DUAL ECONOMY THEORY REVISITED:
GOVERNANCE AND THE ROLE OF THE INFORMAL SECTOR

by

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ABSTRACT

This paper argues that an adequate understanding of Governance in Sub-Saharan Africa requires consideration of not only the economic role of the informal sector, but also its political role. The principal theses are that:

(a) The failure of the formal sector in many African countries to contribute to economic growth with equity has been due to its largely static and inflexible character;

(b) Dynamic adaptation of the informal sector to changing conditions in both domestic and international arenas has been an important domestic contributor to economic survival in those same African countries;

(c) A superficial understanding of the arguments propounded by both the advocates and critics of dual economy theories (during the 1950's and 1960's in particular) contributed to the establishment of counterproductive formal sector economic development policies in African countries; which, in turn,

(d) Contributed to the absence of sufficient attention being paid to the dynamic contribution of the informal sector to those economies;

(e) The inadequate performance of the formal sector in both economic and political terms resulted in the alienation of formal government structures from the political communities they were expected to serve; and, given that alienation,

(f) The requirements of the informal sector (parallel economies) reinforced historically rooted authority structures and/or resulted in the creation of "parallel governments."

Given the experience of the last two decades, increasing attention is being given to redressing the imbalance in our understanding of the relative roles of the formal and informal sectors. However, much of that new attention remains too narrowly focused on conventional economic premises. Therefore, this paper argues that reconsideration of those respective roles requires broader consideration of the political and cultural dimensions of the issue. The most important institutional policy implication derived from the above analysis is that legitimating the informal sector (from the perspective of the formal sector) will require:

(a) Intermediaries/interlocutors between culturally rooted practices and those of the internationally sanctioned formal sector; and

(b) Attention to the legitimacy of informal sector quasi-governmental institutions which are an inherent part of that sector's economic role and behavior.

Because current thinking about the role of the informal sector and its relationship to the formal sector in Africa (and elsewhere) is yet in its early stages, this paper is limited to: (i) providing a critique of both the proponents and critics of previous dual economy theories; (ii) outlining the elements of a new, more appropriate, conceptual framework; and (iii) suggesting some implications for applying the suggested conceptual framework to both policy and operational aspects of economic development in Africa. Thus, this
paper is limited to setting forth the conceptual argument. Testing the hypotheses of that framework will need further empirical work.
I. INTRODUCTION

1. Everywhere is heard the cry of crisis in Africa. Alex de Waal's 1991 statement that, "if official figures are to be believed, all Somalis should have starved to death during the late 1980s," is applicable to much of the African continent. Yet, as de Waal also points out, "at the same time, new taxis [and other vehicles] regularly appeared on the streets of Mogadishu, and sales of petrol increased every year;" another fact also true of much of Africa. Why, or perhaps more important, HOW can both of those economic phenomena be true at the same time? De Waal suggests that the "stagnating official economy is but an appendage of an unmeasured and dynamic informal economy.... [and, therefore,] individual enrichment or communal survival is often ensured by operating outside the formal economy...."

2. Given the experience of the last two decades, increasing attention is being given to understanding the relative roles of the formal and informal sectors. However, much of that attention remains too narrowly focussed on conventional economic premises. Therefore, this paper argues that reconsideration of those respective roles requires broader consideration of the political and cultural dimensions of that relationship. Thus, this paper both acknowledges the importance of the informal sector as an important factor affecting economic development and argues further for the importance of its political role.

3. Because analyses of the informal sector and its relationship to governance issues in Africa is yet in its early stages, this paper is limited to: (i) providing a critique of both the proponents and critics of previous dual economy theories; (ii) outlining the elements of a new, more appropriate, conceptual framework; and (iii) suggesting some implications for applying the suggested conceptual framework to both policy and operational aspects of economic development in Africa. Thus, this paper is limited to setting forth the conceptual argument. Testing the hypotheses of that framework will need further empirical work. More specifically, Section II summarizes the two main theses propounded by dual economy theorists during the 1950s and '60s, the arguments of their critics, and the policy implications derived therefrom. Section III follows with a similar summary of more recent theories of the informal sector and links those theories to the failures of policies derived, at least in part, from both the proponents and critics of dual economy theories. Section IV moves that discussion forward to hypotheses concerning the mutual affects of the informal sector and Governance in terms of the development of "parallel governments." Section V concludes the paper by relating the previous discussion directly to hypotheses about experience in Africa and suggests an agenda

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1. Alex de Waal, "Misgoverned Continent: War, Starvation and the Hidden Economies of Africa," Review Article in TLS (September 13,
for further research in response to those hypotheses.

4. The discussion in this paper acknowledges that the basis on which political decision-makers formulated post-independence economic policy during the 1960s and 1970s was, of course, different in its particulars in each specific country. Further, that the effect of the informal sector on Governance varied significantly within each specific country. Finally, it is probably true that experience in Africa varies even more from experience, however varied, on other continents. Therefore, testing the various hypotheses presented here in country-specific circumstances can be expected to produce a wide-range of variation on the theoretical theme presented in this paper.

II. DUAL ECONOMY THEORIES: 1954 - 1961

A. Historical Precedents

5. Economic thinking about dual economic systems dates back to the work of the French physiocrats. The physiocrats envisioned a system with two sectors; i.e., a productive, agricultural, sector and a small, non-agricultural, sector which provided services and artisanal goods to the ruling class. Since the system included little incentive for productive investment, the physiocratic vision lacked the dynamic approach taken by subsequent economic schools of thought.

6. The transition from the French physiocrats to the classical dualism of Ricardo (1815) and Marx (1857) involved the view that it was the agricultural sector which was static, if pre-dominant, and ascribed dynamic status to the small, but growing, industrial sector. Net profits in the agricultural sector were viewed as providing investment funds for the industrial sector.

B. Modern Dual Economy Theories

7. Although a substantial variety of dual economy models are presented in the literature, most can be categorized as being either "classical" or "neo-classical." Despite important differences among those various dual economy models, this paper focuses primarily, but not exclusively, on similarities among them. As their name implies, these theories continue to emphasize a two-sector model. Such models most often refer to the agricultural and industrial (or manufacturing) sectors. Nevertheless, although less frequently used but synonymous in many respects, other two model pairs include rural and urban and traditional and modern.

8. In the center of both classical and neo-classical models stands the process of transforming a predominant agrarian into a predominant industrial society. In the beginning a majority of the total population works in the agricultural sector while the size of the industrial sector is relatively small. In the course of successful development the contributions of both sectors to output and employment are reversed. Both models enumerate a number of necessary conditions that will assure a growth path toward economic prosperity. First of all it is required that the agricultural sector is able to produce more food than consumed by

its own workers (i.e., an "agricultural surplus").

9. In general, both models stress the importance of balanced development in both sectors as a prerequisite to economic success. In manufacturing, these models expect entrepreneurs to invest at high enough levels to absorb a growing urban labor force. In agriculture, these same models predict a decreasing labor force which will require rural landowners to employ improved technologies to increase food surpluses. It is useful to note here that experience in Africa is not at all consistent with the requirements specified for the agriculture sector. Thus, increasing the productivity of "labor" through labor intensive agricultural production will be required in Africa for an indefinite period into the future. Further, the concept of agricultural "landowners," rather than individual farmers, is rather alien in much of Africa (with the exception of some large, former colonial, landholdings which remain in the hands of a small elite).

10. It should be emphasized that according to both dual economy models, successful development depends on industrialization and that, in turn, depends crucially on the innovative role of the agricultural sector; i.e., the entrepreneurial spirit of rural landowners who must produce surplus and invest such surpluses in manufacturing. Equally important for successful growth is sufficient capital accumulation and/or innovation in the industrial sector to absorb unemployed (or underemployed) workers from the agricultural sector. This condition becomes even more important in those dual economy models which factor in population growth. Given a constant rate of population growth, the transition from a mainly agrarian to a mainly industrial economy requires increases in urban employment at a rate higher than population growth. That, in turn, requires that the savings rate of agricultural landowners equals the level of financial capital required by the industrial sector.

