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**GROWTH WITH DEVELOPMENT:
INFORMAL SECTOR AND HUMAN DEVELOPMENT
IN LOW-INCOME SUB-SAHARAN ECONOMIES**

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Growth with Development: Informal Sector and Human Development in Low-income Sub-Saharan Economies

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Abstract

The low-income economies in Sub-Saharan Africa (SSA) present a segmented economic structure. In this paper we state that, in these economies, informal activities can contribute largely to poverty reduction and to economic and human development. The development process is analysed starting from the assumption that its evolution is influenced by institutional endowments and non-institutional resources endowments.

In the first part of the paper the definition and the role of the informal sector are presented. Afterwards, in order to present a stylised structure of the SSA low-income economies the paper focuses on the informal sector and on the main characteristics of these economies. In the second part of the paper a model derived by the stylised representation is exposed. In this model the economic development is influenced by the presence of institutional and non-institutional resource endowments. In the last part of the paper relevant policy implications are outlined in the direction of a broad based development supporting micro, small and medium enterprises development. The main conclusions are reported.

Keywords: Informal Sector, micro and small enterprises, human development, Sub-Saharan Africa.

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1. Introduction

Poverty reduction and human development¹ are the social and economic goals towards which Sub-Saharan African (SSA) economies should be directed since human beings are the ends of economic activity rather than its means. Past experience in SSA low-income countries has shown that economic growth alone is not a sufficient condition for meeting broad base growth and human development. Indeed, we need to acknowledge that even with economic growth the gap between rich and poor can increase, hence 'the quality of growth matters' (Cornia, 2002, 2004; UNDP 2003). In this paper we affirm that African economic and human development cannot pass only through a rapid expansion of the modern sector as more than fifty years of neglected development demonstrate. Economic growth is relevant since it is one of the prongs to increase human development but it also has to be recorded in those sectors where the income of the poor come from².

As argued in the African Employment Report 1995 (ILO, 1997), the development strategies adopted by many African countries in the early post-independence period were generally guided by the classical theory of economic development in which emphasis was placed on capital accumulation for maximisation of GNP growth. Growth of output was linked to production patterns and technology that were somewhat biased in favour of capital-intensive modes and employment creation was not a central part of this type of development strategy³. With limited infrastructure and institutional capacity for expansion of production and external trade, and given the lack of financial resources and technological know-how for rapid industrialisation, it was virtually impossible for the newly-independent African countries to immediately break out of the colonial legacy of mono-cultural production and diversify their economies in line with the requirements for participating in a more complex international economic system. It was assumed that rapid growth of GNP would suffice to bring about both economic development, improvements in living standards and in human development. This however was not to be the case for most countries in the region: for some, rapid growth of GNP was elusive because of lack of investment and labour skills and due to inherent structural problems; for others which registered respectable rates of growth, the inadequacy of growth for addressing employment and poverty problems soon became obvious as the "trickle-down" process failed to materialise. At best, whatever "development" took place as a consequence of growth-oriented strategies, it was unbalanced and concentrated in the modern sector, and therefore did not contribute much to the need for productive employment and income (demand) of the urban poor and of the large rural population.

The underestimation of the role of the informal sector often contributed to inappropriate analyses and to wrong policy planning and implementation. Indeed, "Contrary to earlier beliefs, the informal sector is not going to disappear spontaneously with economic growth. It is, on the contrary, likely to grow in the years to come, and with it the problems of urban poverty and

¹ Human development is regarded as 'an expansion of capabilities' or of 'positive freedoms' (Sen 1999, Nussbaum 2000, for a review see UNDP 2000).

² Human Development Report use the term of 'ruthless growth' for a growth that do not reach the poor (UNDP, 2003, p. 67).

³ Except for public employment in urban areas or in countries were a socialist system at least started such as Angola, Mozambique, Guinea Bissau Tanzania and, temporarily, in Ethiopia e Somalia.

congestion will also grow” (ILO 1991, p. 63). Moreover, as stated in the African Employment Report 1995, the main structural change in African economies has so far been the growth of the informal sector which in some cases accounts for up to two-thirds of economic activity (ILO, 1997).

From a theoretical point of view, in spite of the fact that informal sector enterprises are now generally considered to form part of a wider economic structure, most studies have treated them in isolation⁴ (ILO, 1989, p. 27) with the tendency of considering these merely as urban activities or, at best, as marginal to the development process⁵.

The misunderstanding of the functioning of the SSA low-income economies was often connected to the overlooking of other two relevant aspects of these countries: the structural characteristics and the institutional endowments and non-institutional resource endowments which affect their socio-economic system development. Neglecting the economic segmentation of SSA low-income economies and the institutional and non-institutional endowments which characterised them, is underestimating both reality and history -which are, in a certain sense, two basic dimensions for analysing an economic development process-. The institutional endowments are the rules (formal, informal) that allow a social and economic system to function, while non-institutional resource endowments are human, physical capital including infrastructure and services (such as health, sanitation, education, training, extension and financial services, ...).

The aim of this paper is to analyse the SSA low-income economies starting from the assumption that their economic development as a dimension of human development is affected by institutional and non-institutional endowments and considering the presence of the informal sector as a non-transitory -although in part dynamic- phenomena. According to Bhaduri "The real economic issues are to identify the nature of constraints and the processes that operate on the demand and on the supply side of a developing economy to regulate the process by which these structural changes occur" (Bhaduri 2003, p. 220).

The value of this analysis lies principally at the level of economic policies considering the growth and development of micro, small and medium enterprises -both in the formal and informal sectors- as a direct approach to reach the main goals of poverty reduction and human development. The informal activities can be considered as a starting point since they constitute the vast majority of these economies and are the core of the income generating activities of the poor.

The analysis focuses on low-income economies and in particular to SSA countries (with labour surplus) for two main reasons. The first reason is that although the informal sector can be considered a universal phenomenon, the structural, technical and institutional contexts are different among developing countries (ILO, 1991, p. 13). Consequently focussing only on SSA low-income economies which have common socio-economic features and similar institutions should bring to more realistic assumptions and policy implications⁶. The second reason is related to fact that SSA Low-income countries have a huge informal sector in term of labour force and

⁴ Recent studies which incorporate the informal sector in development models are reported in the references.

⁵ "When development planners speak assisting the informal sector of developing economies they invariably are referring to operations that are located in urban areas." (McLaughlin 1990, p. 183). Forgetting that if the problems of rural areas are not "answered" they would aggravate the urban "problem".

⁶ In this research the analysis on institutional and non-institutional factors remains at theoretical level. Therefore, no distinction is made on different institutional frameworks among SSA low-income countries.

they also have a similar economic structure (Biggeri, 2000).

In the next section, the second, the main characteristics regarding the informal sector and its role in social and economic development are presented. In the third section, the main characteristics of the economic structure of SSA low-income economies are examined and we propose a stylised representation of the segmented economy of a SSA low-income country. These two sections are neither a data analysis neither a literature review⁷ but they are functional to the following model. In the fourth section, a model for a SSA low-income economy which also includes the presence of informal activities is exposed. This model is based on the cornerstone idea of different labour productivity among sectors, and on the presence of institutional and non-institutional endowments among sectors and sub-sectors of the economy, both influencing employment and wages. Another specific aspect of this model is the different perspective of analysis, because, although we consider both urban and rural areas, the attention remain mainly focussed on the two separately. In the fifth and last section policy implications for economic and human development are presented.

2. Background: Informal sector and economic development

The concept of informality is very important in the study of developing economies/countries. Standard classification among sectors of production give an incomplete and undifferentiated picture of these countries economic structure homogenising complex and different sets of economic activities. The term “informal sector”⁸ is able to incorporate an heterogeneous set of activities which have in common a mode of organisation which is different from the unit of production most familiar in economic theory, the firm or corporation. Further more and they are also likely to be unregulated by the state and excluded from standard economic accounts of national income (Swaminathan, 1992).

“While the precise boundary between formal and informal sectors is often difficult to draw, the two sectors are clearly distinct” (Swaminathan, 1992, p. 31). The formal activities can be considered as a part of the economic system 'structured' or 'guided' (in the sense restricted in their development), while the 'other economic activities' coincide with the informal sector. Note that we exclude criminal activities from economic activities (for further details see the appendix at the end of the paper).

The structured economy or the formal economy is referred and screened in its development by the evolving of the institutions selected during time by governments (or by who has the 'real/legal' power to do it) for the 'satisfactory' development and functioning of the socio-economic system of a country⁹. The 'structured' or 'guided' terms are intended positively as it is the continuing evolution of the institutional framework (ideally in a 'democratic' country) which

⁷ A literature review on informal sector is beyond the scope of this paper for a bibliographic survey see Feldman and Ferretti (1998).

⁸ For details on the definition of informal sector see the appendix A.; while among the references, see ILO 1989, Como 1995, OECD 1997, Livingstone 1991, United Nations 1996, Swaminathan 1992, Fidler and Webster 1996, Morrisson OECD, 1995 and Morrisson and Mead 1996, SNA 1993, Bangasser 2000, Gerxhani 1999.

⁹ Indeed, for instance, they could be created by groups for rent-seeking extraction or for monitoring information. The institutions can be created (or violated, e.g. corruption) by the power on its own interest.

should only lead economic activities to what is perceived as the 'right direction'¹⁰ also in terms of their fiscal contribution to the economic system.

The other economic activities are un-restricted in the sense that they do not follow, at least, part of the normal administrative and legal framework imposed by the government (i.e. un-regulated by formal rules). Informal activities are present in a developing economy as a natural response to 'specific' socio-economic background (which often differ from the 'western' capitalist market institutional framework), as a spontaneous reaction to changing economic conditions, and/or as a reaction to the institutional framework imposed by the governments. The informal activities are often themselves strongly structured showing different and specific institutional arrangements born in relation to local conditions. In particular, the significance of informal institutional arrangements is given by their 'survival ability' connected to the indigenous ethnic or religious networks and, in definitive, providing a context of cohesion and shared norms (Assaad, 1993).

We argue that the formal and informal sectors are both in the rural and the urban areas, giving the economy the characteristic of 'double dualism' (Myint, 1985). However, "... , while many symptoms of the urban informal sector are also to be found in rural areas, the causes and the context are different, and their accessibility to various kinds of remedies is also quite different" (Bangasser 2000, p. 18).

In this study, we define the informal sector as composed by the whole set of those activities not governed by legal institutions and in force laws, and/or those organised in different ways from the ones characterising the economic activities typical of a 'modern' economy (Volpi, 1994)¹¹. The informal sector covers 'everything' from small-scale manufacturing and repair, to trade, transport and construction and services. In urban areas, informal activities range from street vendors to small manufacturing entities and, in rural areas, small enterprises are engaged in the production, transformation and sale of farm and non-farm (e.g. handicrafts and services) products. Following this definition given, the non-modern agricultural sector (subsistence and semi-subsistence or small household farming) is considered part of the informal sector (see also Ray, 1998, p. 348; United Nations, 1996)¹². This gives a more realistic dimension of the informal sector and a different perspective in the analysis of the structure of developing countries especially SSA low-income economies.

