



# The importance of the Informal Economy for Local Economic Development (LED) in Africa

Emma Wadie Hobson\*



While the informal sector in Africa is often blamed for everything ranging from tax evasion to witchcraft, it makes a huge contribution to Sub Saharan African economies. Studies suggest that the sector contributes nearly 55% of the sub continent's GDP and a staggering 77% of non agricultural employment. Given that the aim of LED is usually increased economic growth and employment opportunities at the local level, positive LED outcomes are unlikely to be achieved unless the potential and needs of the informal sector are

adequately considered. This short paper argues that there is a two way relationship, where focusing on the informal sector is crucial for the success of LED strategies and initiatives, while the LED process provides a major opportunity for improving the performance of the informal sector in Africa. As a result, it is imperative that LED strategies and local economy assessments consider the needs and potential of the informal sector as a matter of priority. Bottlenecks facing its performance can then be identified and addressed, towards improving its ability to generate revenue and employment for poor localities and poor people.

\* LED Consultant based in Addis Ababa (Ethiopia). Since May 2011, Ms Hobson has been operating as part-time LEDNA LED expert. For more details on Ms Hobson's profile see: <http://ledna.org/users/wadiehobson> or contact her at: T: +251 910 884 549; E: [wadiehobson@gmail.com](mailto:wadiehobson@gmail.com).

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## Introduction

### Moving beyond vilifying the informal sector to appreciating its socio-economic importance

The informal sector in Africa has been blamed for everything ranging from tax evasion to witchcraft! Some of the more reasonable studies argue that informality impedes growth as businesses operating outside the formal system find it difficult to access credit, therefore limiting the scale of their operations and exploitation of investment opportunities. Others argue that informal economic activity undermines the ability of governments to raise revenue and therefore denies the public sector resources that would otherwise play a complementary role to private investment through infrastructural development or improvement of the business environment (e.g. Loayza 1996; Misati 2007).

In recent years, however, it has become clear that there is another side to this story. People working in the informal sector should not be vilified. There are reasons why they are pushed into informal activities in the first place and

there are benefits to the existence of this sector in the African context. While various definitions exist for informal sector activities, they are, in general, characterized by small-scale, self-employed ventures, with or without hired workers, typically at a low level of organization and technology, with the primary objective of



generating employment and incomes (Misati 2007).

#### 1. The size and contribution of the informal sector to local economies in Africa

In Sub Saharan Africa, the informal sector can be seen all around us. In cities, informal workers include home businesses, domestic workers, petty traders, street vendors, small scale artisans and shoe shiners. While in rural areas informal activities tend to be related to subsistence agriculture and livestock rearing.

*Given the significant contribution of the informal sector to GDP and employment in Africa, positive LED outcomes are unlikely to be achieved unless the potential and needs of the informal sector are adequately considered.*

The informal sector makes a huge contribution to African economies even if not recorded in official statistics. Studies suggest that the informal sector in Sub Saharan Africa contributes an outstanding share of nearly 55% of the sub continent's GDP<sup>2</sup>.

This share rises even higher, up to 60% if Botswana and South Africa are excluded. The contribution of the informal sector is higher in Sub Saharan Africa than in any other part of the world. Thus in North Africa, its share of GDP is 37.7%, Asia 23.9%, Latin America 30.6%, the Caribbean 22.2% and the Transition Economies having the lowest share of 21.7% (Charmes 2006, p.7, Table 1). In terms of employment, the informal sector is even more significant to African economies, with a staggering 77.4% of non agricultural workers in Sub Saharan Africa being employed in informal activities (Charmes 2000, p.3)<sup>3</sup>.

Given that the aim of Local Economic Development (LED) is usually increased economic growth and employment opportunities at the local level, and given the significant contribution of the informal sector to GDP and

employment in Africa, positive LED outcomes are unlikely to be achieved unless the potential and needs of the informal sector are adequately considered. In African cities, informal work is often a dominant sector alongside formal industry and services. For example, Table 1 below shows the percentage of the employed urban male population aged 15-24 whose activity is



part of the informal sector in different African cities – reaching as high as 93% in Douala, Cameroon. While in rural areas in Africa, informal subsistence agriculture and livestock rear-rearing and informal service provision (such as bakeries, restaurants, car repair, etc), remain dominant activities alongside formal production, agro-processing and service oriented businesses. LED processes must harness the potential of these activities, even if they are often invisible in official statistics, if revenue generation and employment creation objectives are to be achieved at the local level.