**Classical Models**

11. For the purposes of this paper, the primary difference between the classical and neo-classical dual economy models are the assumptions concerning wages for agricultural workers and their impact on investment behavior. Thus, the classical model assumes that each agricultural worker obtains a fixed wage income at subsistence level. That income is determined by institutions like "the community, the family, the commune." It is also assumed that such institutions fix agricultural wages at subsistence levels because too many people reside in rural areas and rural society places greater value on sharing rather than on economic efficiency. The difference between the actual agricultural labor force and the economic efficient labor force is called "disguised unemployment". Since total agricultural output is higher than total agricultural wage income, the difference between the two constitutes the "food surplus." The classical model assumes that the food surplus is owned by the class of agricultural landowners, who either consume or save it. Via intersectoral financial markets, agricultural savings are transferred to finance industrial investment. Agricultural surplus and savings are, therefore, a necessary condition for industrial growth. As stated earlier, economic success depends on the dynamic behavior of the agricultural landowner.
**Neo-Classical Models**

12. The neo-classical model assumes competitive behavior among agricultural workers. Therefore, the rural wage rate is economically efficient and there is no disguised unemployment in these models. In order to create a food surplus under those conditions, it is further assumed that beyond a certain level of income, agricultural workers stop increasing their food consumption. Thus, in economic terms, the workers' income elasticity for food drops to zero. At the point beyond which food consumption ceases to grow while income continues to increase, a food surplus is created by farm laborers, rather than just landowners, and investment in the industrial sector becomes possible. As in the classical model, the manufacturing sector is viable if, and only if, there exists a positive and growing agricultural surplus. The difference among the two models is the source(s) of agricultural sector savings.

**C. Critiques Of Dual Economy Theories: 1969 - 1989**

13. Both versions of dual economy theories have been subjected to wide-ranging criticisms; discussing them is well beyond the scope of this paper. Therefore, the major elements of those criticisms are simply listed here:

(a) Dual economy models do not assume economic rationality with regard to agricultural employment levels but do assume rationality of decision-making with reference to agricultural landlords investing surplus in the industrial sector;

(b) A two-sector model is too limited for analyses of the many problems related to development such as modernization, growth, and structural change;

(c) The models present the dualistic conditions of developing economies as static with reference to degrees of interdependence, factor immobility, and asymmetry which are fixed at the time the model was designed and do not change in the course of development;

(d) Both models assume that industrial as well as agricultural labor markets clear instantaneously and, therefore, all unemployment is voluntary;

and

(e) It is argued, at least by the neo-classicists, that food surpluses are produced and available for investment in industry because of an assumption that the elasticity for food is zero.

14. For the purposes of this paper, the two most significant criticisms of dual economy theories in the

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2. John Fei and Gustav Ranis, *loc.cit.*
5. Ibid.
above list concern the assumptions about: (i) the "dualistic" role of agricultural landowners and (ii) the voluntary nature of unemployment. The point to be stressed here is that, if the industrial sector must take the lead for development to occur and producing a surplus in agriculture and investing that surplus in industrial development is the only way that industry can be adequately established, then the behavior of agricultural landlords and workers is essential for the economic development of society as a whole.

**Role of Land Owners**

15. If rural landowners do not behave as posited by the dual economy theorists, the entire model essentially collapses. Thus, criticism such as that argued by Avinash Dixit is, if accepted, particularly devastating:

> Successful development of ... [dual] econom[ies] hinge altogether too crucially on the role played by the landlord. He should be eager to save. He should sell his surplus to industry, and should transfer his savings to industrial entrepreneurs. He should be eager to innovate, and thereby improve the technology in agriculture.... I find it difficult to understand how the landlord, tied down by the "host of environmental factors," generates enough dynamism for the purpose. Alternatively, if he has all these brilliant qualities, I wonder why he sits passively while agricultural employment remains far above a profitable level.

**Unemployment and The Behavior of Labor**

16. The assumption that industrial as well as agricultural labor markets clear instantaneously and, therefore, that all unemployment is voluntary is clearly belied by the widespread evidence of persistent urban unemployment and rural underemployment in almost all developing countries. Given the fact of widespread urban unemployment in most developing countries on the one hand, and the full-employment assumption in the early dual economy models on the other hand, Harris and Todaro developed a model which would account for urban unemployment as a predictable outcome. The essence of that model is that migration from rural to urban areas will occur as long as it can be expected that the wage earned in urban areas, if indeed the migrant is successful in finding employment, will most likely be higher than the income earned in agriculture. The problem is that migrants are drawn by the possibility of securing such jobs, not the actual availability of such jobs. Thus, the model includes the expectation that some level of unemployment will exist within the formal urban sector even in a relatively efficient economy.

17. That reasoning led Harris and Todaro to the identification and specification of an urban "traditional sector" which includes all urban workers without permanent employment in the modern urban sector; i.e., the "unemployed, underemployed or sporadically employed, and those who grind out a meager existence in petty retail trades and services." Nevertheless, the rural to urban migration process is viewed as a two-stage phenomenon which ultimately results in formal sector employment. Thus, after leaving his farm job, the rural worker is assumed to spend some time in the urban traditional sector before attaining a permanent position in the modern sector. Informal sector employment is assumed to be transitional, not permanent,

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8. See Avinach Dixit, *op.cit.*, p. 342. Nevertheless, Dixit agrees that despite this and other shortcomings (e.g., lack of capital markets, externalities, lags in expectation, and so forth), successful economic development as described in dual economy models
18. That theoretical refinement constitutes a link between dual economy models and the literature on the informal sector. In Section III, a short summary of the major steps in the development of the informal sector concept will be presented. However, before doing so, this paper turns its attention to the policy implications of dual economy theorists and some of their most relevant critics.

D. The Legacy of Derived Policies

19. It is hypothesized in this sub-section that a superficial understanding of the arguments propounded by both the advocates and critics of dual economy theories (during the 1950's and 1960's in particular) contributed, at least to some significant extent, to the establishment of counterproductive economic development policies in African countries. Expectations concerning whether or not agricultural landowners would voluntarily perform according to the double role of innovator in agriculture and investor in manufacturing had a critical affect on whether or not policy-makers in Africa (and elsewhere) were prepared to establish a liberal or controlled economic regime. The logic of the analysis provided by the dual economy theorists (and almost everyone else in the 1960s and '70s) was that successful economic development depends on a balanced expansion of both agricultural and industrial output. If policy-makers accepted the three key premises of dual economy theories (i.e., agricultural surpluses need to be invested in industry, agricultural landowners would voluntarily produce surpluses, and the same landowners would voluntarily invest in the manufacturing sector), the clear prescription was a relatively laissez-faire market-based economic policy. However, if policy-makers accepted only the first premise (i.e., that agricultural surpluses need to be invested in industry) but, at the same time, also accepted the argument that agricultural landlords would not voluntarily produce surpluses and/or invest in the manufacturing sector), the clear prescription was either a command economy to extract necessary surpluses and ensure investment in industry or a new theory of economic growth which relied on sectors other than manufacturing.

20. The prescription for a command economy, based on cynicism concerning the economic rationality of rural landowners and/or agricultural laborers, was reinforced in some countries by the fact (or perception) that the private non-agricultural sector was dominated by "foreigners" (i.e., either non-resident foreigners or domestic ethnic minorities) and the belief that the indigenous private sector was incapable of competing with such foreigners. Given that further set of assumptions, logic suggested that not only must the State extract agricultural surpluses and invest such resources in the industrial sector, but it must also directly control the manufacturing sector in order to ensure protection of the indigenous population.

21. Thus, as early as 1964, John Fei and Gustav Ranis argued that:

In all too many cases the conclusion seems to have been reached that private entrepreneurial talents (including those of the industrial entrepreneur and the dualistic landlord) are simply inadequate to the task and that the various - previously enumerated - pivotal functions must therefore be assumed by the government. However, in view of the inherent limited executive capacities of the government which is able to deal with a small
number of large projects but unable to cope with a large number of smaller activities, what often results is a rather unfortunate imbalance involving a sustained drive toward industrialization while agriculture stagnates or lags far behind.

