Informality: Mindsets, Trends and Tensions

Presentation to
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Informal Economy Workshop

Ravi Kanbur*
www.kanbur.dyson.cornell.edu
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1. Introduction

Deputy Minister Hlengiwe Mkhize, colleagues and friends, it is a pleasure and an honor to make a brief presentation to this important workshop. The issue of informality is, as the Minister noted in her opening speech, an issue of central important to South Africa’s strategy for inclusive development. The government is fully aware of the challenges posed by informality, as various policy statements demonstrate, and this workshop is one example of the government’s attempts to engage analysts and practitioners in dialogue on the topic.

The workshop will focus on the detail and the specifics of informality in South Africa. In my presentation, however, I would like to provide a global perspective on informality, drawing on both the analytical literature and from facts and experiences from countries around the world. I want to make three sets of points: first, the analytical and administrative roots of a prevailing policy mindset on informality; second, recent global trends on informality; and third, the tensions that arise when the ruling mindset comes up against the realities on the ground.

2. Mindsets

There are two main historical sources of the current policy mindset on informality—the academic and the administrative. The academic and analytical literature of development economics is dominated by “dual economy” models, where the dualism is modeled as being between a “modern” (or capitalist, or industrial, or urban, or formal) sector and a “traditional” (household enterprise, or agricultural, or rural, or informal) sector. The details vary, but a central proposition, for example in the famous Lewis “surplus labor” model of development, is the tendency for the modern sector to grow relative to the traditional sector during the process of development.¹ The empirical support for this is often provided by ranking a cross-section of countries by their per capita income and noting that measures of industrialization, urbanization, formalization, etc. increase with income. These models and these snapshot stylized facts across countries are so ingrained in our thinking that measures of

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* Cornell University: T.H. Lee Professor of World Affairs, International Professor of Applied Economics and Management, and Professor of Economics.
¹ Lewis (1954)
Informality (or industrialization, or urbanization, etc.) are sometimes used as a measure of development itself. The mindset is thus that informality should decline into insignificance as development takes place and as per capita income rises.\(^2\)

The administrative mindset on informality has somewhat more complex roots. It is best illustrated by a strand of the dual economy literature which goes back to colonial times. Indeed, the term “dual economy” was coined by the Dutch anthropologist and colonial administrator J. H. Boeke in his characterization of the economy of the Dutch East Indies.\(^3\) The distinction here was between those activities that fell under the purview of colonial rules and regulations, and those activities that were beyond the legal and administrative reach of the colonial government. My reading of the colonial administrative literature brings to mind the notion of a wall which separates the formal from the informal. On this side of the wall is the well-ordered colonial state, subject to a set of laws and regulations, managed by its administrators and officials. On that side of the wall is the (mostly native) informal economy, ill understood and misunderstood by colonial policy makers. It is perceived to be chaotic, disorganized, with criminal elements.

The colonial yoke has been lifted but not the mindset. Post-colonial administrators the world over, particularly at the local level, appear to have the same mindset as their colonial predecessors. Informality is a symbol of underdevelopment, a nuisance to be swept away and kept out of sight in the modernizing path of the national economy.\(^4\) This obviously meshes conveniently with the analytical mindset which sees informality as in any case dwindling with development.

### 3. Trends

The second set of points I wish to make relate to the basic global facts of informality. This is not the occasion to delve into the intricacies of defining and measuring informality, on which there is a large technical literature. What is known is that rates of informality, for example the fraction of the total labor force employed in the informal economy, vary greatly across the world. Latin America rates are relatively low, in the 40%-50% range, while African rates are higher, in the 60%-70% range. South Africa is well known to be an anomaly in Africa, with rates in the 20%-30% range, depending on the exact measure used. South Asia has the highest rates of informality in the world. India, for example, has rates in the 80%-90% range.\(^5\)

However, despite this cross-country variation in the levels of informality, a central fact of the last twenty years is that informality rates have been rising everywhere in the world, despite increase in per capita income. India, for example, has had growth rates of 7% or more over the past decade, and 5%

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\(^2\) Ghani and Kanbur (2012)
\(^3\) Boeke (1953)
\(^4\) Guha-Khasnobis, Ostrom and Kanbur (2006)
\(^5\) Jutting and de Laglesia (2009) and Ghani and Kanbur (2012).
or more over the past two decades. Yet, despite what standard economic models would have predicted, informality has not declined; at best it has stagnated, but more likely it has risen.  

