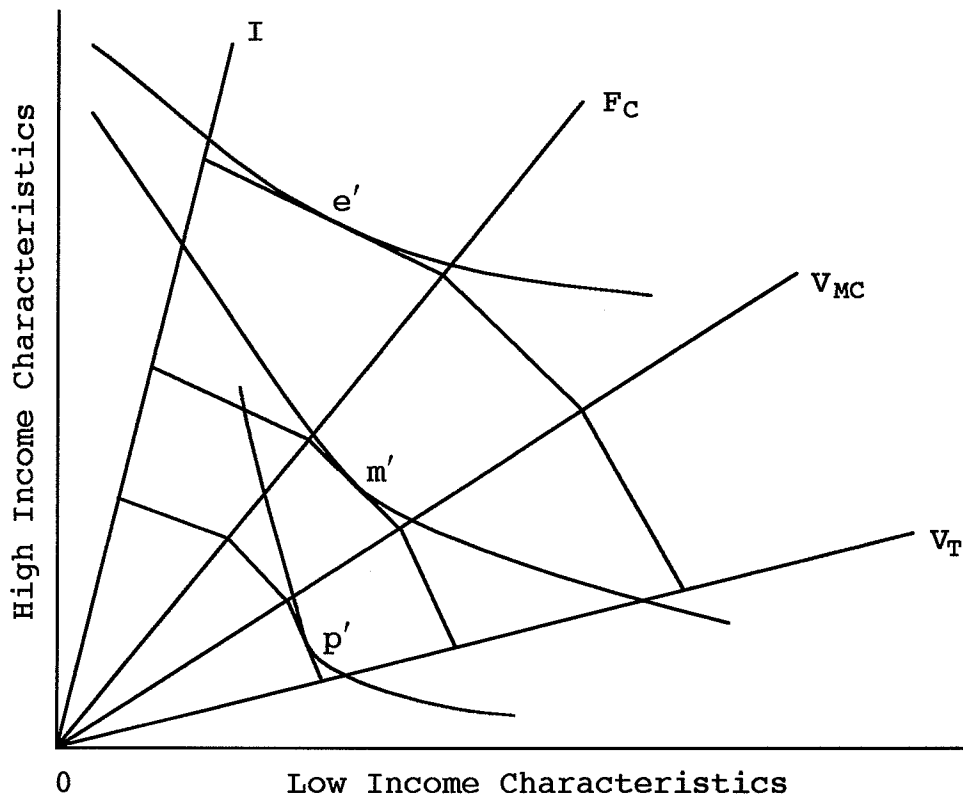
I   = Imported Consumer Goods;
F   = Consumer Goods Produced in Formal Sector;
V_{MC} = Consumer Goods Produced in V_M;
V_T = Consumer Goods Produced in V_T;
e′   = Elite Class Equilibrium Choice;
m′   = Middle Class Equilibrium Choice;
p′   = Low Income Class Equilibrium Choice.

characteristics, ranging from those produced by V_T, by V_M, by F, and imported varieties. The characteristics of these products tend to be increasingly suitable for people with higher incomes as one moves through the continuum, so that elite households mainly consume imported and F-produced goods; middle income households choose mainly between F and V_{MC}; and low-income households mainly between V_{MC} and V_T. This is illustrated in Diagram I. The determinants of consumption include preferences among the four types of consumer goods and the terms of trade between neighboring pairs.

Discussion of some of the more important relationships determining the size of V_M may be further clarified by their representation in Diagram II. Quadrant II depicts the production possibilities curve of the V_M sector, $V_{MC}'V_{MP}'$, as between V_{MC} and V_{MP}, given the total resources available to the sector at a point in time. The output of V_{MP} is allocated in three different ways: a part, OA, is intermediate goods required by V_{MC}; a part, AB, is demanded as intermediate goods by V_{MP} itself (we assume, for convenience, that input-output relationships are such that the demand for intermediate goods from V_{MP} and V_{MC} is the same irrespective of the V_{MC}-V_{MP} composition of total V_M); and a part, BC, is demanded by the formal sector, according to the linkage ratio, BR', showing the demand for V_{MP} products exercised by the formal sector at output level OF'. As noted above, the slope of the linkage ratio is likely to vary according to the competitiveness of the formal sector and other organizational features. The lower the slope, the stronger the production linkages. The total size of the formal sector, OF', at any point in time is, as detailed above, a function of the system's overall macro-economic conditions.

The size of F also, of course, determines the availability of formal sector consumer goods, F_C, at any point in time, as indicated on the OF_C axis, according to the production relationships shown in Quadrant IV. This generates a consumption-possibilities curve as between V_{MC} and F_C, depicted by

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Diagram II
The Modernizing Urban Informal Sector

V_{MC}

t'

V_{MC}'

II

P' — — — D — — C'

I

V_{MP}

V_{MP}' C B A 0 F_C' t' F_C

F'

III

IV

R'

F

$V_{MC}{}'F_C{}'$ in Quadrant I.

Diagram II illustrates an initial static equilibrium as shown by the dotted lines. We start with an exogenously given level of production in the formal sector, OF'. Demand for V_{MP} from the V_M and F-sectors is generated at OC, as indicated above, while the sector produces OD consumer goods, at equilibrium position P'. The formal sector output, OF', is assumed to generate consumer goods output of $OF_C{}'$, shown on the horizontal axis of Diagram II. Consumers have a choice between V_C and F_C. In equilibrium, at terms of trade $t't'$, and the preferences shown, consumers settle at C'.

The terms of trade between V_C and F_C are partly determined by the usual market conditions and partly by policy interventions, focussed on the F-sector. The latter includes subsidies and price controls, import restrictions, production regulations, licensing, labor market restrictions, including minimum wages etc., all of which affect relative prices in one direction or another.

The framework developed above allows us to consider the role of the informal sector over time. We explore alternative dynamic patterns of development in the next section.

IV.   <u>Alternative V-Sector Paths in a Dynamic Context</u>

The path of the informal sector over time in an overall development context depends on the nature of changes in the critical dimensions identified above. In each dimension, there can be factors which are either favorable or unfavorable to the successful evolution of the system. We shall discuss them one at a time.

