

STRATEGIES FOR DEVELOPING THE INFORMAL SECTOR

ASIAN PRODUCTIVITY ORGANIZATION

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**ASIAN PRODUCTIVITY ORGANIZATION
1995**

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Report of APO Study Meeting on Productivity Improvement in Informal Sector (STM-11-93)

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FOREWORD

A major economic problem in many developing countries is the existence of the “working poor”, whose incomes and productivity levels are extremely low mainly because of their limited financial resources, poor management skills and the inadequacy of marketing channels available to them. If industrial policies are designed well and implemented effectively to support the vast majority of the working poor, these countries can make remarkable economic progress.

Recognizing the importance of enhancing productivity in the informal sector, the APO conducted a study meeting on Productivity Improvement in Informal Sector from 2nd to 6th August, 1993. The meeting arrived at some conclusions with rich inputs from resource persons and participants. This volume is a compilation of the presentations by resource persons and participants and of the salient points raised at the meeting. The APO hopes that this volume would be of interest to policy makers in member countries where the informal sector is economically significant.

Taking this opportunity, we would like to express our sincere appreciation to the participants and the resource persons for their valuable inputs, particularly to Mr. K. van der Ree from the International Labour Organization, Mr. Mohammad Masud Isa from the Grameen Bank of Bangladesh, Mr. S. Ghosh and Mr. A.K. Vohra from the National Productivity Council of India and a group of local experts from India. We would also like to record our appreciation to the Government of India and National Productivity Council for their support of and cooperation in this project.

KENICHI YANAGI
Secretary-General

July, 1995

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Conclusions and Recommendations

A major economic problem in developing countries is that of the “working poor,” whose income and productivity are extremely low. Significant economic impact can therefore be made if industrial policies are designed and effectively implemented to support the vast majority of the working poor. Development of the informal sector has the potential of raising the income of the people employed in it. Recognizing the importance of enhancing productivity in the informal sector, the APO conducted the captioned Category-B Study Meeting on Productivity Improvement in the Informal Sector, which was hosted by the Government of India. The Government of Japan also extended its support to invite participants from nonmember countries.

The meeting was held in India from 2nd to 6th August, 1993, with 15 overseas participants from nine different member countries and two participants from two nonmember countries. The participating member and nonmember countries included Bangladesh, India, Indonesia, Malaysia, Mongolia, Nepal, Pakistan, Sri Lanka, Thailand, Bhutan, and Western Samoa. Resource inputs were provided by Mr. K. van der Ree from the ILO, Mr. Mohammad Masud Isa from the Grameen Bank of Bangladesh, Mr. S. Ghosh and Mr. A.K. Vohra from the National Productivity Centre of India, and a group of local experts. Field visit-cum-study trips were made to hand-made paper family labour-run units in Jaipur and Tilonia to study the role of nongovernmental organizations (NGOs) in promoting the informal sector.

The study meeting recommended several policy measures and promotional strategies to strengthen the rural and urban informal sector with a view to raising the level of income and employment through a “package” approach to productivity improvement. These were as briefly outlined below.

Role of Government and the APO in Facilitating Productivity Improvement in the Informal Sector

- 1) The overall role of the government should be promotional and the government may establish an institutional mechanism for the formulation of development policies including government agencies, NGOs, the private sector, voluntary organizations, workers’ organizations, and trade unions. The implementation of the developmental programmes can be preferably entrusted to NGOs, the private sector, and voluntary self-help organizations (SHOs).
- 2) Round-table conferences should be organized to promote common understanding and to forge a consensus among the above-mentioned parties on the formulation of the development strategy for the informal sector.
- 3) The development strategy for the informal sector should be integrated with other policies for other subsectors, such as tourism, which have high employment and productivity potentials. Round-table conferences can be instrumental in facilitating communication among different ministries and agencies, which, in turn, may lead to the development of integrated policy.

