Informal Economy, Governance, and Corruption

MD. HEDAYET ULLAH CHOWDHURY*

ABSTRACT
The informal sector has been growing globally such that it can no longer be considered as a temporary or residual phenomenon. There may be differences in the nature of activity of the informal sector in the developed and developing countries, yet it is evident that this sector is contributing economically anywhere in the world, irrespective of a country's economic system. To some extent, employment in the informal sector is more of a necessity than a choice, as the demand for labor in the formal sector is low and people seem to move into this sector due more to push, rather than pull, factors, since survival is their main concern. In this case, the ability to generate income and to survive depends to a large extent on the probability of getting a job in the informal sector. The biggest challenge to a large section of the people working in the informal sector is their heavy dependence on income from this sector to survive. Against this backdrop, the paper aims to highlight the importance of the informal economy in a less developed country like Bangladesh, where a large section of the people is engaged outside of the formal economic activities. Moreover, the study attempted to find out the determi-

* Assistant Professor, Department of Economics, Kazakhstan Institute of Management, Economics and Strategic Research, Republic of Kazakhstan; Associate Professor (on leave), Department of Development Studies, University of Dhaka, Bangladesh. The author is grateful to the Royal Danish Embassy, Dhaka, Bangladesh, for funding the project entitled "Institutional Strengthening and Capacity Building of the Department of Development Studies," University of Dhaka. He is also grateful to Professor Salahuddin M. Aminuzzaman, former Chair of the Department of Development Studies, University of Dhaka, for providing the inspiration for the Project. He is also thankful to Professor Nasreen Khandker, Department of Economics, University of Dhaka, for reviewing this paper. Lastly, he is indebted to the Philippine Journal of Development whose valuable comments made the publication of this paper in this journal possible.
The concept of informal sector was first coined by Keith Hart (1971) and it was the International Labour Organization (ILO)\(^1\) that defused this idea with a view to developing an "effective development strategy"\(^2\) targeted at a specific population. Since then, the concept has gained considerable currency in the development literature. At the 90th Session of the International Labour Conference in 2002, a new concept, informal economy\(^3\), was used instead of informal sector. Informal sector activities cover micro-entrepreneurs, petty traders, home-based and casual workers, including shoeshine boys, rickshaw pullers, garment workers, and street vendors, to name some. Informal economy\(^4\) encompasses vastly different workers, enterprises, and entrepreneurs that perform activities that are not covered by law—because the law is not applicable or is not applied—or with which the law does not encourage compliance because it is inadequate, burdensome, or overly

\(^1\) The ILO Kenya mission defined informal activity as the "way of doing things" characterized by (a) ease of entry; (b) reliance on indigenous resources; (b) family ownership of enterprises; (c) small scale of operation; (d) labor-intensive and adapted technology; (e) skills acquired outside the formal school system; and (f) unregulated and competitive markets.

\(^2\) By the mid-1960s, the level of poverty and unemployment in developing countries became an increasing preoccupation because the particular characteristics of capital-intensive import-substitution policies and the growth strategy based on maximizing GNP did not lead to the desired level of income redistribution. The fact was that the "trickle-down" effect did not operate quickly enough and the situation demanded an alternative solution to provide redistribution with growth. Due to increased unemployment and underemployment as well as inequality in developing countries, a consensus was developed during that period among policymakers indicating that providing jobs was deemed a convenient way to give the fruits of development to those who needed them most.

\(^3\) The study used the terms "informal sector" and "informal economy" simultaneously.

\(^4\) This issue was discussed at the 90th Session of the ILO Conference.
costly. In any case, the activities involved are lawful, and not criminal in the penal sense.  

To some, the informal sector is a synonym for illegality, since businesses within are unregistered, evade taxes, and in the main, do not comply with labor laws, particularly those affecting nonwage labor. Thus, it has also come to be known as underground economy. Admittedly, not only are firms or businesses operating in the informal sector illegal in the strict sense, but they are also confronted with uncertainty, especially since it is often convenient for the government to look the other way. Consider a peanut vendor who cannot be expected to pay taxes, given his meager income, which in itself is difficult to ascertain, or even if it were not, it would entail some cost on the part of the government that it may not be expected to dispense. Hawkers, shoeshine boys, domestic servants, kiosk or stall operators, and rickshaw pullers, among others, are in a similar lot.

Admittedly, some informal entrepreneurs deliberately conceal their activities from public authorities to avoid taxes or complying with bureaucratic strictures. However, most informal entrepreneurs are either unaware of the regulatory requirements or find them too cumbersome or costly to comply with. In the case of informal wage workers, it is often their employers who do not comply with labor legislation or pay taxes. Many informal wage workers are employed by formal firms either directly or indirectly through subcontract arrangements.

In most cases, agriculture is considered part of the informal sector as tax authorities have no way to observe how much output a farmer produces, and even if they do, they cannot prove it in a court of law, so agriculture often goes untaxed. Likewise, it is very difficult, if not impossible, to implement minimum wages, pension plans, unemployment insurance, and organized old-age security for rural labor on a large scale. Even if there are organized old-age pensions available in the rural areas of Bangladesh, these are not enough to provide protection for rural agricultural laborers.

The nature of activity of the informal sector may vary across the developed and developing countries, yet it is evident that the sector contributes to economic growth anywhere in the world, regardless of a country's economic

---

5 By and large, goods and services produced within the informal economy are not illegal in themselves, which set them apart from illegal drug dealing, prostitution, gambling, and similar activities associated with the criminal sector or law offenders. Still, it must be pointed out that in some respects, what is criminal and what is legal differ across countries, depending to some extent on the prevailing norms in specific societies. For example, prostitution is legal in some countries, but not in others. Hence, the distinction between what is legal and what is illegal must be applied quite pragmatically.

The bulk of new employment in recent years, particularly in developing and transition countries, has been in the informal economy. To some, finding employment in the informal sector is more out of necessity rather than of choice, as the demand for labor in the formal sector is low, prompting some people to go into the informal sector to survive. However, this sector has the potential to grow over time and to build up an industrial base adaptable to local technologies. In addition, it is a viable and dynamic part of the national economy that uses resources more efficiently.

The informal sector is heterogeneous in terms of actors, activities, and scale. To some, this concept is vague and difficult to understand, as it covers a wide range of activities. Varying perceptions and characterizations of the informal sector doubtlessly influence the orientation given to policies associated with this sector. In spite of its heterogeneity, this sector can easily be identified, as it constitutes a large part of the economic activity that is unregistered and unregulated on a small-scale basis in most less developed countries. As the informal sector consists of a large section of the labor force, a sustaining governance structure to govern informal economy could have a greater impact on industrialization and income distribution.

It is easier for policymakers to understand the activities of the formal sector and formulate appropriate policy measures because its structure works in much the same way as the public administration. The informal sector is by definition a different world and its diversity and behavior patterns cannot be readily understood. In this regard, the objectives of the study are as follows:

✦ To give an overview of the informal sector concept;
✦ To highlight the characteristics of the informal sector, its development, and contribution to the national economy of Bangladesh;
✦ To shed light how informal economy can be managed (promoted and controlled) by government policies with special reference to Bangladesh economy; and
✦ To identify the determinant of the informal economy in the global context

According to Castells and Portes (1989), the informal economy is universal, as similar arrangements are found in countries and regions at very different levels of economic development. This sector is heterogeneous, as the forms adopted by unregulated production and distribution vary widely even within single societies. They added that there has been an apparent increase of these activities during the last several years.