Furthermore, considering the aims of the paper and that at least part of the ambiguity formal/informal in the literature stems from the failure to make a clear distinction from sector enterprises (economic activities, i.e. *informal sector*) and sector employment (i.e. *informal economy*) the first definition is applied¹³. According to most researches, the informal sector enterprises or activities are characterised by: i) small-scale operation (small and micro-enterprises as home-based or individual enterprises with few or no employees -employs rarely

¹⁰ This 'right direction' could include rules: to protect environment, to implement an egalitarian development, against child labour, to protect during work and workers rights, etc.

¹¹ "Attività definite 'informali' in quanto non disciplinate dalle istituzioni e norme vigenti o in quanto organizzate in forme diverse da quelle caratterizzanti le attività economiche proprie di un'economia moderna" (Volpi, 1994, unpublished).

¹² There are differences among agricultural and non agricultural sector as it is specified later.

¹³ The 14th International Conference of Labour Statisticians in 1987 concluded that the 'economic unit' (the enterprise) was the most appropriate measurement unit for defining the informal sector the final resolution was reported in the System of National Accounts (SNA) (1993) (Bangasser, 2000).

more than 10 workers, including working family members-); ii) labour intensive and low skills demanding (often acquired outside the formal educational system); iii) reliance on indigenous resources, and, iv) unregulated and often competitive markets with a relatively easy entry (lower levels of investments and less prerequisites requested).

Theoretical debate

In the theoretical debate on the role of the informal sector in the development process “While the phrase ‘informal sector’ came onto development scene in 1972, its roots reach back into the economic development efforts of the 1950s and 1960s” (Bangasser, 2000, p. 2) and in particular, considering its inclusion in a macro development model, in the dualistic literature (Ranis 1988). Dualism relates to various asymmetries in organisation and production of the economic structure of developing countries composed by a traditional and a modern sector. In the dualistic models, the development was seen as an evolutionary process of a developing country into a ‘modern economy’: ... a shift from the traditional or backward sector (subsistence agriculture, ‘informal’ sector) to the modern or ‘advanced’ sector (capitalistic, formal). The dynamic mechanism which brings to development process is given by the passage of resources from the 'traditional' sector to the 'modern' one. “It was axiomatic that, as ‘take off’ was achieved and the development process gained momentum, the ‘modern sector’ would gradually absorb them. So the ‘problem’ was only temporary” (Bangasser, 2000, p. 4).

Although we agree that the literature produced by Lewis and his successors captured very important characteristics of the traditional (informal) sector (Lewis 1954, p. 141) and dynamics of the labour market of developing countries -and later of the urban-rural migration phenomena (Todaro 1969)-, we argue that the dualistic models overlooked some relevant aspects. Indeed, -as field researches and empirical studies on the informal sector flourished in the 1970s- the dualistic models interpretation was debated and the interpretation of the informal sector and of the structure of the economy of developing countries disputed. In particular dualistic models can be criticised since they identify the function of the traditional (informal) sector in the economic system merely as a passive one with the labour force seen as reserve army, as a reservoir from which the expanding modern sector draws labour. Furthermore, in the dualistic models the traditional (informal) sector was depicted as an 'homogeneous' entity neglecting the peculiarities and differences within the sector (to some extent connected to the specific rural/urban location). From the policy implication point of view, another main shortcoming of the dualistic models is probably the insufficient attention to the relevance of institutional and some non-institutional endowments overlooking their importance in economic development and in particular in the labour transfer hypothesising a perfect mobility of labour from the traditional to the modern sector. This is a relevant point, since the workers’ decision (or the economic activities’ decision) to locate themselves in one sector or sub-sector (e.g. rural/urban, traditional/modern) cannot be based explicitly only on expected earnings maximisation (profits) but also on institutional and non-institutional endowments.

Another relevant theoretical work is "Redistribution with growth" edited by Chenery et al (1974, chap. II and XI). It analyses the economies of developing countries stressing that their economic system is segmented. They present a model which divides the economic system into groups based on the distribution of income (i.e. by quintile five groups). The model is relevant

since it demonstrates that different policies (with redistribution aim) bring to different results for poverty reduction. They identify five possible policies. However, again in this model the lower income level group is not able to produce development on itself. Then, the model based on level of income group, fails to capture the characteristics of the societies and does not tell us much about how the society is organised.

Case studies and field researches

Case studies and field researches gave a large contribution to the understanding of the informal sector and to advance in the theoretical debate on its role in economic development, evidencing that the informal sector is far from “stagnant “ and “non-dynamic” -as it is characterised in the ‘modernisation view’-. Indeed, the informal sector role can go beyond the survival function enhancing: employment generation (in the labour intensive sector); poverty reduction (job income, income diversification); output creation; internal/domestic trade expansion opportunities; emerging entrepreneurs formation; local human resource development; the transformation of savings into local investment; the use of appropriate technology in relation to local resources, and skills endowment and a production oriented to satisfy local demand (which can become also a constraint).

Three other relevant features emerge from these studies: the heterogeneity of the sector with the presence of a dynamic part, the importance of the linkages within the sector and by the fact that the sector evolution is affected by institutional and non-institutional endowments.

The heterogeneity is one of the most relevant aspects and can be examined in a two-fold manner. First, as above mentioned, informal sector incorporates an heterogeneous set of activities which are spread within the whole economy considering the standard sector classification (primary, secondary and tertiary) and different location. Second, they present different levels of development and operation (or function) varying from pure subsistence activities to small dynamic enterprises. In other words, on one side the informal sector is a symptom of economic dysfunction and seen just as a low-income job sector creator, on the other it is seen as an opportunity to implement the development process. Considering the diversity within the informal activities the formal vs informal activities dichotomy tends to hide more than it reveals. Therefore, instead of considering the informal sector as an undifferentiated entity, it is necessary to distinguish among a dynamic-advanced component (often related to micro and small enterprises and accompanied by features such as dynamism, flexibility, relatively higher accumulation, entrepreneurs creativity and initiative) and a non-advanced part. This possibility opens the road to new models able to capture important and different aspects among the informal sub-sectors and their relationship with economic development.

The importance of the linkages within the informal sector and their positive dynamic contribution to the economic development is another aspect which emerges in field researches. Enlarging the concept of linkages to consumption and investment (not merely production linkages) these studies gave a different and wiser perspectives. In particular, looking at consumption patterns, these analyses were able to capture better the dynamic contribution of informal activities to economic development through the spin-off effects on local activities and via upward and forward linkages within the sector and with the formal sector through direct (production, consumption and investment) and indirect linkages. Smallholders (the poor) are

more likely to spend on local goods and services. In other words, the informal sector cannot be considered, as before by some economists, as the sand in which the multiplier effects are lost. This important conclusion emerged clearly for rural areas only in recent studies (FAO 1998, Delgado et al. 1998). The inter-relationships among rural informal activities, farming activities - subsistence and semi-subsistence agriculture, very small farm (in size and income generated)- and rural non-farm income generating activities, are very strong¹⁴ and relevant for poverty reduction. Non-farm informal (and formal) activities have demonstrated their ability to provide employment opportunities, thus impacting on underemployment and disguised unemployment in agriculture, and helping to combat problems of rural depopulation and migration to big cities. They provide additional sources of rural household income and an increase in security via its diversification. They contribute to remove income-poverty constraints, by ameliorating food security and reducing the risk-adverse attitude of rural households inducing for instance to programme term farm investment in a longer period. In theory, with higher incomes, farm and non-farm households can increase their consumption -generally of local non-tradable goods and services- inducing further development or they can increase their investment on land, buying modern inputs for farming or for non-farm activities and possibly escaping from the 'poverty trap', and reducing their vulnerability¹⁵.

Another aspect which emerge in SSA low-income countries is that sub-contracting is not common between formal-informal activities (on the contrary for instance of South and South-East Asia). Formal-informal activities linkages are not strong and that there are barriers to spontaneous inter-sectoral trading (ILO, 2000)¹⁶. This problem is connected to the lack of knowledge, understanding and trust of one sector by the other. Informal business lack of ability to undertake large orders, they lack management expertise, product consistency and quality control, capital, credit, production equipment and premises, and secure storage of finished goods. Other difficulties include formal sector payments delays, the high costs of borrowing, and the difficulty in communication. This determines difficulties in demand delivery of quality and quantity on time (Mersi, 2000). Furthermore, it is well known that the value added chain of the product leaves a very small share of value added to the informal sector.

The third point considered, which emerges both from field researches on informal sector and through economic literature on institutions, is the fact that institutional and non-institutional

¹⁴ Rural non-farm informal activities are conditioned, not only by farm households income, but often also by the timing of agricultural activities and thus, in definitive, by climatic conditions (seasons) and reflecting the different activities and positions of male and female in rural societies.

¹⁵ Spillovers in local economic systems improve the availability of farmer inputs and small enterprise employees can become an important market for agricultural products throughout consumption linkages increasing agricultural products commercialisation, while small enterprises themselves through input or production linkages can help to stabilise the demand and the price agricultural products requested.

¹⁶ In the last two decades -with the increasing trade and foreign direct investment liberalisation- we are in the presence to a global business revolution where the competition at international level is in the hand of Multinational Companies (MNCs). Subcontracting in Asian countries reached also informal occupations in production chain which stretch beyond national borders (for the value chain, and sub-contracting to Home base workers see for Asia Mehrotra and Biggeri (2002), in Latin America Tomei (2001). If in South and South East Asia sub-contracting appears to gaining ground for the former for the export-oriented industrialisation for the investment of MNCs, in Latin America the subcontracting and informalisation are a response to globalisation competition to cut costs (Chinese price is held to the benchmark of international competitiveness). In SSA low-income economies the sub-contracting phenomena is not gaining ground in international value chain. The sub-contracting is mainly within the same segment of the economic system and some time between them.

factors¹⁷ affect economic activities and in general economic development. Therefore, these factors contribute to the creation of diverse economic environments because of different modes of production and transaction and different location (rural/urban). The ILO underlines the presence of significant barriers to entry in most of the profitable sub-sector of the informal economy¹⁸. “Social institutions and custom can also affect the functioning of an economy by setting up barriers to mobility. ... Similarly, if there are different types of labour, for example, skilled and unskilled, institutions ... could hamper movement between these categories. This would imply that the wage differentials between these groups of labour would not be equal to the cost of acquiring skill” (Basu K., 1997, p. 324). From a dynamic perspective since the economic development of a country often passes through the transformation of its economic system and society, the process of institutional change and the process of economic change interact with each other and can either promote or retard each other (Banerjee A. V. and Newman A. F., 1998, p. 631). The non-institutional factors are human, physical and capital infrastructure -such as the natural resource endowments, human resource endowments and infrastructural communication system or level of development of financial system-. They can affect the development of economic activities and increase economic opportunities. For instance, if transportation costs are high, due to the absence of infrastructure, product markets remain relatively underdeveloped (demand constraints) and production in most of the agricultural households is largely limited to self-consumption. Another important example of non-institutional factor is the presence of human capital which influences economic performances and human development¹⁹.