- 4) Appropriate incentives and service facilities such as one-stop service centres or industrial service clinics may be provided. Special incentives for environment-friendly activities may be created.
- 5) An international survey of successful approaches and models developed in individual countries should be undertaken by organizations such as the APO with a view to facilitating adaptation of these models by other countries with suitable modifications to suit local conditions.
- 6) Knowledge about successful productivity improvement projects in selected sectors may be disseminated in member countries through symposia, publications, etc.
- 7) The APO and NPOs should intensify their role in networking and facilitating links among enterprises as well as government institutions, NGOs, and voluntary organizations to promote productivity improvement in the informal sector.

Supporting Self-help Organizations, Voluntary Organizations, Women, and Youth

- 1) SHOs should be promoted from the early stages of developing support programmes for the informal sector.
- 2) Emphasis should be given to enhancing the managerial capability of SHOs in order to improve their sustainability and provide a basis for effective participation in policy-making processes.
- 3) The government should initiate action to improve the access of SHOs to facilities such as infrastructure, technology, marketing, skill development, and credit.
- 4) The ILO, APO, and NPOs should provide technical assistance programmes to NGOs and voluntary organizations which in turn should assist SHOs.
- 5) Motivational schemes and approaches need to be designed to ensure full participation of women and youth in all stages of programme development, e.g., planning, decision making, implementation, and evaluation.
- 6) The government should play a catalytic role in encouraging the private sector and large institutions to take up the responsibility of supporting activities of community development, particularly through transfer of managerial skills.

Technology, Marketing, Training, and Skill Development

- 1) A survey on technology status needs to be conducted in order to establish the state of art in selected subsectors such as metal products, leatherware, hand-made paper, textile printing, and the like.
- 2) Demand-driven and user-oriented technology upgradation and modernization programmes should be initiated on a "cluster basis" to improve the productivity and the capacity of employment generation in informal-sector enterprises.
- 3) To implement upgradation and modernization programmes, self-managed service centres should be established. These centres could provide one or more of the following services and facilities: product design development and value-added packaging and presentation; alternative materials and processes; expert technical information; environment-friendly and

waste-minimizing techniques such as joint procurement schemes and centralized waste processing facility; and marketing strategies.

- 4) The impact of the above services should be multiplied through the development of video films and other media.
- 5) Training and skill development packages aimed at improving entrepreneurial and management skills including basic accounting practices need to be development. Master craftsmen should be trained and they in turn could replicate the improvements through on-the-job training in other enterprises in the informal sector.
- 6) Seminars, workshops, study visits, exhibitions, and other know-how exchange programmes should be organized on a national and international basis. These programmes could be supported by NPOs, the APO, ILO, and UNIDO.

Financial Support Services

- 1) Financial assistance schemes by designated institutions should be formulated and launched; the requirements of the target clientele should be given due consideration.
- 2) Priority should be given to easy access to financial services. In view of successful models of making funds available to the informal sectors, notably that of the Grameen Bank of Bangladesh, financial support service should be developed on the basis of easy access, simplified procedures, and limited or no physical collateral. This should be accompanied by continuous monitoring and interaction between the leading institutions and beneficiaries.
- 3) Loans or financial assistance should preferably be extended to groups of beneficiaries rather than to individuals. This would ensure peer pressure for effective utilization of funds.
- 4) Based on these credit groups, additional support services such as referred above in relation to self-managed service centres can be developed and an organizational structure for the self-management of service centres can be mounted.
- 5) A facility for depositing personal savings should be added to the credit provision in view of the future sustainability of intermediate financial institutions. Existing banking regulations may have to be reformed to allow such appropriate, self-managed savings and credit schemes.
- 6) Subsidies, if any, should not be extended to individuals, but should rather be given to financial institutions. The lending rates should be on par with commercial rates.
- 7) Appropriate tax measures for promoting the informal sector at the national as well as municipal level should be undertaken.

