Informal Economies & Microenterprise in Developing Countries
What are informal economies?

- The business activities of small entrepreneurs that are not legally regulated where employees are not legally and socially protected. This can include self-employment, casual, sub contract, day labourers, homemakers, street vendors, etc..

- Microenterprises constitute the majority of these businesses. In most countries they are- Small, informally organized commercial operations owned and operated mostly by the poor.

- Microenterprises account for a large share of total employment and gross domestic product in developing countries.

- Not a phenomenon or fad. A survival response to global economic crisis, lack of formal employment, competitive disadvantages, lack of formal employment, etc..

- Meets the needs of the poor, helps to alleviate poverty.

- Informality due to expensive/inaccessible regulation, taxes, registration fees
What are Microenterprises?

- Micro-enterprises provide most of the goods and services that meet people’s basic needs in developing and redeveloping countries.
- Often micro-enterprises are the only economic organizations that function in a time of crisis.
- Micro-enterprises require small amounts of capital to enter the market and produce results quickly.
- The small size of micro-enterprises makes them simple to operate.
- Micro-enterprises use local products and skills.
- Micro-enterprises are labor intensive and create jobs.
- Micro-enterprises improve the income of the entrepreneurial poor.
- Micro-enterprises are a catalyst for comprehensive community economic development.

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The Statistics

Informal employment comprises one half to three quarters of non-agricultural employment in developing countries (ILO)

- 51% Latin America
- 48% North Africa
- 65% Asia
- 72% sub Saharan Africa
- 68% Indonesia

- OECD records 1.8 billion workers in the informal economy vs. 1.2 billion in the formal sector.
- In 2009, USAID provided $267 million in funding for microenterprise development through 166 cooperative agreements and contracts in 71 countries.
- Rapayment rates typically exceed 95% (ILO)
- Women represent a significant number of employed in informal sector, up to 85% (WEIGO)
More facts

An estimated 973,000 very poor directly benefited from USAID microenterprise programs in 2009.

The average share of the informal enterprise sector in non-agricultural official GDP varies from a low of 27% in Northern Africa to a high of 41% in Sub-Saharan Africa, 29% for Latin America and 41% for Asia.

New working poor: an increase of 200 million working poor, earning less than USD 2 per day, and unable to lift themselves out of poverty (most of whom work in the informal economy) over the next ten years.
Reasons for Informal Sector Growth

- Globalization of economy
- Limited capacity of formal economy to absorb surplus labor
- Barriers of entry into formal economy, expensive
- Weak formal institutions
- Demand for low cost goods and services
- Economic hardship and poverty
- Growth in number of women entering labor market
- Limited access to financing and business development resources
- High transaction costs
- Limited access to technology
- Structural Adjustment policies of World Bank and IMF
- MNC outsourcing and subcontracting at low wages
Importance of Microenterprises

- They have become a basic component of modern capitalist development, a result of both economic growth and global integration.

- Microenterprise is a major contributor to aggregate employment, production and national income.

- They are an important vehicle of income for the poor, alleviating poverty and encouraging overall economic growth in developing countries.

- They have the potential to provide work for the underemployed, promote competition for more effective markets, promote growth in infrastructure, promote social program reforms and community development.

- Can shrink the gap between rich and poor, promotes the 'missing middle'.
Actors

- USAID, UN, World Bank, IMF, ILO, OECD
  - Provide funding, in the form of grants or loans, to microfinance programs & small business
  - Can reform and strengthen institutions for access
  - Provide financial and business development services
  - Implement policy reform to level the playing field
  - Governance and monitoring against corruption

- NGOs:
  - Receive funding from IGOs for microenterprise development programs
  - Can promote private to public sector linkage, collaboration and investment
  - Push for regulatory reform
  - Can provide business development services
  - Disseminate info, monitor, coordinate, fundraise
What about these actors?

- introduce balanced regulation that also benefits small business and informal economy
- provide accessibility to markets and capital
- tax breaks and incentive packages to increase small business competitiveness
- statutory social protections and programs
- build communication and transportation infrastructure
- how much should the state intervene?

- balanced sourcing and value chain contracts with informal sector
- provide balanced employment relationships, legal recognition and protection
- collaboration for training programs in business management, info sharing
- intra industry mutual 'cluster' development, grants for seed capital exchange for products/services
Theoretical Perspectives

Three main schools of thought

informal economy has few linkages to formal economy, it operates as a separate sector where workers represent the poor. It exists because the formal economy has failed to absorb these workers.

sees informal and formal economies as linked in a subordinate relationship, a result of competitive capitalists taking advantage of cheap labor and informal production.

informal economy is a rational response by small entrepreneurs to over-regulation by government. Regulation that only benefits large capital interests, not small business.
Linkages to Global Economy

Competition

Private-Public Sector Collaboration

Barriers to entry
- Global trade and investment patterns tend to privilege capital and mobile labor
- can't capture markets as easily, lack of knowledge, weaker bargaining power
- transaction costs, insecure contracts
- infrastructure

Sourcing and value chain
- Sub Sector exchange: formal sector purchases good and services from informal sector, access to diverse and cheap products
- Pure market exchange: small businesses can sell products on open market
- Value Chain: informal sector produces goods within a chain of distribution
Implications for Global Economy

Increase in informal sector employment can only boost economic growth, especially in developing countries, rural sectors, among women and other previously hard to reach places.

Microenterprise can contribute innovation, diversity, and knowledge to global markets.

The higher the incidence of informality, the greater the vulnerability of developing countries to shocks like the ongoing global crisis.

Smaller communities can begin asset building. Better contribute to open economy

It has been observed that many informal enterprises choose to expand horizontally and diversify their lines of businesses instead of expanding vertically and formalizing themselves.

Governments should be developing policies that recognize the importance of the informal economy, restrict and regulate it when necessary, increase the productivity and improve the working conditions of those who work in it

Democratizing effects. Spread of neoliberal ideologies?
Why do informal economies matter?

- Poverty alleviation
- Gender equality
- Income inequalities - lessens the gap
- Pressure toward Social protections
- Accessibility to markets
- Reform and community building, infrastructure
- Represent opportunity
- Stimulate economic growth
Role of State?
There are different perspectives...

Government interventions lead to market inefficiencies. Increase informal sector.

Do governments have a responsibility to regulate and correct policy biases in regards to the informal sector? (legalist)

Should the informal sector be recognized? “Formalized”?

Does the state have a responsibility to grow/sustain the informal economy?

- business development policy and programs (dualist)
- macroeconomic framework
- social protections, representation
- improve infrastructure
- develop institutions that regulate, monitor and enforce (structuralist)
- lower costs to enter global market place
International Labour Organization
www.ilo.org

World Bank
www.worldbank.org

OECD
www.oecd.org

USAID
www.usaid.gov

WIEGO
www.wiego.org