It has been found that the informal sector is more efficient compared to the formal sector manufacturing industries in Bangladesh (Chowdhury 2005). Amin (1986) found similar results, based on which he concluded that technological choice allows the informal sector to utilize its resource base, economizing on scarce capital and relying more on cheap labor. He also found that capital intensity of formal sector industry is eight times higher than that of manufacturing units in the informal sector. This suggests that the average cost of creating a job in the formal sector is eight times higher than in the informal sector.
SCHOOLS OF THOUGHT
Since the inception of the concept of informal sector, several schools of thought have emerged to interpret and explore the concept in development literature. The Reformist school, originated by the ILO and the World Bank, describes the informal sector as having vast potential for employment creation and growth (ILO 1972; Hart 1973). The ILO and other institutions consider informality as the result of structural mismatches between supply and demand for labor—mismatches that keep the formal or structured economy from generating all the needed jobs. The Marxist school focuses on 'modes of production' based on class struggles in determining unequal patterns of development. Two different standpoints are apparent in this school. "Marginality" theorists argue that the informal sector is a distinct "marginal pole," which, by acting as a reserve army of labor and producing cheap, poor-quality subsistence goods, facilitates capital accumulation in the formal sector (Obregon 1974). "Petty commodity production" theorists, in contrast, argue that the informal sector is subordinated to the formal sector through direct links, thus enabling the formal sector to extract the surplus from the informal sector (Le Brun and Gerry 1975; Moser 1976; Tokman 1978).

Other schools define the informal sector through state versus protection (Weeks 1975; Mazumdar 1976) and state versus legal system (De Soto 1989), focusing on differences and relations with the formal sector. Weeks (1975) argued that "operations in the informal sector are characterized by an absence of benefits. Enterprises and individuals operate outside the system of benefits and regulations of government and are thus without access to formal credit institutions and sources of transfer of foreign technology. In some countries, many of the economic agents in this sector operate illegally, that is, by pursuing economic activities similar to those in the formal sector. Illegality, then, is not necessarily a consequence of the nature of the activity but of official limitation of access to the formal sector" (Weeks 1975). Mazumdar said "the basic distinction between the two sectors turns on the idea that employment in the formal sector is in some sense or senses protected so that the wage-level and working conditions in the sector are not available, in general, to the jobseekers in the market unless they manage to cross the barrier of entry somehow. This kind of 'protection' may arise from the action of trade unions, of governments, or of both acting together" (Mazumdar 1976). De Soto's view (1989) is that "there are activities for which the state has created an exceptional legal system through which informal

---

9 The marginal pole is that part of the economy characterized by a "lack of stable resources and which operates around residual resources and for the most part residual activities" (Obregon 1974).
10 According to de Soto, informality is the result of legal and administrative systems that make the formalization process burdensome and costly.
workers can pursue their activities, although without necessarily acquiring a legal status equivalent to that of the people who enjoy the protection and benefits of the entire Peruvian legal system; these are also informal activities. For de Soto, it is bureaucratic restrictions forcing small enterprises to become illegal that are causing the urban informal sector (UIS).

Like other developing countries, the informal sector in Bangladesh evolved as a result of the failure of the formal sector—which is protected by and enjoys certain incentives from the State—to absorb additional workforce. This condition is consistent with the state vs. protection school posited by Weeks (1975) and Mazumdar (1976).

RULES OF BUSINESS, INDUSTRIAL STRUCTURE, AND THE INFORMAL ECONOMY IN BANGLADESH

The industrial structure of Bangladesh is classified as consisting of large and medium industries, small industries, cottage industries, and the informal sector. The large and medium industries refer to manufacturing units covered under section 2(j) and 5(1) of the Factories Act of 1934 or section 2(f) of the Factories Act of 1965, which covers all units that employ 10 or more workers. Section 2(f) is simple alteration of section 5(1) in order to exclude mining, which is subject to the operation of Mines Act of 1923. A medium industry is defined as establishments with 10 to 49 workers while a large industry is defined as establishments employing at least 50 workers. Small and cottage industries are defined by size of capital employed. A small industry means an industrial undertaking engaged either in manufacturing, processing, or service activities whose total fixed investment, excluding the volume of land, is limited to Taka three crore or 30.00 million. In the case of balancing, modernization, replacement, and expansion (BMRE), even if the total investment limit exceeds Taka 30.00 million, it is still considered a small industry. However, the extent of extended investment for BMRE should not exceed 50 percent of the original investment limit.

A cottage industry means an industrial unit either engaged in manufacturing or services and which is generally run by family members whether as a full-time or a part-time activity and has a total investment of Taka 0.5 million. The informal sector is defined as enterprises employing less than 10 workers. The informal and small industries in Bangladesh are defined based on size of employment and size of capital, respectively. Large and medium industries are also according to

---

12 In empirical work, the size criterion has often been used to measure the informal sector. The criterion based on the number of workers has been more popular because it is convenient to use. However, there is disagreement over the cut-off point.
employment size. In this classification, there could be some overlap between small and medium industries. Please see Amin (1982) for an analytical discussion of problems associated with choice of size criterion.

In Bangladesh an industry is considered as registered when it operates under the Factories Act, which requires enterprises employing 10 persons or more to report to and register with the Inspector General of Factories and submit statistics on their operations. This should not be confused with a trade license, which is a permit issued by the municipal office to do business or engage in hawking within a city, under the Companies Act of 1994.

In Bangladesh, 47 labor laws are now in operation. These relate to (a) wages and employment, (b) trade union and industrial disputes, (c) working environment, and (d) labor administration and related matters. The main labor laws are as follows:

✦ Workmen's Compensation Act of 1923,
✦ Payment of Wages Act of 1936
✦ Maternity Benefit Act of 1936
✦ Employment of Labor (Standing Orders) Act of 1965
✦ Shops and Establishments Act of 1965
✦ Factories Act of 1965
✦ Industrial Relations Ordinance of 1969

Under the Environment Conservation Act of 1995, all industrial projects shall obtain environmental clearance from the Department of Environment. The main criteria for obtaining clearance are set in the Environment Conservation Rules of 1997 established under the Act. Different levels of assessments are required depending on the particular industry concerned.

In Bangladesh, the majority of the laws and regulations that govern the business sector are cumbersome. Inefficient application of rules and regulations causes arbitrary exercise of bureaucratic and political power allowing administration to be corrupt. Moreover, lack of accountability, transparency, and law and order encourages corruption. In most cases, an entrepreneur engages in dealmaking and underpays legitimate transactions with corresponding payoffs to public officials. Payoffs are commonly made to public officials to obtain a trade license, a phone line, an electrical connection, or even just to pay utility bills and pay taxes. Entrepreneurs routinely resort to bribery or illegal payoffs, influence peddling for personal or corporate gains.

In an environment marked by such bad governance, people evade paying taxes to avoid dealing with a cumbersome bureaucracy, complying with labor market regulations and minimum wage legislation, or because they find tax rates too high. Many street traders in the cities of developing countries operate without
licenses. They do so not to evade taxes, since their incomes are unlikely to be big enough to attract the tax collector, but because the authorities do not formally encourage such trading. In the informal sector, where the pressing problems may not be tax evasion but the inability of members of this sector to comply with the rules and regulations, the policy issue is about enabling the poor to improve their earning capacity through training, access to credit, or needed amendments to existing rules and regulations. However, rent-seeking behavior also depends on the collusive behavior of the entrepreneurs themselves. Tax evasion and loan defaulting are prevalent in Bangladesh.

INFORMAL SECTOR CHARACTERISTICS
This section focuses on the characteristics of the informal sector and the identification of the informal sector labor force in Bangladesh. The following diagram13 (Figure 1) illustrates the position of this sector.