**Table 1: Percentage of the employed urban male population whose activity is part of informal sector in selected African cities**

| Country       | City         | Percentage |
|---------------|--------------|------------|
| Benin         | Cotonou      | 61.8       |
| Burkina Faso  | Ouagadougou  | 19.9       |
| Cameroon      | Douala       | 93.2       |
| Chad          | N'Djamena    | 57.3       |
| Congo         | Brazzaville  | 61.4       |
| Cote d'Ivoire | Abidjan      | 52.3       |
| Ethiopia      | Addis Ababa  | 17.4       |
| Ghana         | Accra        | 35.8       |
| Kenya         | Nairobi      | 2.8        |
| Madagascar    | Antananarivo | 48.8       |
| Mali          | Bamako       | 51.0       |
| Mozambique    | Maputo       | 3.7        |
| Namibia       | Windhoek     | 39.7       |
| Niger         | Niamey       | 54.7       |
| Nigeria       | Abuja        | 25.0       |
| Nigeria       | Lagos        | 11.7       |
| Rwanda        | Kigali       | 17.5       |
| Senegal       | Dakar        | 16.9       |
| Uganda        | Kampala      | 18.9       |
| Zambia        | Lusaka       | 6.9        |
| Zimbabwe      | Harare       | 84.6       |

Source: UN Habitat (2008) *The State of African Cities Report*

## 2. The informal sector as a mechanism of economic adjustment and source of livelihoods, particularly in poor localities

In recent years, the informal sector has started to be recognized for its role as a mechanism of economic adjustment and source of livelihood for the poor and unemployed. In most Sub-Saharan African countries, neither the public sector nor the formal private sector is able to provide enough jobs for the ever expanding labour force. Thus self-employment in the informal sector is increasingly the only alternative solution to growing unemployment, particularly among youth. This was particularly obvious during the Structural Adjustment and

liberalization period of the 1990s in Africa, where the informal sector grew substantially as a result of increased retrenchments from and closures of formal sector businesses.

*The informal sector is particularly important to LED in poorer regions due to the employment and income opportunities it offers the poor and unemployed*

For example, evidence from Malawi shows that structural adjustment policies, among other

factors, disproportionately affected female headed small holder farmer households who were increasingly forced to resort to casual labour (Whiteside 2000). Also, Muzvidziwa (1998) showed that Informal Cross Border Trade provided a source of income for traders suffering under the trying conditions of structural adjustment in Zimbabwe, who indicated that this sector was a better paying option than low paid formal employment.



Other factors resulting from underdeveloped economies also push people into informal sector activities. These include a difficult government regulatory environment for business or high entry barriers to formal employment. The informal sector most often thrives in countries with stiff government restrictions, where due to overly bureaucratic or corrupt government regulatory procedures, people conduct their activities underground or without following the laid down procedures in the formal spheres. But the point is that, in such a deficient regulatory environment, these micro, small and medium sized economic activities would not be able to exist unless they went into the informal sector. Furthermore, high entry barriers to formal employment such as high educational qualification requirements or inflexible working hours often prevent many

poor people, especially women, from obtaining formal employment. Informal activities such as home businesses, domestic work or petty trading, therefore become the only possible source of livelihood for them and their families.

The informal sector is, therefore, particularly important to LED in poorer regions due to the employment and income opportunities it offers the poor and unemployed. Poorer regions are more likely to face difficulties in creating the number and type of jobs needed to reduce unemployment. Due to various constraints ranging from underdeveloped infrastructure, low levels of labour skills, low capacities of local firms or low potential to attract investment, the formal sector in poorer regions faces significant barriers against its competitiveness and ability to generate jobs. Moreover, poor people in these areas tend to be more vulnerable to the capacity constraints and the high entry barriers preventing them from obtaining the few jobs that exist in the formal sector. The informal sector is therefore an alternative offering employment and income generation opportunities for people in poorer regions until capacity constraints can be gradually alleviated and formal economic sectors can thrive.

Given women's disproportionate contribution to informal sector activities, paying attention to the needs of the informal sector also has major potential for alleviating gender inequalities. As Table 2 below shows, women often represent the majority of informal sector employees in African countries (as high as 72% in Mali). Improving the performance of the informal sector is therefore likely to impact positively on women in terms of better income and employment outcomes.