1)   We have already discussed the determinants of the total size of the informal sector labor force, V_E, in terms of developments in the rural

economy, population growth, and wage levels and employment growth in the formal sector. The larger V_E, the larger the potential size of V, both as a dynamic force, V_M, and as a low productivity sponge sector, V_T. The smaller V_E relative to the economy's total labor force, the more likely that the dynamic part, V_M, forms a larger proportion of the total informal sector; eventually, as labor surplus is eliminated, V will be largely absorbed by F. If there is a vigorous urban formal sector which is providing all the employment opportunities required, there is no particular need for the continued existence of the informal sector. However, V_M may atrophy only slowly, ultimately becoming the small and medium industry component of the urban formal economy, as happened historically in Japan. V_T is important for maintaining minimal incomes and preventing destitution, but makes little longer term contribution to development.

2) The rate of growth of the formal sector as well as its precise characteristics represents an important dynamic determinant of the system. If it grows fast, *ceteris paribus*, it generates more demand for the products of V_M, both V_{MC} as well as V_{MP}. The pattern of F growth will, moreover, determine the extent to which it seeks linkage opportunities with V_{MP}.

3) Changing government policies towards F may be more or less favorable to V_M -- including the extent of monopoly and competition, the degree of protection, licensing requirements, credit and labor market interventions, etc.

4) The linkage ratio may consequently change positively or negatively over time, depending on the extent and nature of formal sector growth, changing competitive pressures, as well as the evolving supply side capabilities of V_{MP}.

5) Over time, in favorable conditions, (illustrated in Diagram III) there is likely to be a shift in the production possibilities curve, $V_{MC}V_{MP}$, in quadrant

Diagram III
Favorable Dynamic Case
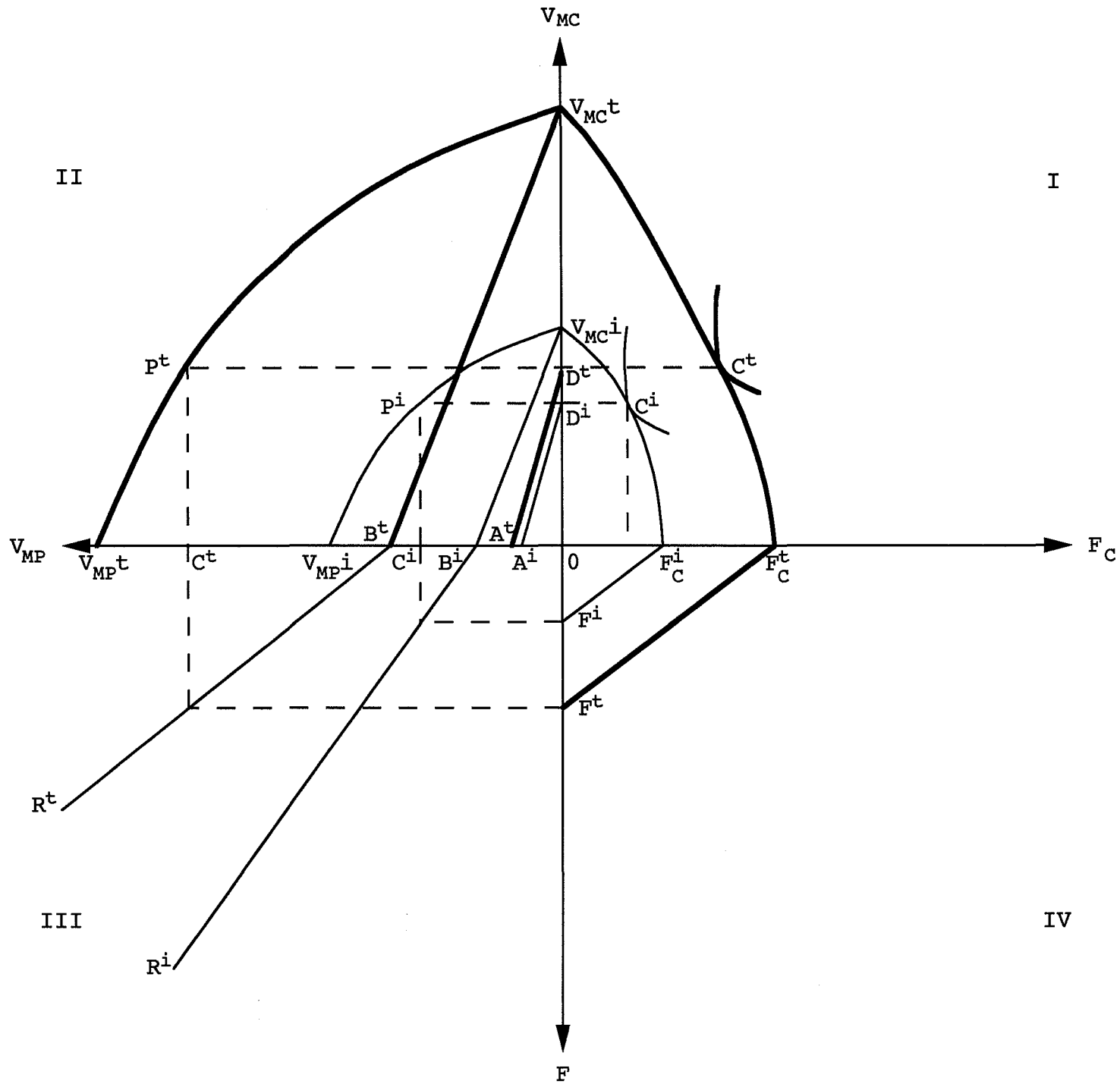
II, for a number of reasons. First, the total resources devoted to the sector may increase. Secondly, learning, technology change (in both processes and products) will occur, shifting the production possibilities curve outwards. In the medium term, it may be possible for V_M's production potential to increase rapidly as its labor supply is abundant and both entrepreneurs and capital can shift from F.