In conclusion, although almost three decades have passed since the report of the ILO/UNDP Employment Mission to Kenya was published (1972) and have been followed by an amount of researches emphasising that the informal sector (especially through small and micro-enterprises development) can make and is making an invaluable contribution to the economic and social development of developing countries- the informal sector was often ignored by authorities and marginalised by development policies. The formal sector revealed inadequate to develop in a way to absorb the national labour supply. While the labour absorptive capacity of the informal sector has been substantial, the bulk of labour in the sector is engaged in low-productivity and low-income activities (ILO, 1997). Ignoring the informal sector activities means leaving out a large part of the population -often the poorest part of- precluding it from being an active part in the socio-economic development.

¹⁷ Institutional and non-institutional factors are often endogenous to the society and path dependent, they can be defined as comprising those basic elements necessary to economic activities function.

¹⁸ “These various financial, educational and ethnic barriers to entry all serve to restrict the absorptive potential of the informal sector, especially within the sub-sectors with some potential for upward mobility: ...” (Meagher 1995, p. 269). Meagher underlines that some of the rules can be seen to protect rather than help the functioning of the economy (Meagher 1995, p. 272).

¹⁹ Basic Social Services (BSS) influence strongly human capabilities. Better education and improved health care can deliver major benefits for productivity because of improved skills and less production losses caused by worker illness. Then, two important synergies can emerge: the one among different BSS and the one between BSS and growth (Mehrotra and Biggeri 2002). Economic infrastructure is considered as part of the enabling environment making economic activities possible and profitable, and is also seen as a determining factor for the productivity and growth capacity of enterprises. The lack of infrastructure directly affects the quality and the quantity of production of an enterprise.

3. A stylised economic structure of Sub Saharan Africa low-income economies

It has been estimated that the informal sector in SSA is contributing to more than 20% of GDP and employing among 60-70% of the total labour force (United Nations, 1996, p. v). Particularly, the largest part of the sector is constituted by service activities in urban areas and by farming in rural areas (for further details and estimates on SSA see Biggeri M. 2000). The presence of a large part of the labour force employed in the informal sector and contributing, in comparison, to a much lower share of GDP, determines, “if GDP per capita growth has to be reached”, the “apparent paradox” of the non-importance of informal sector. On the contrary, the informal sector is central for the socio-economic development of these countries (for further details see Figure 7 in the Appendix at the end of the paper). It represents a strong reality of these economic systems and given both the difficulties which the capitalistic market institutional framework encounters in its diffusion and the high rate of growth of the labour force, it can be considered a non-transitory phenomenon (Mersi, 2000).

Labour market segmentation is a characteristic of SSA low-income economies, reflecting mainly unequal access to education and socio-economic opportunities and inequality in the distribution of assets among people and by the presence of different institutions. This type of economic activity is well typified by the dichotomies urban-rural and formal-informal. However, also within these economic activities it can be further differentiated. Therefore, in these economies the informal sector activities can be grouped into two parts: a large non-advanced component constituted mainly by subsistence agriculture and non-farm low income activities and an advanced component -with a higher growth potential- mainly constituted by micro and small enterprises both in urban and in rural areas. These dynamic informal activities using labour intensive techniques, could be vital to the African development because of their potential in both employment and productivity increase (Volpi, 1994, p. 378; United Nations, 1996, p. 2). This “emerging” component, in particular, can stimulate savings, new and latent entrepreneurial energies, absorb appropriate technology, enhance new techniques and convert local savings into local investments. Furthermore, a different picture on informal sector activity linkages is emerging also for SSA low-income economies. This emphasises that some dynamic contribution to economic development and growth can be apportioned also by the lower part of the informal sector because there are important linkages and synergies among less advanced activities of these economies. In consequence, if consumption and investment linkages are considered, relevant spillovers can be depicted also among the non-advanced informal activities; since this spending in turn has spin-off effects that generate even more new income. In Asia and Africa consumption-based linkages were four-five times more important to growth than production-based linkages (Delgado et al. 1998). For instance, some reports find that in SSA rural areas the farm and non-farm activities are able to propagate income growth better than previously thought (FAO 1998, Readorn et al. 1994). Inter-linkages among agricultural and non-farm activities at household level are very important for poverty reduction given also the tendency of rural farm families to income diversification to reduce risk and the low transaction cost in switching among farm and non-farm activities. Indeed, “... although African households are poorer than those in other regions, the incentive to diversify their incomes is strong (owing to low farm incomes, risks, etc.). This runs counter to conventional wisdom that sees African peasants as being little

inclined towards rural income diversification.” (FAO, 1998, p. 291) Non-farm income is crucial for poor households either to supplement subsistence or as a form of accumulation. The dynamic of local savings and investment generates multiplicative effects and this implies an underestimation of the potential growth also in rural areas .

In SSA low-income economies, more than in other developing countries, the informal sector and in particular small and micro-enterprises encounter many obstacles during their operational activity and especially in their evolution. Informal sector enterprises lack often of adequate economic infrastructure (electricity, water, roads, telephone, waste disposal, etc.) and inputs. Often basic social services including health facilities, water sanitation and education are denied to its workforces. Several studies underline the lack of formal education or training for acquiring skills and managerial capabilities, or of demonstration centres and extension programmes. Evidence suggests that apprenticeship is undertaken as a second-best alternative given the inability to pay for secondary education, and it provides the main way in which commercial and artisan skills are acquired (Meagher and Yusuf 1991). Almost all studies agree that the access to finance is the most critical aspect since informal sector has little access to formal credit (due to poor information flows, absence of collateral, weak contract enforcement and consequently high transaction costs) so it is connected to self-financing or use the informal credit market supplied by traders, money lenders, friend and relatives (Griffin 1996, Mersi 2000). Demand constraints, due to low-incomes, can obscure the possible synergies through the linkages previously highlighted.

In order to present a stylised economic structure of SSA low-income economies the aspects previously examined are here specified. In particular, formal/informal dualism would be further refined taking into account other dichotomies and institutional and non-institutional endowments. Hence, these aspects would be incorporated in a general conceptual framework embracing the economy as a whole.

The institutional and non-institutional endowments are different in the sub-sectors of an economy and they often act as barriers which may influence the workers’ wage level, wage rigidity and the rate of employment and urban/rural and formal/informal economic activities relationships and also market access.

The economic activities can be firstly divided, following the spatial location, among urban and rural areas. This partition not only depicts one of the most important features of developing countries, but it is very useful for policy implications (and for these reasons common in dualistic and migration models). Then, in urban and rural areas, the economic activities can be split in two sectors the formal and the informal ones and these into advanced and non advanced sub-sectors considering labour productivity. This latter sub-division is very important because emphasises that in urban and rural areas formal and informal sectors have different characteristics within themselves, which is functional for the analysis of the development process. It is assumed that within informal non-advanced activities there is underemployment and disguised unemployment (while discouraged and/or open unemployment is excluded) due to the above mentioned institutional constraints and because of the high labour force growth rate at a level that the labour force cannot be absorbed by the development of the formal activities within the economic system.

In particular, considering the urban informal sector, following Ranis and Stewart (1995, p. 4-

5) and as already argued, it is important to distinguish between a more productive and dynamic component and a traditional, relatively stagnant part of the sector, which more closely fits the customary image of the sector. There are, thus, two major types of activity: those we describe as ‘traditional’ (or non-dynamic, non-advanced) which have a very low level of capital formation, low labour productivity and incomes, very small size (three or less workers) and static technology, often organised within the home. The other component of the informal sector consists of ‘modern’ activities (or dynamic, advanced), not rarely linked to the urban formal sector. “These typically are more dynamic in technology. This sub-sector tends to use more skilled labour, partly generated through learning and training activities; its labour productivity is higher, and some incomes, especially entrepreneurial incomes, can be substantial.” (Ranis and Stewart, 1995, p. 5)

Hence, the urban economic activities can be divided among urban formal advanced activities (UFA), urban formal non-advanced activities (UFNA), urban informal advanced activities (UIA) and urban informal non-advanced activities (UINA).

- The urban formal advanced activities (UFA) sub-sector is mainly composed by large enterprises which tend to utilise capital intensive technologies (and which in an opened economy, especially if there are multinationals, usually expatriate profits and rarely reinvest in the local economy). The advanced formal sector is non neutral in the use of technology but is induced to use capital intensive techniques, thus giving a small contribution to the absorption of an increasing labour force.

- The urban formal non-advanced activities (UFNA) sub-sector is, generally, composed by small (and some time medium) enterprises which in general employ labour intensive methods of production. On average they have relatively lower labour productivity in respect to UFA. They are linked to the local economy and usually reinvest their profits in the local economy.

The activities of urban formal sub-sectors pay taxes. Their workers receive a wage which is often higher than marginal productivity because of turnover costs and for the presence of institutional (social benefits for workers, unions action) and non-institutional resources endowments including human capital and better infrastructure for production.

- The urban informal advanced activities (UIA) sub-sector is composed by small and micro-enterprises especially in the manufacturing sector and forms the dynamic component of the informal sector. They tend to use local labour intensive methods of production and reinvest wage surplus into the local economy. On average their productivity is lower than those of the UFNA.

- The urban informal non-advanced activities (UINA) sub-sector is composed by micro-enterprises especially in services. Its the non-advanced part of the urban informal sector and essentially is often considered as “a sponge”. Marginal productivity is very low (lower than UIA), there is the presence of disguised unemployment and the subsistence wage for all workers is reached only if there is sharing income within families or through informal social safety networks with a wage influenced by an antipoverty social norms

As already mentioned, the rural informal sector, as the urban one, has a dualistic structure. A dynamic component can be recognised in the informal advanced (non-subsistence) activities, while the non-dynamic or non-advanced is given by subsistence enterprises: formed by households or individuals in subsistence agriculture and/or in informal non-advanced off-farm activities or both. In this case households can be seen as multi-sectoral (in the traditional sense

i.e. agricultural, industrial and services) micro-enterprises.

The rural economic activities can be divided into formal and informal sector and each is further separated into two sub-sectors. In this case the formal activities²⁰ are represented by rural formal large size activities (RFL) and by rural formal medium size activities (RFM); while the rural informal activities are divided between rural informal advanced activities (RIA) and rural informal non-advanced activities (RINA).

