Some Controversies On Informal Sector Operation in Ethiopia: Problems and Prospects for a Development Strategy

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Abstract
In contemporary issues of development in poor countries, the informal sector has been realized as a significant socio-economic force that should be reckoned with in the development process, particularly in poverty alleviation efforts. Informal sector activities are part of the socio-economic environment whose services are utilized by every member of the communities. Numerous studies have indicated the significance of the sector in poverty alleviation and job creation. The concept of “informality” has been a complicated issue to understand. Professional researchers based their studies on some fundamental questions related to the origin and development of the informal sector which are critical to the understanding of the sector and determination of policy responses to problems of the sector. Informal activities are closely linked with inadequate income maintenance or income generation activities, to which governments are not yet prepared to deal with. Research has shown that some economic activities of the poor lead to environmental degradation that in turn reinforces poverty conditions. The existence of renewed interest in informal sector is reflected in a number of national and international initiatives to study the sector. As a result, countries of the developing world are now placing more emphasis on improving socio-economic situation at the grassroots to open-up better opportunities for employment and income-generation for the underprivileged groups of society and informal economies. The World Bank Report (1990) on the state of poverty in less developed countries helped to attract worldwide attention to conditions of the poor. However, IMF and World Bank devised structural adjustment programs which increased poverty for some groups. In this paper, a modest attempt has been made to articulate the role of informal sector in socio-economic development, provide a framework for understanding the nature of informal sector problems and recommend appropriate strategic measures to improve the sectors development. Accordingly, discussions in the paper identify some essential aspects of efforts to address informal sector problems and clearly indicate critical controversial issues involved. The paper also suggests some areas for further research.
1. Introduction:

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2. The Ethiopian Situation: A Brief Overview

Ethiopia has an area of 1.1m’n sq. km (9th in Africa) and about 64m’n people (2nd in Africa) with per capita GDP of US$120 (1995). The agrarian economy contributes 50% of GDP, 85% of total population and over 90% of foreign exchange earnings obtained from over 95% of agri-production by marginalized small-holder farmers (Befekadu et al. 2000/2001 & MOFED, July,2002). Farm land is characterized by degradation of natural resources with 90% contribution to poverty (Ibid.).

In Ethiopia, people below poverty line in urban areas is estimated to be 34% for male-headed households and 49% for female-headed households (1999/2000). This situation has made Ethiopia one of the poorest countries in the developing world (World Bank’s World Dev. Report 2000/2001). The Bank’s Report (using 1999 data) has ranked

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Ethiopia 206th out of 206 countries with per capita income of US$100 (for Kenya US$360!) and with average income for low income countries being US$410 and average for Sub-Sahara Africa being US$500 i.e. 5 times the average income of Ethiopia for the same year (Befekadu Degefe et al. Vol II, 2000/2001, p.1).

Survey results also show that per capita consumption expenditure of Ethiopia for 1999/00 was estimated at about US$ 124 in constant prices of 1995/96 while the real per capita consumption expenditures were equivalent to US$ 139, 131 and 191 at national, rural and urban levels, respectively, in 1999/00 (MOFED, March 2002, p.xi). Studies have also indicated that the incidence of poverty is much higher in rural than in urban areas with the poverty head count index being 45 and 37 percent respectively in 1999/00 (Ibid.). During this same period, people under absolute poverty at national level were 44.2% with rural and urban areas showing 45% and 37% respectively (Ibid., p.xii).

The UNDP Human Development Report (1998 data) has ranked Ethiopia 171st out of 174 countries (Befekadu Degefe et al, p.2). The rapidly growing population and the underutilized human and natural resource potential are critical challenges in the poverty alleviation efforts in Ethiopia. Although there is visible shortage of capital and poor management of resources, Ethiopia is believed to be endowed with large number of working age population and potentially cultivable land and other natural resources. In this regard, creation of opportunities for self employment and increased productivity of land utilization for enhanced capital accumulation seems to be the only way out from the poverty trap (MOFED, p.x, July 2002).

The haphazard, un-integrated and resource-deficient grassroots development and lack of vision in community-based labor intensive development strategy have resulted in the impoverished socio-economic situation in the country. Moreover, the absence of operational linkage and partnership between gainful activities at the grassroots and big formal enterprises have further aggravated the poverty situation. This presupposes the need for developing grassroots businesses to serve as breeding ground for entrepreneurs who can promote socio-economic development through their creative and innovative capacity.

3. Significance of the Study

Several studies on informal sector development have been conducted by various professionals and researchers in different countries for different purposes. The contribution that such studies have made in efforts to create awareness and bring about change of attitude on the part of governments and other stakeholders has been significant. Ever since the recognition of the informal sector as a socio-economic force, the debate on the importance of the sector in socio-economic development and poverty alleviation has continued to date among government authorities, formal sector operators, the community and the informal actors themselves.

As a result, governments are trying to consider the sector as the fundamental base for entrepreneurship development and effective utilization of scarce resources. In this regard, various studies have been made to accommodate issues of the informal sector.

This study is a modest contribution to that end and would highlight some issues of significance in relation to the sector's role in poverty alleviation and socio-economic development efforts.

4. Objectives of the Study

The main objective of the study is to examine the controversial issues surrounding the informal sector within the Ethiopian context and in the light of its universal character as understood by various socio-economic environments. More specifically, the study will address the following objectives:
4.1) Examine fundamental questions critical to the understanding of the sector
4.2) Study the role of the sector in poverty alleviation efforts and long-term
development in Ethiopia and the critical problems that hamper the growth and
development of the sector.
4.3) Indicate possibilities for long-term integration of the informal sector into the
formal sector for more and better partnership in development efforts.
4.4) Recommend appropriate strategic measures that can facilitate livelihood
enhancement of the underprivileged.

5. Study Methodology

In order to understand the nature, causes, effects and controversial issues
surrounding the informal sector, a methodological framework that made effective use of
available secondary information, observation and discussions with concerned authorities
and stakeholders has been applied. The study has reviewed various literature on the
operation and development of the informal sector in the developed and developing
countries and evaluated policy-oriented studies on poverty alleviation strategies and
informal sector activities in Ethiopia.

6. The Informal Sector: Origin, Definition and Characteristics

The origin of the informal sector and the causes for its emergence are diverse.
Informality is mainly associated with the socio-economic, cultural and political
conditions peculiar to the respective environments in which it takes place (Portes et al.,

Accordingly, it is generally argued that informality has come about as a result of
the coping behavior of individuals and families during socio-economic crises which
forced small operators to undertake their activities behind state regulations (World Bank
Group, n.d, working paper, p. 1). The lack of government resources and social welfare
provisions for the unemployed have created the “invisible workforce” of destitute people
performing unregulated income generating activities (Portes et al., p.12). Thus,
informality is an attempt to cope with periods of hardship and displacement (Ibid., p.23-
30; Gibbon, 1995, pp. 24-30).

The deficiencies of macro-economic policies have forced people to look for
innovative livelihood strategies which is a micro-level response within the basic need-
oriented sectors of the economy (Seppala, 1998, p. 173). The informal sector emerged as
part of the process of economic restructuring and corporate austerity policies and as a
“reaction against state regulation in terms of taxes, social legislation, health and
environmental controls” (Portes et al., p.28). The informal sector was also a result of the
need to resort to sub-contracting and multiple sourcing (Ibid.).

The economic crises put the underprivileged in a state of harsh living conditions
which forced them to look for ways out of the misery and, therefore, people mobilized
themselves to work and earn a living on the margins of rules and organizational
arrangements as part of their survival strategies (Ibid., pp.28-29). Informal sector
activities are more flexible and ad hoc form of economic activities which also provide
adequate room for socialization of activities and make living through periods of socio-
economic crisis more manageable (Ibid.).

The process of decentralization to cope up with the socio-economic crises
couraged workers to enter into the informal sector (Ibid., p.33). The formal-informal
dichotomy that emerged in the course of socio-economic development is a result of the
intrusion of state authority in private interests which created economic activities that
violated or bypassed state regulations (Ibid., p. 298). This is an indication that
Informality may become unnecessary in cases where state regulation of economic relations is minimal.

On the other hand, attempts by the state to apply its regulatory practices to control previously unmonitored activities would even force activities in the formal economy to be converted into informal businesses. Thus, informal activities are designed to avoid being part of the regulated economy which affected by state controls (Ibid.). Informality took place because of the tendency to manipulate the formal rules and controls for private gains. In many developing countries, heavy burden of taxes, bribes and bureaucratic problems drive many producers into the informal sector (Azuma & Grossman, 2002, p.1). The informal sector offers the potential for independent growth and serves as reservoir of “over exploited” workers and usually plays a subordinate role with formal institutions (Portes et al, p. 299).