Figure 1. Informal sector in terms of enterprise characteristics

IDENTIFYING THE INFORMAL SECTOR LABOR FORCE
By means of a diagram, it is possible to identify the labor force that will comprise the informal sector in developing countries.

The figure below (Figure 2) consists of three contiguous triangles representing the unemployed, the employed in the rural sector, and the employed in the urban sector of an economy. A circle enclosing the juncture of all three triangles denotes the labor force engaged in the informal sector.

13 $B$ = small-scale enterprise, outside the scope of the Factory Act, holding a trade licence, and adaptive to local and labor-intensive technology; $C$ = small-scale enterprise, adaptive to local and labor-intensive technology, outside the ambit of the Factory Act but does not have a trade license; $A$ = small-scale enterprise, not labor intensive, outside the coverage of the Factory Act but holding a trade license.
The "unemployed" labor force has two parts. Subpart "a" consists of unemployed people who are skilled enough and full-time job seekers in the formal sector but are not engaged in any economic activities before entering the formal sector. Hence, they are not part of the informal sector and are thus excluded from the circle inside the diagram. Subpart "b" consists of individuals who have little skills to enter the formal sector even if they are theoretically qualified to find work in this otherwise sluggish sector. This forces them to turn to the informal sector for employment.

As in most developing countries, there is a surplus of labor force in the rural sector. Without any formal sector skills or relevant experience, they have little hope of finding employment in the formal sector. Part "c" of the diagram above comprises the surplus labor displaced from agricultural activities for several reasons and thrust into the informal sector for livelihood. Subpart "d" of the rural sector is made up of full-time rural workers who are not likely to move to other occupations.

Part "e" of the urban sector triangle consists of laborers in the formal sector and have no other sources of income. Part "f" covers workers in the informal sector, including individuals earning extra income within the informal sector.

Figure 3 identifies the informal sector in an economy. As illustrated, the total labor force in an economy is segmented into two parts, namely, ABC and ACD, which stand for the labor force in the urban and rural sectors, respectively. The circle “U” represents the labor force characterized as unemployed and “M” the migrated people. The circle “abcde” stands for the labor force engaged in the informal sector, where the subpart “ae” corresponds to members of the labor force with very limited skills and whose best chances for employment lie in the informal sector. Subpart “ed” consists of other workers that have migrated from the rural to the urban areas. Subpart “cde” represents the urban informal sector and subpart “ab” the rural informal sector.
DEVELOPMENT OF THE INFORMAL SECTOR IN BANGLADESH

Economic development entails the rapid growth of some parts of the economy, while other parts are left behind to stagnate or even shrink. The structural transformation that inevitably accompanies change is an integral part of the development process.

In the last two decades, the Bangladesh economy has undergone structural changes with a proportionate increase of service, a declining share of agriculture in both output and employment, and an almost constant share of manufactured output and employment. In the public sector, a decline in employment growth during the 1980s resulted in the retrenchment of many workers with the implementation of a structural adjustment program. The growth in agriculture at the margin has been labor displacing rather than labor absorbing (Khan 1989). This tends to push labor out of agriculture and throw it into low productivity. This is also borne of observations that due to the unavailability of jobs in the agricultural sector as well as landlessness and poverty, people come to the city hoping to find employment. Both rural push and urban pull factors have played a role in the migration process. In addition to the sluggishness of the formal sector, the lack of education, skills training, and experience of rural migrants have extreme difficulty finding employment in the formal sector, and even in the "intermediate segment" of the informal sector, which requires skills and substantial capital. This situation sets off a host of problems such as being forced to live in slums and squatter settlements. To survive, they join the "subsistence segment" of the informal sector.

---

Rempel (1974) and Rempel and House (1978) in their characterization of the informal sector in Kenya divided informal sector into (i) an intermediate sector, which appears as a reservoir of dynamic entrepreneurs and (ii) the community of the poor, which contains a large body of residual and underemployed labor. In the former group are enterprising individuals, many of whom are generating reasonable incomes both for themselves and their employees. In contrast, the latter group is composed of many long-standing
which is inhabited by the poor. To some extent, the intermediate sector competes with the formal sector. Sometimes, it is complementary to the formal sector.

The light engineering industries in Bangladesh are examples of intermediate sector that have occupied a unique position in its economy through their combined contribution to technological development and poverty alleviation. This sector also plays a significant role in the development of the national economy by generating employment opportunities and producing important alternative machines and machinery parts, thus saving huge foreign currency for the country. The sector is a good vehicle for the transfer of improved technologies and more so for the production of technologies the country needs (Debpriya 1989). Over time, the intermediate sector may graduate into the formal sector as it expands and upgrades its technology and merge with medium industries as has been witnessed in Japan.

**Figure 4. Development of the informal sector**

The reality and the growth of the informal sector in an economy

urban residents who are forced by their circumstances to eke out subsistence in the lower echelons of the informal sector. On the other hand, the 'subsistence sector' or the 'community of the poor' is composed mainly of marginal people. It produces consumer goods that satisfy the demand for lower-income groups and is considered the bottom layer of economic activities. For a brief description of this classification, see also House (1984).
STRUCTURAL CHANGE OF THE INFORMAL SECTOR IN BANGLADESH

The composition of the informal sector shows that the share of the manufacturing industry is quite small compared to trade and services, which comprise a very large share of the informal sector in Bangladesh (see Appendix Table 2). During the period 1989-1990 and 1996-1997, the share of manufacturing was around 5.81 and 7.36 percent of the total informal sector establishment, respectively. Over these two periods, small manufacturing industries increased by 48.77 percent. On the average, small manufacturing industry grew at 8 percent per annum. The manufacturing subsector (including household manufacturing) accounted for 14.9 and 18.8 percent of the total establishments in 1989-1990 and 1996-1997, respectively. During the period 1989-1990 and 1992-1993, household manufacturing increased by more than 100 percent while it increased by 48.51 percent only during the period 1989-1990 and 1996-1997. The share of distributive trade was 48.20 and 49.72 percent of the total establishments in 1989-1990 and 1996-1997, respectively (Figure 5).

Figure 5. Share of different industries in the informal sector

Distributive trade as a whole increased by increased by 21.09 percent during the period 1989-1990 and 1996-1997. Service industries accounted for about 31.81 and 22.85 percent of the total informal sector enterprises in 1989-1990 and 1996-1997, respectively. The service subsector, including distributive trade, and households other than manufacturing, accounted for 85.09 and 81.13 percent of the total informal sector establishments in 1989-1990 and 1996-1997, respectively. Thus the service sector dominated the informal sector of Bangladesh.
Informal sector value added (Figure 6) increased by 29.65 percent during the period 1989-1990 and 1996-1997. The average annual growth rate of informal sector value added was about 4.9 percent during the same period. During the period 1989-1990 and 1996-1997, the average annual growth rate of value added in small-scale manufacturing and household manufacturing was 34.32 and 54.18 percent, respectively. The growth rate of value added in distributive trade was negative at a rate of 0.31 percent while the service industries experienced a positive growth rate of 4.45 percent only during the period 1989-1990 and 1996-1997.

Figure 6. Informal sector value added

EMPLOYMENT IN DIFFERENT SUBSECTORS OF THE INFORMAL SECTOR IN BANGLADESH

Overall employment in the informal sector grew, on the average, by 0.80 percent from 1989-1990 to 1996-1997. Informal employment in 1992-1993 increased significantly due to an increase in employment in the household manufacturing industries (Figure 7). Small manufacturing industries employed 7.15 percent of the total employment of the informal sector in 1989-1990 and 13.08 percent in 1996-1997. During the same period, employment in the household manufacturing increased from 9.11 percent to 19.94 percent of the total informal employment.