6) Changes in the consumption choices in quadrant I are again of various types. For any change in income level (with a given distribution of that income), there will be a new consumer equilibrium along the income-consumption curve. Changes in income distribution, for equivalent rates of income growth, will also have the effect of altering demand patterns, as previously discussed. A more equal distribution of income is likely to favor V_{MC} relative to F_C.

7) Finally, the terms of trade may change due to policy changes, as well as due to changes in underlying market conditions. Changing market clearance conditions, for a given structure of government interventions, will also change the terms of trade. Thus, the ultimate impact of changes in the terms of trade could go in either direction.

In tracing the impact of these various types of change on V_M it is helpful to contrast three cases:

- Case 1: the case in which all the changes work in the direction of enhancing the role of V_M over time: more rapid growth of F; more equal income distribution; increasingly favorable linkage ratio; technological progress and capital accumulation in V_M. This case is likely to emerge when the F-sector is becoming more competitive over time.

- Case 2: the case in which V_M grows even when the F-sector is uncompetitive, high-cost and growing only moderately; V_M may then succeed because it is a low

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cost alternative to the F-sector in both producer and consumer goods. But it is likely to be less buoyant than Case 1 since the overall macro-economic conditions including the growth of F are less favorable.

- Case 3: the case in which there is stagnation in V_M, accompanying stagnation in F; this arises due to failures both with respect to demand and supply conditions in V_M, with slow overall growth and/or unequal income distribution and a weak linkage ratio, all leading to weak demand for the products of V_M, while supply deficiencies make it difficult for V_M to provide effective substitutes for the products of F.

Case 1 is likely to be associated with the fastest growth of V_M which will gradually absorb all the labor in V. We have illustrated this, the most favorable, case in Diagram III, indicating increased output of both producer and consumer goods by the V_M sector, with increased consumption of both F_C and V_{MC} goods. The new linkage ratio, indicated by B^tR^t, is stronger than before, as indicated by B^iR^i. In this very favorable case we would expect V_M eventually to crowd out V_T, and, later, for F to crowd out V as labor surplus disappears from the economy as a whole. The informal sector can here appropriately be described as having played an 'evolutionary' role.

In contrast, with more moderate growth of V_M, as in Case 2, V_T will continue to play a role. In the third or least favorable case, we would expect V_T to increase in absolute and relative size as a consequence of the deficiencies of both F and V_M and to continue to be an 'involutionary' sector, offering stagnant or even falling incomes over time for ever larger numbers.

Table 1

Latin America: Structure of Non-Agricultural Employment
(%)

	INFORMAL SECTOR	Independent Workers	Domestic Services	Small Enterprises	FORMAL SECTOR	Public Sector	Large Private Enterprises
Latin America							
1980	40.2	19.2	6.4	14.6	59.8	15.7	44.1
1985	47.0	22.6	7.8	16.6	53.1	16.6	36.5
1990	52.7	24.0	6.9	21.8	47.3	15.6	31.7
1992	54.4	25.0	6.9	22.5	45.7	14.9	30.8
Argentina							
1980	39.4	20.4	6.0	13.0	60.7	18.9	41.8
1985	42.7	22.9	6.5	13.3	57.3	19.1	38.2
1990	47.5	24.7	7.9	14.9	52.5	19.3	33.2
1992	49.6	25.9	7.8	15.9	50.4	17.7	32.7
Brazil							
1980	33.7	17.3	6.7	9.7	66.3	11.1	55.2
1985	44.7	21.1	9.1	14.5	55.4	12.0	43.4
1990	52.0	21.0	7.7	23.3	47.9	11.0	36.9
1992	54.1	22.5	7.8	23.8	45.8	10.4	35.4
Colombia							
1980	52.5	25.3	6.7	20.5	47.5	13.8	33.7
1985	55.7	28.0	7.0	20.7	44.2	12.4	31.8
1990	59.1	25.1	6.2	27.8	40.8	10.6	30.2
1992	60.3	25.4	5.9	29.0	39.5	9.9	29.6

Table 1 (continued)

Latin America: Structure of Non-Agricultural Employment
(%)

	INFORMAL SECTOR	Independent Workers	Domestic Services	Small Enterprises	FORMAL SECTOR	Public Sector	Large Private Enterprises
Costa Rica							
1980	36.4	16.3	6.1	14.0	63.6	26.7	36.9
1985	40.5	17.2	6.2	17.1	59.4	26.3	33.1
1990	45.2	17.6	5.6	22.0	54.7	23.0	31.7
1992	49.7	20.9	5.8	23.0	50.3	20.9	29.4
Chile							
1980	50.4	27.8	8.3	14.3	49.6	11.9	37.7
1985	53.3	24.4	9.8	19.1	46.7	9.9	36.8
1990	50.0	23.6	8.1	18.3	50.0	7.0	43.0
1992	49.5	23.0	7.5	19.0	50.4	8.1	42.3
Mexico							
1980	49.1	18.0	6.2	24.9	50.9	21.8	29.1
1985	51.3	23.5	6.4	21.4	48.7	25.5	23.2
1990	55.5	30.4	5.6	19.5	44.6	25.0	19.6
1992	56.0	30.5	5.5	20.0	44.0	24.5	19.5
Venezuela							
1980	34.5	21.2	4.5	8.8	65.4	25.6	39.8
1985	39.9	21.3	4.9	13.7	60.1	24.5	35.6
1990	48.5	21.4	5.0	22.1	51.5	22.6	28.9
1992	50.9	22.3	5.0	23.6	49.1	20.0	29.1

Source: PREALC

Table 2

Africa

Urban Working Population in Urban Informal Sector[1]
(%)

Country	Year	Percentage
Burkina Fasso	1986	73
Congo	1979	37
Djibouti	1980	20
Gambia	1975	42
Ghana	1974	65
Ivory Coast	1975	44
Kenya	1972	44
Niger	1976	65
Nigeria	1976	50
Senegal	1976	59
Togo	1976	50

Source: Charmes (1990)

Note:
1. Note that in some of these cases the 'urban' informal sector may include
   some agricultural activity.