The prevalence of unemployment and under-employment of economically active population has become a significant reason for self-employment and taking refuge in the informal sector (Ferej, 1996, p.2). For example, the decline of investment in Addis Ababa from 80% in 1992/93 to 10% in 1999/2000, due to various policy and administrative problems, has reduced the labor absorbing capacity of the formal sector which forced people to go underground as a survival strategy (Addis Ababa Chamber of Commerce, 2001, p. 2).

**Conceptual Definition of the Sector:**

The informal sector is considered as employment which is unregistered and operates outside of the regulated formal economy. There is no common or single definition of the informal sector. Some consider the number of employees engaged in a particular informal activity while others take the volume of capital deployed (Yitbarek Tsige, 2001, pp. 7-8). Thus, an indicative definition which is appropriate for the respective socio-economic environments are used. However, in the majority of cases micro-enterprises and informal sector activities are used interchangeably (Addis Ababa City Administration, July 2000, P.2 ).

Although the sector has gained wider coverage during the last two decades, its conceptual basis has remained somewhat unclear and vague. The fact that the sector embraces highly diversified actors and activities has also contributed to that confusion. For example, actors include those operating own businesses with or without family workers, employers in small businesses with “few” hired workers and apprentices, while the activities range from shoe shine service, petty trading and those involving manufacturing, construction and transport. Workers engaged in self-employed service such as domestic work and casual labor are rarely considered as actors in the sector.

The essential characteristic of informal actors is that they produce and distribute goods and services for sale in the market to earn their livelihood. It is, therefore, argued that the focus of policy interventions should be to assist those in the sector to help themselves through improved income earning capacity and better market opportunities.

The main reasons why micro entrepreneurs prefer to be involved in informal activities include the following (Sutheraman & UNDP, 1997, pp. 10-12):

- flexibility that activities offer in economic relations at the grassroots level and freedom enjoyed to undertake them at the convenience of the operators
- possibility for informal sector actors to exploit market opportunities through tailored services
- micro-entrepreneurs prefer to remain small and unregistered or unlicensed or invisible to avoid regulatory constraints.

One of the key characteristics of the urban informal actors is the attempt to improve incomes by directly acquiring inputs needed, transforming them into final products and disposing them off in the market entirely through their effort. After
identifying income opportunities, they rely on their own network such as neighbors, ethnic groups, migrants from the villages of origin using them as sources of market information. Their efforts are geared towards overcoming their internal constraints related to skill, capital, premises, know-how or information about markets and other opportunities (Ibid.,).

The informal sector was first appreciated by ILO (1972) as a distinct socio-economic force. It is regarded as non-formal employment in micro-enterprises (Seppala, p. 170). The definition given by ILO is still widely accepted to represent the conceptual basis of informal sector activities and is presented below (Ferej, p.1):

“...all small-scale activities that are normally semi-organized and unregulated, use simple labor-intensive technology.... undertaken by artisans, traders and operators in work sites such as open yards, market stalls, undeveloped plots, residential houses and street pavements... not legally registered and in most cases not have licenses from local authorities for carrying out businesses”

Informal sector actors are independent self-employed individuals who produce and distribute goods and services largely in urban areas. Some of the small scale operators employ family labor and/or a few hired workers or apprentices. The low capital base and the low level of technology utilized has made them to be less productive. As a result, they can only obtain very low and irregular incomes from their unstable employment. Informal sector operators do not have easy access to organized markets, credit institutions, formal education and training institutions, or to many public services since they are not recognized and supported by the government. They generally work and live in underdeveloped parts of urban areas. Since they operate outside the framework of the law, they do not enjoy social and legal protection at the work place (Ibid., P.4).

Eventhough there is no universally accepted definition of the informal economy, ILO’s concept of informality considers “all activities that operate largely outside the system of government benefit and regulation” and related to informal ways of doing things. Nevertheless, three broad types of activities that lie outside of the regulatory framework such as informal, parallel and black market activities are also characterized as informal activities (ILO/JASPA, 1993, P. 11). The distinction between formal and informal sectors is arbitrary since most of the characteristics overlap (Ibid., p. 12). Informal sector activities are carried out to ensure survival with the help of backward and traditional technology and low capital requirement. Studies have indicated that about half of the operators are home based with 90% of them depending on start-up capital from own savings, family contributions and from other informal sources (UNECA, December 1994, p. 4).

Characteristics of the Sector:

The informal sector encompasses diverse situations and activities with varied characteristics. Such activities are mostly handled by micro-operators such as men and women, children, youth and adults who are engaged in micro businesses as a means of livelihood. Informal activities operate with low capital base and are mobile with no fixed or permanent sales premises and operating as “satellites” to big businesses on subcontracting (Street Business Operators Task Force/Addis Ababa, 2000, pp. 1-2). The informal sector serves as unofficial earning strategy for low profit enterprises with low quality working conditions and poor resource capacity (World Bank Group, n.d., working paper, p. 2).

The informal sector reflects illegality in doing business with tendencies to evade government taxes and avoid labor and other instituted regulations which are characteristic of underground activities. Informal businesses cover only gainful economic activities that are considered socially desirable and are aimed at exploiting market opportunities. This
excludes activities such as begging, prostitution, drug trafficking and other criminal activities considered by most societies as anti-social since they are regarded as violating existing regulations through activities like black-marketing, smuggling, illegal cross border trade, production of counterfeit or fake products (Sethuraman & UNDP, 1997, p. 12).

The fundamental characteristics outlined by ILO on the basis of its experience in Kenya in 1972 are still regarded as acceptable by professional researchers and policy-making bodies. These characteristics have been cited by several studies (World Bank Group, p. 1; Yitbarek Tsige, pp. 4-5; Ferej, pp. 1-2; Portes et al, p. 12.; Street Business. Operators Task Force/Addis Ababa, p. 1; King, 1996, p.7). Major characteristics include:

- ease of entry and exit and reliance on local resources
- unregulated small-scale operation based on family or individual ownership
- labor-intensive and use of backward and adaptive technology and low infrastructural facilities
- minimum labor force mostly family labor, low capital base
- skill from job practice and rarely from formal training
- business done at home or temporary places & no license and no tax payment
- retailing and service provision with low irregular and unreliable income
- lack access to information, training, productive resources and premises.

Informality is mainly described by its “low visibility, ease of displacement, appropriate setting for casual hiring, unreporting of income, easy to convert into underground enterprises, flexible in their establishment, can easily close or open, escape government record-keeping... encompass diversity of situations and activities” and engage in complementary than cut-throat competition (Portes et al, p.301).

The informal sector encompasses diverse economic activity in service and manufacturing and has the capacity of absorbing huge labor force (Street Businesses Task Force/Addis Ababa , pp. 8-9). A large number of informal actors are concentrated in limited areas of activities such as manufacturing, trade, hotels and restaurants, agriculture, hunting, forestry and fishing, mining and quarrying, transport which account for about 22% of national operators (Ibid.).

According to ILO-JASPA study (1990), the operators are also engaged in bakeries, grain mills, traditional cloth weaving, knitwear production, tailoring services, leather shoe production and mending shops, furniture shops, pottery production, metal works, electrical equipment repair services, watch/clock repair services, garages, tyre repair services, tapestries etc. (pp.111-125). Informal operators provide basic goods and services which are cheap and accessible to the majority of the low-income earners (Asmamaw Enquobahrie, p. 18). Because of their low level of investment, the operators are only able to realize low output and unstable, irregular and insufficient income to cover household needs (Ibid.). The operators use crude non-sophisticated implements to produce goods and services and have the capacity to modify tools and equipment to suit local circumstances and needs. They are restricted to quick-return, short gestation period, low-risk and small capital requirement activities (Addis Ababa Chamber of Commerce, p.1).

In view of the socio-economic and political impacts of the informal sector, efforts have been made by scholars, practitioners and research institutions to study the nature and significance of the sector in national development. Various researchers have attempted to describe and understand the conceptual basis of informal sector operation. Accordingly, they have made use of working definitions to suit their purposes and as a result, definitions of informality, in most cases, remain arbitrary with some basic characteristics reflected in the definitions (Mamo Wejega, 1996, p. 7; Wolde Emmanuel
Walombo, 1996, pp. 7-8). However, the common features outlined above indicate the universal nature of informality despite some differences in socio-economic, cultural and political environments.

7. The Informal Sector in Ethiopia: Emergence and Expansion

Like any developing socio-economic environment, the majority of Ethiopia’s population (60%) lives in a state of absolute poverty. Ethiopia is characterized by low level of economic growth, rapid population expansion, drought, famine and rural to urban migration, which has been experienced over the last couple of decades. The per capita GNP was about USD 110 in 1992 with an average growth rate of -1.9% since 1980 (Hayat Abdulahi, 1997, p. 173, as quoted from WDR 1994). The poor performance of the economy has resulted in rising unemployment and decline of real wages.