II. Resource Papers

Improvement of Income and Employment in the Informal Sector Through Enhancement of Productivity, with Particular Reference to the Approach and Structure Adopted in India

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Introduction

The concept of the informal sector (IS) is rather complex as it is difficult to define in precise terms. The IS manifests itself in different ways in different countries because of its heterogeneity. There is a disagreement on precisely what types of activities and what categories of workers are covered by the IS. The IS is understood better by its characteristics rather than by spatial location.

This paper outlines the status of the IS and the latest policy directions on it given by the Government of India. The strategies for growth of the IS are examined in terms of sectoral and subsectoral characteristics and various programmes established by the government. For this, the role of various support-financial institutions and nongovernmental organizations (NGOs) is examined in the IS in India.

Definition, Scope, and Coverage of the IS

“Unregulated,” “residual,” “an appendage to the formal (modern) sector,” “accidental,” and “peripheral” (reflecting the scant attention paid to it) are some of the expressions that have been used to describe the IS. However, several economic imperatives are now forcing planners and strategists to take a fresh look at this hitherto neglected sector, not simply to combat poverty, unemployment, and underemployment but also because it can be a major source of funds and infrastructure for sustaining the economy as a whole. But the very nature of activity within the sector, coupled with definitional and perceptual differences in the approach to it, have hampered recent efforts at identifying, let alone organizing, the IS.

There is disagreement on precisely what types of activities and what categories of workers are covered by the IS. In selecting the IS as the subject of his report to the 78th session of the

International Labour Conference in Geneva, ILO Director General Michel Hansenne felt that he was venturing into relatively unexplored, controversial territory. The IS is relatively unexplored because, in spite of a considerable amount of research and data gathering, our understanding of what the IS is, why it is there, and how it operates is still far from adequate. It is significant that, even after two decades of investigation by scholars and international civil servants, there is still no generally accepted definition of the term "informal sector." All that we know for certain is that it exists.

It is controversial because there are many different viewpoints from which one can observe the IS. It can be viewed in a positive way as a provider of employment and income to millions of people who would otherwise lack the means of survival. It can be viewed more negatively as a whole segment of society that escapes regulation and protection. It can be romanticized as a breeding ground of entrepreneurship which could flourish if only it were not encumbered with a network of unnecessary regulation and bureaucracy. It can be condemned as a vast sea of backwardness, poverty, crime, and insanitary conditions. Or it can simply be ignored (ILO, 1991).

Can we ignore the IS? Disorganized, usually illegal, neglected by planners and aid agencies, denigrated by economists, and harassed by officialdom, the IS represents as much as half the workforce in Third World cities, and a growing proportion of the rural workforce. Enrique Iglesias, president of the American Development Bank, has acknowledged that the IS in the Caribbean and Latin America represents 30 million individuals, or one-third of the workforce, and that between 1980 and 1985, while the modern formal sector grew by 2%, the urban IS grew by 6.8% annually (Iglesias, 1992).

The majority of poor people live and work in the IS. The Indian Planning Commission (1992) has admitted that after 40 years of planned development, about 200 million are still poor in rural India. Improvement in the productivity of the workforce assumes particular significance in developing economies, where low productivity and low incomes of a vast number of employed persons constitute a much greater problem than unemployment. An overwhelming majority of the poor apparently are not unemployed, but spend a major part of their time in some economic activity, albeit at very low levels of productivity and earnings (Government of India, Planning Commission, 1992).

National development strategies in most developing countries concentrate an agricultural production at one end of the development spectrum and urban-based industrialization at the other. Between them are sandwiched the small-scale, IS entrepreneurs. Village-based or urban, in many cases individual women or groups of women, these unsubsidized people have contributed significantly to keeping national economies afloat while subsidized industry and the formal sector stagnate, and in some cases collapse around them. Carpenters, metal fabricators, bakers, soapmakers, weavers, dyers, tinkers, tailors, and candlestick makers, they are innovators, skilled at surviving, and sometimes prospering in a highly regulated environment. Initially these people were considered a problem that needed fixing. But as the failure of the prevailing bureaucratic model of development became clear, a new attitude toward informal workers and their potential role in development began to appear.