Table 3

Asia

Urban Working Population in Urban Informal Sector[1]
(%)

Country	Year	Percentage
India	1971	40-50
Indonesia	1976	45
Malaysia	1970	35
Pakistan	1972	69
Singapore	1970	23
Sri Lanka	1971	19
Thailand	1976 1986	26 45
Specific cities		
Dhaka (Bangladesh)	Early 1970s Early 1980s	57 65
Calcutta	Early 1970s Early 1980s	40-50 54
Madras	Early 1970s Early 1980s	50-70 60
Jakarta	Early 1970s Early 1980s	41 65
Metro Manila	Early 1970s Early 1980s	43 50
Bangkok	Early 1970s Early 1980s	43 49

Source: Charmes (1990); Romijn (1993); Hallgren et al., 1990 (quoted in ILO, 1992b).

Note:
1. Note that in some of these cases the 'urban' informal sector may include some agricultural activity.

Table 4

Urban Informal Sector by Branch of Activity
in Selected Countries of Latin America Around 1970
(%)

Country	Manufa-cturing	Construc-tion	Commerce		Trans-port	Ser-vices	Other	Total
			Fixed Location	Itinerant				
Argentina	14.1	9.5	40.7[1]	n.c.	3.2	30.2	2.3	100.0
Brazil	18.0	8.2	11.3	4.8	3.4	42.3	12.0	100.0
Chile	22.8	6.6	26.1[1]	n.c.	4.1	40.4	--	100.0
Colombia	29.5	--	36.2[1]	n.c.	6.2	25.0	3.1	100.0
Dominican Republic	19.0	8.0	23.0	15.0	--	33.0	2.0	100.0
Ecuador	21.8	3.1	25.2[1]	n.c.	3.9	42.0	4.0	100.0
El Salvador	12.0	4.0	17.0	14.0	--	49.0	4.0	100.0
Mexico	22.7	6.4	12.3	3.5	2.2	39.3	13.6	100.0
Paraguay	18.0	6.0	20.0	8.0	--	40.0	8.0	100.0
Peru	17.2	5.4	19.0	7.6	6.0	26.8	18.0	100.0
Venezuela	13.0	--	28.0[1]	n.c.	--	23.0	36.0	100.0
Total	18.6	6.3	16.4	4.0	3.3	37.5	13.9	100.0

Source: Tokman (1978)

Note:
1. Itinerant commerce population of urban informal sector are included in the
   fixed location statistics for these countries.

Table 5

Proportion of Manufacturing in Total V-Sector Activity in Africa and Asia

Country/town	% of activity in manufact.[a]
AFRICAN URBAN INFORMAL SECTOR	ESTIMATES
Abidjan 1970	32[bc]
Freetown 1976	20
Lagos 1976	40
Nouakchott 1977	14
Bamako 1978	24
Khartoum 1976	42[c]
Ouagadougou 1977	42
Guinea 1987	19
Kenya 1988	18[c]
Ghana 1989	39
Zambia 1989	22
Swaziland 1980s	61
Lesotho 1980s	58
Zimbabwe 1980s	70[d]
ASIAN URBAN INFORMAL SECTOR	ESTIMATES
Dhaka 1982	25[c]
Pakistan 1985/6	28[c]
Manila 1976	12
Colombo 1977	5
Indonesia 1982 Jakarta and Yogjakarta 1990	8[c] 66[c]
Four Indian Cities 1986	7-25
Delhi and 6 other cities 1987	81

Source: Lubell, 1991; Livingstone, 1991; Peters-Berries, 1993a; 1993b; Amin
and Sudarsono, 1993; WEP, 1993.

Notes:
a. % of informal sector workforce, unless otherwise stated.
b. Industry and construction.
c. Enterprises.
d. Manufacturing and repairs.

Table 6

Characteristics of Informal Sector Activities

	Entrep Income	Worker Income	Techn.	Credit	Skills	Link-ages
Indonesia Sarong[a]	+	+	+	na	na	+
textile-handloom[a]	-	-	-	-	na	-
Rattan furn.[a]	+	-	-	-	+	+
Batik[a]	+	-	na	+[1]	+	+
Footw.[a]	+	-	+	na	+	+
metal working[a]	+	+	+	+[2]	+[5]	+
homeworkers[b]	-	-	-	-	-	+
rooftile manuf.[c]	-	-	-	+[3]	-	+
Phil. Homeworkers[b]	-	-	-	+[4]	-	+
Jeepney operat.[d]	+	+	+	+	+	na
Trimob. operat.[d]	+	+	+	+	+	na
Trimob. manu. & repair[d]	+	+	+	+	+	+
Manual skate op.[d]	-	-	-	-	+	-
Thailand Bangkok[e]	+	+	+	na	+[8]	+
Kenya Small busin.[f]	-	-	-	-	-	-
Nairobi, inf. sector[g]	+	+	-	-	-	-
Mathare valley[h]	-	-	-	-	-	some
Tanzania small enter.[i]	+	-	-	-	+	-

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Table 6 (continued)

Characteristics of Informal Sector Activities

	Entrep Income	Worker Income	Techn.	Credit	Skills	Link-ages
Rwanda metal workers[e]	+	na	+	-[7]	+	+
Mali metal workers[e]	+	na	+	-	+	+
Ecuador metal workers[j]	+	-	+	-	+	+[6]
Peru metal grills[e]	+	+	+	-	+	+

Sources:
a. ILO, 1994.
b. ILO, 1992a.
c. Harper and Thiam Soon, 1979.
d. ILO, 1982.
e. Maldonada and Sethuram, 1992.
f. AID, 1985.
g. ILO, 1990a.
h. Mwega, 1991.
i. Bagachwa et al., 1993.
j. ILO, 1990b.

Notes:
Income: + = entrepreneurs' income at or above average wages in formal sector;
   - = below; workers' + = income at or above minimum wages in formal sector;
   - = below.
Technology: + = moderate or high tech. used; - = low technology.
Credit: + = some access to formal sector credit; - = no access.
Skills: + = moderate skills or more; - = only basic skills.
Linkages: + = significant forward linkages with the formal sector; - = insig.
   linkages.