Growth of population and labor force due to rural-urban migration has inflated the urban workforce. Accordingly, lack of capacity on the part of the formal sector to absorb the growth in population forced the unemployed to seek refuge in the informal sector in order to create own employment (Street Business Operators Task Force/Addis Ababa, pp. 7-8). This resulted in concentration of labor force in micro-income generating activities urban areas as a natural desire for survival on the part of destitute men, women and the youth (Ibid.). Studies have shown that in many poor countries, like Ethiopia, heavy burden of taxes, corruption and bureaucratic intricacy have driven formal actors into the informal sector (Azuma & Grossman, p.1). The structural adjustment programs, the various austerity measures and the proliferation of economic activities outside of the formal structure have made the economically active labor force to align itself with the informal sector (Haeri, n.d, p. 1).

Another factor that helped in the expansion of the informal economy is the reaction against government’s regulation of the economy. The taxation systems, social legislation, health and environmental controls that are imposed on the activities of the business community and the economic hardship during periods of economic recession forced business people to go informal to operate outside of the regulatory framework (Portes et al, pp. 27-28). Because of cheaper imports and illegal inflow of commodities from outside, the labor-intensive manufacturers of consumer goods could not remain competitive in the market and were forced to close or move underground. (Ibid. p. 28). In addition, the industrialization process that took place under unacceptable social and economic conditions that imposed standards set by governments also pushed formal enterprises to use informal means to obtain comparative advantage relative to the more regulated areas of the economy. (Ibid., pp. 28-29).

The diminishing supply of rural lands and population explosion and resource scarcity, could not enable rural people to sustain life in their localities. The widening gap between the resource-loaded urban centers and the poverty-ridden rural areas facilitated migration as an option for survival (Addis Ababa City Administration, p.1). For example, the 2.9% increase in the population of Addis Ababa is found to be a result of rural-urban migration which has escalated the rate of unemployment in the city. According to the 1994/95 survey, it is indicated that 46.7% were unemployed. From among the economically active population of 10 years of age and above 61% was found to be in the informal sector (Central Statistical Authority/Ministry of Labor & Social Affairs - Ethiopia, 1997).

Because of the labor intensive nature, use of local raw materials and more simple and flexible technology and the innovative tendencies of informal activities, the actors operate in response to market forces and are skilled in taking advantage of their close links with grassroots communities and institutions. The ease of entry and exit
opportunities enables them to be more flexible in coping with the dynamic socio-economic environment.

Although the informal sector exists as a natural ally of the formal sector, it has remained neglected and has not been integrated as useful partner in the development process. Such a situation has created a hostile environment resulting in uncertainties to undertake risk-ridden business activities which threatened the income earning and productive potentials of the sector.

Despite the economic crisis and the problems of the structural adjustment programs that have adversely affected the economic development of poor countries, the informal sector has survived and supported a significant proportion of the impoverished population through employment creation to provide the means for their livelihood. In the Ethiopian situation, like other developing countries, the informal sector has come about as a result of the socio-economic crisis created by local and external forces and as a response to the search for a means of earning a modest living (UNECA, October 1993, p. 9). Its expansion and development is, thus, determined by the worsening socio-economic crisis and the creation of enabling environments to accommodate the needs and requirements of the sector.

In Ethiopia, the informal sector has currently become a priority issue of concern by the government, in particular the Addis Ababa City Administration where the majority of informal actors in the country exist. Accordingly, all efforts are being exerted to assist informal sector operators to get organized in preparation for a relatively formal business undertaking which will facilitate enhanced performance and better partnership with the formal sector. In view of modernizing the city of Addis Ababa as the seat of the African Union, UN agencies and several international organizations, attempts are being made to clear informal operators that have congested residential areas, main streets pavements and the big business centers. To that effect special working spaces are being allocated around the peripheral areas of Addis Ababa and some open spaces within the city. Therefore, the tendency of the government to focus on policies and development strategies concerning informal sector development seems to be a positive step towards accepting the sector as a useful partner of development.

8. **Significance and Importance of the Informal Sector in Ethiopia**

8.1 **Significance of the Sector**

Several scholars agree that the “informal economy” encompasses a wide variety of social arrangements and economic practices among different environments. The term “informal” performs a unifying function in the use of related terms like underground, submerged or secondary, unofficial etc. which all carry similar meanings (Portes et al, pp. 2-3).

Informality is part of the daily life of individuals and households. It is the means through which important production and distribution functions take place. This assists individual survival strategies to be in line with the broader socio-economic process. The informal economy occupies a distinct position where the emergence of new breed of entrepreneurship and self-employment is growing more rapidly than salaried employment. Such an economy consists of sets of survival activities performed by destitute people on the margins of society and economic dynamism of unregulated income-generating activities (Ibid., p. 12). Although most individuals engaged in informal economic activities are poor, informal economic processes are also observed in social structures which help define production and distribution relationships in the formal and informal dichotomy (Ibid.).
The informal economy is unregulated by the institutions of society in a legal and social environment. Any change in the institutional boundaries of regulation of economic activities produces a parallel realignment of the formal-informal relationship. (Ibid.). The existence of a formal economy that operates through institutional framework of economic activities has created a sector that is informal in all its undertakings. In an ideal free market economy where regulatory practices are minimal, the distinction between the formal and informal sectors would almost be insignificant. However, informality takes place as institutionalization is emphasized to define power relationships of economic activities and reject individual actors that attempt to operate outside of the institutional framework. (Ibid., p. 13).

It is also understood that the informal sector grows at the expense of already formalized work relationships. The development of unregulated activities outside of the institutional system of control causes new forms of production to overcome old ones.

The absence of institutional regulation in the informal economy may affect various elements of the work process in the following manner (Ibid.):

- labor engaged in informal activities is undeclared, lack entitled social benefits and is paid under minimum wage or employed under circumstances that society’s norms would not otherwise allow.
- conditions of work under which labor is employed does not conform to normal health conditions, public hygiene, work place safety etc.
- the management of underground activities engages itself in systematic fiscal fraud or use of unrecorded cash payments as a means of economic transactions.

Informal economy is regarded as the fundamental socio-economic process found at the heart of many societies either in developing or developed countries (Ibid., p. 15.) Accordingly, informal economic activities represent sources of economic opportunity outside the domain of institutional regulation with activities of distinct characteristics that are socially defined unlawful.

The basic distinction between formal and informal activities hinges on the manner in which they are legally regulated or unregulated production arrangements (Ibid.). As various studies have shown, the universality of the informal sector is indicated by the existence of similar arrangements found in countries and regions at different levels of economic development. The divergence of the sector is also reflected in the kind of operational modality adopted by unregulated production and distribution which vary widely even within a single society. It is generally observed that informal activities have increased during the past decades because of rapid growth in informal arrangements across all economic sectors (Ibid., pp. 15 - 18.)

In the various studies examined, it is found that the understanding of informal employment is associated with only the self-employed. It excludes the unrenumerated family workers and domestic servants, casual workers who lack social security protection and other professionals and technicians. Accordingly, all wage workers are taken as part of the formal sector which is felt to lead to gross underestimates of informal employment since the large proportion of wage laborers are employed in micro-enterprises which do not follow the legal practices in doing business.

Some field studies have indicated that growth of small business in urban areas is a result of the rural-urban migration as well as workers displaced due to acceleration of organized labor crisis brought about by political and economic factors. The survival strategies of the migrants to cope with the difficulties encountered in a new urban environment has further expanded the informal sector through encouragement of informal arrangements with formal economic institutions (Ibid., pp. 20 - 23).
Various research efforts have also consistently shown that the informal sector is an integral component of total national economies. Specialized networks formed by unregulated enterprises help free large firms from constraints imposed upon them by social control and institutional norms. Small businesses started as extensions of large firms which helped to decentralize production and distribution. This has further encouraged informalization as a working strategy to make better use of flexibility in unregulated activities.

Although informal actors are found to be frequently harassed by the forces of law and order, the informal sector as a whole operates and develops under government leniency and tolerance. Governments are even forced to promote and stimulate informal economic activities as an alternative for resolving potential social conflicts and as a means to promote political patronage to help reduce the rate of unemployment.

During periods of economic crisis because of global recession and austerity policies, people became subjected to harsh living conditions that made them accept any alternative that can pull them out of their misery. Under such conditions formal employment diminishes significantly forcing people to mobilize themselves to work and earn their living on the margins of rules and organizational arrangements. In their quest for survival, people under such miserable conditions struggle to find ways of attaching themselves to more flexible and ad hoc forms of economic activities that provide more room for personal interaction making life through the crisis more manageable (Ibid., p. 29).

Such a situation of expanding informal economy helped in the decentralization process and created networks of economic activities and brought about emergence of more growth-oriented entrepreneurs. The informal economy relied more on decentralized networks with the formal economy mostly through sub-contracting (Ibid., p. 29 - 30). Although there is some evidence showing increased productivity of capital in the informal sector due to reduction of overhead costs, the use of less advanced production technologies and service activities tend to lower productivity of labor and related gains (Ibid.). However, the cost-saving feature of informality (Ibid. p. 30) due to low cost of labor and reduced state-imposed constraints, the informal sector is believed to contribute directly to capital profitability leading to significant labor absorption (Ibid., pp. 30-31.)