Service and distributive industries in the informal sector play a dominant role in labor employment even though both experienced a declining trend of employment during the period 1989-1990 and 1996-1997. Service industries em-
ployed about 41 percent of the total labor employment in the informal sector in 1989-1990, and 31 percent in 1996-1997. Distributive trade absorbed about 36 and 30 percent of the total employment in the informal sector in 1989-1990 and 1996-1997, respectively. Service industries, distributive trade, and household industries other than manufacturing employed 83.75 and 66.97 percent of the total labor employment in the same periods, respectively. Small manufacturing industries, including household manufacturing, employed 16.26 and 33.02 percent of the total informal labor employment in 1989-1990 and 1996-1997, respectively.
CONTRIBUTION OF THE INFORMAL SECTOR TO TOTAL EMPLOYMENT IN BANGLADESH

In the Dhaka Metropolitan area, over 60 percent of all employment is in the informal sector. (Others place the figure at 90 or higher.) In Bangladesh, over 80 percent of the labor force is found in the informal sector. Of the total informal sector employment, about 71 percent is classified as either unpaid family workers or self-employed. Pro-poor policies in the recent past have brought about a significant increase in the share of self-employment in Bangladesh (Table 1).

Quasem et al. (1998) found that the informal sector of Bangladesh accounted for the overwhelming proportion of the total employment in the country although its share (including that of agriculture) declined from 96.4 percent in 1983-1984 to 84.5 percent in 1995-1996. Based on the same study, the bulk of informal employment was in agriculture, which accounted for 60.6 percent of the total informal employment in 1983-1984 falling slightly to 59 percent in 1995-1996. Despite a significant fall in relative share, informal employment (including agriculture) continues to grow annually at the rate of 2 percent, or 2.3 percent, excluding agriculture, suggesting a slightly larger growth of informal employment in the sectors other than agriculture. There is a very limited opening in the formal sector for prospective new entrants although formal employment in trading, hotels, and restaurants singularly showed a phenomenal growth rate (40.6 percent) during 1984-1996. This means that low-productive informal activities still constitute the main source of employment, implying further that people are making do with meager incomes. Even if one excludes agriculture, the informal sector in Bangladesh remains a great development challenge.

The above discussion is focused on the importance of the informal economy in a less developed country like Bangladesh. However, it has been observed that the informal economy is growing in every corner of the globe (Castells and Portes 1989). Against this background, the study made an attempt to identify the determinants of the informal economy in the global context.

Table 1. Estimated labor force by category of employment in Bangladesh (percent of total employment)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Self-employed</td>
<td>37.9</td>
<td>39.7</td>
<td>46.7</td>
</tr>
<tr>
<td>Unpaid family workers</td>
<td>15.8</td>
<td>18.9</td>
<td>12.0</td>
</tr>
<tr>
<td>Day laborers</td>
<td>26.7</td>
<td>24.2</td>
<td>24.3</td>
</tr>
<tr>
<td>Formal sector employed</td>
<td>17.5</td>
<td>16.8</td>
<td>16.7</td>
</tr>
<tr>
<td>Unemployed</td>
<td>1.8</td>
<td>2.5</td>
<td>3.4</td>
</tr>
</tbody>
</table>

DETERMINANTS OF THE INFORMAL ECONOMY IN THE GLOBAL CONTEXT

An informal economic activity is one which is unregulated, unregistered, and does not pay tax to the government. Cumbersome entry procedures push entrepreneurs into the informal economy, where businesses pay no taxes and many of the benefits that regulation is supposed to provide are missing. Products are not subject to quality standards. Businesses cannot obtain bank credit or use courts to resolve disputes. Women are disproportionately hurt, since they make up 75 percent of informal employees. Corruption is rampant, as bureaucrats have many opportunities to extract bribes. That is why it is very important to know the determinants of the informal economy at the global level. The study considered the size of the informal economy, measured as percent of gross national income, as dependent variable. Secondary data were collected from different sources for year 2005 for 96 countries. However, the study used the data on marginal tax rate (MTR) and irregular payment (IRP) for year 2004 as the data for year 2005 were not available.

The following equations are estimated based on cross-section data for 96 countries for year 2005.

\[
\begin{align*}
\ln\text{SINF} &= \beta_0 + \beta_1\text{VA} + \beta_2\text{PS} + \beta_3\text{GE} + \beta_4\text{RL} - \beta_5\text{REG} - \beta_6\text{REI} - \beta_7\text{SBMC} - \beta_8\text{POL} - \beta_9\text{CORRP} - \beta_{10}\text{MTR} - \beta_{11}\text{GOV} \quad (1) \\
\ln\text{SINF} &= \delta_0 + \delta_1\text{VA} + \delta_2\text{PS} + \delta_3\text{GE} + \delta_4\text{RL} - \delta_5\text{REG} - \delta_6\text{REI} - \delta_7\text{SBMC} - \delta_8\text{POL} - \delta_9\text{CORRP} - \delta_{10}\text{MTR} - \delta_{11}\text{GOV} \quad (2) \\
\ln\text{SINF} &= \gamma_0 + \gamma_1\text{PS} + \gamma_2\text{GE} + \gamma_3\text{RL} - \gamma_4\text{REG} - \gamma_5\text{REI} - \gamma_6\text{SBMC} - \gamma_7\text{POL} - \gamma_8\text{CORRP} - \gamma_9\text{MTR} - \gamma_{10}\text{GOV} \quad (3) \\
\ln\text{SINF} &= \tau_0 + \tau_1\text{PS} + \tau_2\text{GE} + \tau_3\text{RL} - \tau_4\text{REG} - \tau_5\text{REI} - \tau_6\text{SBMC} - \tau_7\text{POL} - \tau_8\text{CORRP} - \tau_{10}\text{MTR} - \tau_{11}\text{GOV} \quad (4) \\
\ln\text{SINF} &= \xi_0 + \xi_1\text{PS} + \xi_2\text{GE} + \xi_3\text{RL} - \xi_4\text{REG} - \xi_5\text{REI} - \xi_6\text{SBMC} - \xi_7\text{POL} - \xi_8\text{CORRP} - \xi_{10}\text{MTR} - \xi_{11}\text{GOV} \quad (5) \\
\ln\text{SINF} &= \eta_0 + \eta_1\text{PS} + \eta_2\text{GE} + \eta_3\text{RL} - \eta_4\text{REG} - \eta_5\text{REI} - \eta_6\text{SBMC} - \eta_7\text{POL} - \eta_{10}\text{CORRP} - \eta_{11}\text{MTR} - \eta_{12}\text{GOV} \quad (6) \\
\ln\text{SINF} &= \phi_0 + \phi_1\text{PS} + \phi_2\text{GE} + \phi_3\text{RL} - \phi_4\text{REG} - \phi_5\text{REI} - \phi_6\text{SBMC} - \phi_7\text{POL} - \phi_{10}\text{CORRP} - \phi_{11}\text{MTR} - \phi_{12}\text{GOV} \quad (7) \\
\ln\text{SINF} &= \theta_0 + \theta_1\text{PS} + \theta_2\text{GE} + \theta_3\text{RL} - \theta_4\text{REG} - \theta_5\text{REI} - \theta_6\text{SBMC} - \theta_7\text{POL} - \theta_{10}\text{CORRP} - \theta_{11}\text{MTR} - \theta_{12}\text{GOV} \quad (8)
\end{align*}
\]

Where:

SINF is size of the informal economy measured as % of GNP (in log form, i.e., LNSINF);
VA is voice and accountability;
PS is political instability and violence;
GE is government effectiveness;
RL is rule of law;
REG is business regulation;
REI is rigidity of employment index;
SBMC is minimum capital for starting any business measured as % of income per capita;

---

15 Data on SINF, REI, SBMC, POP, and GNIPC were collected from the World Bank (2005). All governance indicators like VA, PS, RL, and GE were collected from Daniel et al. (2006). Data on MTR and IRP were collected from Gwartney et al. (2006). Data on REG and CORRP were collected from Kane et al. (2007).
EXPLANATION OF THE VARIABLES

Voice and accountability
Voice and accountability (VA) measures the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and free media. Deepening voice and accountability is fundamentally about the construction of societies that deliver welfare for the prevalence of their citizens. Deepening voice and accountability in developing countries is about people, including those living in poverty, making the decisions that affect their lives. By deepening voice and accountability, so many nations try to improve the effectiveness and sustainability of national poverty reduction strategies. Hence, voice and accountability may have a positive impact on the size of the informal economy.