1. usually from the subcontracting firm in the formal sector.
2. many enterprises received credit from government programs designed for
   small enterprises.
3. Working capital provided by traders.
4. 36% of enterprises received credit from buyers.
5. Workers with skills mainly came from formal sector.
6. Excludes retailing.
7. Little credit until set up own bank.
8. 90% of output goes to private house-building.

Table 7

Markets Served by the Informal Sector

Place/date	Sales to Households %	Informal Enterprises/ Retailers %	Formal Enterprises %
ASIAN STUDIES			
Jakarta (75)	87	12/13	'virtually non-existent'
Jakarta[a] (90)	66 - low : 6 - mid+: 15 - govt: 45 offic.	1.6	32
Yogjakarta[a] (90)	36 - low : 2.5 - mid : 17 - govt: 16 offic.	--	64
Bangkok[b] (89) Informal, 0-4 Small, 5-20	68 (poor: 17) 60 (poor: 10)	8 n.a.	n.a. 10[c]
Bangkok (80)	n.a.	n.a.	20[d]
Manila (76)	most	n.a.	n.a.
Indian NCR (87)	n.a.	'strong'	negligible
4 Indian cities (86)	94	4	2

Table 7 (continued)

Markets Served by the Informal Sector

Place/Date	Sales to Households %	Informal Enterprises/ Retailers %	Formal Enterprises %
AFRICAN STUDIES			
Freetown (76)	most		
Lagos (76)	87	9	negligible
Kano (76) Nigeria	87	10.5	n.a.
Ghana (three cities)[h] (88-89)	n.a.	15.5	3.5
Kumasi (75) Ghana	72		negligible
Bamako[e] (78) Mali	83[f] (30)		17[g]
Yaounde[e] (78) Cameroun	95[f] (35)		5[g]
Dakar (88) Sudan	55	'significant'	'significant'
Khartoum (76) Sudan	n.a.	n.a.	< 1
LATIN AMERICAN STUDIES			
Campinas (76) Brazil	88	12	
Buenos Aires (80)	75	15	10

Sources: Studies surveyed in Lubell, 1991; Amin and Sudarsono, 1993; Romijn, 1993; Aboagye and Yankson, 1992.
a. Produced goods only.
b. Covers six sectors only chosen as likely to be dynamic.
c. Sales to medium and large manufacturing enterprises.
d. Subcontracting.
e. A small subset of the informal sector in Bamako, defined to include only 'modern' activities; this includes less than 10% of the total enterprises enumerated as in the informal sector.
f. Includes both sales to households and informal enterprises. Figures in bracket are sales to government officials.
g. Includes formal sector commerce, modern sector enterprises and government.
h. Data on subcontracting arrangements only; formal sector includes government.

V.   Preliminary Evidence and Conclusions

Existing data on the size and composition of the informal sector in the third world is plentiful but dispersed, unorganized and difficult to interpret. While there have been more systematic efforts at gathering consistent data in Latin America -- predominantly under the auspices of PREALC and Victor Tokman[8] -- most of the individual micro surveys available are based on African data. Asia undoubtedly is the setting for the most vigorous representatives of the modernizing sub-sector, and consequently probably also represents the best arena for the future collection and marshalling of relevant primary data on this sub-sector.

Aggregate PREALC data are presented in Table 1. It should be noted that V_E is not only very large, comprising nearly 50% of total urban employment in Latin America, but that it has been growing relatively over the past decade. Turning to Africa, Table 2 indicates that the informal sector plays an even more predominant role there. In Asia (Table 3) there seem to be larger variations among countries and among different sources for the same country. While the informal sector appears to be somewhat smaller in Asia, these comparisons must be treated with caution since so much depends on the different methods and definitions adopted in these surveys.

The break-down by activities within the typical Latin American V-sector is shown in Table 4. It indicates that manufacturing, which can be assumed to constitute the main home for V_M, comprises approximately 20% of the total. Data for Africa and Asia (Table 5) show very large variations; some studies indicate a much higher proportion in manufacturing, but again problems in the comparability of definitions and coverage must be noted. While available aggregate information consequently does not permit us to decompose V into V_M and V_T, if V typically approaches 40-50% of total urban employment and manufacturing comprises around 20-50% of V, we can assume that 10-25% of the

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[8]   See, for example, Tokman, 1990.

total urban labor force represents an approximate upper limit for V_M, with the upper limit around 10% in Latin America and higher in the other two regions where the manufacturing component generally appears to be larger.

Turning to the composition of manufacturing activities at the individual country level, most available studies do not attempt to distinguish between the V_M and V_T components of V. Nor is there a hard and fast dividing line between the two; but our analysis leads us to propose a set of criteria which can be checked against the sparse existing data and should be the basis for any future empirical research.

What we describe as V_M includes enterprises with some or all of the following characteristics: (i) production of intermediate and consumer products; (ii) significant linkages (production or consumption) with the formal sector; (iii) incomes not very much below formal sector minimum wages for workers and comparable to formal sector wages for entrepreneurs; (iv) capital per person of $100 or more; (v) significant deployment of skills; (vi) employment of up to 10 workers; (vii) predominance of family enterprises, but frequently also employing non-family members.

In contrast, characteristics of the traditional informal sector V_T are: (i) production almost exclusively of consumer goods and services; (ii) few linkages with the formal sector; (iii) wages typically significantly below minimum wages in the formal sector; (iv) capital per person below $100; (v) insignificant skill requirements; (vi) employment of typically three or less workers; (vii) almost exclusively composed of family enterprises.

Table 6 brings together information on some of the criteria differentiating V_M and V_T for a number of informal sector activities in different parts of the world. In most regions there appear to exist some modernizing activities within the informal sector, with metal-working industries apparently showing

such characteristics wherever they are located. Beyond metal-working, there are more modernizing elements in evidence in the three Asian countries than in the African countries for which we have any evidence. For Latin America, we have independent evidence of footwear as a clear case of V_M in a number of countries, but overall the data we have been able to gather to date is too limited to permit any firm conclusions.