The emergence of the informal economy has created specific social grouping that clearly differ from those associated with stable groups confined to specific markets and segregated working space. It is understood that the more the informal economy develops, the more the economy and society become relatively autonomous spheres of social action. The informal economy does not result from the inherent characteristics of the activities but from the social definition of state intervention. (Ibid., p. 32).

In explaining the long-term significance and importance of the informal sector, Portes et al (1989) have rightly expressed their observation as follows (Ibid.):

"... entry of new workers into the informal sector in cities and expansion of these practices throughout the advanced economies should persuade us that the process of decentralization is here to stay and that the question is whether it will continue uncontrolled or will be brought under some sort of regulation. In the real world, however, there is nothing incongruous about the informal economy, for the livelihood of millions depends on its existence, and the future of many societies, on its form of evolution."

8.2 Importance and Contribution of the Sector

The informal sector is an important socio-economic phenomenon which can contribute to economic development in Ethiopia. Its role is multidimensional and serves as an important breeding ground for entrepreneurs with opportunities for self-
employment. As a flexible and decentralized model of economic organization, the sector can create network of economic activities through sub-contracting, facilitating linkage between different socio-economic processes. The sector is widely regarded as a foundation for economic growth of developing countries (Gibbon, 1995, p. 137). The size of the informal sector varies from 4-6% in high income countries to over 50% in low-income countries, with increases in size and role experienced during economic crisis and periods of economic adjustment. (World Bank Group, p.1).

The informal sector plays a supplementary and subordinate role to activities of the formal sector and helps realize the creative potential of economically active population (Portes et al., p. 300). Thus, the informal sector makes invaluable contribution to economic and social life through provision of employment, generation of income, development of skills and other social services to those neglected and marginalized groups (Street Business Operators Task Force/Addis Ababa, P. 8; Addis Ababa City Administration, p. 2; Yitbarek Tsige, p. 3). For example, taking the case of Addis Ababa (Ethiopia), the informal sector takes up 43% of total establishments in the country and absorbing 42% of the national work force (Ibid.).

Through the development of entrepreneurship, the informal sector facilitates mobilization of untapped resources and the use of labor which helps minimize problems of unemployment and poverty. Because of flexibility and diversification of activities, the informal sector creates a better environment for its actors to be more responsive to opportunities for growth (Addis Ababa Chamber of Commerce, p. 41).

In developing countries like Ethiopia, the informal sector serves as a bridge towards industrial development with the necessary entrepreneurship base. Informal sector activities in the manufacturing areas can also contribute towards import substitution efforts by producing items affordable by low income groups of the population. Through its diversified activities, the informal sector is able to absorb excess labor force in the economy. (Ferej, p. 1).

The informal sector is regarded as the natural home of entrepreneurship which provides ideal environment for building the foundation for economic growth and social progress (Addis Ababa City Administration, pp. 2-3). It helps to develop the business know how and skills of the operators in the pursuit of employment creation, generation of income and more equitable distribution of resources. The sector contributes towards the dynamism of the market environment and activates competition for market opportunities through enhanced productivity and technical change which are stimulants to economic development (Ibid., p.3). The informal sector is an important link in the production and distribution chain which is an essential part of development in Ethiopia (Ibid., p.1).

As indicated above, one of the significant contributions of the informal sector in the development process has been employment creation. The rural to urban migration, combined with a relatively freezing wage employment opportunities in the formal sector, has raised the importance of informal business occupations. For example, according to the Central Statistical Authority Survey (1996), out of the total urban population 80.02% were informal sector operators which consisted of females (64.92%) and males (35.08%).

A further breakdown of the total employment in the informal sector showed that 48.55% were engaged in manufacturing, 40.41% in trade, hotels and restaurants while 11.04% consisted of construction, transport, community and personal services, mining & quarrying as well as agriculture, hunting, forestry and fishing activities (Central Statistical Authority, 1996, P.24). Trades, hotels and restaurants contributed 62.23% of the gross value of income for the overall national urban informal sector with manufacturing being the next highest contributor (29.32%). (Ibid., P. 40).

Informal sector activities play significant role in poverty alleviation efforts by providing the required means of survival for impoverished households and disadvantaged groups during periods of economic recession, drought and famine which are
characterized by declining household incomes and growing under-employment. Thus, another important contribution of the sector is income generation for the underprivileged. According to ILO’s estimates of the average contribution of the informal sector to the total GDP, the share is found to be about 20%. This is an indication of the sector’s role in meeting the basic needs of the poverty-ridden population of Africa in general and Ethiopia in particular.

The goods and services delivered to low income groups are produced at the grassroots level through informally operated activities such as food processing, tailoring, cloth repair, shoe making and repair, wood work products, metal fabrication, vehicle repair, selling goods, house construction and general services such as laundries and hairdressing. The volume of value added and output achieved by the informal sector is a clear manifestation of its absorptive capacity of the unemployed and the gainful application of resources for the generation of surplus to enhance capital formation.

Informal sector operators are products of on-the-job practice and apprenticeship exposure with little or no contribution of education. For example, ILO survey (1984) indicated that 20.1% of entrepreneurs surveyed did not have formal education. The skills acquired were mainly through individual efforts and apprenticeship opportunities and growth driven ambitions of informal operators.

Informal sector enterprises are vital complements to the formal sector which mainly consist of public, private or NGO sectors in the pursuit of socio-economic development. In addition to serving as sources of employment and resource generation, the sector also enhances the dynamism of socio-economic growth and development.

The informal sector is universally viewed as providing the following benefits in promoting sustainable development in poor countries like Ethiopia.

- serve as the spring-board for development by providing refuge for self-employed, talented and growth oriented entrepreneurs.
- mobilize and utilize local development resources which otherwise could be wasted.
- decentralize business activities and provide linkage between rural and urban communities and various branches of socio-economic establishments to meet people’s needs at grassroots level.
- contribute to equitable distribution and utilization of national resources.
- stimulate entrepreneurial spirit to build on the innovative and creative potential of opportunity-driven citizens to serve as vehicles for development.

Labor force absorption for some countries in Africa, such as “Botswana (44%), Kenya (25%), Malawi (56%), Swaziland (92%), and Zimbabwe (86%)”, clearly indicates the contribution of the sector to employment generation (UNECA, DMS #14, p.12).

ILO’s estimates also indicate that informal sector employment accounts for 21% of total labor force in Sub-Saharan Africa, with 59% of employment in urban areas. In some towns like Accra the sector constitutes 80% of total labor force. Nowadays, the informal sector is considered as important source of employment in many African countries even better than the modern formal sector which contributed only 25% of total employment in 1985 (ILO/JASPA, 1993, p. 14, as quoted from Aboagye 1989). The informal sector, therefore, plays significant role as “labor sponge” for the majority of unemployed African peoples (UNECA, 1995, p. 13).
The informal sector is particularly an important source of employment and income for the disadvantaged groups such as women and children. For example, surveys in Tanzania indicated that 75% of total employment in food vending, 32% in tailoring and 5% in carpentry were women. Female participation in activities operated in the household, like beer brewing, is particularly high (ILO/JASPA, 1993, p. 15, as quoted from Bagachwa 1981, 1982, 1983, 1991).

ILO study (1989) has shown that some sub-sectors in the informal sector such as retail trade and restaurants, manufacturing, other services and transport are found to have contributed significantly to employment and production (UNECA, December 1994, p. 5). Moreover, private sector development in general and that of the informal sector in particular enhance the proper utilization of scarce development resources to facilitate generation of employment opportunities and economic independence through improved efficiency and promotion of innovative and creative efforts (Asmamaw Enquobahrie, 1994, p. 1). This would necessitate the creation of an enabling environment which can help remove obstacles that hamper the development and expansion of the informal sector with the view to improving the living condition of the people (Ibid.).

Accordingly, developing countries like Ethiopia have shown the tendency to appreciate the developmental role of the informal sector and it as one of the priority objectives of their development strategy.

9. Experiences of Other Countries

The experience of various countries in the area of informal sector operation is as varied as their socio-economic environments. There are similarities and differences in the nature, characteristics and conceptual understanding of the sector.

Comparative studies of different countries have shown that similar structural characteristics such as small-scale, avoidance of state regulations, flexible sites, use of family labor, unregulated production and distribution, etc. do exist in the informal sector. The informal economy is found to be the focal point of socio-economic dynamics of less developed countries including the developed western countries (Portes et al., p.2). Its universality is reflected in the fact that similar arrangements are found in various countries at different levels of economic development with apparent difference in size. The sector provides less skilled informal jobs for the unemployed like women and the youth.