Political instability and violence
Political instability and violence (PS) measures the likelihood of violent threats to, or changes in, government including terrorism. The more political instability, the higher the level of informal economy, ceteris paribus.

Government effectiveness
Government effectiveness (GE) measures the competence of the bureaucracy and the quality of public service delivery. The more effective the government, the lower the level of informal economy, ceteris paribus.

Rule of law
Rule of law (RL) measures the extent to which agents have confidence in and abide by the rules of society, and in particular, the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence. The stronger the rule of law in a country, the lower the level of informal economy, ceteris paribus.

Business regulation
Business freedom is the ability to create, operate, and close an enterprise quickly
and easily. Burdensome, redundant regulatory rules are the most harmful barriers to business freedom. Regulation and restrictions make it difficult for entrepreneurs to maintain business. With burdensome entry regulations, few businesses bother to register. Instead, they choose to operate in the informal economy. Faced with high transaction costs to get formal property title, many would-be entrepreneurs own informal assets that cannot be used as collateral to obtain loans. A government regulation or restriction in one area may create an informal market in another. The more burdensome business regulation (REG) is, the higher the size of the informal economy, *ceteris paribus*.

**Rigidity of employment index**
With the rigid regulation common in developing countries, employers choose conservatively. Some workers benefit—mostly men with years of experience on the job. But young, female, and low-skilled workers often lose out and are denied of job opportunities. Inflexible labor markets stifle new job creation and push workers into the informal sector. The rigidity of employment index is the average of three subindices: difficulty of hiring index, rigidity of hours index, and difficulty of firing index. The higher the rigidity of employment index (REI), the higher the level of the informal economy, *ceteris paribus*.

**Minimum cost of starting a business**
The paid-in minimum capital requirement reflects the amount that the entrepreneur needs to deposit in a bank before starting any business. Many countries require paid-in capital but allow businesses to pay only a part of it before registration, with the rest to be paid after the first year of operation. In this case, the informal economy will have limited access to those economic activities that require a high start-up capital. The higher the minimum cost of starting a business, the lower the level of the informal economy, *ceteris paribus*.

**Population**
To some, informal economy is a phenomenon mostly seen in developing countries, where population size is much higher than in developed countries. However, as can be seen, the informal economy is growing in every corner of the globe irrespective of economic system. This leads credence to the belief that some other institutional and regulatory restrictions may be positively influencing informal economic activity. Moreover, in both developed and developing countries, the percentage of dependent population has been increasing on one hand while on the other hand, so many unemployed people also do not get involved even with meager income-earning informal activities due to the existence of unemployment benefits. In this sense, a larger population may not always have a positive impact
on the size of the informal economy even though one may expect a positive relationship between the size of the informal economy and the population especially in developing countries.

**Per capita income**
A higher level of per capita means greater capacity of the individual to pay and collect taxes, as well as higher relative demand for income-elastic public goods and services (Bahl 1971; Chelliah 1971). One would expect a negative relation between level of per capita income and level of the informal economy. In other words, the higher the level of per capita income, the lower the level of informal economy, *ceteris paribus*.

**Irregular payment**
Irregular payments (IRP) include irregular, additional payments in connection with import and export permits, business licenses, exchange controls, tax assessments, police protection, or loan applications. The higher the practice of irregular payments, the higher the level of the informal economy, *ceteris paribus*.

**Freedom from corruption**
This variable is based on quantitative data that assess the perception of corruption in the business environment and the levels of governmental legal, judicial, and administrative corruption. As the level of corruption increases, the size of the informal economy increases, because the citizens often engage in corrupt activity, such as bribing an official, so they can enter the informal market. The score of freedom of corruption (FCORRP) ranges from 0 to 100. A higher value means a lower level of corruption. The higher the FCORRP score, the lower the level of informal economy, *ceteris paribus*.

**Marginal tax rate**
This encompasses income tax rates and corporate tax rates. Marginal tax rate is considered the price paid for economic effort or entrepreneurship. It is expected that higher tax rates interfere with the ability of individuals to pursue their goals in the marketplace, which means that with a higher fiscal burden, informality grows in an economy. Hence, the higher the marginal tax rate or fiscal burden, the higher the level of the informal economy, *ceteris paribus*.

**Government intervention**
To some, informal economy is the result of some kind of government intervention (GOV) in the marketplace. The more government intervention in the economy takes place, the higher the level of the informal economy, *ceteris paribus*.
DISCUSSION OF THE REGRESSION RESULTS

The study followed step-wise regression and estimated eight different equations. All variables have their expected sign. All coefficients except MTR in equation 7 and FGOV in equation 8 are statistically significant. MTR in equation 8 is statistically significant at 10 percent level (Table 2). Government intervention might have certain closeness to the business regulation variable. Political instability and government effectiveness are statistically significant with the strongest quantitative effects among all the variables. Corruption, irregular payments, and business regulations are also found as key variables that shape the size of the informal economy. Among the governance indicators, rule of law has been found as a significant variable in all the equations. The coefficient of the population is negative and significant at one percent level. However, a separate regression on developing and developed countries may confirm the true nature of the relationship between sizes of the population and the informal economy. High start-up capital for starting a business may have a negative effect on the informal economy. The variable SBMC is significant at one percent level in equations 4, 5, and 6 and significant at 10 percent level in equations 7 and 8. Equation 8 has the highest $R^2$ and all variables in this equation, except government intervention, are significant at either one or five percent level.

HOW GOVERNMENT POLICIES COULD IMPACT THE INFORMAL ECONOMY

The small industry sector is usually discussed alongside the informal sector. Small enterprises are largely in the informal sector and are commonly referred to as micro-enterprises. The informal sector occupies a unique position in Bangladesh given its contribution to total employment. Its inherent advantages include lower investment, more jobs per unit of invested capital, lower capital-output ratio, lower infrastructure requirement, shorter start-up time, creation of micro entrepreneurial talent, lower consumption of energy, less environmental risk, and ability to stimulate personal savings.