The bureaucratic model sees development, to use an analogy from physics, in Newtonian terms, viewing society as a machine trying to make development happen. This theory has thus

gravitated toward the optimal economic conditions related to resource endowments, demographic rates, and suitable technology, among other economic variables. All attention to poverty and the poor focused on “what the poor lack.” This focus has led to a regulatory, bureaucratic approach to poverty with an emphasis on “fixing” the poor. According to this model, the poor in developing countries are passive, dispirited people whose dysfunction prevents real self-improvement. Their only hope therefore is for state or foreign aid that provides various social services, including training, health services, and housing. This model has not produced results. Faced with a lack of job opportunities in the formal sector, many of the poor survive by working for themselves or for family members. Operating outside of the rules and regulations of the formal economy, their businesses provide a wide variety of important goods and services. The reason for the poverty of these people does not seem to be lack of entrepreneurial initiative. The poverty of the IS would certainly be attacked more effectively, and growth with equity would be achieved, if, apart from an environment more conducive to self-help and microenterprise development, policy makers and administrators would recognize the individual’s right to economic initiative by providing access to capital, training, technology, and markets.

Salient Features of the IS

In this paper, the term “informal sector” refers to very small-scale units producing and distributing goods and services. They consist largely of independent, self-employed persons in rural and urban areas of developing countries, some of whom employ family labour and/or a few hired workers or apprentices; they operate with very little capital, or none at all; and they utilize a low level of technology and skills. Therefore, they operate at a low level of productivity and generally provide very low, irregular incomes and highly unstable employment to those who work in them. They are informal in the sense that they are for the most part unregistered and unrecorded in official statistics; they tend to have little or no access to organized markets, to credit institutions, to formal education and training institutions, or to many public services and amenities; they are not recognized, supported, or regulated by the government; they are often compelled by circumstances to operate outside the framework of the law; and even where they are registered and respect certain aspects of the law, they are almost invariably beyond the net of social protection, labour legislation, and protective measures in the workplace. IS producers and workers are generally unorganized and in most cases are beyond the scope of action of trade unions and employee organizations. Being unrecognized, beyond the protection of the law, and working at very low levels of productivity and income, they generally live and work in appalling, often dangerous and unhealthy conditions, without even basic sanitary facilities, in the shantytowns of urban areas or in villages.

S.V. Sethuraman (1981) distinguishes different employment sectors (industrial production, construction, transportation, retail trade, and services) in proposing criteria for inclusion in the IS. By his criteria, a production unit in the construction industry belongs to the IS if it meets one or more of eight conditions:

- 1) employs no more than 10 people (including part-time and occasional workers);
- 2) avoids social regulations;
- 3) does not operate at fixed hours;
- 4) employs workers from the household of the head of the enterprise;
- 5) has an itinerant nature or occupies temporary premises;
- 6) does not use electrical or mechanical energy;
- 7) does not use credit from formal institutions; and
- 8) employs workers with fewer than six years of schooling.

Other investigators group informal activities in three categories according to the degree of complexity of their accounting systems: enterprises with no accounting system; those with a rudimentary system; and those with an elaborate system. These three levels are correlated with levels of development and size of production units; the more accurate and controlled the accounting system, the greater the indication that a firm is fulfilling conditions for passage into the modern formal sector.

Much of the IS, especially that part engaged in nonfarm rural activities, is made up of women. In Bangladesh, for example, women represent 34% of the workforce in rural industries; in Honduras women own 61% of all small enterprises; and in rural Guatemala, women constitute 50% of the workforce in textiles, 47% in food processing and baking, and 65% in commercial services (Bhalla, 1992). Women are disproportionately represented in the IS partly because they are underrepresented in the formal sector. Discrimination against women in the formal sector, due in large measure to the perceived higher costs of employing women, leaves many of them no alternative but to seek employment in the IS, where many "female" occupations are located. In the IS, women tend to be concentrated in the most insecure, unsafe, and lowest-paid employment. A large majority of them are found in petty trading and service activities where it is possible to start a business with little or no capital and few or no skills. Many work at home, performing small jobs for manufacturing enterprises and are thus vulnerable to exploitation, invisible, and hard to count.

