The State of the Informal Economy

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Abstract

Focusing on the informal economy, this policy brief addresses whether it is appropriate for development policy purposes to view the economy as a dual economy, made up of a ‘first’ and ‘second’ economy. Appropriate policy analysis which would have the greatest impact on improving the lives of those in the informal economy is suggested.

Introduction

This policy brief addresses economic and labour market policy issues, specifically policies affecting the poor and marginalised. The broad question we consider is whether the South African economy should be conceived of as a single economy, or as a dual economy with a ‘first economy’ and a ‘second economy’ as characterised by President Mbeki in August 2003 (and increasingly viewed this way by government and the ruling party). We analyse available official data on the informal economy (as an approximation for the ‘second’ economy) and expose some of the dynamics in this segment of the economy.

The tendency to look at the ‘first’ economy as distinct from the ‘second’ continues to keep elements of our economy invisible, and therefore outside the mainstream of economic and social debate. One of the concrete expressions of this - which we also look at - is the lack of government support for the informal economy.

The conceptualisation of the ‘first’ and ‘second’ economy tacitly acknowledges the failure of trickle down economic growth policies and informs much of government’s more recent emphasis on poverty alleviation. The dualism suggested by arguments about a structural break between the two allows government to argue that its economic policies have been successful for the first economy and it is able to address issues of poverty and unemployment in the second economy having now stabilised the first economy. General agreement exists on the need to intervene in the economy in order to boost incomes at the lower levels, but how we perceive or understand it affects the methods used to intervene, and the final policy outcome.

President Mbeki stated in November 2003 that ‘The second economy (or the marginalised economy) is characterised by underdevelopment, contributes little to the GDP, contains a big percentage of our population, incorporates the poorest of our rural and urban poor, is structurally disconnected from both the first and the global economy and is incapable of self generated growth and development’ (Address to National Council of Provinces). Our research shows (using the informal economy as an example) that this is not all necessarily the case.

What constitutes the informal economy, and what is its contribution?

1. Definitions - Informal activities encompass different types of economic activity, different employment relations and activities with different economic potential – features not adequately captured by the term informal sector. If both formal and informal activities are seen as part of the economy we are better able to see the linkages between the two. The 2002 International Labour Conference for Labour Statistics sees the informal economy as comprising informal employment in informal enterprises and informal employment outside informal enterprises.

2. It is growing. Based on our calculations using the October Household Survey (1997-1999) and the Labour Force Surveys (2000-2005) we see that one segment of the economy which seems to have generated employment is the informal economy. In this segment of the labour force employment increased from 965 000 in October 1997 to just over 2.3 million in September 2005.

Figure 1: Trends in the South African Labour Market, 1997-2005.

3. It is concentrated in trade with just under half of all informal workers located in this sector. There are significant numbers in construction, manufacturing and services. Those working in the informal economy also tend to be poor and black and with women represented in the less lucrative tasks. As in the rest of the world there is a gender dimension to the informal economy.

4. It contributes to GDP – Contrary to popular belief, figures from various studies show that the informal economy contributes somewhere between seven and twelve percent of GDP (source).

5. Linkages exist – In our view the ‘second economy’ far from being structurally disconnected from the mainstream of the economy is very much linked to it. Case study evidence shows there are multiple forward and backward linkages between formal and informal activities. Data from the Labour Force Survey shows that there is a surprising level of churning within the labour market, with the status of more than half the workers having changed at least once in the period under analysis (February 2002 to March 2004). Another study suggests intra-household links between self-employment activities and formal economy workers. Capital moves between the two because

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Figure 2: Figures shown here are indicative purposes. For a fuller explanation see the full papers from which this policy brief is drawn.
it is usually households that have some form of regular income that are mostly involved in self-employment initiatives. In addition much of the ‘formal economy’ is becoming informalised.

What are the implications for policy?

Policy should take the needs of survivalist workers and the informal economy into account more than it has done up to now. Research shows that government policy for the ‘second economy’ is either absent, or where it does exist, is either piecemeal or ineffective. Analysis of DTI funding allocations for the period 1994-2003 shows these tended to favour established SMMEs rather than ‘survivalist enterprise, women entrepreneurs and rural SMME’s’. Training support is also absent for the informal economy workers according to research undertaken in Johannesburg and Durban.

Policy analysis and intervention: changing the framework to include the poor.

Internationally there is a trend towards applying the commodity chain or value chain approach to growing the informal economy. This view necessitates seeing the informal economy as part of the entire economy, identifying those working in the informal economy at each stage of production. Using a sectoral/commodity chain approach allows for key policy level and project interventions to be identified in order to expand the sector and enhance the incomes of those working within it. Sectoral analysis of this kind has already been applied to the traditional medicine sector in KwaZulu-Natal. Similar sectoral analyses should be conducted in the segments of the informal economy that both contribute to economic growth and where there are large numbers of people working, such as clothing, craft, fruit and vegetable distribution and waste collection.

Conclusion

The informal economy is growing and should be acknowledged as making a significant contribution to the South African economy. It needs to be integrated into the mainstream and not seen as disconnected from the general functioning of the economy.

Further reading:


School of Development Studies website http://sds.ukzn.ac.za