**Table 2: Size of female employment and contribution of women in the informal sector in various African countries**

|              | <i>Percent age of women's contribution in</i> |                            |                                   |                  |
|--------------|---|----------------------------|-----------------------------------|------------------|
|              | <i>Informal sector employment</i>             | <i>Informal sector GDP</i> | <i>Total non-agricultural GDP</i> | <i>Total GDP</i> |
| Benin        | 59.7  | 51.1                       | 21.8                              | 14.0             |
| Burkina Faso | 41.9  | 61.4                       | 28.6                              | 19.3             |
| Chad         | 53.4  | 62.3                       | 27.8                              | 13.9             |
| Mali         | 71.9  | 68.2                       | 26.1                              | 14.8             |
| Kenya        | 60.3  | 46.2                       | 10.7                              | 7.9              |
| Tunisia      | 18.1  | 15.7                       | 3.6                               | 3.2              |

Source: Charmes (2000), p. 9

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### 3. Constraints affecting the ability of the informal sector to further contribute to local economic growth in Africa

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Despite its importance, the informal sector in Africa faces major constraints affecting its ability to further contribute to economic success. Constraints exist in pretty much every determinant of economic performance including regulatory barriers, infrastructure, access to capital, human skills, management and marketing skills.

*It is at the local level that the specific constraints affecting particular activities within the informal sector are better known and can be efficiently addressed*

Lack of access to finance is often rated as the most important constraint to informal businesses, preventing them from expanding their production and productivity. This relates to both informal small and medium enterprises, often based in cities (e.g. see Kallon 1990; Kigundu 2002) as well as smallholder farmers who often cite cash flow as their major problem (e.g. Saito 1994 survey in Kenya and Nigeria). Lack of official status, lack of collateral, low levels of literacy and inconvenient locations of banks are among the main factors impeding businesses in the informal sector from accessing finance. Their main sources of finance, therefore, continue to be informal; moneylenders, relatives and savings and credit organizations, which cannot provide the necessary amounts of financing.

Regulatory difficulties and harassment by public officials are also among the most problematic issues for informal sector operators. For example, female traders in Ghana cited government inspections as the most important obstacle, with roadblocks being the second and extortion by public officials the third. More than half the respondents lost 8 or more days in lost wages per month in extra legal payments (Morris and Dadson 2000, p.15).

Lack of access to transport and business related infrastructures are also an important constraint. For example, informal cross border traders mention various infrastructure con-

straints including the lack of efficient road and railway networks between African countries, warehousing facilities, telecommunication services, packaging facilities or acceptable lodging (e.g. WIDTECH 2000). While informal city based traders often cite the lack of acceptable market stalls, with toilet facilities, etc as a constraint to their ability to work, especially for women. Low skill levels and lack of access to market information also lead to missed opportunities for informal workers. For example, informal cross border traders often miss trading opportunities due to their low literacy levels and low access to telecommunication (WIDTECH 2000).

The above barriers, not only limit the economic success of the informal sector, but also perpetuate informality by increasing the cost of entering into formal sector activities. If the regulatory environment for business was improved and informal workers had better skill levels, access to finance, legal working spaces, etc, there would be a much higher chance that their activities could gradually become legalized, generating more revenue for African countries.



It is at the local level that the specific constraints affecting particular activities within the informal sector are better known and can be efficiently addressed. For example, in a rural region, the constraints affecting subsistence farmers are better known. While in a city, the constraints affecting petty traders and other informal workers can be easily identified through surveys or dialogue forums, for example.

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#### 4. How can the development and implementation of LED strategies alleviate constraints to informal sector performance?

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Relating to the above mentioned constraints, measures that can be taken at the local level to address these issues, therefore, range from improving the regulatory environment to increasing knowledge of market opportunities among informal workers. Of course some issues, such as the need for better statistical data collection on informal sector activities, are better addressed at the national level. But there is much that local actors can do through the LED process.

Taking the 5 stages of LED as a guide (see World Bank 2006 for more information), the following measures can be taken to improve the local performance of the informal sector:

##### *Stage 1 – Organising the Effort*

When organising the group of local stakeholders that will form part of the local LED taskforce or forum, informal sector operators must be actively included. Associations of informal sector workers will be invaluable members of such forums in terms of inputting their knowledge on the needs of the informal sector into LED strategy formulation and investment prioritization.