The plight of children in the IS is perhaps its most tragic aspect. Although child labour is prohibited by legislation in most countries, millions of children are working, often engaged in the most unhealthy and unsafe practices in the IS, and many times in the formal sector as well. They are employed in small manufacturing firms preferred to their meekness and adaptability; there they can be most severely exploited, often working long hours in dangerous conditions for exceedingly low wages. Children may work in a family business or have jobs of their own, shining shoes or selling all sorts of things. Whatever form it takes, child labour is a gross example of poverty, since the survival of the poorest families depends on those children's labour. At the same time, it leads to never-ending poverty, preventing children from acquiring the education and skills that would equip them for better employment, and better paid jobs, in their adult life.

Dynamism of the IS

The microenterprises in the IS can be among the most dynamic and healthy sectors in developing economies. As such, they fill an essential role in providing job for large numbers of

urban workers and adapting to both general patterns of economic growth and to negative shocks. Not only do IS entrepreneurs survive in the face of government-subsidized, large-scale industrialization, but their flexibility and adaptability have allowed them to provide essential goods and services on which large-scale modern manufacturing enterprises depend, such as clothing, weaving, woodwork, repair services, and production of small machines. They can provide these goods and services because of their competitiveness, their proximity, and their low unit costs.

The informal sector is enormously important in most, if not all, developing countries. An average of 50-60% of the workforce, producing 40-60% of GDP, belongs to it. In Bangladesh, with a per capita income of only US\$165 per year, the numbers are much higher. There more than 70% of the urban workforce is informal, as are an even larger percentage of rural workers. Only 5% of GDP is produced by large-scale industry, which employs less than 2% of the workforce (de Soto, 1989). The number of informals working in particular industries is extraordinary. One approach to measurement of the sector in the Philippines, for example, produced estimates that in 1983, 73% of nonagricultural employment was informal, including 93% of people working in the trade sector, 86% of those in transportation, and 78% of those in construction.

Although overwhelmingly poor, people in the IS show themselves to be among the most extraordinary entrepreneurs in their societies. If encouraged and given real opportunities, they could make an even greater contribution to economic and social progress. Poverty is not caused by the pathologies of the IS or by "what the poor lack." Poverty is not primarily a technical problem based on lack of skills. Many informal entrepreneurs who are extremely successful are illiterate. The most dramatic testament to the dynamism of the IS in developing countries is available from Bangladesh, where the Grameen Bank has used small amounts of credits to help hundreds of thousands of the poorest rural people to gain control over their lives and develop productive means of self-support.

Factors Influencing the Growth of the IS

Factors influencing the growth of the IS emanate from the bureaucratic model of development, which focuses on government promotion of large-scale enterprises and advanced technology as the essential tools in a successful development strategy. This model, accepted and followed by many policy makers in developing countries and some scholars until the early 1970s, was influenced by the belief that development depended on transforming traditional society, which theorists believed was retrograde and therefore a "problem" that policy should aim to "overcome." This model looked to bureaucratic enterprises to replace traditional economic and social structures with modern (posttraditional) ones.

By playing down the role of individuals in development, the policies associated with bureaucratic industrialization aimed to impose development from the top down. They paid little or no attention to individuals or firms. Unfortunate in itself, this approach brought with it another unfortunate by-product: it often turned into an engine for generating class privileges, both for people lucky enough to obtain jobs in the bureaucracy administering the whole process and for those lucky enough to obtain jobs in favoured (subsidized) sectors. These sectors, in