The sector absorbs excess labor supply that is beyond the intake capacity of the formal sector. Informal sector in developing countries "represents about 50% or more of full-time workers and produces 40% to 60% of national income “ (Mulat Demeke and Wolday Amha, 1997, p. 240, as quoted from Chickering & Salahadine, 1991). Informal enterprises also provide most of urban employment opportunities and a significant portion of employment in rural communities.

However, the fact that the sector operates in unfavorable macro-economic policy environment is shared by the different socio-economic environments as a common phenomenon (Street Business Operators Task Force/Addis Ababa, p.26). Despite such a situation, the informal sector is considered as an important vehicle for economic growth and development, particularly in poor and underdeveloped environments. The informal economy operating in partnership with the formal sector through informal arrangements is the fundamental socio-economic process experienced by many societies (Portes et al., pp.15-18).
A brief look at the experiences of some countries indicates the state and nature of informal activities and the attitude of governments and their intervention strategies. For example, in Central Italy, informal artisan enterprises evolved into complex network of small-scale firms specializing in different facets of activities as part of the growth sector and integrated into the sphere of entrepreneurial development which helped reduce the rates of unemployment (Ibid., p.301). Hong Kong, an export economy mainly built on network of small and informal producers, marketed their products through specialized import-export houses which enabled the export economy to generate opportunities for self-employment (Ibid.). In Spain, articles produced for export are prepared by informal operators (Ibid., p.25). The South African experience has also shown that economic development cannot take place in developing environments without the support and active participation of the informal sector which necessitates policies that are supportive of growth-oriented enterprises (Morris et al., 1997, p. 12).

Lessons obtained from experiences of various countries have indicated the need to create an enabling environment through change of attitudes on the part of government and other stakeholders. Creation of educational systems are also believed to reinforce values of individual initiative, achievement orientation, adaptability and growth (Ibid., p. 13).

Like some African countries, South Africa has introduced some initiatives in the provision of access to saving and credit facilities and construction of special market places. South Africa established a job creation center in 1990 which is mainly engaged in helping small business development through creation of sustainable employment in the manufacturing areas (Street Business Operators Task Force, p. 29).

Studies have identified some factors that impede the growth and development of the informal sector such as lack of proper work premises, market access limited to low income areas as well as limited access to institutional finance. In South Africa, the job creation center (JCC) developed “incubator centers” using donor funding and helped strengthen networking between informal and formal businesses (Ibid., p. 30). The JCCs focused on areas such as construction, cleaning, security etc. for sub-contracting opportunities considering the labor-intensive nature of the activities. In addition, some arrangements (“fronting”) were encouraged to use informal operators to sale items of formal businesses in front of the big shops (Ibid.). In Zimbabwe, city councils provided market stands and working sites for informal traders who pay modest fees to local governments to cover costs of working premises, security services, and some nominal license fees. However, studies indicated that lack of sanitation and infrastructural facilities made it difficult for the operators to use the premises effectively (Ibid., p. 31). Formation of cooperatives is encouraged to facilitate provision of training in textiles and handicrafts, weaving and carpentry as well as acquire other common services. Another initiative in Zimbabwe is the provision of opportunities for traditional informal healers to work with the formal health sector (Ibid.).

In the Gambia, on the other hand, the government has helped to increase the skill and capacity of informal mid-wives further using them as “change agents in the areas of infant malnutrition, morbidity and mortality” (Ibid.). The Kenyan experience shows that the informal sector absorbs significant proportion of new entrants into the job market. For example, the share of employment in the formal sector was 3.1% in 1967 while that of the informal sector was 18% in 1966 and has been able to absorb school drop-outs, retired workers and retrenched workers. The government in Kenya has facilitated the provision of “simple workshops fully equipped with electricity, toilet and public telephones” (Ibid.).

Studies on micro-enterprises in some African countries have also indicated that efforts have been made to redesign the educational system with emphasis on vocationally
- oriented subjects to provide the youth with sufficient knowledge and skills to enter self-employment (Ferej, p.2). The youth are also given opportunities to develop their skills through on-the-job training and informal apprenticeship systems. (Ibid., p. 3).

In Nigeria, the government has undergone changes in attitudes towards the informal sector and the “Peoples Bank of Nigeria” provides credit to micro entrepreneurs without collateral (Ibid.).

The Mexican experience has shown that the increase in informal operators was due to economic crisis, urbanization, government policies and cultural heritage. Because of the envisaged political potential of the sector, the government had to intervene in an attempt to create an environment in which informal and formal operators and the authorities can have healthy relationship to enhance peaceful coexistence. (Ibid., pp. 31-32). Efforts were made to design programs to formalize the operators subjecting them to tax provisions. Accordingly, a market construction program was designed whereby special market places were constructed which informal operators bought on loans payable on installment basis. The informal operators formed associations which represented the interests of the operators in their dealings with the government. However, the program was found to have experienced limited success due to the inadequate participation of the operators beginning from program design to implementation (Ibid.).

In Colombia, government authorities assisted in improving market sheds on the street and providing uniforms for the operators. Official intervention was made to encourage “off streets” occupations to absorb the unemployed on the streets (Street Business Operators Task Force/Addis Ababa, pp. 32-33). According to researches conducted, it is also indicated that beggars in the street were engaged in income generating activities mainly petty trading, such as newspaper vending and peddling as an initial attempt to survive and mobilize funds for subsequent build up of resources to stand on their own feet (Ibid.).

In Tanzania, as part of the efforts of the government to eradicate poverty, municipal officials promoted micro and small enterprises by assigning 10% of their revenues as soft loans to the operators. In this regard, local authorities passed on their recommendations and approval concerning eligibility and certified the trustworthiness of the operators. Technical Committees pay visits to project sites prior to release of loans and upon approval facilitate training on basic business skills. The Tanzanian experience also shows that “official arrangements are made to sub-contract some municipal activities such as street cleaning and road maintenance through tenders which favor micro operators” (Ibid., p. 30). In response to the problems of informal operators, the municipalities also provided free land in suitable locations and even built movable or permanent structures in collaboration with NGOs, and the UNDP. (Ibid.).

10. Problems and Constraints of Informal Sector Development

The problems encountered and the constraints imposed on the informal sector have adversely affected its growth and development. In developing countries, the sector encounters a range of problems and constraints such as legal impediments, inadequate capital, lack of appropriate skills to operate businesses (Ferej, p. 2). Although there are similarities in the nature of problems faced by the sector, some of the critical problem areas may be peculiar to the respective socio-cultural, political and economic environments. Continued policy neglect, attempts to discourage informal operators and efforts to suppress them have always created drawbacks in the development of the sector (Gibbon, p. 137). The low level of capital that can be locally mobilized in a resource deficit environment has also been one of the major obstacles to the sector’s enhanced operation (Seppala, p. 173). In their struggle to survive and develop, informal sector
operators face challenges of unfavorable legislative practices and constant threat of confiscation and harassment in the market place. (Morris et al., p. 12).

According to some studies, informal sector respondents indicated that obstacles that hampered business start ups in the sector were unfavorable government regulation (85%), lack of access to finance (73%) and lack of training (31%), where the majority of informal operators were self taught (77%) (Ibid., p.9). Other problem areas also included poor urban land administration, bureaucratic inefficiency, the tedious process and long procedures in issuing housing permits and the shortage of supply and high cost of construction materials, shortage and irregularities in the supply of inputs combined with low demand for informal sector products (ILO/JASPA, p. 126). This is further aggravated by the decline in purchasing power of the population due to the economic crisis in urban areas and the persistent drought in rural areas (Ibid., p. 127).

Moreover, collateral requirements, which sometimes goes up to 125%, poses a serious impediment to entry into business (Addis Ababa Chamber of Commerce, p.40). The lack of access to formal financing due to inadequate collateral, viable business plans and absence of work premises were also found to be some of the obstacles (Ibid.).

According to a study on problems of micro-enterprise development in Ethiopia, particularly in Addis Ababa, some obstacles and problems encountered were caused by factors such as the following (Addis Ababa City Administration, p. 3):-

- unfavorable legal and regulatory environments
- lack of access to institutional finance and business information
- absence of business premises at affordable rent
- inability to acquire business skills and managerial expertise
- lack of access to appropriate technology and business infrastructure
- discriminatory government policies and practices

The findings of the Central Statistical Authority (CSA) and other studies (Yitbarek Tsige, p. 12; Terefe Amberber, 1996, pp.9-13) have also indicated critical problem areas that have adversely affected informal sector growth and development. These obstacles to informal sector development include:

- lack of smooth supply of raw materials
- problem of government rules and regulations
- inadequate skills
- getting market opportunities
- lack of sufficient capital and access to credit facilities.

In the studies, 49% of respondents indicated lack of sufficient capital as the main constraint, 19% expressed inability to get market for their products while 12% indicated lack of premises as constraints for their growth and development (Ibid.). However, inappropriate or unduly restrictive legislative and regulatory environment was found to be the major drawback that blocked opportunities for access to markets and finance (Central Statistical Authority,p.8).