Another way to attempt to separate the two sub-sectors of V empirically is by examining the markets being supplied. In the earlier sections we differentiated between the following outlets for V-sector goods: With respect to consumer goods: (i) low-income households supplied mainly by V_T and V_M; (ii) middle income households supplied mainly by V_M and F_C. With respect to producer goods: (i) other informal sector enterprises, supplied mostly from V_M; (ii) formal sector enterprises, often in a two-way subcontracting relationship with V_M.

There are a number of empirical studies of the informal sector which have tried to differentiate among the markets primarily served by the sector, as summarized in Table 7. These surveys, of course, vary in methodology and coverage, so that the data must be treated with caution. However, it is clear that consumer goods sold to households form by far the largest portion of total informal sector sales everywhere. According to these studies significant producer goods linkages (from V_{MP}) appear to be present in Indonesia[9] and Thailand in the case of one-fifth or more of total sales; the Bamako and Buenos Aires surveys also show linkages with the formal sector to the extent of one-tenth or more of total sales. But the samples in Thailand, Bamako and Yaounde were pre-selected, i.e. biased, with the intent to focus on the more modern informal sector activities.

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[9] We should note, however, that the 1975 study in Jakarta showed negligible forward linkages with the formal sector.

The studies in Indonesia and Thailand break down consumer markets according to income level. Only around one-tenth of consumption sales are to low income groups according to these estimates, the rest going to middle income consumers and government officials. This would indicate a sizeable V_{MC} in both these systems; together with data on V_{MP}, it suggests the presence of modern informal sectors of significant magnitude. Unfortunately we do not have data to compare this fully with other economies, but the nearly negligible evidence of production linkages with the formal sector in most of the other studies indicates little V_{MP} activity elsewhere.

A 1978 ILO Census of Africa's informal sector indicated that 60% of its customers were low income families not engaged in F.[10] The Bamako and Yaounde surveys, however, show significant consumer sales to government officials (as well as production linkages) to F, all indicating the presence of some V_M. But biased sampling again makes it impossible to assess its relative size or to make comparisons with other countries.

Linkages to F seemed to be more in evidence in terms of backward linkages, with most producer goods, spare parts, etc., in V coming from F. Within Africa, 40% of informal sector inputs are procured from the formal sector. Another important linkage is via the movement of people who have acquired skills and experience in the formal sector into the informal sector, as testified to by numerous studies throughout the world.[11]

Very few of the numerous Latin American studies yielded even rough and ready indicators of the importance of V_M activity. Footwear industries, however, e.g. in Uruguay and Brazil, seem to be nearly always linked to the formal sector via subcontracting relations, with F purchasing nearly all the

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[10] Nihan, G. et al., 1979.

[11] See e.g. Lubell, 1991; Turnham et al., 1990.

intermediate processed output.[12]

Finally, we found it useful to present a preliminary look at the comparative role of the informal sector in two Asian countries, Thailand and the Philippines. These represent examples, although not extreme ones, of differing development patterns, following the favorable/unfavorable typologies suggested earlier. Thailand has a thriving V_M sub-sector, with rapid F-focussed industrialization raising the demand for manufactures and gradually eliminating the labor surplus and thus V_T. The poor performance of the Philippine economy, by comparison, has led to the emergence of a large V_T sponge sub-sector, although there is evidence also of elements of a small modernizing V_M. Thailand comes close to falling into Case 1 (though income distribution is not very egalitarian), while the Philippines falls somewhere between Cases 2 and 3.

Thailand

Rapid and relatively well balanced, economic growth over the past decade has transformed Thailand into a newly industrializing country. In addition to the expansion of large scale formal sector firms using imported capital there is a significant V-sector in evidence which has a large modernizing component, V_M. It is the successful interaction between agriculture and F and between F and V, together with the rapid growth of output and demand in the economy as a whole, which has made V_M flourish.

The proportion of the labor force in the urban informal sector appeared to grow quite rapidly in the 1960s and 1970s, according to successive surveys. In the 1980s, however, 'with rapid growth in the 1980s, employment in informal sector as a percentage of total urban employment declined from 59 to 56%.'[13]

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[12] See Beneria; Fortuna and Prates; and Roberts, 1989.

[13] Hutserani, S. and Yonkittikul, T., 1992, quoted in ILO, 1992b.

A number of surveys testify to the strong and growing presence of a modernizing component of V. Almost 63% of the manufacturing firms in Thailand in 1980 employed less than ten workers; in Bangkok this figure was as high as 66% and this statistic underestimates the true size by excluding many underground firms.[14] A 1989 survey records the characteristics of V-sector manufacturing in Bangkok.[15] Although the industry selection was again designed to focus on the more dynamic of the firms, the findings do reveal something about the nature of V_M. Activities included assembly and repair, metalworking and electronics, wood and metal furniture production, garments, umbrella making and food processing. 90% of the entrepreneurs said their products were also produced in the formal sector (78% at comparable prices). These are clear indications that many of these V_M products are competitive substitutes for formal sector output, rather than non-competitive low quality consumer or producer goods.

Table 8 presents a break-down of informal urban sector activities. Within manufacturing, presumably the main location of V_M, we find especially strong representation in the metal-working, jewelry, repair, wood and leather products industries. Middle or upper income consumers account for over two-thirds of the markets of garments and jewelry, and between a half and two-thirds of food sales, metal working and personal services produced by the informal sector, another indication of the presence of a strong modernizing component, V_{MC}, in these industries.[16]

Further evidence of the strength of both production and consumption linkages between V_M and F in Thailand is provided in Table 9. Garments, jewelry and non-metallic products clearly have strong subcontracting relations with large

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[14] Amin, 1989.

[15] Amin, 1993. Data above also from Romijn, 1993.

[16] Phongpaichit et al., 1988. The rest of the market includes low income consumers and an 'uncertain' category.