##### *Stage 2 – Local Economy Assessment*

When conducting Local Economy Assessments, the informal sector must not be ignored due to a lack of official data. The assessment stage is a major opportunity to collect quantitative and qualitative information on the contribution and needs of the local informal sector, including:

- Quantitative data on the number of people employed in informal activities, and the quantities and yields that they produce or trade, etc (using surveys and any secondary data available)
- Qualitative information on the constraints affecting different types of informal sector activities and what could be done to alleviate them (using surveys, focus group discussions or interviews with informal workers)

##### *Stage 3 – Developing the LED Strategy*

As mentioned above, the informal sector representatives within the LED Task Force or Forum will be able to input valuable information and ideas on policies and initiatives to alleviate the bottlenecks faced within the sector. Likely areas of intervention will include:

- Improving the regulatory environment for business, including taxation, business registration and trading across borders processes as well as attempting to reduce corruption and harassment among public sector officials
- Incentivizing financial providers to provide financial services to informal sector operators on flexible terms
- Training and capacity building for informal sector workers, particularly in the areas of business and financial management, literacy, business regulations and increasing their access to market information
- Improvement of local infrastructures including local roads, railways, public transport, market structures and telecoms infrastructures
- Given that the majority of informal workers are women, interventions are needed to alleviate the specific gender based constraints that affect them including all the above general constraints in addition to gender discrimination, division of labour and time constraints.

##### *Stage 4 – Implementing the LED Strategy*

In addition to inputting into strategy development and investment prioritization, informal sector organisations can also implement particular initiatives alongside other public and private sector entities. For example, informal sector associations are in a good position to implement initiatives related to training, capacity building and increasing access to business information among their membership. While public sector bodies are best able to improve the regulatory environment and invest in local infrastructure. And the private

sector is often best able to implement interventions to provide access to finance or business development services, such as management advice.

### Stage 5 – Reviewing the LED Strategy

Again, it is important to involve informal sector representatives in the monitoring and evaluation of LED Strategy implementation to assess the impact of initiatives implemented on the performance of the sector.

## Conclusion

The above paper therefore shows that there is a two way relationship, where focusing on the informal sector is crucial for the success of LED strategies and initiatives, while the LED process provides a major opportunity for improving the performance of the informal sector in Africa. As a result, it is imperative that LED strategies and local economy assessments

consider the needs and potential of the informal sector as a matter of priority. Bottlenecks facing its performance can then be identified and addressed, towards improving its ability to generate revenue and employment for poor localities and poor people.

## Endnotes

<sup>1</sup> For example, see Cheater (1998) for a review of gender biased characterization of Informal Cross Border Traders in the Zimbabwean state owned press.

<sup>2</sup> Including the informal agricultural sector

<sup>3</sup> See also recent findings from the 2010 report of the United Nations Economic Commission for Africa (UNECA) upholding these earlier statistics <http://bit.ly/rlfaae>.

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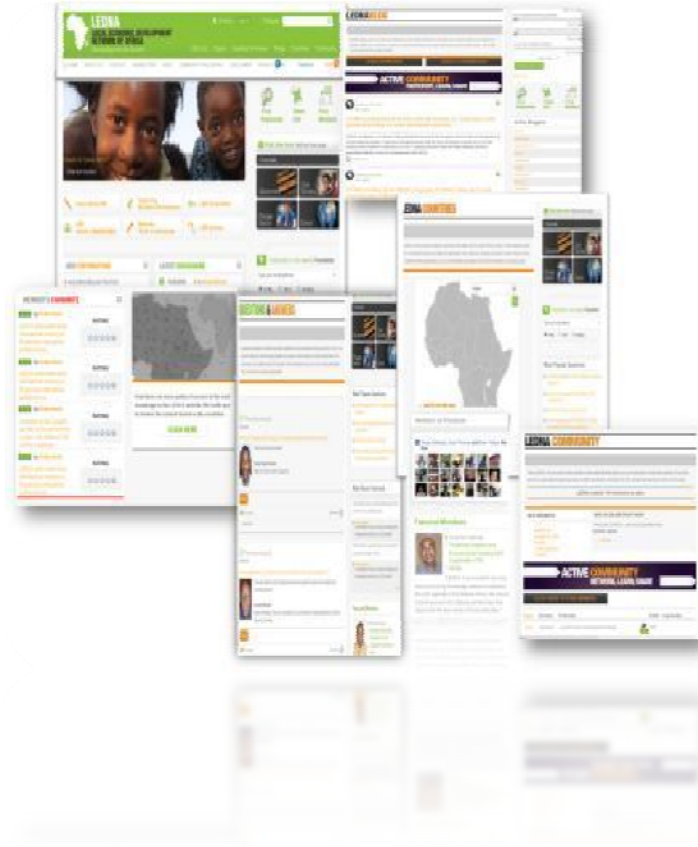
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*LEDNA is funded by the Swiss Development Cooperation (SDC), the French Development Agency (AFD) and UCLGA.*

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**Issue n° 1. August 2011**