- The rural formal large activities (RFL) sub-sector is composed by large plantations and/or large size farms (often linked to export crops, MNCs) or by off-farm large size enterprises such as mining. The specific characteristics (derived from period of colonisation) are high profits (often exported) and low wages -often near the subsistence- for their employees “working poor”. The average RFL wage can be taken as the regulatory wage.

- The rural formal medium activities (RFM) sub-sector is composed mainly by medium size non-farm enterprises and farms (producing export crops and food crops). These activities have a relatively higher average income and quite often a higher labour productivity.

- The rural informal advanced activities (RIA) sub-sector is composed by non-farm small and micro-enterprises household and by small size farms (non-subsistence, commercial farmers) producing cash crops and food crops. These activities in general have a lower labour productivity than RFM.

- The rural informal non-advanced activities (RINA) sub-sector is composed by rural households conducting subsistence, semi-subsistence farming or non-farm activities or both (and this is also one reason why the subsistence household farming is classified together within the non-farm rural informal non-advanced activities). Marginal productivity is very low, there is the presence of disguised unemployment and the subsistence wage for all workers is reached only if there is sharing income within families (or throughout informal social safety networks). As for UINA discouraged and/or open unemployment is excluded.

In particular, subsistence and semi-subsistence farm households agriculture, which form part of the rural informal sector, still produce with traditional techniques, recording a lower level of labour productivity and a high self-consumption. Often in the subsistence and semi-subsistence farm households wage is based on income sharing within the household (Ghatak S. and Ingersent K., 1984). This brings to the fact that marginal productivity is often lower than wage. The reason is that the payment system is not based (and cannot be based) on marginal product (Ray D. 1998, 360-362). Low marginal productivity is mainly due to the typical vicious circle of poverty for low-income households and individuals –e.g. low investment, low demand (low income), low productivity because of low investment-. Farm households often suffer of risk aversion which is relevant in maintaining them within the poverty vicious circle.

Another important sector to be mentioned is the State sector. The State sector is composed both by the bureaucracy (civil servants) and workers in public enterprises. Its main characteristics are that it is part of the formal sector, mainly located in urban areas and it generally utilises labour intensive techniques of production. The average wages, for reasons connected to institutional and non-institutional characteristics, are quite low but workers receive some benefits in terms of social protection, basic social services (and stability, fringe benefits)

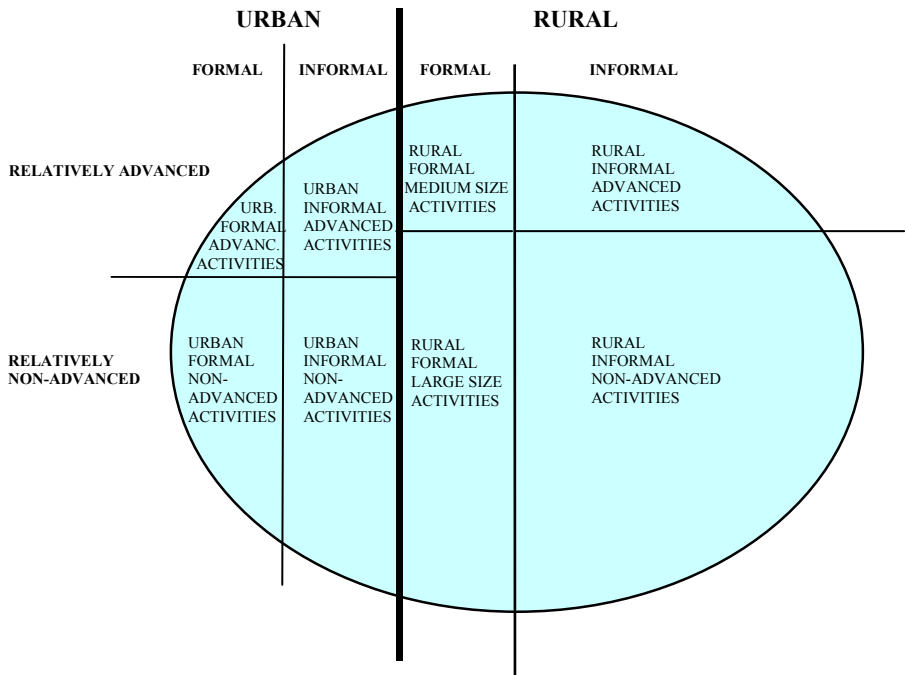
²⁰ These are formal activities (enterprises) although they often use informal employees (without social protection).

(Volpi, 1994). Although it is not considered as a sector *per se* in the model it would be mainly in UFA and UFNA sub-sectors.

Therefore, the economic activities can be partitioned into the eight sub-sectors above mentioned as reported in figure 1. which is a stylised representation of a SSA low-income economy. Indeed, economic activities as a whole can be seen as a lake, the presence of institutional and non-institutional borderlines is depicted by dams which separate the sub-sectors. The economic activities, which are in a more advanced sub-sector benefit of a better economic environment and resource endowments.

This partition of the economic activities gives the opportunity to look at SSA low-income economies from a different perspective than the one usually proposed. However, the structure of production of an economic system is just one side of the coin, the demand pattern is the other one. Indeed, as emphasised by many development economists, if the labour force consists of low productivity food farmers, with only a tiny surplus, the market for domestic goods (e.g. manufactures produced in the advanced formal sub-sector) is strictly limited. The importance of the demand intensity in determining the production, in the earlier phase of development (in a close economy), is well emphasised in the literature: there is no sense in increasing production if there is no demand for the product since this bring to over-production crises (Georgescu-Roegen N., 1976, p. 43). For instance, in rural areas small scale non-farm enterprises production is strongly demand linked to agricultural earnings, and thus, in this case it is the agricultural income increase which can enlarge the demand as already discussed.

Figure 1. A stylised representation of a SSA low-income economy. The economic structure segmentation into economic activities is done considering work force partition (a).



(a) The areas are not indicative of the real size of the respective labour force.

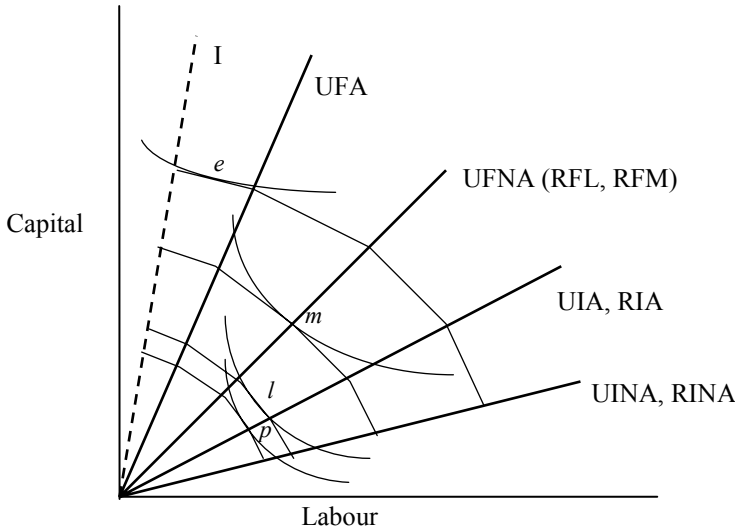
This section is concluded with some observations and characterisations of a simplified consumption structure which characterises the demand pattern of a SSA low-income economy.

It is assumed that everyone consumes and contributes to a part of the total demand, the kind and share of good consumed depends on wage level, and on the characteristic of the goods (e.g., expensive capital intensive products). The pattern of consumption, as emerged in many SSA studies, is as follows: the lower is the level of income of the class, the less capital intensive goods are consumed, the higher is the level of income of the class the more capital intensive goods (often non-tradable) are consumed and a smaller food share in consumption is registered as predicted by Engels' law.

Following Ranis and Stewart, in figure 2., a simplified pattern of consumption with four different classes of income groups is represented for a SSA low-income country. There are four classes of income groups.

Therefore, the two classes of smallholders with low and very low income, which form the larger part of the population in SSA low-income economies, are more likely to spend on local non-tradable labour intensive goods and services. In particular, the very-low-income-class *p* is likely to spend mainly in the products of UIA, UINA, RIA and RINA sub-sectors and the low-income-class *l* in the same sub-sectors plus UFNA and RFM. While medium-class *m* is likely to spread the consumption among all sub-sectors. The elite-class *e* or richer households would tend to spend on items from the modern manufacturing sector often located in cities and produced usually in the UFA, UFNA, RFL, and RFM sub-sectors (or on imports I). The implications of these observations, given the structure of the SSA low-income economies, are important. A change that benefit informal/formal smallholder and their activities will have a greater impact on the local economy via consumption linkages and via production-investment linkages.

Figure 2. Simplified consumption structure and demand pattern for a SSA low-income country



- I, imported consumer goods
 - UFA, consumer goods produced in the UFA sub-sector
 - UFNA (RFL, RFM), consumer goods produced in the UFNA (RFL, RFM) sub-sectors
 - UIA, RIA, consumer goods produced in the UIA, RIA sub-sectors
 - UINA, RINA, consumer goods produced in the UINA, RINA sub-sectors
 - e*, elite-class equilibrium choice
 - m*, middle-class equilibrium choice
 - l*, low-income-class equilibrium choice
 - p*, very-low-income-class (poor-class) equilibrium choice
- Source: Our elaboration on Ranis G. and Stewart F. (1995) and Biggeri (2000).

4. The model

In this section a development model for SSA low-income economies which includes the informal sector is presented. The purpose is to advance the debate on the possible role of the informal activities and particularly of small enterprises in the development process of SSA low-income countries and to examine the growth process from a poverty reduction and human development perspective in order to determine policy implications.

The model presented evolves from the cornerstone idea of the dualistic approach, based on the different productivity of labour between an advanced and a non-advanced sectors²¹. The model, however, differs substantially from dualistic models for some key assumptions and for the fact that the development mechanism is determined not only by the market force but also by the presence of institutional endowments and non-institutional resource endowments and by the investment decisions of policy makers and thus in definitive by factors endogenous to the economic system.

First of all, it is assumed that the economic system of SSA low-income countries is composed by more than two sectors, presenting an economic structure more complex and segmented economic structure. Then, the economic system presents within each sub-sectors institutional endowments and non-institutional resource endowments. Borderlines can be virtually identified between the sub-sector which allow for different wages among sub-sectors and, within the some sub-sectors, for wages higher than the marginal productivity of labour as well as for wage rigidities thus influencing the employment rate of the labour force. Institutional and non institutional endowments may be seen as imposing severe costs to the economic system or as opportunity for the development process. These institutional endowments can be formal and informal and while non-institutional endowments are human, physical capital and services such as education, training, sanitation and other facilities, such as infrastructure facilities, credit,

Hence, the model attempts to consider simultaneously both dualistic aspects and other structural characteristics of SSA low-income economies. The low-income economy is close and divided into the eight sub-sectors previously described:

- the urban formal advanced activities (UFA);
- the urban formal non-advanced activities (UFNA);
- the urban informal advanced activities (UIA);
- the urban informal non-advanced activities (UINA);
- the rural formal large size activities (RFL);
- the rural formal medium size activities (RFM);
- the rural informal advanced activities (RIA);
- the rural informal non-advanced activities (RINA).