The importance of the informal economy in Bangladesh implies the formulation of government policies that at best will regulate, not criminalize, informal economic activities. Yet, this sector has received very little attention in terms of allocations of public investments and institution building under the Five-year Development Plans of pre- and post-independent Bangladesh. The First Five-Year Plan (1973-1978) placed this sector under the "nonmonetized rural sector." There was no government policy guaranteeing institutional or financial support to the informal sector. This was also true of the Two-Year Plan (1978-1980). The Second Five-Year Plan (1980-1985) underscored infrastructural and institutional building for providing training and service for the multisectoral promotion of
Table 2. Least square regression of the size of the informal economy (LNINF)

<table>
<thead>
<tr>
<th>Constant</th>
<th>VA</th>
<th>PS</th>
<th>GE</th>
<th>RL</th>
<th>REG</th>
<th>REI</th>
<th>SEMC</th>
<th>POP</th>
<th>LNGNPC</th>
<th>IRP</th>
<th>FCORRP</th>
<th>MTR</th>
<th>FGOV</th>
<th>F</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>3.55639</td>
<td>0.10969‡</td>
<td>3.80930</td>
<td>-6.4215†</td>
<td>-0.4173†</td>
<td>0.620889</td>
<td>37.25886</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(7.6109)</td>
<td>(1.59099)</td>
<td>(1.80221)</td>
<td>(-2.2424)</td>
<td>(-6.928)</td>
<td>0.604225</td>
<td>0.00000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>3.31891†</td>
<td>0.10656†</td>
<td>3.64762†</td>
<td>-6.3253‡</td>
<td>-0.4934*</td>
<td>0.0061*</td>
<td>0.637755</td>
<td>31.69013</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(7.3499)</td>
<td>(1.5955)</td>
<td>(1.74201)</td>
<td>(-2.2224)</td>
<td>(-6.147)</td>
<td>(2.17831)</td>
<td>0.61763</td>
<td>0.00000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>3.08214†</td>
<td>4.81036*</td>
<td>-7.9240‡</td>
<td>-0.4112‡</td>
<td>0.00810§</td>
<td>0.00388§</td>
<td>0.637419</td>
<td>31.64404</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(6.6982)</td>
<td>(2.32964)</td>
<td>(-2.9450)</td>
<td>(-8.108)</td>
<td>(2.4786)</td>
<td>(1.9272)</td>
<td>0.617275</td>
<td>0.00000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>2.82932†</td>
<td>5.08673*</td>
<td>-6.5327†</td>
<td>-0.4149†</td>
<td>0.00791†</td>
<td>0.00397†</td>
<td>-0.0001*</td>
<td>0.651407</td>
<td>27.71869</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(5.6506)</td>
<td>(2.41047)</td>
<td>(-2.4433)</td>
<td>(-8.063)</td>
<td>(2.3768)</td>
<td>(2.0079)</td>
<td>(2.8025)</td>
<td>0.627906</td>
<td>0.00000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>3.2794†</td>
<td>3.74408*</td>
<td>-6.5824†</td>
<td>-0.4171†</td>
<td>0.00627*</td>
<td>0.00292†</td>
<td>-8.67E-05*</td>
<td>-6.02E-10*</td>
<td>0.691155</td>
<td>28.13318</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(7.3092)</td>
<td>(1.82730)</td>
<td>(-2.4274)</td>
<td>(-7.968)</td>
<td>(1.84709)</td>
<td>(1.70557)</td>
<td>(-3.7701)</td>
<td>(-3.1759)</td>
<td>0.668587</td>
<td>0.00000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>4.19593†</td>
<td>1.60219§</td>
<td>-5.7919†</td>
<td>-0.3430†</td>
<td>0.00740†</td>
<td>0.00346†</td>
<td>-9.71E-05*</td>
<td>-6.82E-10*</td>
<td>-0.07853†</td>
<td>0.706532</td>
<td>26.18182</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(6.1074)</td>
<td>(0.66118)</td>
<td>(-2.1952)</td>
<td>(-5.323)</td>
<td>(2.1759)</td>
<td>(2.18073)</td>
<td>(-4.2291)</td>
<td>(-4.4651)</td>
<td>(-2.20407)</td>
<td>0.579546</td>
<td>0.00000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>3.45900†</td>
<td>-0.2823‡</td>
<td>0.00607‡</td>
<td>0.00525‡</td>
<td>-0.0002†</td>
<td>-7.36E-10*</td>
<td>-0.09874†</td>
<td>0.108981‡</td>
<td>-0.0091‡</td>
<td>0.01988NS</td>
<td>0.742344</td>
<td>24.64977</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(8.1333)</td>
<td>(-2.776)</td>
<td>(1.6811)</td>
<td>(2.43118)</td>
<td>(2.1167)</td>
<td>(-5.7110)</td>
<td>(-2.99632)</td>
<td>(2.50889)</td>
<td>(-1.6764)</td>
<td>(1.26713)</td>
<td>0.712228</td>
<td>0.00000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>3.661088</td>
<td>-0.3012‡</td>
<td>0.00644‡</td>
<td>0.005024‡</td>
<td>-0.00026†</td>
<td>-7.22E-10*</td>
<td>-0.105503†</td>
<td>0.105759‡</td>
<td>-0.00892‡</td>
<td>0.025514‡</td>
<td>-0.00254NS</td>
<td>0.747407</td>
<td>22.48793</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(7.789225)</td>
<td>(-2.767)</td>
<td>(1.8606)</td>
<td>(2.29647)</td>
<td>(-1.9553)</td>
<td>(-5.8184)</td>
<td>(-3.02681)</td>
<td>(2.34048)</td>
<td>(-1.5189)</td>
<td>(1.629212)</td>
<td>(-1.286)</td>
<td>0.714171</td>
<td>0.00000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Figures in parentheses are t-statistics. * significant at 1% level; † significant at 5% level; ‡ significant at 10% level; NS NOT significant.
rural development. Due to inadequate resources and faulty implementation procedure, the Third Five-Year Plan (1985-90) emphasized decentralization of institutional and infrastructural framework for effective rural nonfarm self-employment generation. This Plan also pointed out the importance of institutional strengthening for self-employment generation. The Fourth Five-Year Plan (1990-95) envisaged the promotion of female entrepreneurship. Yet, the succeeding measures largely focused on the development of the manufacturing informal enterprises while other activities, namely, trading, service, construction, and transport went unnoticed. Overall, the Plans highlighted the need for access to training, skills training, and technology improvement, with emphasis on the development of micro-enterprises. They also emphasized the grant of credit at concessional rates to micro-enterprises. Informal enterprises, however, have received little attention from policymakers.

Institutions that govern the informal economy should be those dealing with local economic planning and development. Any policy targeted at the informal economy should be informed by the need to treat each segment of the informal economy accordingly and should follow:
- a context-specific (local and national circumstances) approach;
- a gender-sensitive approach; and
- a democratic and participatory approach.

The reality is that most of the development plans in Bangladesh are prepared by the central government agencies and handed to the local units for implementation. Admittedly, the latter have limited power to introduce new policies and regulations. Moreover, there is no strong chain or relationship between them.

This existing pattern in Bangladesh runs counter to the increasing trend toward decentralization worldwide. By and large, decentralization provides greater autonomy to local governments and is believed to be a tool for a more efficient, responsible, responsive, and transparent government. The process of decentralization delegates certain services to the local level, at least in theory. The assignment of government functions to the municipal government, municipal collaborations of shared management, or to metropolitan governmental entities is becoming an increasingly important topic as metropolitan areas continue to grow. At the municipal level, strengthening management and governance, reorganizing functional departments, aligning them with defined service delivery targets and standards, and assisting with the implementation of participatory

---

16 See Becker (2004).
planning processes are seen as having the potential to bring certain benefits to those who need them most.

To reduce red tape and bureaucracy for business approvals, and improve planning and development, the municipal government should introduce one-stop approval services, and make application forms and information available online for easy access.