The observed discrepancies between government policies and their implementation and the discriminatory nature of regulatory practices in handling informal sector issues have reduced the optimism and enthusiasm of the operators in doing business. This has also resulted in the loss of confidence on the part of the operators in the socio-economic environment in which they operate (Addis Ababa Chamber of Commerce, p.3). The high cost of land and working premises and attached utilities and services, transportation costs, the high cost of production and the reduced barriers for
imported items and increased scale of dumping have worsened conditions for the general growth of domestic businesses (Ibid.).

Institutional restrictions consider the informal sector as being risky due to inability to meet the necessary collateral and technical requirements that can satisfy formal financial institutions. Thus, the operators are forced to rely on their own meager resources (34%) and assistance from family, friends and relations (26%), and borrowing from friends and relatives (30%) while the remaining (10%) comes from formal and informal financial sources (Ibid.). Accordingly, the operators struggle to survive with small resource capital, the major resource being their human power and entrepreneurship qualities. For example, the CSA study in 1996 indicated that the amount of start-up capital of informal sector operators (75%) in urban centers in Ethiopia was equal to or less than Birr 500 which is equivalent to about USD 60 (CSA/MOLSA, Ibid.).

Informal sector operators have difficulty in accessing a wider market environment due to legal and institutional barriers which confines them to street corners and places of limited exposure to avoid intrusion of the forces of law and order. This makes competition among the informal operators fierce retarding their efforts to speed up capital formation which is an important ingredient of their growth and development.

The informal sector operators have limited networking with the formal business sector which has resulted in the lack of access to information sources. In addition, the sector suffers from lack of skilled manpower because of the background of the operators mostly characterized by poor education and vocational training. Moreover, the underdeveloped socio-economic condition in which they operate does not allow them to attract skilled labor to enhance their productive efforts. This situation has created drawbacks in the development of the informal sector.

Lack of access to infrastructural facilities, such as water, electricity and means of communication, which are vital for doing business, adversely affect the efforts of entrepreneurs in the informal sector. Absence of adequate provisions for appropriate working spaces, premises and residential facilities or, even if available, inability to acquire them on rental or purchase basis have become critical impediments to the activities of informal sector operators. Such a working environment has forced them to be mobile and operate in highly congested areas without due regard for facilities required of settled businesses.

Diversification of informal sector activities in the face of socio-economic crisis in Africa has created new social networks which reinforced informal sector operation. However, the absence of legal means of enforcing contracts with informal business transactions has left the operators in a state of distrust and loss of confidence on the part of potential sources of support (Street Business Operators Task Force/Addis Ababa, pp. 24 - 30).

Most informal sector operators have indicated that a critical problem area that has impeded their development is lack of capital due to restrictions imposed on them by formal financial sources (UNECA, DMS # 14, p.19). Moreover, lack of access to appropriate markets and lack of and/or cost of raw materials to produce goods and services have also hampered their operation and development (ILO/JASPA, 1985, pp. 39-40; ILO/JASPA, 1984, pp. 40-41). In addition, the informal sector operators are internally affected by their own constraints such as lack of managerial abilities, poor record keeping, lack of technical abilities to study markets and business plans for purposes of securing formal loans (Wolde Emmanuel Walombo, 1996, p. 32).

Under such conditions, enhancing the growth and development of the informal sector in the interest of national development would be a difficult task.
11. Some Controversies on Informal Sector Operation in Ethiopia

Although the informal economy, both in industrialized and less developed countries, constitutes a major structural feature of society, there have been no positive policy measures to promote the sector or even help relax legal restrictions which hamper its operation. (Gibbon, p. 137). And yet, the ideological controversy and political debate surrounding its development have obscured the comprehension of the true nature and characteristic of the sector (Portes et al., p. 1).

Professionals engaged in the study of the informal sector have expressed their views that adequate studies have not been conducted that examined the dynamics and significance of the sector in different settings and its linkages with the regulated economy. However, some studies conducted have made it clear that informality was very much part of economic reality in the developed and developing countries. Some attempts on comparative multi-country studies have discovered that informal sector activities have common structural characteristics across different settings (Ibid., p. 2.)

Developing environments encounter serious development challenges resulting from the rapid growth of urbanization which has resulted in the deterioration of people’s living standards and degradation of the environment. Investment in infrastructural facilities has not moved in harmony with the growth in population. Apparently, the consequence has been negative as reflected in poor living condition, low productivity of labor and other resources. The negative impacts on the urban environment as a result of rapid urbanization and the high concentration of informal sector operators are outlined as follows:-

- indiscriminate processing of materials and setting up of shelters for residence and working premises in densely inhabited areas
- poor and insufficient waste disposal systems which inflict serious health risks and increase the threat of epidemics
- increasing number of urban population living in marginal and environmentally vulnerable locations due to scarcity of land and inappropriate human settlement policies
- inadequate water supplies of acceptable quality pushing households to draw water from sources that are increasingly polluted
- poor city maintenance causing a variety of atmospheric pollution and traffic congestion

Thus, attempts to transform the urban environment in developing countries would bring about major challenges that need to be tackled. This will, apparently, make the situation of the informal sector difficult. With its rapid expansion in the past couple of decades, the informal sector has become a focus of serious controversy particularly in relation to operators doing business in the streets and around city corners and congested parts of cities which are alleged to be spoiling the modern face of cities. Accordingly, the difficulties brought about in areas of controlling environmental degradation and atmospheric pollution has triggered considerable controversy.

Moreover, despite substantial studies made on informal sector since the 1970’s, the conceptual basis and the scope of informal sector activities has remained controversial with regard to its magnitude, characteristic and composition (Sethuraman & UNDP, pp. 10-11). The informal sector, on one side, is considered as illegal or marginal activity and hence parasitic, whereas on the other side the sector is taken as representative of productive, small-scale, self-employed activities which serve as vehicles for the
employment promotion, resource equity and growth (Street Business Operators Task Force/Addis Ababa, p.8).

Although the informal sector helps in poverty alleviation through provision of job opportunities and reduction of unemployment and underemployment, it is considered to be a low-pay job with poor job security for the workforce involved. In addition, the sector is also considered to undertake its activities contrary to state regulations regarding tax provisions, labor regulations and other aspects of legal control mechanisms.

The controversies surrounding the informal sector emanate from the struggle among the sector’s operators and other interest groups from the formal sector. Issues over the use of public spaces between wealthier and established residents and poor informal operators have been highly controversial. Accordingly, attempts have been made to drive away informal operators from the street corners, entrance of shops and places of residence. However, with some tactical resistance and “corrupt toleration” by local authorities and a series of repression and toleration, the informal sector actors have managed to survive. The survival and operation of the informal sector has been fundamentally influenced by the changing interests of the authorities, transformation efforts in the urban environment and changes in the employment situation resulting from the persistent inability of poor economies to generate adequate job opportunities (Gordon, p.1).

Obstruction of pavements, street corners and entrances of high businesses by informal operators has opened up arguments with regard to the style and mode of doing business by informal operators. The informal sector operators are considered as illegal and exploitative segment of the economy taking advantage of the ease of entry and absence of exit restrictions. In addition, the authorities with all the responsibilities bestowed upon them to create organized and unobstructed public transit and working environments for the population has created negative attitude towards the sector’s operators further considering them as impediments to modern city life (Ibid.).

On the other hand, the informal operators have taken “peddling” as a last refuge before starvation or criminality and claiming their activity as their constitutional right to earn an honest and decent living. The operators depend on heavy traffic areas to sell their merchandise which they consider to be the only places for better market opportunities. This situation has attracted the attention of established businesses in the area which accuse the informal operators of blocking entrance to their shops and congest their market environments. Thus, because of such conflicts of interest, attempts have been made by authorities to shift informal sector actors to quickly developing peripheral areas and further restricting the operators from blocking streets, crowding schools and residential areas (Ibid., pp. 2-4).

Another issue of debate is that informal sector actors can absorb potentially dangerous anti-state elements which are alleged to facilitate state collapse and remain threats for governments. However, several studies on informal sector operation have proven to the contrary and despite the allegations, the informal sector has contributed to state transformation and played instrumental role in reshaping the political economy and social relations in developing environments (Haeri, p. 5). Due to the flexibility and dynamism of the sector, people’s initiative and entrepreneurship drives have been facilitated which has become crucial to the survival of millions in Africa, Latin America and the rest of the developing world.

Accordingly, research evidence has suggested that the informal sector would remain an important feature of the political economy in developing countries in the years to come (Ibid.). The sector is predicted to survive as long as the complexity and the highly bureaucratic formalization procedures prevail along with subjective and ambiguous tax systems and absence of official opportunities for access to resources and
facilities remain in the socio-economic environment. In Sub-Saharan Africa, the nature of taxation is considered to be “numerous, ambiguous and complex” which makes it a serious deterrent to formal incorporation (Ibid.). In the African socio-economic and political setting the issue of taxation is considered highly selective targeting government opposition, ethnic identity and degree of government affiliation and support for ruling bodies (Ibid.). The existence of situations indicated above would make it difficult for the informal sector to operate legally and, therefore, the continued operation of its underground activities would be inevitable.