The economy is characterised by disguised unemployment in the urban and rural non-

²¹ “This question of marginal productivity has not gained close attention, although it has been raised in a theoretical way by Mazumdar (1976). Mazumdar produced a two sector model of an urban economy which held the prediction that the income differential between the formal and informal sectors will widen over time as informal sector income is blocked among an ever growing informal sector labour force. The same phenomenon could apply in the rural areas with respect to nonfarm activities and indeed is likely to apply there more directly” (Livingstone, 1991, p. 665).

advanced informal activities (the discouraged or open unemployment is excluded).

The main assumptions on the sub-sectors characteristics are summarised in the following points:

1. The average workers wage (income) differs between sub-sectors and the order is: $w_{UFA} > w_{UFNA} > w_{UIA} > w_{UINA}$ in the urban area, and $w_{RFM} > w_{RIA} > w_{RFL} \geq w_{RINA}$ in the rural one.
2. In particular, the three sub-sectors UINA, RFL and RINA have a wage level (w_{UINA} , w_{RINA} , w_{RFL}) nearby the subsistence wage w . The RFL is the regulatory wage (relevant for urban/rural migration).
3. Marginal productivity of labour is different among sub-sectors. In particular, $UFA > UFNA \geq UIA > UINA$ and $RFM > RIA > RFL \geq RINA$.
4. The average wages, for reasons connected to institutional and non-institutional characteristics, are not equal to the respective marginal productivity of labour in the following sub-sectors UFA, UFNA, UINA and RINA. For instance, this could be due, for UFA and UFNA sub-sectors, to labour turnover costs and to allowances (or trade unions interventions), while for UINA and RINA sub-sectors to income sharing (Basu, 1997)²².
5. Production techniques used vary between the eight sub-sectors. Capital intensive production techniques (capital labour ratio) decrease in the urban areas from UFA to UINA sub-sectors ($UFA > UFNA > UIA > UINA$), while in the rural areas the situation is ($RFL \geq RFM > RIA > RINA$).
6. The new technology employed in the UFA sub-sector is biased towards capital intensive techniques and it is neutral for the other sub-sectors.
7. Everyone consumes and forms part of the total demand, the kind and share of consumer goods depend on wage level, following the consumption pattern already described (in section 3): the lower is the level of income of the class, the less capital intensive goods are consumed, higher is the level of income of the class more capital intensive goods are consumed.

The economy, given the assumptions made so far, can be represented as in figure 3. This figure reports a “snapshot view” of a closed SSA low-income economic system when the development process is already in operation.

In the horizontal axe l the total labour force L of the closed economy is reported. The economic activities are divided into urban and rural activities in base of their spatial location. Then, each urban economic activity is further divided considering the belonging to the four urban sub-sectors. The same is done for the rural economy. Therefore, each sub-sector is represented with its own labour employed. It is worthwhile to remember that an employee is into a sub-sector if is employed by a generic economic activity operating in that sector²³.

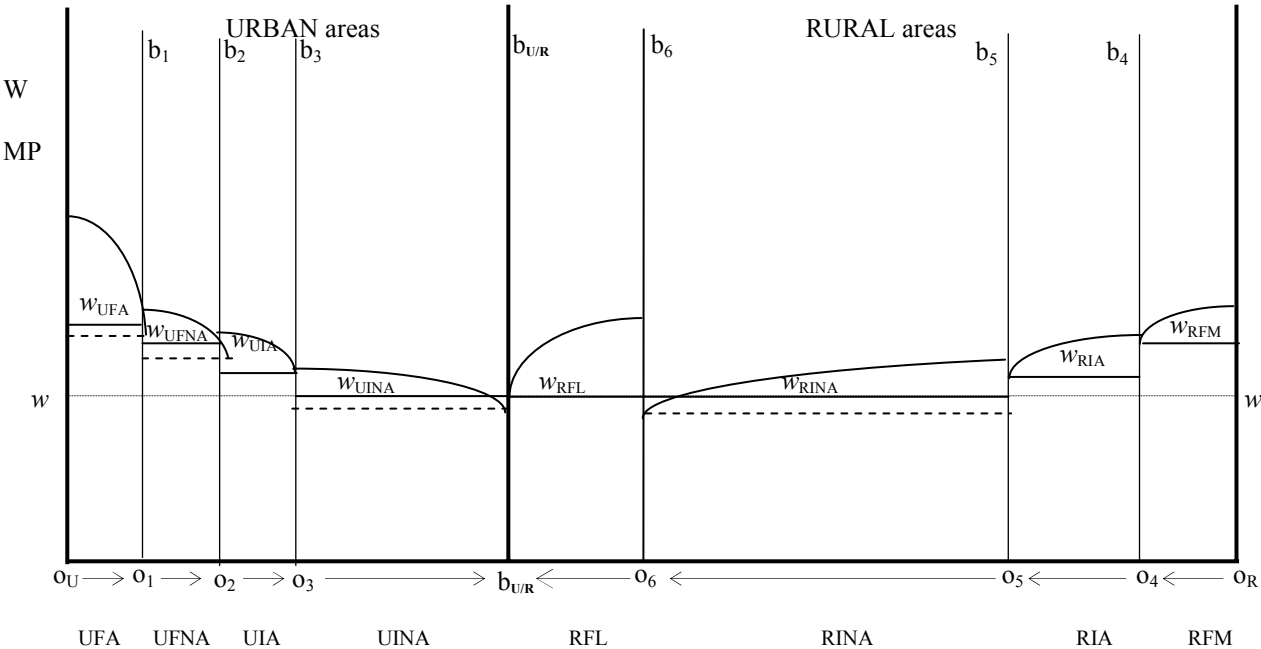
In the x axis two main “origins” are given the one on the right is the origin of the urban areas activities o_U , the other on the left is the origin of the rural areas activities o_R . Urban and rural areas are divided by a barrier $b_{U/R}$. From the origin o_U to the right till $b_{U/R}$ are reported the urban economic activities and the relative labour force. In particular, the UFA and its relative engaged

²² As in Mazumdar (1976, p. 676) the idea is that in some sector the wages are held at a high level by institutional forces and then that at the same time the institutional factors and non-institutional-factors ensure that only a certain proportion of the labour force is able to obtain employment in those sectors. On the difference on wages among sectors Mazumdar (1983, p. 256).

²³ For instance, although a worker is not regularly engaged by a urban formal advanced activity (enterprise) is accounted to be part of the UFA sub-sector.

labour force till the point o_1 from which the UFNA sub-sector starts finishing at o_2 . In the same direction it is followed by the UIA sub-sector till o_3 and there on by the activities of the UINA till $b_{U/R}$. From the origin of the rural areas o_R to the left till point o_4 can be found the RFM activities with the relative work force, followed by the RIA sub-sector (till point o_5), the RINA (among o_5 to o_6). Finally from the point o_6 to the vertical axis $b_{U/R}$ there are the RFL activities and their relative workers engaged. Among each area and each sub-sector there are borderlines - the six vertical lines (b_1, b_2, b_3, b_4, b_5 and b_6)- which divide the economy into segmented sub-sectors with different institutional endowments and non institutional resource endowments which influence the wages level (and their rigidity) and the rate of employment and determine for each sub-sector a different “economic environment”.

Figure 3. A closed SSA low-income economic system



In the vertical axis y , the marginal productivity of labour (MP), and the wages (W) (average income level for each sub-sector) are measured at constant prices.

Let w be the subsistence wage level in the economy. Each sub-sector has its own wage level. In particular, they are $w_{UFA}, w_{UFNA}, w_{UIA}, w_{UINA}, w_{RFM}, w_{RIA}, w_{RINA}, w_{RFL}$ with the last three close to the subsistence wage w . The wage bill of each sub-sector is given by the area under the wage horizontal lines. The dotted lines are referred underline when the average wage is different from the marginal productivity.

The curves of the marginal productivity of labour are reported for each sub-sector. Therefore, the margin available to reinvest (surplus on wage bill or profit) for each sub-sector is given by the respective area under marginal productivity curve minus the wage bill of the sub-sector.

The mechanism of functioning of the model is as follow. Each period the margin of each sub-sector is reinvested in the same sub-sector -where is created²⁴- to respond to the potential

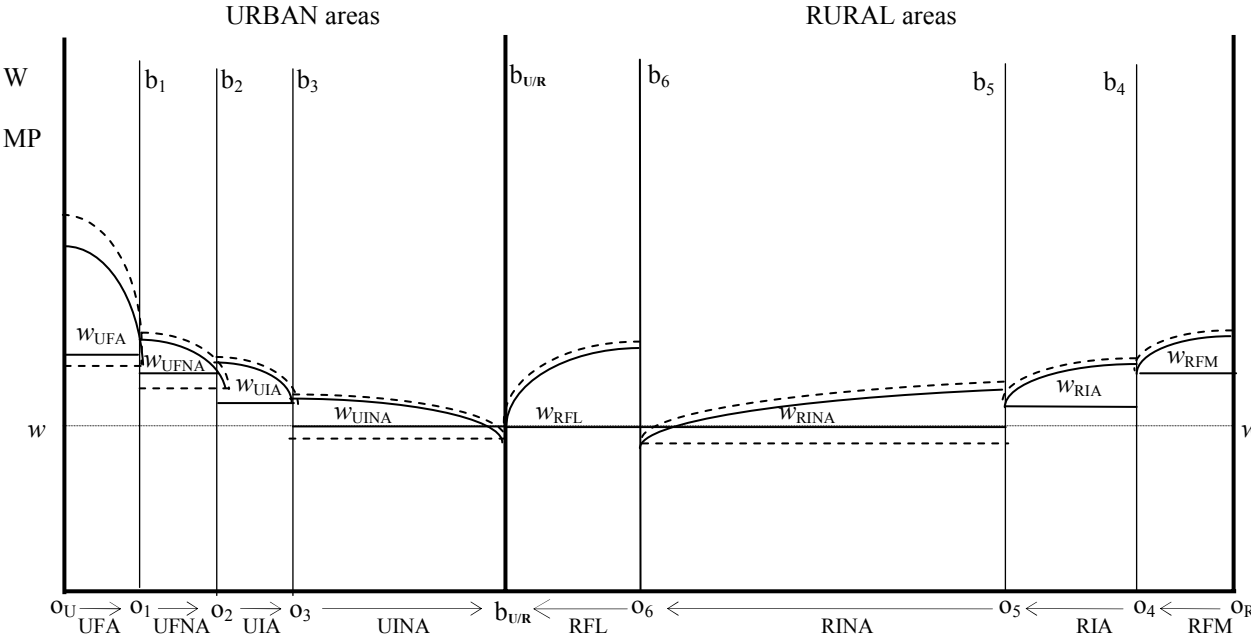
²⁴ It is assumed that economic activities reinvest or invest in new activity in the economic environment they know better: the one where they are active. Part of the profits can be used differently i.e. in other un-productive use of resources generated (e.g. corruption, bribes, ...) and not reinvested.

demand for products. The expansion of capital brings, given the capital labour ratio, to an expansion in the demand for labour. Demand of labour is generated by the potential demand for products²⁵. In other words the potential demand must coincide with the real demand for products and with the demand expected by producers (economic activities) for their products. The pattern of production adjusts itself to the pattern of demand and vice-versa.