As a result, policies were pursued, in at least some developing countries, which emphasized industrial development while introducing disincentives for agricultural production; with the result that the agricultural sector stagnated.

III. THEORIES Of The INFORMAL SECTOR

22. The key hypothesis presented in this Section is that both the dual economy theorists and their critics "got it wrong" in different ways. On the one hand, the industrial sector turned out to be less, not more, efficient than either the agricultural or service sectors (given the policies adopted by various governments) and, on the other hand, greater rationality characterized the non-formal sectors than the formal sectors of those economies. More specific hypotheses include: (i) the formal sector has largely failed to contribute to economic growth with equity in Africa; (ii) that failure has been due to the formal sector's largely static and inflexible character as actually practiced; and (iii) the dynamic adaptation of the informal sector to changing conditions in both domestic and international arenas has been the primary domestic contributor to economic survival in those same African countries. If those hypotheses are correct to any significant extent, a totally insufficient amount of attention has been paid to the dynamic contribution of the informal sector to those economies.

A. Definitions

23. Although later dual economy models acknowledge the existence of the urban unemployed, they were also criticized for not identifying yet a third group which were neither employed nor unemployed. These people were viewed as being engaged in low-productivity and low-pay activities which merely allowed them to reproduce the labor force. Since most of their activities were categorized as unregistered and/or illegal this labor market segment has been called the "informal sector." Although some economists argue that the concept of an "informal sector" is, itself, not useful, most disagree. Nevertheless, even among those who find the concept useful, there is a substantial lack of clarity concerning the definition of the term. Thus, since the term appeared for the first time there has been an intensive debate about its exact definition of "informality." After considering a wide range of compound definitions, two basic alternatives can be discerned:

(a) The informal sector consists of those who are employed in either unregistered or registered entities which are engaged in the same (or similar) sectors of economic activity and share similar levels of organization, scales of operation, and levels of technology;

10. This was essentially the synthesis of different definitions presented at the 14th International ILO Conference of Labour Statisticians in 1987.
or

(b) The informal sector consists of those economic activities which do not conform to legally required registration and/or regulatory requirements which operate in sectors within which other similar enterprises do so conform.

24. The primary differences between the two definitions is that the constant element in the first is essentially the size of the enterprise and the nature of the economic activity it is engaged in (rather than the entities’ legal status) while the constant element in the second is the extent to which the enterprise adheres to legal registration and regulatory requirements (regardless of size or type of activity). Given that choice, this paper rejects the first definition in favor of the second definition because it is, at least in part, the costs of non-compliance and the need to ameliorate such costs which contributes to the perpetuation and/or creation of parallel quasi-governmental institutions in the informal sector (see Section IV, especially paras. 49 - 51 and 56).

25. Given the broad definition employed in this paper (para. 23[b]), four non-formal sectors are distinguished in terms of the extent to which formal registration and adherence to specific procedural regulations are legally required: (i) small-scale agriculture (as distinct from "agri-business"); (ii) economic activities which do not require registration and/or monitoring of business procedures; (iii) economic activities for which registration and/or monitoring of business procedures is required, but the involved enterprise is not, in fact, registered nor monitored; and (iv) economic activities for which registration and/or monitoring of business procedures is required, the involved enterprise is, in fact, registered, but required operating procedures are not adhered to. The latter two forms of non-formal business activity are, thus, included in the definition of the informal sector employed in this paper and are, therefore, the subject of this Section. The other two sectors are non-formal because there is no requirement to legally register or adhere to regulated procedures in the first place. Distinguishing between "non"-formal and "in"-formal is important because the former encompasses those enterprises which are unregulated in the first place, while the latter encompass those enterprises which, as defined above, are not registered when they are required to be and/or do not adhere to formal sector legal requirements even if registered.

B. Characteristics

11. Manuel Castells and Alejandro Portes provide a recent and well written characterization of the informal sector which corresponds to this definition; see "World Underneath: The Origins, Dynamics, and Effects of the Informal Economy," in Alejandro Portes, et al (eds), The Informal Economy: Studies in Advanced and Less Developed Countries (Baltimore: Johns Hopkins University Press, 1989), p. 15 - 37. In that paper, they define informal sector activities as "the unregulated production of otherwise licit goods and services" (p. 15). This is essentially the definition also provided by Hernando de Soto, loc. cit. On the other hand, this definition is also criticized by several economists, including Victor Tokman, who criticizes de Soto directly and argues that illegality is the result of informality, not its cause. Thus, he argues that non-observance of the law is a widespread phenomenon in Latin America and not an exclusive characteristic of the informal sector. Therefore, Tokman favors a definition based on forms of production: i.e., "informal production is performed at a low level of development of productive forces [which] involve little capital and simple technology," essentially the first of the two definitions identified in this paper. See Victor Tokman, "The Informal Sector in Latin America: Fifteen Years Later," in D. Turnham, B. Salome, and Antoine Schwarz (eds.), The Informal Sector Revisited (Paris: OECD, 1990), p. 94 - 110.
26. Based on the clarification that the informal sector consists of those enterprises which are either not registered when registration is required or are registered but consistently avoiding adherence to regulatory requirements, Castells and Portes enumerate the following characteristics of informal economic activities based on various country-specific studies:

(a) Many informal entrepreneurs have relatively high incomes (some even higher than the income of workers in the formal sector);
(b) The informal sector grows, at the expense of already formalized work relationships;
(c) The informal economy is found in countries at all levels of economic development (e.g., the "underground cash economy" in the United States);
(d) The informal sector is heterogenous (i.e., there exists a wide range of unregulated production and distribution activities within different societies);
(e) The informal sector is an integral component of the total economy, not a marginal appendix to it; and
(f) Work in the informal sector tends to be performed by labor which accepts the disadvantages of those jobs with the expectation that such employment is temporary and will eventually lead to formal sector jobs.

27. Finally, Castells and Portes attribute the growth of the informal sector to the: (i) increased power of organized labor; (ii) expansion of State regulation of the economy; (iii) intensified international competition; (iv) non-enforcement of laws due to potential losses in employment; and (v) the economic crisis of the 1970s.

Costs

28. In those countries with an active informal sector, the co-existence of informal and formal markets are believed to cause substantial economic losses to both sectors. Operations in the formal sector incur the costs of: (i) entry; (ii) distortions in the market resulting from inappropriate economic policy (the assumption being that if there were no distortions, the existence of the informal sector would be superfluous); (iii) illegal utilization of utilities by informals which is either charged to formal consumers or subsidized by government; and (iv) competition with those operating in the same sector who do not pay those other costs. In addition, the very "rules" by which the formal sector operates create costs due to the effective exclusion of many potential clients who are incapable of adhering to such rules. For example, Nick Nteirho points out that formal sector financial institutions normally require that borrowers "(a) have some form of collateral; (b) have a specific purpose on which to use the loaned funds; (c) have a good credit record as backed by a good payment record in the past, and, (d) have a level of functional literacy to enable the applicant to deal with application procedures and financial statements." Potential borrowers who cannot, or will not, meet those conditions are lost to formal sector financial institutions. Where the numbers of potential borrowers lost to the formal sector are significant, the very viability of formal sector financial institutions might be at stake.