Local government units can do much to help organize and strengthen small businesses, especially the informal sector. Yet, it should take precautions not to give disproportionate attention to the informal sector. This therefore requires strong national and local government cooperation. Enabling policies for small business creation and growth is vital to urban development planning. Local government can and should undertake entrepreneurship development projects (alone or through public-private ventures) and address market gaps, especially when they negatively affect low-income people or seriously constrain the overall performance of the urban economy. Along with local government, third-sector organizations can assist people in creating their own small businesses through training, reduction of red tape and bureaucracy, and provision of support to small business licensing, among others. Short-term training is important for increasing their skills, particularly when cities are in dire economic straits. For example, immediately after the Asian financial crisis in 1997, the Bangkok metropolitan government trained over 100,000 people to start up a business like hair dressing, motorcycle repair, and home renovation using minimal capital.

The local government may introduce a minimum license fee for informal economic activities instead of imposing taxes on the lower stratum of economic activities. By doing so, government could encourage informal enterprises to register and operate legally. In the absence of such a system, these enterprises are shelling out more for transaction costs in the form of bribes to police and local mastans (muscle man) and fees to shopkeepers and other stakeholders. Such costs exceed the total legal costs of licenses.

Those who work in the informal economy do not have the opportunity to organize or form unions. In fact, it is difficult to organize the poor, who in turn find it difficult to take advantage of collective organization, since they are often excluded from these organizations. Most workers in the informal economy have little or no social protection, and receive little or no social security

---

17 The ADB (2001) defines social protection as a set of policies and programs designed to reduce poverty and vulnerability by promoting efficient labor markets, diminishing people's exposure to risks, and enhancing their capacity to protect themselves against hazards and interruption/loss of income. It is made up of five major kinds of activities: labor-market policies and programs, social insurance, social assistance, micro- and area-based schemes, and child protection.
coverage, either from their employer or from the government. They work in very poor working conditions, which pose threats to their health and affect their productivity. This brings to the fore the need to support informal workers so they can form or join unions, and provide them with social protection and a better work environment.

Obtaining credit from financial institutions is difficult for informal enterprises, since they have no collateral to offer as guarantee. Introducing joint or collective liability as a substitute for collateral could have more impact on the growth of informal enterprises. Policies like those of the Grameen Bank, which was pioneered in Bangladesh, could be an appropriate approach to providing the informal sector with better access to credit. Improving the work environment entails measures like providing better lighting, toilets, shelter, storage space, water, etc.

Competitive advantages need to be assessed and identified to determine, among others, how competitive a given industry or economic cluster is like the light engineering industry. Key economic clusters should be the focus of urban competitiveness assessment. Government should promote the productivity and growth of informal enterprises by allowing them access to incentives that are otherwise available only to formal enterprises. These include reserving a certain portion of land for intermediate informal economic activities, making raw materials more affordable, easing the requirements for formal credit, and providing them more skills training opportunities.

Policy formulation should be informed by data on the size and composition of the informal workforce by industry, trade, and gender; goods and services; raw materials; savings; investment; machinery; equipment and tools used; and consumption patterns of households that rely on informal enterprises and informal jobs and on the links between formal and informal sectors. In this light, government should make a national database to enlist informal workers and provide them with identity cards that will facilitate their access to public, private, and NGO-provided incentives. A more responsive approach to dealing with the informal economy also requires the government to understand first and foremost the needs and interests of its workers and the structures required in an informal economy. The heterogeneity of the informal economy complicates the emergence of common identity in terms of which organization and political entitlement could evolve.

The Bangladesh Small and Cottage Industries Corporation (BSCIC), a government statutory body that promotes and supports small and cottage industries (SCI) in the private sector in Bangladesh, could extend its service toward the informal sector development in Bangladesh. With headquarters in Dhaka, it has four regional offices and 64 district offices. The government may form an informal sector development center under the BSCIC structure. All decisionmaking processes
could be undertaken by forming an appropriate committee consisting of different stakeholders and informal sector participants. Representatives from the following agencies or sectors may comprise this committee:

✦ Informal sector participants
✦ BSCIC
✦ Bangladesh Bank
✦ National Productivity Organization, Bangladesh Standard and Testing Institution, and the planning wing of the Ministry of Industry
✦ Local government (e.g., Union Parishad/Pourashava/City Corporation)
✦ Other government institutions such as utility providers
✦ Private sector associations
✦ Financial intermediaries
✦ Nongovernment organizations
✦ Donor organizations
✦ Academe
✦ Legal groups

Efforts must be made to form two different committees for governing the two broad subparts of the informal economy, namely, the intermediate sector and the subsistence sector. Given the heterogeneity of the informal economy, an informal sector development center may have different subdivisions based on varying economic activities such as small-scale manufacturing, service industries, distributive trade, household manufacturing, and household industries other than manufacturing. Several functional units need to be organized based on service delivery mechanism for all these broad economic subdivisions. The structure of the governing body should make provision for the participation of different stakeholders and representatives from the informal sector.

All functional units should work directly under each economic subdivision. Each functional unit should forward their decisions, problems, and ideas, collated from the informal sector participants, to the respective economic subdivision for further discussion, planning, and policy development and then to the informal sector development committee.

---

18 A similar SME coordination committee has been formed in Rajshahi and is the first of its kind in Bangladesh. It aims to increase awareness of local government and promote business in the locality through the creation and sustenance of a conducive business environment. The stakeholders themselves brought up the issue of not having a proper forum where business-related constraints can be addressed. The SME Coordination Committee was formed with the representation of all the key stakeholders in Rajshahi who can exercise decisionmaking powers. It was composed of top-level officials of government, leaders of the BMOs, and prominent entrepreneurs.
Figure 9. Structure of the informal sector governance

Informal Sector Development Center

Intermediate Sector (IS)
- City Corporation/Fourthave; NGOs; Private Sector; Civil Society; Financial Intermediaries/Bank; Representatives from Academe; Legal Advisor; Informal Sector Representatives

Subsistence Sector (SS)
- UP Chair/Ward Commissioner/UP Member; NGOs; Private Sector; Civil Society; Financial Intermediaries/banks; Small-scale enterprise Representatives

Economic Subdivision
- Social Policies; Macroeconomic Policies; Labor Policies; Urban Regulation; Social Protection

Small Scale Manufacturing
- Service Industries
- Distributive Trade
- Household Manufacturing
- Household Industries (other than manufacturing)

Units
- Registration
- Investment and Finance: Technology; Machinery, Equipment and
- Training and Skills Development
- Quality Control
- Innovation; Research and Development
- New Product; Design; Process of New Production; Improve uses of Raw Materials

Raw Materials
- International Trade
- Space and Zoning
- Quality Control
- Innovation; Research and Development
- New Product; Design; Process of New Production; Improve uses of Raw Materials

Marketing
- Advertisement; Product Promotion
- Formal- Informal Linkage
- Environment
- Social Protection
- Property Rights
- IT
- Availability of Data on Individual Firm