Table 8

Thailand:
Distribution of Urban Informal Sector Workers
(%)

Activity	Profes-sional	Traders (vending/petty trade	Small-Scale Production Workers	Housewives	Other	Total
Vending/ Trade	3.3	40.0	13.3	20.0	23.4	100.0
Retail	9.1	36.4	31.8	4.5	18.2	100.0
Food Sales	12.0	20.0	52.0	12.0	4.0	100.0
Metalworking	13.3	--	60.0	13.4	13.3	100.0
Wood Products	--	14.3	42.9	--	42.8	100.0
Leather	20.0	--	40.0	20.0	20.0	100.0
Garments	3.1	16.3	37.5	21.9	21.2	100.0
Jewelry	8.3	--	87.5	--	4.2	100.0
Transportation	6.3	18.7	31.2	--	43.8	100.0
Repairs	13.3	16.7	66.7	3.3	--	100.0
Personal Services	6.8	17.2	51.7	13.8	10.5	100.0
Total	8.1	17.4	47.7	10.2	16.6	100.0

Source: Phongpaichit et al. (1988)

Notes:
-- = Zero or inapplicable.
Total is the percentage of workers in that activity as a percentage of the total labor force in the urban informal sector.

Table 9

Thailand:
Urban Informal Sector Activities:
Principal Buyers of Products/Services
(%)

Industry	Large Firms/ Subcontrac- ting	Large Firms/ Wholesale	House- holds	Small Firms	Govern- ment	Other	Total
Vending/ Stall Trade	--	--	90.0	6.7	--	3.3	100.0
Retail/ Wholesaling	9.1	27.6	50.0	13.6	--	--	100.0
Food Sales	--	--	100.0	--	--	--	100.0
Metal- working	--	23.1	46.2	30.8	--	--	100.0
Wood Products	22.2	--	55.6	22.2	--	--	100.0
Leather	20.0	--	80.0	--	--	--	100.0
Jewelry	75.0	16.7	4.2	4.2	--	--	100.0
Garments	65.6	--	31.3	3.1	--	--	100.0
Non- metallic Products	50.0	50.0	--	--	--	--	100.0
Transporta- tion	--	6.3	87.5	--	--	6.2	100.0
Repairs	3.3	3.3	86.7	3.3	3.3	--	100.0
Personal Services	--	--	100.0	--	--	--	100.0
Total	19.6	6.8	66.4	6.0	0.4	0.8	100.0

Source: Phongpaichit et al. (1988)

Notes:
-- = Zero or inapplicable.
Total is the percentage of output from the informal sector purchased by that
agency. Percentages in the table are the breakdown of the industry numbers by
purchasing agent (horizontal summation).

firms in F, while those of metal-working, wood and leather products are significant if somewhat weaker. Of these, garments, wood and leather products are serving domestic final consumers competitively. Jewelry products are largely exported while metal-working serves other V_M firms as well as F and households.

The majority of V_M enterprises were over ten years old. Over three-quarters had fixed locations. Most workers were skilled, with unskilled workers representing less than a third of the total.[17] The filtering down of skills from the formal sector was apparently important to the sub-sector, i.e. more than 40% of its entrepreneurs had once been formal sector employees; 28% of the skilled workers (those with more than five years of experience) but none of the unskilled -- had come from that sector.

The dynamism of these enterprises is indicated by the growth in their sales and employment. Average enterprise employment increased in each of the industries surveyed, with demand rising by nearly 50% since the establishment date. Over one third of the enterprises had innovated in some way, with nearly 75% adding at least one product to their range. For more than 25%, the new ideas emanated from formal sector contractors.

In summary, it appears that the success of the formal sector's boom in Thailand has filtered through to the informal sector which has developed a broad base of both complementary (on the production side) and competitive (on the consumption side) enterprises. As growth continued, the activities constituting V_T sector sponge employment have been in decline as labor was drawn into higher income opportunities in V_M and F.

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[15] Romijn, 1993.

The Philippines

At the time of independence, the Philippine government inherited an economy biased towards cash crop primary products to the neglect of rural development. A long period of heavy emphasis on urban import-substituting industrialization followed, relying on capital goods imports and the selective promotion of large scale firms. In the 1970s, population growth outstripped labor absorption by agriculture or the urban formal sector. The result was falling real wages, with migration into urban areas and the expansion of the informal urban sector. The share of urban employment in total employment rose from 30% in the early 1970s to 36% in the late 1980s and 47% in 1991.[18] This was associated with a growing urban informal sector which accounted for 62% of total urban employment in 1976.[19] The informal sector grew further over the 1980s and was estimated to account for 82% of non-agricultural employment by the end of the 1980s.[20]

In the early period, there is some evidence of a proportionate growth in V_M,(though less than in Thailand) with a rise in small scale industrial activities relative to household enterprises during the 1960s, including growth in metal-working and electrical machinery. The increasing share of chemical products, metal working and machinery from 1960 to 1975 (Tables 10 and 11) also indicates some modernization of the sector. But from the mid 70s to the end of the 80s, a rise in the share of own account workers, from 24% to 30% of total urban employment, is an indication of the relatively faster growth of V_T.[21] Alonzo also notes a shift away from manufacturing towards the service sector and away from wages and salary work towards self-employment in

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[18] Balisacan, 1994. Part of the rise is due to differences in definitions.

[19] World Bank, Philippines Industrial Development Strategy and Policies, Washington, D.C., 1980.

[20] This includes rural as well as urban informal sectors. Balisacan, 1994. Part of the rise is due to differences in definitions and boundaries.

[21] Balisacan, 1994.

Table 10

Philippines:
Formal/Informal Breakdown by Industry
(%)

	1960		1970		1975	
	Informal	Formal	Informal	Formal	Informal	Formal
Food/ Beverages	62.9	37.1	28.9	71.1	44.5	55.5
Clothing/ Footwear	84.1	15.9	88.8	11.2	79.3	20.7
Wood Products	36.2	63.8	60.1	39.9	59.0	41.0
Printing	0.0	100.0	11.1	88.9	33.7	66.3
Leather	0.0	100.0	24.7	75.3	65.7	34.3
Chemical Products	0.0	100.0	5..3	94.7	48.2	51.8
Metal- Working	38.0	62.0	18.2	81.8	43.4	56.6
Machinery	12.6	87.4	76.9	23.1	62.3	37.7
Other	97.1	2.9	67.7	32.3	85.0	15.0

Source: World Bank (1980)

Notes:
Definition of the informal sector: Less than 5 workers, but may have
additional family members as employees.