12. Manuel Castells and Alejandro Portes, loc.cit.
29. At the same time, substantial costs accrue to operations within the informal sector. The catalogue of such costs to entrepreneurial investment, as well as employment, in the informal sector has been enumerated by many of the authors cited in this paper and is relatively well known to most economists. The most significant of these costs include:

(a) **For Investors/Employers** --
   
   (i) Inefficient financial management (e.g., the generalized use of unrecorded cash-payments),
   
   (ii) Costs in finance, time, energy, and/or anxiety related to non-compliance with procedural regulations and evasion of taxation and labor codes (i.e., costs to avoid punishments for non-legal or, sometimes, directly illegal activities),
   
   (iii) Lack of access to formal sector credit requiring collateral,
   
   (iv) Net transfer costs (indirect taxation, inflation tax, higher interest rates on non-collateralized loans),
   
   (v) Loss of the protection of beneficial laws (property-rights, formal enforcement of contracts) and the resulting inefficiencies of other, informal, enforcement mechanisms,
   
   (vi) limited technological progress (e.g., inability to take advantage of economies of scale, lack of protection for investments in fixed plant and large scale equipment, small size of firms, no legal protection for technological innovation),
   
   (vii) Continuing dependence on formal sector enterprises for access to some raw materials and/or essential equipment,
   
   and
   
   (viii) The absence of incentives to invest in large projects with a high rate of return because of the degree of uncertainty concerning the arbitrary enforcement of regulations on informal enterprises.

(b) **For Employees** --

   (i) Lack of benefits mandated by law (e.g., minimum wages, pensions, and so forth),
   
   (ii) Generally lower wages,
   
   (iii) Non-adherence to legally mandated conditions of work (e.g., safety standards), and
   
   (iv) The undermining of the power of organized labor.

**Benefits**

30. Given the substantial cost of operating in the informal sector, such systems appear to operate

13. A study of 425 food hawkers in Nairobi (68% of whom were women) shows that 97% come from the four major ethnic groups of the city. Because many of these hawkers are unlicensed and (when they trade in downtown areas of the city) constantly harassed, social support mechanisms become more important. Winnie Mitullah estimates that some 25,000 hawkers *are always at war with the city authorities.* See *“Hawking As a Survival Strategy For The Urban Poor in Nairobi: The Case of Women,”* Environment and Urbanization, 3 (October 1991), p. 16; as cited in Richard Stren, loc.cit.

14. See also Nick N. Nteireho, loc.cit.

15. For a relevant case study of petty producers in Dakar, Senegal, see Chris Gerry, “Petty Production and Capitalist Production in
reasonably well under the circumstances. Clearly, where informal sectors exist, they are likely to be characterized by more of a competitive market than the formal sector. The fact that many informal entrepreneurs earn incomes above, sometimes far above, minimum wage levels in the formal sector also suggests the operation of a market which rewards entrepreneurial initiative and dynamic behavior. None of that is meant to suggest, however, that the operations of the informal market represent an optimal model of an open and non-distorted economy. Far from it. Rather, what is significant, and an impressively sad commentary about the character of the formal sector economy in many developing countries, is that even with the costs enumerated above, the rate of investment in the informal sector suggests that it is still more efficient (or perceived to be so) than the formal sector; at least for the provision and production of some private goods and services. At a minimum, in cases of economic decline, the informal sector often serves as a safety net; as it has for much of Africa during the last two decades (see Section V). Finally, Castells and Portes argue that additional benefits derived from an active informal sector include the decentralization of economic activities more broadly through society and a blurring of class-based structures of authority.

IV. GOVERNANCE

31. To this point in the paper, the relationship between theories of dual economies and the informal sector have been addressed from a conventional economic perspective. The purpose of this Section is to move that discussion forward to hypotheses concerning the relationship between the existence of an informal sector and good Governance. The incrementally refined hypothesis presented at this point is that:

(a) A misapplication of the theories of dual economists and their critics resulted in fundamentally unsuitable economic policies for many developing countries (Section II);

(b) The enhanced role of the informal sector has been the result of those unsuitable economic policies (Section III);

(c) The relatively stagnant performance of the formal sector, in both economic and political terms, resulted in the alienation of formal government structures from the political communities (as distinct from the predatory elite) they were expected to serve; and

(d) Given that alienation, the economically rooted requirements of the informal sector reinforced historically rooted authority structures and/or resulted in the creation of informal "parallel governments."

32. Because it is probably true that experience in Africa varies even more from experience on other continents, specific discussion of the theme enumerated above in the African context is reserved for Section V. This Section will be limited to a more generic discussion of the concept of Governance and its impact on economic performance.

A. Elements of Efficient Governance

Definitions

33. Increasing interest in the role of Governance as a factor in economic development has resulted in a proliferation of definitions. Such definitions range from:

(a) The "exercise of authority, control, management, power of government;"

through

(b) "The manner in which power is exercised in the management of a country's economic and social resources for development;"

to

(c) "The impartial, transparent management of public affairs through the generation of a regime (set of rules) accepted as constituting legitimate authority, for the purpose of promoting and enhancing societal values that are sought by individuals and groups."

For the purposes of this paper, the first (i.e., Webster's Dictionary) definition is accepted for the root concept of Governance because it is broadly comprehensive and without politically normative content. For the purposes of this paper, the third definition is accepted as denoting "good" Governance; as addressed further below.

Good Governance = The Exercise of Legitimate Authority

34. The essence of "good" governance is "legitimate authority" which, in turn, requires that decision-makers be accountable to those they are supposed to serve which, in turn, requires transparency of decision-making. Therefore, the terms "authority," "legitimacy," "accountability," and "transparency" will be briefly discussed below.

35. Authority. Compliance with decisions made by others is the essence of Authority. Although the concept of "Authority" is important, it is beyond the scope of this paper to provide a lengthy theoretical discussion of it. Suffice it to state here that Authority can be derived from several sources ranging from coercion to the belief by those affected that voluntary compliance with decisions is the "right thing" to do. When compliance is voluntary because of widely shared political values, the authority derived therefrom is understood to be "legitimate."

36. Legitimacy. As with the concept of Authority, it is beyond the scope of this paper to provide a lengthy theoretical discussion of the concept of legitimacy. Suffice it to state here that beliefs concerning the "rightness" or "wrongness" of voluntary compliance with political decisions, when shared by a critical mass of

17. Webster's Unabridged Dictionary.
18. The World Bank, Managing Development: The Governance Dimension (A Discussion Paper) (Washington, D.C.: The World Bank, August 29, 1991), p. 1. This discussion paper identifies three distinct aspects of Governance: (i) the form of political regime (parliamentary/presidential, military/civilian, authoritarian/democratic); (ii) the processes by which authority is exercised in the management of a country's economic and social resources; and (iii) the capacity of governments to design, formulate, and implement policies, and, in general, to discharge government functions.
a country's population, represent the essence of "political culture." Although the substance of political value systems vary by the number of cultures in the world, the fact that cultural values do affect voluntary compliance (and opposition) to political decisions is a generalizable truth.

37. Political cultures, in turn, can be broadly differentiated by whether values associated with "right" or "wrong" decisions are weighted more toward: (i) the substance of such decisions; (ii) the process through which such decisions are made; or (iii) the status of the person or small group which is believed to be making decisions. The relationship between governmental decision-making and regime stability is most likely to be high where: (i) the boundaries of the sovereign-state encompass a relatively homogeneous political community with shared values concerning the proper form of authority (see para. 41); (ii) legitimacy is derived from shared values vis-à-vis due process or the office/status of the decision-maker, rather than agreement on each substantive decision; and (iii) decision-making conforms to those due process or status-related values.

38. Accountability. The normative aspect of legitimacy requires some form of accountability of decision-makers to those affected by decisions. Again, a thorough discussion of accountability is beyond the scope of this paper. Suffice it to state here that there are a very wide variety of mechanisms which, in some combination, can contribute to accountability. Such mechanisms can be divided into two broad categories: (i) those which operate internally within the public sector itself (e.g., managerial supervision and evaluation of individual staff and effective performance of accounting and auditing functions) and (ii) those which are a function of "balances of power" among public sector institutions on the one hand and stakeholders outside of government on the other hand. Mechanisms in support of accountability from outside the public sector include such things as elections, the use of influence through pressure/interest groups, and/or public protests/demonstrations.

39. Transparency. The transparency of decisions and the manner in which they are implemented facilitates accountability. It is essentially the political equivalent of perfect information for economic decision-making. This theme is discussed more fully below (paras. 45 - 46).

