

# THE INFORMAL SECTOR AND ECONOMIC DEVELOPMENT

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# Features of the Informal Sector

- Employment
- Enterprise
- Habitat
- Credit

Osarenhcoe (2009)

## Features of the Informal Sector

The concern with the size of the informal sector stems from the understanding that workers in the informal sector are generally poorer and work under harsher conditions than workers in other parts of the economy (Lund and Nicholson, 2006).

The OECD (2009) notes that *“a strong link exists between informality and poverty; most of the working poor in the world work informally, either in self-employment or as wage earners. Many of these people lack basic social protection and are locked into low productivity activities, with scant opportunities for economic mobility”* (p. 96).

# Features of the Informal Sector

*“Informal activities can provide a much needed source of income for a great number of people. At the same time, informality motivated by regulatory distortions, tax evasion, or in the pursuit of illegal activities can be a development trap that deprives governments of needed funds and leaves participants without legal protection” (IADB, 2006).*

# OPTIONS AVAILABLE TO POLICY MAKERS

The options available to policymakers are two-fold, namely

1. facilitate the development of the informal sector and those who participate in it

or

2. formalize the sector.

# OPTION #1 - INITIATIVES

Facilitating the development of the trade and the traders will require several initiatives.

This **first initiative** brings the governments into the centre of facilitating the development of the informal trade.

- a better understanding of the informal sector
- national databases of participants
- a legal framework

The **second initiative** speaks to the development of traders into small to medium sized enterprises.

- creation of an enabling environment
- training of the participants
- marketing support and promotion
- technological innovation
- microfinance

The **third initiative** speaks to tapping into the potential of the Caribbean Single Market and Economy (CSME) for creating greater freedom of movement, removing barriers, and generating better economies of scale and wider market access for traders.

## OPTION #2 - INITIATIVES

Why attempt to integrate the informal sector with the formal economy?

If emphasis is to be placed on integrating the informal sector into the overall economic system, it should be undertaken in a three pronged approach:

The first approach involves the provision of support systems primarily for the development of micro enterprises that must be afforded easier access to markets and productive resources.

The second approach deals with the welfare and poverty aspects associated with engaging in informal trading. In particular, it consists of poverty alleviation policies in the larger frame but also targets family and small business needs since it is very visible that capital commodities serve dual purposes.

The third approach focuses on the regulatory framework while recognising that informal activities are not caused by regulatory inadequacies, but rather by the failure of the economic system to create enough productive employment.

# OPTIONS

Governments in the region would need to review the positive and negative aspects of the informal sector as a prerequisite action for formalizing the sector.

Policies must be so designed so as to strengthen the positive attributes of this sector and suppress the various negative attributes.

These negative aspects include the loss of government revenue, the under-reporting of national economic statistics, possible misallocation of public funds due to the unknown size and structure of the sector, rent seeking behavior and adherence to health and sanitation standards.

The positive aspects are the creation of employment and income, human capital formation and eventually, sustainable livelihoods and the contribution to government revenues resulting from the indirect taxes applied to the informal activities of the sector. There are also the psychological positive benefits of the realization of the desire for independence; enhanced self esteem; the potential to earn income and provide for families; and the capacity to identify and exploit business opportunities in a stagnant economic market.

These policy initiatives should incorporate the gender dimension, given the increasing feminization of the informal sector.



# OPTIONS

Given the cumbersome nature of starting a formal business in the region, governments need to improve on the processes for EODB as a precondition for formalizing the informal sector.

In those economies in which a **high tax burden** is the dominant causal factor for the persistence of the informal sector, one policy option is the lowering of the effective tax rate and homogenizing this rate across all sectors of the economy.

For countries in which **inflation** is the dominant causal variable, the policy recommendation is to tighten monetary policy and stabilize prices.

The transition of the shuttle trade from the informal sector to the formal sector raises the issue of **mobility**.