Some studies have uncovered that the informal sector is misunderstood in some respects. The sector is considered to pose challenges on governments through the creation of a “parallel economy” which is alleged to undermine the regulatory and administrative functions of the state. Despite such allegations, governments in Africa and Latin American countries have encouraged the sector's existence and operation as an alternative to make up for socio-economic deficiencies during economic crisis which threatened their credibility. The informal sector enables individuals and communities to acquire “welfare” in the absence of public provisions (Ibid., p.4).

Another argument is that the informal sector operates in haphazard and lawlessness basis in the absence of structured economic set-up and effective state regulatory controls which would ultimately result in conditions of anarchy as the “unofficial economy” creates its own institutional setting (Ibid.). However, the observed stability of economic transactions in the informal economy is due to informal mechanisms of control with the mode of relationship being based on trust, reciprocity and security of pre-made interactions.

Since informal sector activities are highly entrenched in the social structures, the degree of business confidence reflected in the informal sector is found to be greater than its formal counterpart. Another misunderstanding concerning informal sector operation is the perception that departure from formality makes the sector lose its legal protection which makes informal activities costly. Nevertheless, empirical studies have found things to be the opposite. On the contrary, the formal sector in Africa face regulatory environments which have made their operation to be costly because of excessive costs of transactions which are operated through official channels (Ibid., p. 4).

Studies have indicated that the informal sector has become the “most contentious and debated subjects of scholarship in contemporary African studies” (Haeri, p. 1). The studies have shown that distortions and misunderstandings of reality at the grassroots level suggest that the informal sector is “synonymous” with lawlessness and that through avoidance of formal modes of doing business it is considered to challenge local authorities (Ibid., p. 1).

However, such arguments do not suggest that lack of regulatory framework alone would create problems for development practitioners, individuals and businesses. Despite such arguments, it is generally agreed that the sector on its own may not be taken as something that is “neither an economic nor social panacea” (Ibid., p. 2). The dynamism, freedom and the efficiency with which the sector undertakes its business is more related to the underground economic elements of the free market than to lawless confusion with which it is associated. The informal sector is a conglomerate of diverse activities that are not formally registered.

Some arguments also indicate that the informal economy’s avoidance of the formal systems could ultimately threaten its very existence since its activities tend to escape rules, regulations and taxation systems. However, the formal-informal interdependence facilitates provision of cheap and flexible sources of goods and services for the community and gives indirect support to formal businesses by lowering subsistence costs which helps supplement income earned within the formal sector (Ibid.).
Another argument stresses the concern that informal sector activities disintegrate at the bottom and do not show signs of growing into medium and large scale enterprises. In order to enhance the growth of the informal sector, governments need to serve as facilitators in the attempt to intervene to help it grow in a way that would not affect the sector’s dynamism and innovative capacity. The other side of government support could be the creation of an enabling environment for the informal sector to expand in the periphery of big cities, facilitate the provision of duty exemptions for purchase of equipment and machinery as well as developing market incentives to encourage subcontracting to formal enterprises. Government can also help reduce harassment as the operators do business on open public yards as well as improve the credit worthiness of the operators to enable them to have access to financial sources (Ibid., p. 7).

Despite the sector’s tendency to evade taxes and focus on activities undertaken outside of the legal framework, governments even tend to tolerate informality as survival mechanism for the poor or as a supplement to increase the competitiveness of formal businesses (Portes et al., p. 303).

A similar argument is that parallel market activities as part of the informal economy involve illegal production and trade of goods and services as alternative market opportunities. These activities usually develop in response to excessive government interventions which create excess demand or supply. For example, if tax rate is high, there is tendency for tax evasion in order to build illegitimate profit. Moreover, price control in the face of shortages in products and services and in cases of inflation, the tendency for people to buy at unofficial prices would divert outputs to these illegal market opportunities. Another situation is that high tariffs on imports may also induce over-invoicing while quantitative restrictions on foreign trade induce smuggling (ILO/JASPA, 1993, p. 12). Informal sector operators are considered illegal because of their engagement in systematic fiscal fraud in economic transactions and involvement in the production and distribution of goods and services prohibited by law and society (Portes et al., pp. 13-15).

The black market activities produce and distribute goods that are illegal and strictly forbidden by government regulations. Examples may include unlicensed deals in arms, narcotics trafficking and other illegal transfers e.g. thefts, bribes etc. (ILO/JASPA, 1993, p. 13). The lack of distinction between the various aspects of informal activities operating out of the regulatory framework have created confusion in the working interpretation of the informal sector and the development of negative attitude on the part of authorities (Ibid.).

People who argue against informal sector express their concern that workers involved in such activities are poorly treated, receive fewer benefits and lower wages and experience worse working conditions which is considered anti-social (Portes et al., p. 26). Other arguments in support of the sector emphasize that informality can serve as a remedy for the negative consequences of underdevelopment by helping to free the energies and creative capacities of micro entrepreneurs. However, studies have indicated that even the most promising informal initiatives would fail in the absence of favorable state policies and supplementary external assistance at the take off stage (Ibid., p. 300).

Despite the significant role of the informal sector in socio-economic development, its activities have been highly controversial in the government and the private formal sectors in view of their assumed illegality. This has created a situation whereby the sector has been denied of the benefits and privileges required for its development and expansion (Asmamaw Enquobahrie, 1996, p. 1).
12. Challenges and Prospects for Informal Sector Development

As can be understood from the discussions in the preceding sections, attempts to deal with informal sector issues would require serious strategic thinking and pragmatic approach. It may be vital to emphasize on integrating the sector into mainstream development in a way that could be conducive for its operation and development. Obviously, such an approach would be a serious challenge to those concerned with informal sector issues in the development process.

Significant structural changes in the developing countries and elimination of anti-informal sector bias in government policy are needed. Those inheritance laws and property ownership rights that discriminate against the vulnerable groups of informal sector actors such as women have to be reviewed. Moreover, restructuring and reorienting the supply sources such as credit, training, technical know-how, information etc. and linking them to the informal sector operators would be a step in the right direction.

In view of the contribution of the informal sector to socio-economic development, an enabling legal and regulatory environment has to be created to prepare the ground for long-term opportunities to facilitate the transition from informal to formal ways of undertaking business activities. In this regard, the government needs to strategically define the role of the informal sector and play a coordinating role to effect the transformation process. Formulation of enlightened policies that can help to tap the growth potential of the informal sector and reinforce social and economic integration in the productive sectors of the economy is vitally important (Morris et al., p. 13).

The difficulties encountered in areas of raw material provision, government rules and regulations, acquisition of skills, access to markets and credit facilities, inadequate capital base and absence of working premises have to be tackled through the support of government and other stakeholders (Street Business Operators Task Force/Addis Ababa, p. 9). In addition, the absence of conducive legal environment, lack of working tools and equipment, lack of access to information, inadequate training, poor infrastructural facilities, lack of transparent taxation system, simplified government regulations and bureaucratic procedures and absence of institutions to help address strategic problems of the sector are regarded as critical impediments of informal sector development (Ibid.). These factors should, therefore, be considered in order to encourage informal sector development and facilitate its integration into the formal economy (Ibid., p. 25).

The informal sector has to be supported by the government to develop its vision and entrepreneurial capacity. Provision of sub-contracting policy can enhance its productive engagements in a wide range of activities and strengthen its relationship with the formal sector. Such an opportunity can help the sector in the following areas (Addis Ababa Chamber of Commerce, p.50) : -

- reducing obstacles for survival
- building sufficient know-how and capital
- transfer of appropriate technology
- improving the capacity utilization of big enterprises
- helping enterprises reduce labor problems during economic recession
- acquiring knowledge of local markets

The government should also create conducive environment through social and economic infrastructures that can support and enhance private sector development (Ibid., p. 9). Studies on the Ethiopian small business situation, particularly in the Addis Ababa area, have identified some problems that have adversely affected local businesses and, thus, deserve government attention and action. These problem areas include, among
others, damping of foreign goods and contraband items, unfavorable land acquisition policy, licensing procedures, long and difficult customs procedures, high tax rate and the inefficient bureaucracy and related unfair practices. Moreover, lack of accountability and absence of fair enforcement of the law and loss of interest in enterprise development has created an environment that works against the private sector. Such a scenario would discourage the movement from informal to formal ways of doing business and may even work the other way round (Ibid., p. 60).