B. Factors Negatively Affecting Legitimacy of Formal Governments

40. This sub-section identifies five factors which, in some combination, are assumed to have negatively affected the legitimacy of many governments in developing countries: (i) absence of political community; (ii) alienated political elites and institutions; (iii) lack of transparent decision-making; (iv) ineffective economic policies; and (v) the existence of parallel governments. Each of these factors will be briefly discussed below.

Absence of Political Community

41. It has been argued above that voluntary compliance with government decisions requires that they
conform to shared norms and values within a political culture. Such cultures are shared by persons within the same political community. Most people everywhere are members of at least one (and sometimes more than one) political community. However, a major problem within many developing countries is that their boundaries do not conform to those of any political community and, hence, their citizens do not, in aggregate, comprise such a community. Therefore, many sovereign-states in Africa and Asia do not correspond to nation-states. Rather, most of them were, at least originally, arbitrary creations of colonial powers which grouped several, often hostile, communities within the same country and/or established boundaries which split such communities. The fact that countries are not sufficiently homogenous with regard to norms and values complicates the ability to make decisions which a critical mass of the population consider legitimate. Thus, the forging of new national identities has been an explicit objective of supposed "modernizing" elites within many developing countries.

**Alienated Political Elites and Institutions**

42. As implied above, public sector decision-makers within the formal institutions of sovereign-state governments were often alienated from the citizens of the country for which they were ostensibly responsible. Who, after all, were these decision-makers who formulated policies based, at least in part, on the assumptions of both dual economy theorists and their critics; as outlined in Section II above? Some combination of the following characteristics describe many, if not most, of them:

(a) A very large number received their secondary and post-secondary education in the "West" or in local schools employing a "Western" curriculum (and, often, European teachers);

(b) That curriculum would have stressed the differences between "modern" (i.e., western) and "traditional" (i.e., indigenous) modes of thought and behavior with an implicitly paternalistic view of the responsibilities of the western educated to take care of those without the "benefit" of that education;

(c) Such an education, combined with leadership in some form of anti-colonial struggle, resulted in acceptance of the "Western" concept of internationally recognized sovereign-states as an important element of "proper" political organization; and

(d) The combination of "Western" education with hostility toward the economic systems of colonial powers resulted in commitment to the alternative, yet still "Western," approach to large-scale State organization; i.e., socialism of one kind or another.

None of these characteristics are surprising. For people combining those characteristics, it should also not be surprising that the "synthesis" which could be drawn from the analyses of the dual economy theorists on the one hand and their critics on the other hand was transformed into policy prescriptions (as described in Section II).

43. What is important to stress here is that the characteristics of the "Sovereign-State Elites" enumerated above result, at least to some extent, in political values and loyalties which are likely to be
substantially different from those of "Political Community Elites" whose legitimacy stems from the sharing of norms and values rooted in ethnically homogeneous cultures. Sovereign-state elites have a vested interest in maintaining those formal structures which conform with international (i.e., essentially "Western") structures and practices because their values are, at least in part, consistent with such systems and there sources of power are to a significant extent reinforced by maintaining such external relationships. The power of political community elites is more directly linked to their position within the local political community itself, rather than on relations with external actors.

44. If the theory of alienation summarized above is correct, it can be further hypothesized that the informal sector in many developing countries represents the economic system of actual political communities found within the boundaries of artificially created sovereign-states and that the formal private sector represents the economic system of the more artificial sovereign-state's public sector. This paper will return to this hypothesis again further below (paras. 49 - 51, 56, and 71 - 72).

**Lack of Transparent Decision-Making and Procedures**

45. In the context of the roles of the informal private and formal public sectors, decision-making in each sector is more transparent to internal participants than to those outside each of those discrete systems. Ignorance of decisions and/or confusion over procedures within the formal public sector reinforces the informal actors avoidance of interaction with government. Under such circumstances, the perceived legitimacy of decisions taken within one sector affecting those in the other sector can be assumed to be negative; with relationships between them characterized by hostility.

46. Thus, for those involved in the informal sector, making their decisions transparent to the government can result in "being caught" and punished. Being too transparent to potential suppliers and/or customers can also lead to being "caught" and the payment of some sort of transaction cost. On the other hand, in an environment characterized by a climate of hostility and suspicion, governments also often believe it necessary to keep its decisions, especially those involving measures to control the informal private sector, secret as long as possible in order to prevent the latter from crafting efficient mechanisms for non-compliance.

**Ineffective Economic Policies**

47. An important assumption underlying contemporary economic reform models is that a relatively free market always exists for the performance of, at least some, economic activities. Where governments attempt to tightly control economic activities and, thus, create distortions in the operation of the market, such

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21. A sociological analysis, focusing on the networks of social support for different sub-sectors of the informal economy (drum sellers, metal artisans, garment makers and food sellers) shows the importance of ethnicity (through kinship and friendship ties) in both the initial choice of occupation and the success of the business (Macharia 1989). And a study of 425 food hawkers in Nairobi (68% of whom were women) shows that 97% come from the four major ethnic groups of the city. Because many of these hawkers are unlicensed and (when they trade in downtown areas of the city) constantly harassed, social support mechanisms become more important. Winnie Mitullah estimates that some 25,000 hawkers “are always at war with the city authorities” (1991), p. 16); cited in Richard Stren, loc.cit.
activities are performed, although less efficiently, within parallel economic systems. Such systems are synonymous with the "informal sector." Hernando de Soto argues that the rise of the informal sector is the consequence of ill-conceived government regulation. Such a regulatory framework is characterized by sins of both commission and omission; i.e., many existing laws are counter-productive to efficient economic performance and laws which could facilitate such performance in a context of equity do not exist. Existing, counter-productive, legislation contributes to the generation of income through redistribution rather than the creation of new wealth. Laws which do not exist, but should, are those which would provide investment incentives through a system of contractual and property rights and encourage specialization and interdependence of economic activities by creating an environment of trust and certainty.

48. Thus, the implementation of inappropriate policies and the failure of governments to effectively deliver goods and services leads to the creation of their own illegitimacy a la the Chinese Emperors' Mandate of Heaven. In a perfectly rational, but ultimately perverse, way, the illegitimacy of formal government decision-making is, by definition, the philosophical justification for informal sector activity in the first place; the existence of an informal sector is, itself, an indicator of governmental illegitimacy. Of such situations are self-fulfilling and self-perpetuating prophecies made.

Existence of Parallel Governments

49. With the perspective of the role of parallel economies in mind, it should be understood that similar phenomena operate with regard to the civic responsibilities of governments. In spite of the understandable desires of many utopian political theorists, some form of government exists universally in human society. Most people understand intuitively what functions, at a minimum, governments should perform. It is from that understanding that governments derive their legitimacy. When governments do not, in fact, perform their necessary functions and/or where they do so in substantially ineffective ways, many of those functions will be performed in one way or another outside of the formally and officially sanctioned governmental system in much the same way that necessary economic functions are performed in parallel systems under similar circumstances. Thus, Elinor Ostrom, Larry Schroeder, and Susan Wynne argue that "the fact that social life has not totally disintegrated even under the impact of the most repressive regimes implies that small-scale organization that allows people to maintain some of the most basic functions exists everywhere."

50. The importance of that perspective for both economic reform programs and the role of decentralized governmental systems is illustrated by the emergence of, what are in effect, parallel authority structures within poor urban neighborhoods in Latin America. In brief summary, rapid urbanization combined with insufficient opportunities for employment resulted in the "marginalization" of a significant segment of the

22. Ibid.
urban population. That segment of the population was highly dependent on services historically provided by the public sector to survive. However, the economic and debt crisis beginning during the mid-1970s resulted in significant deterioration of governments' provision of such services. As a result, that “marginalized” segment of the population had to establish alternative strategies for survival outside of the formal economic and political systems.

51. Although there are different analytical perspectives on the result, one school of thought is that these survival strategies have relied mostly on collective action at local neighborhood levels through exchanges of labor intensive services, communal kitchens, collective workshops, shopping cooperatives and so forth. Such activities have required the establishment of identifiable structures of authority which, within such neighborhoods, provide the functional equivalent of "government." Indeed, it has been argued that some governments tolerate or stimulate informal economic activities in order to ease real (or potential) social conflicts (e.g., the acceptance of squatter settlements as a way to "solve" the housing crisis).