This means that after a period of time each marginal revenues curves coincides with the respective new marginal productivity curve (which measure the increase the value of output at constant price) only if there is a increase in demand for the products that does not change the relative prices (Spaventa, 1959, p. 405-408). In order to induce an increase in productivity maintaining the same conditions there is the need of a demand equal to the expected demand for the products of the sub-sectors considered otherwise the change in relative price of factors and products would kill the gain in productivity. Demand stimulus will lead to real income growth or to the choking off of growth through rising relative prices of wages goods.

Therefore, if the surplus on wages of each sub-sector is reinvested -shifting up to the right (or the left if in the opposite direction as in figure 4.) the marginal productivity curve of labour- and the employment will increase in the sub-sector. This will bring to the absorption of labour in the advanced sector from the non-advanced one²⁶.

Figure 4. Reinvesting the margins



The new marginal productivity curve of labour of each sub-sector will be parallel to the respective old one if the technical progress is neutral. While, if the capital investment are not reinvested in neutral technology, but the capital labour ratio changes and it is biased to capital intensive techniques, as in the UFA sub-sector, the marginal productivity curve of labour does

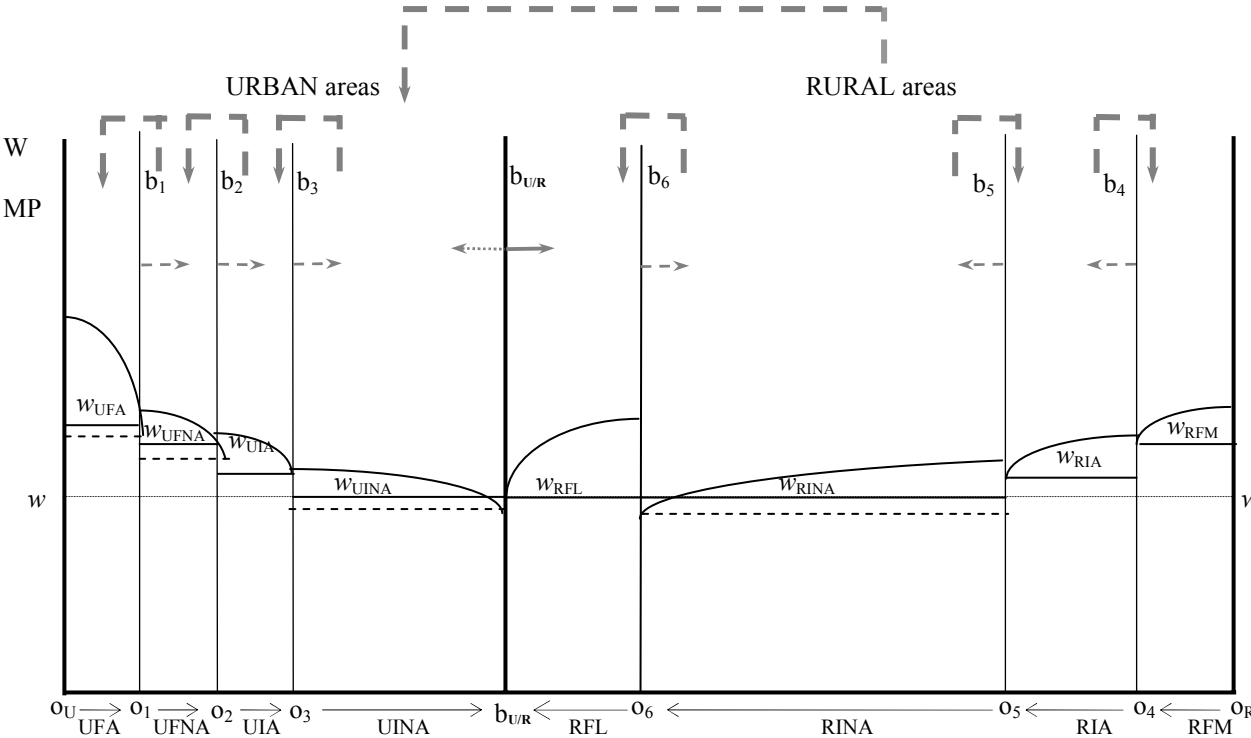
²⁵ Potential demand depends on the structure and the income level of a society, on income consumption pattern as described in figure 2.

²⁶ The process, in dualistic models at a constant capital labour ratio, goes on until the point when all the excess of labour forces is absorbed and the disguised unemployment falls to zero. In SSA low-income economies the labour

not shift parallel to the right. Hence, over time there is the tendency to use more capital intensive techniques, instead of employment creation there could be a labour displacement which would aggravate problems of disguised unemployment. This, given the rigidity of the wages, can determine an increase on the value added just by an increase in profits. “Such a state may be described as growth of national income due to rise in capital accumulation without real development.” (Ghatak and Ingersent, 1984, p. 104). A growth with increasing inequality and where large part of the population is excluded from the economic system or marginalised by it. Opposite to the growth without development -the ones described above- a growth with development is based on an increase in the productivity in the informal sector segments of the economy.

However, in this model the development path is given, not only by the characteristics of the new technology employed but, also, by the presence in the economy of the above mentioned different institutional endowments. Indeed, the development is constrained by the “technical” absorbing capacity to increase productivity which can be defined absorption of technological progress by 'creating the capacities'. This development process -dynamic and cumulative- should be accompanied, if not anticipated by the institutional change and non-institutional investment (figure 5) ²⁷.

Figure 5. Institutional and non-institutional barriers and development



In other words the enlargement of the sub-sector employees can be generated also by change

force increases at very high rate especially in the sectors of low-income people.
²⁷ Conflicts (national/international, ethnic/non-ethnic or religious/non-religious), pandemics (as Hiv-Aids) and natural disasters (also human provoked) are among the main enemy to the development process (moving the barriers in the opposite direction) damaging the sub-sectors economic environments since institutional and non-institutional factors are cumulative and path dependant by nature.

of institutional factors (and accompanied by the movement of the barriers and the entrance of the new employees in the sub-sector) only if it is accompanied by an improvement of the non-institutional factors endowments. This can be seen as an expansion of human development. Thus, only in this case the movement of labour force can be implemented (dotted arrows). In other words the development is facilitated by the adjustment of human capital, services, and infrastructure as well as of institutions. For instance, an unskilled worker of the UINA sub-sector can pass to the UFNA sub-sector only if trained. It is expected a passage from rural to urban areas although the reverse could occur in some specific circumstances²⁸.

In this model, the growth of the value added, in a closed economy and in the presence of wages rigidity, can be obtained in two different ways within each segment of the economy:

1. by an increase in profits through the reinvestment of the margin with the increase (shift) in marginal productivity curve of labour (within each segment of the economy.);
2. by a change in institutional endowments and by an increase in non-institutional resource endowments (movement of the borderlines or within them).

These movements permit:

- a) to increase the value added by the wage bill increase through the income increases of the labour force absorbed by the relatively more advanced sub-sector;
- b) to increase marginal productivity of labour, not due to reinvestment of profits, but through externalities by the overcoming of some barriers through institutional and non-institutional adjustments, including collective action, organisation of production, synergies among basic social services.
- c) to increase directly the value added if some institutional constraints are removed.

The point a) is self-explaining and does not need any further explanations. Different is the case of the last two points containing some important aspects.

The marginal productivity of labour or simply the productivity (considering the constant wages) can increase in different manners and not just by increase in capital investments (point b); for instance, through changes in attitudes (e.g. by indirect externalities; risk aversion reduction and, consequently, new allocation of resources), by increasing incentives, by different organisation of work (e.g. from subsistence household farming to co-operative or collective tribal farming; through economies of scale or scope), by a better allocation of existing resources (differentiating production), by enhancing collective efficiency (positive externalities in medium, small and micro-enterprise activities). In other words it is possible to improve the productivity by the co-ordination of activities and by taking into account the benefits of positive externalities and spillovers. The positive externalities are strongly connected with the social overhead capital and BSS which facilitate development through the diffusion of technological progress. Human capital and physical infrastructure are fundamental in this process. The point b) can occur in sector with disguised unemployment, also without any movement of the barriers, by the increase of the marginal productivity curves of labour not due to margin reinvestment, e.g. a better allocation of existing resources (differentiating production)²⁹. Very important becomes the

²⁸ In China during the recession (in 1989 and 1990) rural labour migrants moved back from urban to rural areas because of the land use right (safety nets). In some circumstance 'inverse' movement could be connected to conflicts urban to rural.

²⁹ These aspects can be enhanced together and are often self-sustaining. For example, in farming, the reduction of

diversification as well as the synergies in the system, since they generate important dynamic contribution.

The last point c) reminds that institutions (formal and informal) can influence both the level and the pace of economic development. Changes in institution may change the position of an economic activity (e.g. from the UIA sub-sector to the UFNA sub-sector). For instance, “Informal constraints embedded in norms and networks, operating in the shadows of formal organizational rules, can both limit and facilitate economic action” (Nee V. 1998, p. 85).