The study further indicated the discouraging effect of the regulatory environment, which is reflected in the proportion of formal businesses that renewed their licenses and those that did not. For example, in 2000 only 41% renewed their licenses while the rest 59% simply operated without renewing their licenses with the main reason being the difficulty of paying taxes (Ibid., p. 61). On the other side, 3.2% of the total registered businesses returned or canceled their licenses and ceased operation (Ibid.). According to the same study, the small businesses were found to be in a state of collapse. This is an indication that a lot has to be done in the revival of small businesses through favorable policies and regulatory mechanisms which can encourage the role of private enterprise in economic development (Ibid., p. 66). Apparently, a change of attitude and strategic outlook on the part of the government would be vitally important.

Government efforts to promote informal sector development and ensure genuine partnership between the formal and informal sectors is envisaged to play a significant role in the effectiveness of the poverty reduction strategy. However, this would require the concerted action of all stakeholders interested in areas of informal sector development (Addis Ababa City Administration, pp. 1-2).

The emergence of micro finance institutions, some initiatives for partnership and sub-contracting opportunities, donations and grant schemes from agencies in support of private sector development can go a long way in organizing the informal sector activities. In addition, government support programs can assist in the initiation and facilitation of organization of groups to drive the unorganized informal activities some steps forward in the attempt to formalize the activities. (Ibid., p. 19).

Establishment of industrial zones, business start up and commercial premises, and other common facility centers can help in organizing the informal activities. Cost sharing arrangements and pooling of energy, know-how and resources by the informal sector operators would assist in establishing such centers. Other social considerations like education, health facilities and low-cost housing privileges would encourage settled form of doing business (Ibid., p.15). Mobilization of voluntary assistance from individuals and organizations for training, consultancy and technical services as well as the provision of “extension services” can also assist in designing and implementing such programs. The government can facilitate human resource development programs, information and advisory services and the promotion of grassroots businesses. (Ibid.).

In order to restrict the congestion of cities due to migration from the rural to the urban areas, efforts must be exerted to create opportunities for people to remain in their own localities. Such conditions can be done if the capacity of the people in the rural areas can be improved through support programs in the development of vocational, technical and business skills training and provision of resource back-up and appropriate technology to help them engage themselves in productive activities and reduce migration into cities. This would require the creation of enabling environments through awareness creation and commitment of authorities and the beneficiaries in the respective localities (Ibid., P. 6).

Support programs can also be initiated for school drop-outs, the disabled, the unemployed youth and the small-scale manufacturers such as food, textile, leather, clothing, metal work, crafts, builders and small agro-industry operators to be engaged in more formal productive activities (Ibid., p.7). Thus, attempts to help overcome the
constraints and commercial obstacles that hamper informal sector development would enable the actors to exploit available opportunities for their growth and development. Traditional financial and self-help institutions like Ekub and Idir can also play a significant role in the mobilization of funds for micro enterprises development.

In the direction of assisting informal sector operators in their systematic integration into the regulated economy, the study on informal sector activities in Addis Ababa has also proposed some areas of sub-contracting opportunities for the operators. Such opportunities revolve around municipal works like street cleaning, dry waste clearing, maintenance of buildings and roads. The study even proposes allocation of certain percentage of government purchases from small enterprises (Ibid., p. 10). Such opportunities for sub-contracting can also be extended to include other private and government organizations.

The linkage between formal and informal sectors would facilitate the transmission of growth factors such as demand creation, diversification of supply sources and exchange of know-how and experience among the sectors. For example, purchase of components by the formal sectors from the informal sectors would create “derived demand” for informal sector products (ILO/JASPA, 1984, p. 27). The efforts that are currently being considered within the Ethiopian context are, to some extent, consistent with the experiences of developing countries that have taken the initiative to consider informal sector development.

13. Conclusion and Recommendation

The informal sector is no doubt a useful partner of the formal sector in the socio-economic development process of poor countries like Ethiopia. Despite continued research evidence supporting its significant role in development and poverty alleviation efforts, the sector has not been able to win the confidence and support of the authorities in Ethiopia and other African countries. The informal sector requires support and assistance of government and other stakeholders to facilitate its survival and active partnership in the development process and in the fight against poverty, disease and other forms of backwardness. Along this line, researchers on informal sector development have agreed on some key measures that need to be taken by governments in developing countries. These measures include, among others:

- creating an enabling environment with appropriate policies and regulatory practices with regard to access to finance, support services, ownership of resources.
- provision of facilities for technical and vocational training.
- provision of business advisory centers, small enterprise extension systems, and physical facilities such as workshops, craft centers, water, electricity and public telephone.
- establishment of cooperatives for joint marketing and distribution activities.
- facilitation of networking and partnership among informal sector operators themselves and formal business operators.
- strengthening micro-finance institutions, revolving fund schemes and donor and government funding programs for informal sector development.
- creation of favorable legal environment to encourage banks and other financial institutions to design appropriate mechanisms for credit lines and advisory services for informal sector operators.

The urban informal sector is a major source of employment and income in developing countries. The sector has helped the impoverished groups of the urban
population to improve their business skills and income levels required for business development. The informal sector has to be integrated into mainstream development in order to enhance its effectiveness in bringing about tangible results that can change the socio-economic life of the people at the grassroots level. Accordingly, informal sector actors have to be organized to face challenges and exert joint efforts in creating favorable environment for doing business. Efforts by government and other stakeholders to help informal sector operators do business in an organized urban setting should consider issues of assigning appropriate location’s which take into account traffic congestion, security, environmental cleanliness and protection, health and sanitation. In this regard, the necessary financial and material support and assistance could be mobilized from sources interested in private sector development.

For example, indigenous societies like Ekub, Idir etc., micro-finance institutions and other formal financial institutions could also be initiated and encouraged by the government and other stakeholders (Abebe Adera, 1995, p. 10). Apparently, such efforts would require “modification of economic and social behavior patterns as well as appropriate adaptation of structures and procedures” and the active participation of the government, NGOs and the formal private sector (Ibid.). The resources that can be mobilized could go a long way in facilitating poverty alleviation programs and employment generation for the unemployed and under-employed citizens thereby helping them to become productive members of the community worthy of contributing to national development (Ibid., pp. 17-18). Such assistance can supplement the efforts of the government and that of the operators themselves in the early stages of establishment. Organizing the informal sector actors in their respective trades in the form of service cooperatives would also help pool resources and efforts to create the synergy required to do business.

Experience has shown that any intervention programs to support the development of the sector must consider the active participation of target beneficiaries to ensure fair provision of facilities, services and resource support (Street Business Operators Task Force/Addis Ababa, p. 34).

Lessons learned from some African and Latin American countries indicate that as informal operators get organized in specific locations, some moderate fees may be charged for the use of the premises and facilities provided and also nominal license fees to help them operate in a formal way. Encouragement of sub-contracting and partnerships between the informal operators and formal production and commercial firms would help strengthen informal businesses that have the potential for growth and development (Ibid., p. 35). Formation of service cooperatives would facilitate organized self-help and joint marketing of products and acquisition of services and materials for their activities and also help the operators to solve common problems and arrange their own appropriate development strategies.

The necessary pre-condition for informal sector dynamism and development is securing the genuine support and intervention of the government which would enhance small-scale entrepreneurial initiatives and the creation of positive attitude on the part of the local authorities. The government should relax some of the restrictions imposed upon the operation of the informal sector (Gibbon, p. 137). Accordingly, policies and other formal arrangements have to be able to reinforce features of flexibility and dynamism as a new model of economic organization (Portes et al., p. 308). Such a positive move by the government can ensure healthy relationship between the formal and informal sector operators through mutual coexistence as partners of national development.

Establishment of industrial zones which consist of shops, stands, open markets, information centers, infrastructural facilities like utilities, public telephone, sewerage systems, incubators, commercial premises and common facility centers would help bring
about real development in informal sector activities. Informal sector operators can be organized along this line to mobilize their own resources to cover initial costs of establishment for the provision of common facilities.

Since the overall growth of the Ethiopian economy is envisaged to depend on the effective partnership of both the formal and informal sectors, their growth and development should be supported and stimulated in an integrated manner through appropriate national strategies. One of the important components of such a strategy would be the creation of a conducive legal environment and the provision of incentives and other benefit packages to facilitate incorporation of the informal operators into the formal socio-economic framework of doing business (Mamo Wojega, pp. 28-29; Terefe Amberber, p. 19).

Finally, to address issues of informal sector development, there is a need to examine the essential features of partnership between the formal and informal sectors including problem areas that have made the informal sector highly controversial in the development debate. More specifically, the role of government in making effective use of the informal sector to improve the livelihood of its people and the impact of regulatory practices on the sector's operation in Ethiopia would require further studies.

Other studies should also be conducted to examine the dynamics and significance of the informal sector in different settings and its linkage with the regulated economy. Along this line, an ideal definition of the informal sector appropriate for the Ethiopian situation should be agreed upon by concerned government authorities, professionals and various other stakeholders. This would serve as a basis for common understanding in handling issues of informal sector development and help isolate development-related informal activities from those that are considered socially and legally undesirable.
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