What explains this persistence of informality in the face of economic growth in the last quarter century? There are two main candidate explanations which are debated by analysts. The first explanation is “regulation.” It is argued that informality is caused by excessive regulation in the formal sector, which creates incentives for economic activity to operate outside the purview of regulations—informality, in other words. But even if the presence of regulation could explain the level of informality, for it to explain increases in informality the regulatory burden would have had to have increased. But, in fact, it is well appreciated that in the last two decades of liberalization, the regulatory burden has if anything decreased. The regulation based explanation of increasing informality is thus weak at best.

The second main candidate explanation is to do with fundamental trends in technology and trade which have reduced the employment intensity of growth in the formal sector. The “jobless growth” phenomenon means that the formal sector cannot provide employment for a growing labor force, which then has to go into either open unemployment or the informal sector. The technology/trade explanation seems to me to be a more plausible explanation for trends in informality. But if one accepts this then, since the forces shaping technology and trade are unlikely to reverse in the next two decades, we are also forced to accept that informality is here to stay. Far from receding as a result of development, the very nature of current development means that it will increase. A recent OECD report asked the question in its title: “Is Informal Normal?” The answer it gave was a definite “Yes”.  

4. Tensions

When the irresistible force of increasing informality meets the immovable object of current analytical and administrative mindsets, tensions arise which are reflected in policy schizophrenia. Different parts of the government end up doing different, contradictory, interventions. Sometimes, even the same part of government gives with one hand and takes away with another. The result is that the government as a whole shows policy incoherence, and ends up giving mixed signals.

These are phenomena we see around the world. In India, for example, the government has introduced a plethora of schemes to support workers in the informal economy, including training schemes, support for saving and investment by small operators, etc. However, at the same time, cities have become enamored of the “city of the future” label, with a mindset which sees the informal sector as something of a nuisance in achieving this goal. The city of Ahmedabad has designated some of its new roads “modern” roads, along which no street vending is to be allowed. Cities and governments are also vying to stage international events—the Commonwealth Games in the case of India’s capital, Delhi. The new stadiums and the flyovers lead to huge displacement of informal activities, with inadequate and

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7 Jutting and de Laglesia (2009)
inappropriate allocation of new space for these activities. In the rush to become what they think Singapore looks like, cities in the developing world are trying to sweep away the informal economy. But the global trends identified in the previous section that this will ultimately be unsuccessful.

5. **A National Commission on Informality?**

Despite the recognition of its growing importance, there is considerable uncertainty on the issue of informality at the national level. There is analytical uncertainty, on the basic facts about informality and its trends. There is also policy uncertainty and incoherence, as discussed above. This uncertainty leads to lack of consensus and makes it difficult to build a political basis to address the problems of informality.

What can be done? One practical answer towards building a consensus is to form a National Commission on Informality, charged with addressing a broad range of technical and policy issues. Such a Commission was formed in India by the then newly elected government in 2004. The Commission worked for the lifetime of the Parliament. Its work established a platform on which analytical consensus could be built on the definition and measurement of informality in India. Further, it made a series of recommendations, some of which were accepted by the government and legislated on. Even those recommendations that were not legislated upon formed the basis for national dialogue and debate.8

Madam Deputy Minister, I would like to suggest that such a Commission, with composition and terms of reference tailored to the South African situation, might be one step in advancing the dialogue on informality in South Africa.

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8 National Commission on Employment in the Unorganised Sector (2009)
References