From the New Institutional Economics (NIE) point of view, it is relevant to establish how institutions (rules) tend to influence transaction costs. However, it is often very difficult to determine if an institution is a constraint to development or not, as this distinction cannot be accomplished by simplifying it as a matter of economic growth and often needs to be accompanied by non-institutional factors improvement. For instance, some informal institutions such as religion and the family, although may not facilitate the economic system short term growth (the increase in GDP per capita), are fundamental for the welfare of the human being³⁰. Therefore, analysing informal activities and relative institutional arrangements through the “western” lens, there is the risk to arrive to wrong interpretations of stylised facts. “Instead of evolving concurrently with the evolution of the production process and the social struggles that accompanied such an evolution, regulatory frameworks in much of the Third World were simply copied from societies at vastly different stage of social and economic development.” (Assaad, 1993, p. 926). “Most modern social science has been developed in DCs and assumes their legal, political and economic institutions to be ones essential for the economic, political, and social development of LDCs However, since the institutional structures of LDCs are different from those of DCs, some institutions regarded as inefficient in DCs may turn out to be efficient given the specific institutional structures of LDCs” (Lin J. Y. and Nugent J. B., 1995, p. 2341). “Likewise, tribal institutions, such as chiefs and communal ownership of land, can perform the important functions of reducing [*negative*] externality and free-rider problems in scarcely populated, arid and semiarid LDCs where conditions are quite different than in Europe and North America. ... Such institutions are often regarded as inefficient and barriers to economic development. Many African countries have practiced various policies designed to eliminate these institutions. While some of these policies have been well motivated, often they were based on faulty understanding of local conditions (e.g. aridity) in general and of the special problems of certain activities (like transhumance) in particular. Not surprisingly, therefore, the results of those policies have often been rather disastrous” (Lin J. Y. and Nugent J. B., 1995, p. 2342).

Furthermore, as emphasised by Mersi, it is not so important to judge their backwardness, often view only in relation to the ideal market system functioning models, rather it is relevant to judge their functionality in relation to the actual situation and to the development objectives and perspectives (Mersi, 1998, p. 4) and, furthermore, in relation to the fact that, in some cultures, more than in others (given the same level of real income), the social relations have a higher importance and benefit for people.

risk aversion could bring to different resource allocation, to the abandonment or to an improvement of a wrong or scarce technique, to different organisation of production and thus increase the opportunities and by the end to a further reduction of risk aversion.

³⁰ The same can be said for some formal institutions, such as the ones created through union pressure to defend

For human development a relevant progress is given by the capacity to translate part of the gain in productivity in real wages increase (Reinert, 2003). This can be obtained throughout collective action and/or trade union action. Furthermore, this is relevant in determining an increase in the demand.

5. Policy implications

The model presented emphasises that the economy of SSA low-income countries is segmented and that the development process is determined by investment and by institutional endowments and non-institutional endowments changes within each sub-sector. Then, it underlines that fostering economic growth *per se* may determine low results in terms of human development³¹. For example, the positive effect of the higher income generated in the formal advanced sector of the economy in SSA economies is not taken by the rest of the economy because of the “structural dis-articulation” of the production system since different segments of the economic system are endowed with different institutions and non-institutional resources. The excess labour force supply from the non-advanced sub-sectors is not absorbed by capital accumulation in the advanced ones (also for the capital intensive techniques argument). Therefore, if such policy is implemented in this economic dualism is not a static but a dynamic concept, which designates a tendency towards uneven growth.

This implies that an alternative path of development is required to obtain growth with human development and to allow poor to be involved in economic activities and to have the opportunity to participate to economic development as producers and consumers. Sectors with substantial linkages (i.e. articulated in the economic system) should be preferred to others since they are likely to contribute more to development than just the immediate value added and employment they generate (Livingstone, 1991, p. 665). In countries such as SSA low-income countries where there is disguised unemployment and capital is a scarce factor, economic activities with labour intensive technologies should be considered a milestone and preferred as starting point. Therefore, as already emerged in the literature, an ‘alternative road’ could be the development through medium, small, and micro enterprise within formal (ILO, UNIDO) and informal sub-sectors (ILO, FAO). Medium, small and micro-enterprise activities -in the model the UFNA, UIA, RFM and RIA sub-sectors- can foster positive externalities and offer many potential linkages between and within urban and rural areas and formal/informal sub-sectors. On that

workers rights.

³¹ Human development, if we keep out participation, has two main prongs strongly related to each other. One in terms of human endowments (education, health, ...) and two in terms of economic endowments (the one we are discussing here). Assuming that the economy is segmented into eight sectors above mentioned, the rate of growth of each sector (over a specified the period) is g_j ($j = 1, \dots, 8$). The rate of growth (economic endowments) of the economy as a whole can be defined as a weighted sum of the growth of income of all the sub-sectors:

$$G = w_1 g_1 + w_2 g_2 + w_3 g_3 + w_4 g_4 + w_5 g_5 + w_6 g_6 + w_7 g_7 + w_8 g_8$$

Where G is the growth of the economy and w_j is the weight of the sub-sector. According to the model, the economic growth of each sub-sector is determined by the following factors: capital accumulation, labour force increase, but also by institutions and non institutional resource endowments such as human capital, infrastructure and services which together contribute also to human development through human endowments increase.

account, this 'alternative road' would benefit local economic development in terms of employment and investment, and through consumption linkages generated³².

Obviously there can be a number of problems in implementing this type of development strategy through micro, small and medium enterprises. From many studies also emerge that the problem in SSA is mainly connected not only to low savings and investment but also to demand constraints (Delgado et al. 1998, Yong He 1994)³³³⁴.

The increase of the demand of local good and services would foster entrepreneurs incentives and would be a key to bring an increase in productivity, technology upgrading, and a different mode of organisation of production gaining in economies of scale and externalities. SSA low-income economies are composed mainly by poor (low-income families) and scarce infrastructure which imply that the potential demand could be un-capable to sustain or maintain the supply - bringing to over-production crises-. The internal demand would remain scarce if the work force which is mainly concentrated in the subsistence sub-sectors UINA and RINA did not ameliorate its relative position increasing consumption of local goods and services and increasing investment in local activities. Thus, these informal low-income activities need to increase productivity. The benefits in subsistence and semi-subsistence agriculture would be direct since an increase in productivity of food crops could bring to a change in the attitude (through risk reduction) of farmers enabling them to allocate better the resources and escaping poverty trap in connection to more opportunities of income diversification (also through non-farm activities). Low productivity depends on lack of incentives (demand) and especially poor techniques and organisation methods. Extension services and infrastructure can be fundamental to solve these problems³⁵.

An important dimension of sectoral policies should deal with the transfer of public resources and the removal of discriminatory practices and regulations to improve the productivity of workers. For small and micro-enterprises access to credit, infrastructure, education and training are the base of a development strategy since they can solve production difficulties including

³² Another possible road could be the export led-growth and FDI. As Lewis argues, "If 70 percent of the labour force consists of low productivity food farmers, with only a tiny surplus, the market for domestic manufactures is strictly limited. As the limits are approached, the pace of industrialisation can be maintained only by exporting manufactures. ... (Lewis, 1977, p. 31-32). Although it is not a immediate solution for SSA low-income countries could became a complementary strategy especially if pursued with small and medium enterprises. Otherwise it would be very difficult to diffuse the welfare and technology and although the GDP may increase substantially most of the population would not receive any benefits (apart in the form of tax revenues and wages). For instance, the UFA sector is usually connected with exports through multinationals which expatriate profits, usually do not invest in local economies and use capital intensive technology and/or pay low wages, while the RFL, which export agricultural exotic product and raw materials (from colonialism), main contribution is towards wage (very low). In this second case most of the population working in the informal sub-sectors would remains poor or stagnating with low productivity and disguised unemployment or would be used by globalisation without getting any benefit from growth taking place in the rest of the world economy.

³³ In SSA low-income economies the development of an economic activity can be a slow and difficult process because of demand constraints, infrastructural constraints, physical and human resources constraints, financial constraints, institutional constraints and of course because entrepreneurship requires capacity building.

³⁴ Furthermore, in general many SSA countries emerges that political instability (including conflicts), and corruption have a negative impact on development and employment generation.

³⁵ Furthermore, research at national and international level should concentrate on these sector to ameliorate the inputs and the techniques of production for small scale production (scale neutral input and techniques for small agriculture and other micro-enterprises) enhancing local factor endowments (Cornia 1994). Moreover, "technical change in agriculture that benefits smallholders will have a greater impact on the local economy via expenditure linkages than would technical change that benefits large landholders." (FAO, 1998, p. 289).

demand delivery (of quality and quantity) on time. Credit facilities and especially access to credit for smallholder would be crucial. Investments, for the provision of basic infrastructure (like water, electricity, good roads, telephones, etc) facilitates the development process of small enterprises and contribute to improving productivity and the working conditions of the informal and informal and micro and SMEs³⁶. Therefore, they would benefit from public policy in terms of, investment in infrastructure, marketing facilities, and services and information network. Education policies and training courses would improve labour force skills and managerial capacities; demonstration and local research centres could be fundamental for technological upgrading³⁷. Furthermore, local policies on family planning, health and sanitation would ameliorate the environment and the capabilities of the workers.

Bottom-up institutional innovations should be encouraged, promoting and strengthening informal sector organisations and institutions for collective action³⁸. Pooling of community resources collective action could be the way to increase the possibility and reduce the risk (sharing it in the community) and at the same time would permit a better organisation and participation. Co-operatives can be fundamental in overcoming individual investment constraints while centres rendering services to the informal sector favouring concentration area for enterprises in order to capture positive externalities and try to implement a virtuous circle and a high road development through collective efficiency (competition and co-operation among informal or formal small and medium enterprises). If there is scarce entrepreneurial capacity, because of scarce risk propensity, co-operatives, collective (village) and local government actions and investment should intervene. This means that there is not an unique response to institutional constraints which in different context need different answers.

Decentralisation measures would help the participation in decision making especially through the 'voice' in the management, in more control over corruption and in the change of institutions. Endogenous development is connected to the evolution of institutions, thus, participation of population would be fundamental in determining the success of institutional reforms. ONG role could be relevant in accompanying local institutional arrangement changes increasing the civil society participation to local development.

As the number of small enterprises increases, spill-over effects arising from the creation of positive externalities are spread throughout local economic systems, the resulting multiplier effect having an enhancing effect on local development (Volpi, 2000). At this point a further stage is necessary, the micro and small enterprises dealing often with non tradable goods can survive from globalisation, but at the same time is relegated by it to the local production. Some

³⁶ Following Pan-African analysis, firms can adopt four different coping strategies to tackle deficiencies in infrastructure: Relocation is a first strategy. Because of high costs this option is not obvious. Moreover, there is a considerable risk of trading one set of lacking infrastructure for another. A second option is factor substitution to make production less infrastructure intensive and reduce dependence on infrastructure services. Self-provision is a third solution. Full self-sufficiency is rare. In many cases, self-provision serves as a reserve for public services and is not aimed at self-sufficiency. Self-provision is related to the size of the enterprise. Micro-enterprises rely less on self-provision because they often lack means for it but also because their production methods depend less on infrastructure services. A last and very common option is reduction of output. This solution is especially forced on small enterprises which do not have the means for self-provision.

³⁷ Apprenticeship is an important alternative strategy for acquiring skills and thus may be fostered by giving at the end of the period a grant to the owner and to the apprentice.