C. Policy Implications

52. **Informal Private Sector.** Viewed from the normal perspective of formal sector economic policy reform, the existence of the informal sector is, itself, a problem. The solution to that problem offered by free-market economists is to recognize the reality of the market-oriented parallel economy represented by the informal sector and integrate it into the formal, and officially sanctioned, economic system. By so doing, it is believed that mutually supportive relationships can be established between the interests of both the public and private sectors. As only one example of this reasoning, if government is able to legitimate and regularize economic activities currently undertaken in the informal sector, it should be able to increase its tax revenues while reducing the cost of operations for the private sector.

53. But why assume integrating the informal and formal sectors is necessary or a good thing? The answer to that question seems to be that economists as varied as Manuel Castells, Hernando de Soto, Chris Gerry, John Weeks, and Alejandro Portes all seem to agree that some form of integration is necessary because neither sector can serve as a sufficient source of economic growth. The essential logic is that the existence of an informal sector is only a symptom of distortions in the formal sector. Thus, if such distortions in the formal sector were eliminated, the informal sector would evaporate. After all, the principal characteristic of the informal sector is its illegality and operating illegally is inherently inefficient (see paras.


23[b] and 28 - 29).

54. At its source, therefore, it is hypothesized here that the problem is twofold: (i) the legal system which constrains efficient formal sector operations and (ii) the incompatibility of operational values between the formal and informal sectors. This latter aspect is critical to an effective response to the question “who integrates or coopts whom” (see paras. 52, 56, and 73).

55. Changing Role of The Public Sector. While the theses of this paper is consistent with the view that integrating the formal and informal sectors is, on balance, the correct policy prescription, implementing it would clearly not be a simple thing. Effectiveness of such a policy would require much more significant changes in the role of the public sector in the economy, at least in a significant number of countries, than merely trying to incorporate the informal private sector into the formal private sector. Indeed, one of the reasons for the existence of the informal sector, given the reasoning outlined above, is that insufficient scope was allowed for the establishment and dynamic expansion of the private sector as a whole in the first place. Thus, a precondition to legitimating/formalizing the informal sector is, in many cases, the substantial expansion of the legally sanctioned role of the private sector, both formal and informal, as a whole. Thus, Hernando de Soto’s policy recommendations include the simplification of existing laws, decentralization of central government responsibility to local and regional authorities, and major deregulation of the economy. The central feature of his set of recommendations is presented in terms of “removing unproductive restrictions from the legal system and incorporating everyone into a new formality.”

56. Incorporating the informal sector into the formal sector, however, must also address the issue raised by the existence within many informal sectors of parallel governmental institutions (see paras. 44, 49 - 51, 71 - 72, and 75); the future of which would be problematic if real integration with the formal system is attempted. Thus, in much the same manner that one objective of economic reform programs is to coopt the informal economic system into the formal system, many governments have the objective of coopting parallel political systems. The issue of integrating the informal sector into the formal sector has two important dimensions to it: (i) integration of the private informal sector’s economic activities into the private formal sector economy and (ii) integrating the informal sector’s quasi-governmental institutions into the formal public sector or establishing mutually compatible links between such quasi-governmental informal institutions and formal governmental institutions. Effective implementation of such strategies can be expected, however, to require the establishment of positive relationships with such communities, rather than attempts to replace such organizations by externally manufactured structures.

V. THE INFORMAL SECTOR and ECONOMIC DEVELOPMENT In AFRICA: A RECONSIDERATION

Identifying generic lessons about the informal sector in Africa as a whole is a complex undertaking. Indeed, it is not yet possible to do so with much confidence. There are at least five reasons for that state of affairs:

(a) Variety is the essence of political, cultural, and economic conditions in Africa and general lessons applicable to that continent as a whole are few indeed;

(b) Although a substantial number of country or city-specific case studies have been completed, very few are comparative in nature;

(c) Most of those case studies are limited to petty trading, the financial sector, or urban settlement and housing;

(d) The various studies do not agree on the defining characteristics or parameters of the “informal sector” and, therefore, the data collected and the form of presentation are not consistent or comparable; and

(e) Perhaps most importantly, the “illegal” nature of informal enterprises, at least from a formal sector perspective, does not facilitate the collection of sufficiently comprehensive nor reliable data.

Therefore, as indicated earlier, this paper emphasizes the presentation of hypotheses and suggestions for further research. Nevertheless, before turning to that research agenda, the following two sub-sections provide a summary background of what the limited data on Africa suggests about the characteristics of the informal sector with respect to economic performance, relationship to governance, and possible role in an economic growth strategy for that continent.

A. The African Informal Sector: Economic Characteristics

The limited, and often conflicting, data available, as well as non-systematic observations by people with experience in Africa, suggests that the informal sector is in many countries large, growing, productive, dynamic, and linked in several ways to the formal sector. Those characteristics are discussed briefly below in terms of: (i) size and growth of employment; (ii) performance; and (iii) intersectoral links.

Size and Growth

Informal sector employment in Sub-Saharan Africa:

(a) Accounted for somewhere between 31 percent and 75 percent of the non-agricultural labor force within a selected group of African countries during the late 1970s (Attachment 1, Tables 1 and 2);

(b) Accounted for greater growth in employment than the formal sector in a sample of six Sub-

27. J. Charmes, loc. cit. and K. King, loc. cit. The figures in Table 2 indicate a larger share of informal sector employment because small enterprises with less than ten workers are included in the Survey, whether or not such workers earned regular wages and/or the enterprise was registered, not required to be registered, or, if registered, did or did not adhere to applicable regulations. In 1985, approximately 30% of all urban employment in Kenya was estimated to lie in the informal sector; see Ian Livingstone, “A Reassessment of Kenya's Rural and Urban Informal Sector,” World Development, 19 (June 1991), p. 653 - 657.
Saharan African countries during the period 1978 - 1985 (Attachment 1, Table 3);

and

(c) Provides opportunities for employment and successful entrepreneurship to persons with little or no formal education through on-the-job training and informal apprenticeships (Attachment 1, Tables 4 and 5).

Performance

61. Going beyond the basic indicators identified above, what does the data suggest concerning the performance of the informal sector in Africa?

62. **Positive Contributions.** The positive contribution of the informal sector to African economies is indicated by:

   (a) A diverse distribution of informal enterprise activities across production, commercial, and service sectors (Attachment 1, Table 6);

   (b) The fact that the incomes of owners of informal enterprises within a sample of 11 Sub-Saharan African countries during the early and mid-1980s were, in all cases and in all sectors, above the legally "guaranteed" minimum wage (and were often substantially higher [Attachment 1, Table 7]);

   (c) The fact that the average income of wage employees in the informal sector within a sample of eight Sub-Saharan African cities during the late 1970s and early-1980s were marginally higher than the legally "guaranteed" minimum wage (Attachment 1, Table 8);

   (d) The employment of large numbers of unskilled workers who would not be employable in the

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28. Although there are no direct estimates of employment growth in Africa available, Table 3 presents an indirect measure consisting of a comparison of regular wage employment and non-agricultural labor force trends in urban areas. By that measure, informal sector employment grew faster than formal sector employment in the six countries during the 1978 - 1985 period. Since the index numbers for the urban (non-agricultural) labor force grew faster than the numbers for formal urban (wage) employment the residual magnitude (the urban informal employment) must have grown at a higher rate than employment in the formal sector; see (i) J. Charmes, *loc.cit.*, (ii) Richard Stren, *loc.cit.*, and (iii) Philippe Hugon, "The Informal Sector Revisited (in Africa)," in Turnham et al (eds), *The Informal Sector Revisited* (Paris: OECD, 1990). Hugon points out in yet another version of that study that reductions in formal jobs have been severe almost everywhere. Citing a number of local studies of Tananarive, Madagascar, he notes that, while informal sector jobs were being dismantled at the rate of 400 per year in the industrial sector alone, informal jobs in the important sectors of woodworking, metalworking, garage work, and repairs were increasing (depending on the study) at a rate which varied from 2.5% per annum of 23% per annum; see "Les Politiques d'Appui au Secteur Informel en Afrique," in Catherine Coquery-Vidrovitch and Serge Nedelec (eds.), *Tiers-Mondes: L'informel en Question?* (Paris: L'Harmattan, 1991), p. 65 - 66.