Infrastructure
- Electricity, Gas, Water, & Telephone
- E. 911 System
CONCLUSION

While governments in developing countries view self-employment in positive terms and tend to have programs for training and credit delivery to promote these enterprises, they also discriminate against the smallest of these enterprises, such as the street traders and the rickshaw pullers. Bangladesh, like other developing countries, recognizes the significance of the informal sector as an expanding source of employment, given the failure of the rural and urban formal sectors to absorb more workers (ILO 1994). The informal economy in a wide range of economic activities assumes greater importance when seen from a development perspective. It is the result of restrictions and imperfections in private markets. The study found that increased burden of taxation, combined with labor market regulation, corruption, and lack of good governance are the driving forces of the informal economy. It is evident that the higher the level of informal economic activity, the lower the level of economic freedom. However, a regulatory support to the informal sector of the economy is important since a major segment of the labor force belongs to this sector. The urgency of formulating a policy framework in rural-urban regional planning to ensure the growth of this sector cannot be emphasized enough. A bottom-up policy should be introduced to generate employment through micro- and small enterprise development, which will help workers in the informal economy organize themselves; facilitate their skills upgrading, business services and finance; and improve their living and working conditions. Policy regarding informal economy should address the issues of social, macroeconomic, labor, urban regulation, and social protection. It is important for participants in the informal sector to have space in appropriate zone (places to vend, relocation); start-up and working capital; infrastructure; raw materials; and license and registration. Licenses or ID cards help ensure protection from harassment and extortion from various sources. All these policies should also address the situation of home-based workers, garbage and paper pickers, and informal transport workers. They should also guarantee protection and the ability to work without unnecessary disruptions for the informal sector workers. Unless organized, microentrepreneurs can rarely influence decisionmaking to their advantage against established interests (Rakodi 2003). ILO recognizes the inevitability of informal sector activities and their poverty reduction potential (Carr and Chen 2002), and thus encourages governments to create an enabling environment for the sector, and for the trade unions to foster their grassroots organization. An appropriate governance structure could ensure

19 India has several programs to promote self-employment. It also has several policy initiatives to encourage small and "tiny" businesses and cottage industries. Much has been written about how these policies discriminate against large enterprises but not enough on how they discriminate against the smallest ones such as the household enterprise that hires no labor.
a healthy growth for this sector. In the context of promotion, development, and sustainability of the informal sector, government policies should enhance financial support schemes, technology and training, marketing and infrastructure, and external development institutions. Government should also reduce the cost of doing business by making the public services work more effectively, combating corruption and reducing harassment from the usual rent seekers within and outside the government, and maintaining a peaceful law-and-order situation.
### Table 1. Estimate of the growth of formal and informal employment (aged 10 years and above) in Bangladesh during 1983/84–1995/96

(Number of persons in ‘000’)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agri., Forestry and Fishery</td>
<td>16448</td>
<td>101</td>
<td>16347</td>
<td>20608</td>
<td>493</td>
<td>20115</td>
<td>1.9</td>
<td>14.1</td>
<td>1.7</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>46</td>
<td>2</td>
<td>44</td>
<td>22</td>
<td>8</td>
<td>14</td>
<td>-6.0</td>
<td>12.2</td>
<td>-9.1</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>2483</td>
<td>452</td>
<td>2031</td>
<td>3994</td>
<td>1759</td>
<td>2235</td>
<td>4.0</td>
<td>12.0</td>
<td>0.8</td>
</tr>
<tr>
<td>Electricity, Gas and Water</td>
<td>68</td>
<td>34</td>
<td>34</td>
<td>103</td>
<td>68</td>
<td>35</td>
<td>3.5</td>
<td>5.9</td>
<td>0.2</td>
</tr>
<tr>
<td>Construction</td>
<td>487</td>
<td>23</td>
<td>464</td>
<td>1013</td>
<td>132</td>
<td>881</td>
<td>6.3</td>
<td>15.7</td>
<td>5.5</td>
</tr>
<tr>
<td>Trade, Hotel and Restaurants</td>
<td>3255</td>
<td>18</td>
<td>3237</td>
<td>5980</td>
<td>1078</td>
<td>4902</td>
<td>5.2</td>
<td>40.6</td>
<td>3.5</td>
</tr>
<tr>
<td>Transport, Storage and Comm.</td>
<td>1088</td>
<td>69</td>
<td>1019</td>
<td>2299</td>
<td>320</td>
<td>1979</td>
<td>6.4</td>
<td>13.6</td>
<td>5.7</td>
</tr>
<tr>
<td>Finance and Business Service</td>
<td>136</td>
<td>41</td>
<td>95</td>
<td>213</td>
<td>169</td>
<td>44</td>
<td>3.8</td>
<td>12.5</td>
<td>-6.2</td>
</tr>
<tr>
<td>Community and Personal Service</td>
<td>2294</td>
<td>260</td>
<td>2034</td>
<td>5046</td>
<td>2193</td>
<td>2853</td>
<td>6.8</td>
<td>19.4</td>
<td>2.9</td>
</tr>
<tr>
<td>Household Sector and NAD</td>
<td>1671</td>
<td>-</td>
<td>1671</td>
<td>1036</td>
<td>24</td>
<td>1012</td>
<td>-3.9</td>
<td>-</td>
<td>-4.1</td>
</tr>
<tr>
<td>All Sectors</td>
<td>27976</td>
<td>1000</td>
<td>26976</td>
<td>40314</td>
<td>6244</td>
<td>34070</td>
<td>3.1</td>
<td>16.5</td>
<td>2.0</td>
</tr>
</tbody>
</table>

(11528) (899) (10629) (19706) (5751) (13955) (4.6) (16.7) (2.3)

Notes:
1. Formal employment is defined as employment in establishments employing 10 and more workers.
2. *Formal employment for 1984 is estimated based on annual growth rate during 1982-1994 and that for 1995-1996 is obtained from BBS (1996) and covers employed persons aged 15 years and above.
3. Figures in parentheses are corresponding values excluding agriculture.
Source: Quasem et al. (n.d.)
### Table 2. Industry-wide comparative statement of units, persons engaged, and value added

<table>
<thead>
<tr>
<th>Establishment</th>
<th>Small-scale Manufacturing</th>
<th>% of Total</th>
<th>Distributive Trade</th>
<th>% of Total</th>
<th>Service Industries</th>
<th>% of Total</th>
<th>Household Manufacturing</th>
<th>% of Total</th>
<th>Household Other than Manufacturing</th>
<th>% of Total</th>
<th>Total Informal Sector</th>
<th>% of Total</th>
<th>Number &amp; %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-93</td>
<td>5.885497</td>
<td>31.815039</td>
<td>42.0091165</td>
<td>42.0091165</td>
<td>17.018289</td>
<td>17.018289</td>
<td>7.2720585</td>
<td>7.2720585</td>
<td>2243175 (100)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1993-94</td>
<td>6.204724</td>
<td>24.5400855</td>
<td>44.8706864</td>
<td>44.8706864</td>
<td>18.40417</td>
<td>18.40417</td>
<td>5.9803336</td>
<td>5.9803336</td>
<td>2265693 (100)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1996-97</td>
<td>7.36239</td>
<td>22.8580577</td>
<td>49.7174017</td>
<td>49.7174017</td>
<td>11.505055</td>
<td>11.505055</td>
<td>8.5570956</td>
<td>8.5570956</td>
<td>2211089 (100)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Persons Engaged</th>
<th>% of Total</th>
<th>Number &amp; %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989-90</td>
<td>7.14661033</td>
<td>36.1519861</td>
</tr>
<tr>
<td>1992-93</td>
<td>8.90722738</td>
<td>30.1345322</td>
</tr>
<tr>
<td>1993-94</td>
<td>10.6611634</td>
<td>26.6500511</td>
</tr>
<tr>
<td>1995-96</td>
<td>12.4547915</td>
<td>28.1308146</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Value added</th>
<th>% of total</th>
<th>Million BD Taka &amp; %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989-90</td>
<td>5.866347</td>
<td>61.9293205</td>
</tr>
<tr>
<td>1992-93</td>
<td>6.843313</td>
<td>57.6163367</td>
</tr>
<tr>
<td>1993-94</td>
<td>10.73271</td>
<td>48.550471</td>
</tr>
<tr>
<td>1995-96</td>
<td>10.21244</td>
<td>45.1641544</td>
</tr>
<tr>
<td>1996-97</td>
<td>13.84205</td>
<td>46.8770106</td>
</tr>
</tbody>
</table>

REFERENCES