³⁸ In Zimbabwe for instance, important network were created for the informal sector such as: Small Business Advisors (SBAs), Information flow, Credit availability, Informal sector Associations (ILO, 2000)

degree of protection and/or export promotion could be helpful especially if there is the potentiality to develop further and create a cluster able to trigger positive externalities and synergies. Arguments for protection of a potential cluster could be very similar to the infant industry argument. Their potential in economic development is limited if specific local policies are not accompanied by macro policies to gain dynamic comparative advantages such as trade policies, co-ordination policies to capture positive externalities and reduce negative ones and investment into physical and social infrastructure.

The development of the informal sector is often limited by formal constraints. Informal activities rarely receive service (law protection), finance, or infrastructure (roads, energy, education formation) from government, because of budget constraints or because 'they do not pay tax'. Nevertheless, if tax holiday are often given to FDI and multinationals and infrastructural park area are built to induce foreign to invest³⁹, some incentives should be given, at least, initially to small and micro-enterprises⁴⁰. In this direction, there could be also an increase in the incentives for the informal sector to embrace some relevant formal rules through the admission to infrastructural facilities, to credit facilities and to social benefits (medium term policy of registration, protection and promotion see Mehrotra and Biggeri 2002). On the other side it is important, if possible, to embrace some informal sector rules as formal ones (this would give to informal activities rights and duties). Obviously, there are problems inherent to “informality” in SSA low-income economies as in most other countries including developed countries. From a productive point of view there is the lack of protection of workers rights -with their inability to meet the security requirements- and often an exploitative relations (e.g. dependent on the formal sector and global economy through sub-contracting relationships). A co-ordinate answer for worker protection and social security from the civil society, international organisations (unions) and governments is needed.

³⁹ These can be a vehicle of transmission of technology upgrading only if absorbing capacities are already in the receiving country.

⁴⁰ Although tax revenue could be seen as a medium to long-run policy agenda, in order to reduce budget burden provider based pre-payment schemes may be relevant for cost recovery.

Appendix: On the three dimensions of the informal activities

The informal activities are those activities not governed by institutions and in force laws, and/or those organised in different ways from the ones characterising the economic activities typical of a 'modern' economy. Therefore, following the ordinary economic classification, the formal and informal sector can hardly be described as sectors, as they almost embrace all the three sectors –primary, secondary and tertiary- usually considered and which can be further divided into branches⁴¹.

Therefore, since there are still disagreements about the definition and application of the term informal sector, it is pertinent in this appendix, to focus on the three dimensions of its definition. As in most of other relevant studies, criminal illegal activities such as smuggling, drug dealing, armed robbery, ... - which may provide an income to those engaged in them, but little of value and benefits to society and to the economy- are not considered part of the informal sector and of economic activities⁴². Then, considering that at least part of the ambiguity in the literature on the informal sector often stem from the failure to make a clear distinction from informal sector enterprises and informal sector employment⁴³, the former -including small, micro and household enterprises- is applied. Consequently, in order to determine if an economic activity or an enterprise is within the formal or informal sectors, the economic activities of a developing country can be represented in a three dimensional space as in figure 6. The three dimensions -determined on the basis of earlier and recent research findings⁴⁴- are flexible to the evolution of conventions. Obviously for an empirical research purpose and from a pragmatic point of view, there would be a need for specific categorisation within the perceived continuum of the informal-formal economic activities some fixing measures should be given (ILO, 1989, p. 10).

The Z dimension delineates the economic activities integration into the modern capitalistic market institutional framework -informal activities have often a different mode of organisation⁴⁵. The Y axe represents the economic dimension of the activities; for instance: the quantity of fixed capital per employee or the number of employees utilised by the enterprise, the micro-enterprise or by the household. The X axe depicts the integration of the economic activities into the normal administrative and regulatory framework (OECD, 1997, p. 15) or in other words if the activity “operate under the umbrella of accepted rules and regulations imposed by the government” (Ray, 1998), which can be, and often are, summarised by the involvement of the activities in registration system and especially in the fiscal system and may receive infrastructural facilities (it is typical of informal activities their refusal to pay taxes and also to adhere to administrative standards such as to safety-health standards).

In the first space I it is possible to find the formal sector economic activities, while in the other three

⁴¹ A classification in branches which follow the SEC (Sistema Europeo di Conti Economici Integrati) is the following: the primary agriculture (farming, forestry and fishery), the secondary or industry (energy production, manufacturing and construction) and tertiary or services (transportation, trade, other services and public administration) (EUROSTAT, 1981). Therefore, the term sector is not coherent with the «usual» productive classification. Although the differences among the terms informal activities and sector are important for the sake of simplicity the two are often used as synonymous in this paper.

⁴² In particular, the System of National Accounts (SNA) distinguishes two kinds of illegal production: the production of goods or services whole sale, distribution or possession is forbidden by law (e.g. narcotics, prostitution, etc. ...) -named criminal illegal activities in this paper-; and production activities which are legal but which become illegal when carried out by unauthorised producers (but with mutual consent between the buyer and the seller) (OECD, 1997, p. 12). Another important SNA distinction is among Underground Economy and Informal Sector where they are both considered part of the informal sector? (SNA 1993 pp. 111-112 and pp. 126-127).

⁴³ «Empirically, when an enterprise is in the informal sector then the workers in that enterprise also belong to what can be termed informal sector employment. The reverse, however, is not always true.» (Swaminathan, 1992, p. 25)

⁴⁴ Following the ILO 1972 report, informal sector correspond to: easy entry, reliance on indigenous resources, family ownership of enterprises, small-scale operation, labour intensive and appropriate technology, skills acquired outside the formal school system, unregulated and competitive markets (ILO, 1989, p. 6-7).

In a relevant research of the United Nations the informal activities: operate outside the formal economy; utilise lower levels of investments and less demanding skills; handle relative simpler products; in terms of workforce small enterprises may employ from a minimum of one or two persons as many as ten or more employees or working family members (United Nations, 1996, p. 1).

For a study of the UNDP informal activities are small and micro-enterprises as home-based or individual enterprises with few or no employees (7) while for UNCDF the informal sector enterprise employs rarely more than 10 persons.

⁴⁵ In an interesting study of the OECD (1997, p.16) the informal activities are characterised by: absence of «formal» premises (e.g. small-scale-business operating from private homes, in street or markets, or without a fixed base); minimal sophisticated investment; being wholly or mainly run by family members.

spaces are situated the informal sector which coincide with the “other economic activities”. The informal activities include among themselves some “illegal” activities but, as already mentioned, illegal criminal activities are not considered to be part of it.

Figure 6. Economic activities classification

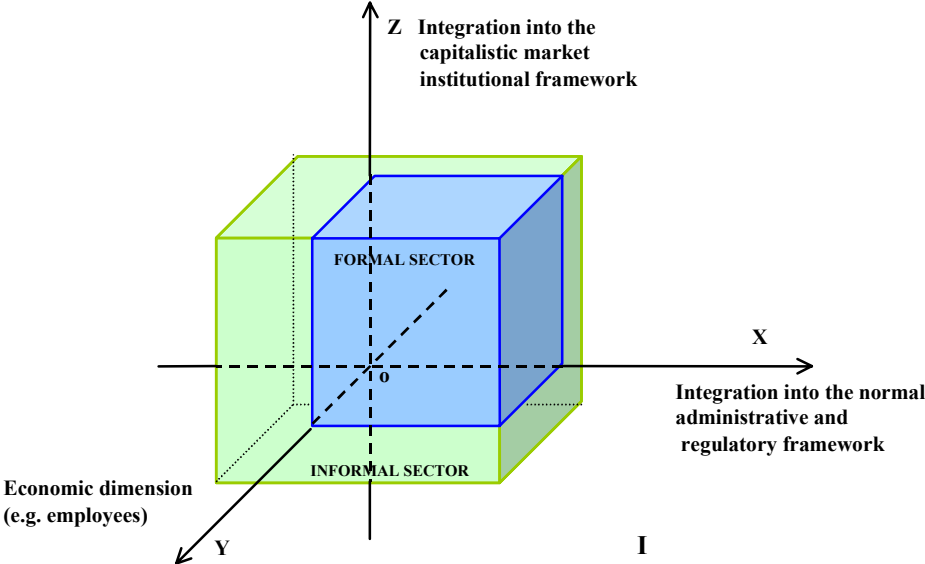
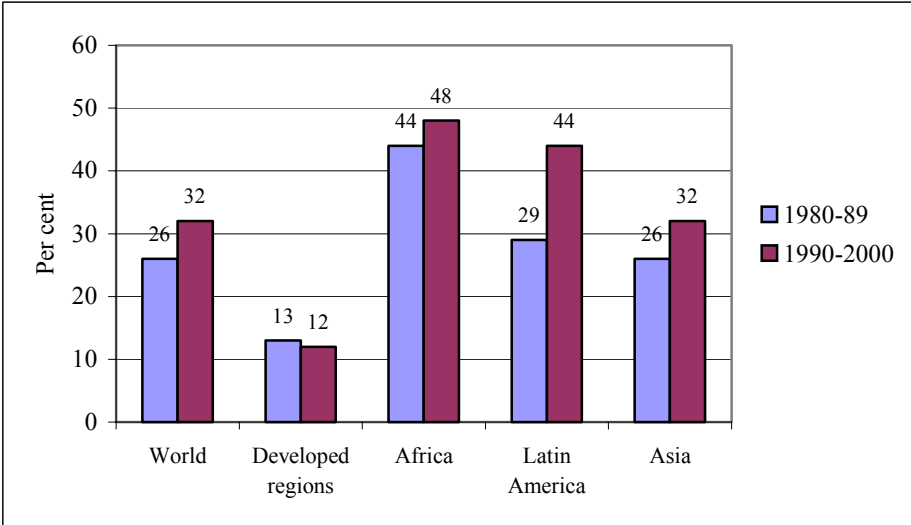


Figure 6. should not be interpreted as a static one as the variables involved are part of a dynamic context. The origin of the axes o changes position during time because is depending by the continuing evolution of conventions and of the institutional framework of the economic system. For instance, the origin for the axe Y -the economic dimension- corresponds on different “size” of the enterprises which could depend on conventions and also on the branches of the activities. This dimension is often the easiest detectable characteristic and most used on empirical ground and for policy options for the informal sector (e.g. the small and micro-enterprise category). Finally, the integration into the capitalistic market institutional framework is depicted by the Z dimension in the figure.

Direct data on employment in the informal economy are not readily available. The share of self-employment (figure 7), which for most developing regions is a proxy indicator for the size of the informal economy, increased in all developing regions (with the exception of some countries in East and South-east Asia).

Figure 7 Non-agricultural self-employment 1980-89 and 1990-2000



Source: World Commission on the Social Dimension of Globalization (2004), ILO (2002), Women and men in the informal economy.

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