29. For example, among 12 Sub-Saharan African countries surveyed between 1977 and 1987, 50 percent scored higher than 60% of informal sector entrepreneurs without any formal education (Table 4) and, among 4 African cities, the aggregate average of informal sector entrepreneurs acquiring their skills through informal sector apprenticeships was 84.1 percent (Table 5); J. Charmes, *loc.cit.*. Donald Freeman also found that 64 percent of his respondents were female in Nairobi and that they tended to have primary education or no education at all; see Donald Freeman, *loc.cit.*.

30. With what might be a weighting towards non-agricultural production in rural areas with an increasing trend toward trade and services in urban areas; see J. Charmes, *loc.cit.*. Looking at the urban "small-scale enterprise" sector (since 1987, that has been the official Kenyan designation for the informal sector) in 1988, 17.6 percent was in manufacturing, 56.2 percent was in wholesale and retail trade, 15.8 percent was in community, social and personal services, 8.7 percent was in restaurants and small eating establishments, and the rest was in miscellaneous services.


32. That data suggests that informal sector wage income is high enough to compete with formal sector salaries; see J. Charmes., *loc.cit.*. For an opposing view, based on a different data set, see Philippe Hugon, *loc.cit.*, (1990).
formal sector;

(e) The employment of significant numbers of apprentices who would not have equivalent opportunities to learn skills in the formal sector (Attachment 1, Table 5);

(f) The fact that within a sample of eight Sub-Saharan African countries at different points in time during the 1980s (with the exception of Freetown, Sierra Leone), labor productivity in the informal sector was above the minimum wage, higher than the average informal wage, and higher than per capita GNP (Attachment 1, Table 9);

(g) The generation of surplus capital and reinvestment;

and

(h) The value of urban agricultural production in terms of both employment and substitution for wage income.

63. **Negative Contributions.** Negative characteristics of the informal sector in Africa comprise a shorter, but not insignificant, list. Thus:

   (a) There appears to be an inverse relationship between the size of the informal sector and per capita GNP (Attachment 1, Tables 1 and 2);

   (b) A majority of informal sector workers might be non-wage earners and, therefore, they are not accounted for in wage income statistics or, in many cases, estimates (Attachment 1, Table 10), with the result that the average income (or income equivalent) of informal sector workers is probably overstated;

and

   (c) The majority of **unskilled** workers and most apprentices earn less than the legally mandated minimum wage (Attachment 1, Table 11).

64. **Ambiguous Indicators.** Finally, there are a few indicators which could be perceived as either positive or negative depending on interpretation of the data and policy objectives concerned. For example, it

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34. Although the investment of surplus capital, above a certain threshold, is directed toward diversification rather than intensification to minimize risk; see Philippe Hugon, *loc.cit.* (1990).
35. In 1985 a study of urban agriculture in Kenya estimated that 29 percent of all urban households grew food within the cities and that 17 percent kept livestock, the aggregate value of which was estimated to be the approximate equivalent of US$4 million annually. Another study of urban agriculture in Lome, Capital of Togo, also indicated significant added value to the local economy; the net value of production from each of three small subsistence plots and five commercial plots ranged from an equivalent of approximately US$262 to US$10,944. For Kenya, see Diana Lee-Smith, Mutsembi Manundu, Davinder Lamba, and P. Kuria Gathuru, *Urban Food Production and The Cooking Fuel Situation in Urban Kenya* (Nairobi: Mazingira Institute, 1987), cited by Richard Stren. For Lome, see Christine Schliter, *L'Agriculture Urbaine a Lome: Approches Afronomique et Socio-Economique* (Paris et Geneve: Karthala et IUED, 1991); also cited by Richard Stren, *loc.cit.* Stren also cites, in support of this point, (i) Donald Freeman, *loc.cit.*, and (ii) Carole Rakodi, “Urban Agriculture: Research Questions and Zambian Evidence,” *Journal of Modern African Studies*, 26 (September, 1988), p. 495 - 515.
36. J. Charmes, *loc.cit.* Those statistics, as is the case with much of the data employed here, might be misleading because it can be hypothesized that the poorer the country the larger the underestimate of GNP since substantial informal sector activities are likely to be unaccounted for; i.e., formal sector statistics are, in effect, tautological.
37. Ibid.
38. Ibid.
is understood that women often predominate in the less productive, but labor intensive, activities of the informal sector. Thus, women were the most prominent in trade and food preparation services in Kenya in 1985, the majority of those who work on urban crop production in Kenya and Zambia are women, and, throughout francophone Africa, enterprises owned or operated by women are, on average, smaller than men's enterprises, do not employ salaried workers, most transform only local primary materials into consumable products, and seldom use materials supplied by the formal sector.

65. All of these characteristics suggest discrimination vis a vis entry of women into the more productive activities of even the informal sector. On the other hand, such patterns of discrimination mirror those of the formal sector, and perhaps to a lesser extent. Further, as in the case of all unskilled and semi-literate persons (a large number of which are women in Africa), the informal sector provides employment and opportunities for entrepreneurship which would not otherwise be available. That has special significance in view of the finding that such employment in urban areas allows for the unification of migrant families who might otherwise be separated (the male working in the city and the female, children, and elderly living at home in the rural areas); as well as reducing the cost of urban subsistence through employment of female members of families in non-wage productive activities.

**Intersectoral Links**

66. Indicators of intersectoral links include the following facts:

(a) In four African cities, 47 percent of small entrepreneurs in the informal sector had previously worked in the modern sector while 20 percent had previously worked in agriculture;

(b) Members of the same households are often employed in both the formal and informal sectors of the economy;

and

(c) Many informal sector enterprises must continue to rely on raw materials and other products/services produced by the formal sector as inputs into their own production process.

However, as distinguished from much of Asia, subcontracting by the formal sector to the informal sector appears to be less well developed in Africa.

67. The operations of both formal and informal financial institutions in Africa provide a good illustration of links between the two sectors. Nick Nteirho cites the research on Ghana of Aryeetey and Gockel to illustrate strong linkages between the formal and informal sectors. Thus, “although the financial markets in the two

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42. K. King, *loc. cit.*

sectors are highly segmented, demand for credit in one sector is not entirely exclusive of the other sector. In the case of Ghana, "Susu Collectors" collect savings from Market Traders on a daily basis and deposit them in commercial banks; as do rural Money-lenders who sometimes borrow from commercial banks and on-lend to their own borrowers. Such "susu collectors" and rural money-lenders serve as intermediaries between the commercial banks and those persons not able or willing to engage directly such formal sector institutions.

68. Both formal and informal sector institutions are limited in what they can or cannot do. Thus, the commercial banks are limited by the discipline imposed by a country's central bank and the diseconomies of scale associated with small up-country loans. Such banks prefer lending to larger clients who require limited supervision and offer the greatest probability of timely repayment. "Susu Collectors" and rural money-lenders qualify as large clients who then on-lend to their own clients at higher interest rates. Mutually supporting relationships of one kind or another among formal and informal sector institutions and/or clients in a variety of fields often require intermediaries. The additional transaction costs incurred by the non-formal and/or informal sector client are not necessarily exploitive. Rather, such costs often reflect the actual economic value of the services provided.

B. The African Informal Sector: Governance

69. As weak as the data is for empirically determining the role of the informal sector in the African economy, it is stronger than theoretical frameworks and data concerning the relationship between the informal sector and governance in Africa. Given those limitations, the starting point in this paper are the broad issues outlined generically in Section IV above. In particular, the focus in this sub-section is on two of the hypotheses presented in Section IV:

(a) Formal sector political elites and institutions associated directly with the institutional framework of sovereign, rather than nation, States are alienated from the communities they ostensibly are in office to serve; and

(b) The informal sector in many developing countries represents the economic system of actual political communities, and their "parallel governments," while the formal private sector represents the economic system of the more artificial sovereign-state's public sector.