Table 11

Philippines:
Manufacturing Employment by Industry Groups:
Formal and Informal Sectors
(%)

	1960		1970		1975	
	Informal	Formal	Informal	Formal	Informal	Formal
Food/ Beverages	19.7	33.4	5.4	30.2	11.3	28.6
Clothing/ Footwear	48.6	21.8	70.2	21.5	45.3	24.2
Wood Products	2.9	11.3	9.1	9.7	8.8	12.2
Printing	0.0	4.8	0.2	4.0	1.6	2.7
Leather	0.0	0.6	0.0	0.4	0.4	0.4
Chemical Products	0.0	6.8	0.1	7.9	3.6	8.1
Metal- Working	2.7	10.4	1.1	7.4	5.2	11.1
Machinery	0.2	7.4	12.4	8.2	19.1	8.8
Other	25.9	3.4	1.5	10.7	4.7	3.9

Source: World Bank (1980)

Notes:
Definition of the informal sector: Less than 5 workers, but may have
additional family members as employees.

the seventies and eighties.[22]

In the 1970s, 16% of the Philippine urban informal sector was reported to be engaged in subcontracting operations, higher than in many countries (see Table 7 above), but less than Thailand or Indonesia. Major constraints on subcontracting included lack of confidence in the ability of informal sector firms to meet production and quality standards; it was suggested that the subcontracting that did occur was largely related to the desire to avoid minimum wage legislation.[23]

In the early 70s, 81% of commerce, 78% of transport and 73% of personal services was defined as informal.[24] Comparing the breakdown of informal activities in the Philippines and Thailand indicates that metal working, machinery and leather goods (modernizing activities) make significantly less of a contribution in the Philippines than in Thailand.

A 1991 survey found that enterprise heads accounted for 52% of all employment in the informal sector, other family members for 27%, and hired labor for just 21%. The role of hired labor rose, however, to 30% in manufacturing firms, reflecting the greater role of skills in those activities. The sector was marked by relatively low educational attainments, i.e. 48% of its entrepreneurs and 54% of its workers had not completed high school and only 3% of its entrepreneurs had any relevant training.[25] Surveys show that female employment was particularly large in the informal sector, indicating the sector's importance as a secondary source of household income.

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[22] Alonzo, 1988.

[23] World Bank, 1980, op. cit.

[24] ILO, 1974, Sharing in Development: A Programme of Employment, Equity and Growth for the Philippines, Chapter 5, Geneva. Special paper #9 of this report also shows that the number of urban self-employed and unpaid family workers continued to increase during the 60s.

[25] WEP, 1993.

In summary, poor economic performance over time caused a large labor surplus to flow into the urban informal sector, largely in the form of V_T. The Philippine informal sector exhibits some modernizing activities, but not as many as Thailand. The growth in V_T seems to have been particularly marked in the 1980s. In comparison with Thailand, the Philippines exhibited slower growth of V_M, and, especially in recent years, faster growth of V_T because of the greater labor surplus. Both are related to differences in the performance of the economy as a whole in the two countries.

Conclusions: Some of the conclusions we are able to draw from the combination of conceptual framework and scattered empirical findings presented here are as follows:

1) The overall size of the urban informal sector in terms of employment depends on:

    a) the extent to which agriculture and linked rural non-agricultural activities are experiencing output and productivity increases permitting them to "hold" their large and growing population in productive employment;

    b) the extent to which the urban formal sector is absorbing labor, while maintaining relatively modest wage gaps for unskilled labor compared with the rural areas. To the extent that relatively balanced growth takes place between rural and formal urban activities without generating large wage gaps, the pressure for urban informal sector expansion is eased.

2) The composition of the urban informal sector, as between its traditional and modernizing components, depends on:

    a) the rate of growth and competitiveness of the urban formal sector, determining the strength of its production linkages with V_M;

    b) the distribution of income affecting the pattern of demand for the consumer goods produced by V_M, relative to the products of the urban formal sector and those imported from abroad;

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c)   resources including skills and experience, entrepreneurship, capital and appropriate infrastructure, available in support of a V_M response.

d)   the strength, pervasiveness and time path of various government interventions which critically affect all the variables just noted, impacting both on the urban formal sector and the informal sector.

3)   The traditional urban informal sector V_T may be viewed as a residual but one which serves an important function providing a source of subsistence for the low end poverty tail of the urban population. However, most of the worst urban poverty is to be found among households depending on this sub-sector.

4)   The role of both components of the urban informal sector over time is illuminated by contrasting such relative success cases as Thailand with less successful cases such as the Philippines. In the success cases we can expect:

a)   the overall size of the urban informal sector to be relatively more modest, as favorable macro-economic conditions entailing rapid rural-urban formal sector growth takes the pressure off;

b)   the modernizing urban sector, though initially comprising probably not much more than 10% of the total urban labor force, to grow in relative importance, gradually reducing the size of the traditional sub-sector and becoming increasingly indistinguishable from the small and medium enterprises in the urban formal sector;

c)   once rural labor surplus is exhausted as a result of a combination of rural productivity growth and migration into urban formal sector activities, the urban traditional sub-sector to shrivel up, as labor becomes scarce and wages rise;

d)   public policies favoring an increasingly competitive F sector and a more equal distribution of income over time to facilitate this outcome.

In the non-success case we can expect to see a large influx of labor into the urban areas, enhancing the overall size of the urban informal sector;

moreover, as illustrated by the Philippine case, given the relatively weak
linkage demands emanating from a heavily protected urban formal sector,
dominated by large scale, vertically integrated industry, much of that inflow
will end up in the services, the distributive trades and other activities
typically associated with V_T. Combined with the effects of an unequal
distribution of income on the demand side, under such circumstances we can
expect the end of labor surplus to be much delayed, the size of V_M to remain
modest and an expanding V_T to have to continue to provide subsistence for
growing numbers of poor households.

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