Legitimacy and Alienation

70. The essential point to be made here is that sovereign-state elites and institutional structures in Africa are alienated from much of the economic and political activity within their sovereign-state borders for much the same generic reasons as outlined in Section IV above. Since this particular subject is the focus of two other companion papers to this one

and in the interest of conserving paper, evidence in support of that conclusion is limited here to quotations from three other sources:

*Because many ... hawkers in Nairobi are unlicensed and (when they trade in downtown areas of the city) are constantly harassed, social support mechanisms become more important. It is estimated that some 25,000 hawkers "are always at war with Nairobi city authorities [italics added].'*

From an institutional point of view, the central apparatus of the state [in former African colonies of France] plays a dominant role, permitting few initiatives to other actors in the system .... Moreover, [for example] urban and regional planning was (and remains) under the exclusive responsibility of a bureaucracy which has little or no contact with, or interest in local reality [italics added].

Although the subject of dual or multiple polities as they evolved and currently exist within and among many LDCs cannot be specified in any detail here .... notice need only be taken of the fact that the inviolability of current African borders is a doctrine enshrined in the Charter of the Organization of African Unity (OAU) and considerable pressure has been brought to bear on those African governments which might appear to be contemplating any kind of adjustments to their external boundaries.

**Parallel Governments**

71. Evidence, although partial and, therefore, only suggestive, does exist in support of the hypothesis that the informal sector in at least some African economies do have a directly related "governmental" aspect and that at least some of those informal "governments" are rooted in the political culture of distinct ethnic or broader cultural communities. Thus, in countries as diverse as Kenya, Nigeria, and Tanzania, community-based associations have provided some combination of services which might normally be expected of formally designated governments of the sovereign-state structure, such as: (i) credit (through, for example, rotating credit societies); (ii) voluntary security teams in large housing areas (i.e., in effect, non-formal police); and (iii) financing of flood relief, orphanages, medical services, secondary schools, water and power grids, and so forth.

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46. Jerry M. Silverman, *Public Sector Decentralization*....

Based on studies of Enugu in eastern Nigeria during both 1961 and 1987, Josef Gugler argues that the evidence for a "dual commitment" among urban Nigerians to the city where they currently reside and the rural village from whence they came is "overwhelming." But the evidence cited by Gugler suggests that the commitment is, in fact, quite unbalanced; the more fundamental and longer term commitment is to the rural area which continues to be identified as "home." Within the informal sector, it is well understood that various activities within a particular city or neighborhood are essentially the exclusive domain of one ethnic group or another. Further, in urban areas, many of the associations or clubs which provide both social opportunities and services to their members are organized according to criteria of ethnicity and place of origin. Many of those organizations provide services not only to their members in the cities within which they are organized, but also serve as organized mechanisms whereby those members can provide goods and services to their "home" areas as well. Further, anyone familiar with Africa is aware that many urban residents plan to retire "back home" and attempt to purchase land and build houses "back home" for that purpose.

C. Role in Growth Strategy

It is not the intended purpose of this paper to discuss or evaluate alternate scenarios concerning the potential role of the informal sector in African economies. Suffice it to state here that there can be little question about the desirability of integrating the formal, non-formal, and informal economies of Africa in the sense that they are mutually reinforcing rather than at odds with each other. Such integration will require, at a minimum, the recognition by sovereign-state political elites of the legitimacy of most activities of the informal sector and the manner in which such activities are organized. If it is assumed that legitimacy within the formal sector is derived from legality, such a policy shift by sovereign-state elites would, by definition, result in the elimination of the "informal sector" as a conceptual category precisely because it is illegality that defines the sector. However, in substance, the activities of the former "informal sector" should be expected to continue; indeed, such activities must continue if those societies are to survive in some economically effective sense. But in what form should such activities continue? That question is too often answered by the assumption that "progress" and "development" would be best served by the former "informal sector" being integrated into the norms, values, and structures of the formal sector. Thus, from that perspective, the formal sector would integrate or coopt the informal sector. However, it is argued here that the alternative of the informal sector becoming part of the non-formal sector is likely to be more efficient and effective. After all, the primary factor distinguishing the informal from the non-formal sectors is legality; the former being illegal while the latter is legal by virtue of not being subject to regulation in the first place (Section III, para. 23[b]).

This latter approach conforms to that implied, at least, by King in his argument that the preoccupation of policy-makers and researchers with "productive" enterprises in the informal sector has distorted the reality that the "informal sector" in much of Africa is, in fact, the "ordinary sector" in Africa. Thus, he argues the term "ordinary economy" is more suitable than the term "informal economy" because it is that
economy which, in Africa, actually "builds most of a nation's houses, runs most of its transport, makes most of its clothes, and trains most of its young people." The term "informal sector" is retained here in order to maintain the useful distinction between the terms "informal" and "non-formal." Nevertheless, the argument presented here is consistent with the substance of King's observation.

75. Thus, the approach advocated here posits that the solution to the problem is not to shift the relative benefits derived from alternative transaction costs so that compliance is viewed as more attractive than avoidance, but rather to substantially deregulate the operations of current informal sector activities so that the informal sector becomes a part of the non-formal sector "overnight," simply as a function of policy changes by decision-makers within the formal sovereign-state structure. Nevertheless, it is important to reiterate the problem identified in the previous Section; i.e., that such a strategy will also need to address the issue raised by the existence within many informal sectors of parallel governmental institutions (see para. 56). Thus, not only will those involved in formulating such policies need to take into account the integration of the private informal sector's economic activities into the legitimate system, but will also need to give serious thought to (ii) methods for integrating the informal sector's quasi-governmental institutions into the formal public sector or establishing mutually compatible links between such quasi-governmental informal institutions and formal governmental institutions.

76. A premise underlying the conclusion presented above is that the informal sector is, in some fundamental sense, more "real" than the "formal" system superimposed on it. Thus, there should be less need for those operating in the informal sector to accept the legitimacy of the sovereign-state elite than there is a need for the reverse, at least in the short (and probably medium) term. Nevertheless, mutual acceptance based on the kind of policy changes suggested above should, over time, contribute significantly to increasing legitimacy for the "Nation-Building" objective supported by the sovereign-state elite.

D. A Research Agenda

77. This paper has limited itself primarily to outlining a conceptual framework for an understanding of both the economic and governance dimensions of the informal sector and their related impact on economic development in Africa. As suggested at the outset (para. 3), testing the hypotheses of that framework will need further empirical work. Therefore, important issues which remain from consideration of those hypotheses and the current state of knowledge about African experience are presented below as suggested foci for future empirical research:

(a) Were African sovereign-state elites directly influenced by the arguments propounded by both advocates and critics of dual economy theories during the 1950's and 1960's (this question is of more than simple historical interest because the answers to it might illuminate biases in analyses which persist to this day);

(b) Has the relatively stagnant economic and political performance of the formal sector in Africa resulted in the alienation of formal government structures from the political communities they
were expected to serve and, if so, what, exactly, is the form and substance of that alienation;

(c) By contrast, has dynamic flexibility to changing conditions characterized the informal sector in Africa and, if so, has it been the primary domestic contributor to economic survival in a significant number of African countries;

(d) Does, in fact, the informal sector include institutions of "parallel government" which perform quasi-governmental functions and, if so, are such institutions both more legitimate and efficient than the formal institutions of government (at least from the perspective of those served by such alternative institutions);

(e) Should community organizations/associations be understood to be a form of quasi-governmental institution and, as such, do they perform functions along cultural/ethnic lines within Africa and, if so, what is the impact of such activities on both economic and political behavior;

(f) What functions serve to mediate between the informal and formal sectors with reference to both economic and political policies and actions, who perform such mediation functions, and how are such mediation functions performed; and

(g) What methodological approaches are most likely to facilitate relevant research so as to produce valid data on experience in Africa?