

*Edited by*  
*A. Lawrence Chickering and Mohamed Salahdine*

# THE SILENT REVOLUTION



THE INFORMAL SECTOR  
IN FIVE ASIAN AND NEAR  
EASTERN COUNTRIES



*International Center for Economic Growth*

**Executive Summary**

THE INTERNATIONAL CENTER FOR ECONOMIC GROWTH is a nonprofit research institute founded in 1985 to stimulate international discussions on economic policy, economic growth, and human development. The Center sponsors research, publications, and conferences in cooperation with an international network of correspondent institutes, which distribute publications of both the Center and other network members to policy audiences around the world. The Center's research and publications program is organized around five series: Sector Studies; Country Studies; Studies in Human Development and Social Welfare; Occasional Papers; and Reprints.

The Center is affiliated with the Institute for Contemporary Studies and is headquartered in Panama; the administrative office is in San Francisco, California.

For further information, please contact the International Center for Economic Growth, 243 Kearny Street, San Francisco, California, 94108, USA. Telephone (415) 981-5353; Fax (415) 986-4878.

## ICEG Board of Overseers

- |   |   |
|---|---|
| Y. Seyyid Abdulai<br><i>OPEC Fund for International<br/>Development, Austria</i>                    | Woo-Choong Kim<br><i>Daewoo Corp., Korea</i>  |
| Abdalatif Al-Hamad<br><i>Arab Fund for Economic and Social<br/>Development, Kuwait</i>              | Adalbert Krieger Vasena<br><i>Argentina</i>   |
| Nicolás Ardito-Barletta<br><i>Chairman, Panama</i>  | Pedro Pablo Kuczynski<br><i>USA</i>   |
| Roy Ash<br><i>Ash Capital Partnership, USA</i>  | Agustín Legorreta<br><i>Inverlat S.A., Mexico</i>   |
| Raymond Barre<br><i>France</i>  | Sol Linowitz<br><i>Coudert Bros., USA</i>   |
| Roberto Campos<br><i>National Senator, Brazil</i>   | Jorge Mejía Salazar<br><i>Colombia</i>  |
| Carlos Manuel Castillo<br><i>Costa Rica</i>   | Saburo Okita<br><i>Institute for Domestic and International<br/>Policy Studies, Japan</i> |
| A. Lawrence Chickering<br><i>International Center for<br/>Economic Growth, USA<br/>(ex officio)</i> | Tomás Pastoriza<br><i>Banco de Desarrollo Dominicano, S.A.,<br/>Dominican Republic</i>    |
| Gustavo Cisneros<br><i>Organización Cisneros, Venezuela</i>   | John Petty<br><i>Petty-FBW Associates, USA</i>  |
| Roberto Civita<br><i>Editora Abril, Brazil</i>  | Stephan Schmidheiny<br><i>Anova A.G., Switzerland</i>                                     |
| A. W. Clausen<br><i>BankAmerica Corp., USA</i>  | Anthony M. Solomon<br><i>S.G. Warburg (USA) Inc., USA</i>                                 |
| Robert B. Hawkins, Jr.<br><i>Institute for Contemporary Studies,<br/>USA</i>                        | J. J. Vallarino<br><i>Consejo Interamericano de Comercio y<br/>Producción, Panama</i>     |
| Ivan Head<br><i>International Development Research<br/>Centre (IDRC), Canada</i>                    | Amnuay Viravan<br><i>Bangkok Bank Ltd., Thailand</i>                                      |
|   | Paul A. Volcker<br><i>James D. Wolfensohn, Inc., USA</i>                                  |

— *Executive Summary* —

# **The Silent Revolution**

## **The Informal Sector in Five Asian and Near Eastern Countries**

Edited by  
A. Lawrence Chickering  
and Mohamed Salahdine



A Copublication of the International Center for Economic Growth  
and the Harvard Institute for International Development

ICS PRESS  
San Francisco, California

**© 1991 International Center for Economic Growth**

Printed in the United States of America. All rights reserved. No part of this book may be used or reproduced in any manner without written permission except in the case of brief quotations in critical articles and reviews.

Publication signifies that the Center believes a work to be a competent treatment worthy of public consideration. The findings, interpretations, and conclusions of a work are entirely those of the author and should not be attributed to ICEG, its affiliated organizations, its Board of Overseers, or organizations that support ICEG.

Inquiries, book orders, and catalog requests should be addressed to ICS Press, 243 Kearny Street, San Francisco, California, 94108. Telephone: (415) 981-5353; fax: (415) 986-4878. To order, call toll free in the contiguous United States: **(800) 326-0263**.

This is an executive summary of the book *The Silent Revolution*, edited by A. Lawrence Chickering and Mohamed Salahdine, published by ICS Press in 1991 and distributed to the trade by National Book Network, Lanham, Maryland.

Cover design by Ben Santora.

ISBN 1-55815-177-X

# Contents

<b>Preface</b> . . . . .	5
<b>Summary of Conclusions</b> . . . . .	7
<b>An Overview of <i>The Silent Revolution</i></b> . . . . .	14
Background . . . . .	14
Country Studies . . . . .	17
<i>Morocco / Philippines / Sri Lanka / Thailand / Bangladesh</i>	
Conclusion . . . . .	25
<b>About the Contributors</b> . . . . .	26

## **Contents of the book *The Silent Revolution***

- Chapter 1 Introduction  
*A. Lawrence Chickering and Mohamed Salahdine*
- Chapter 2 The Informal Sector in Morocco: The Failure of Legal Systems?  
*Mohamed Salahdine*
- Chapter 3 The Informal Sector in the Philippines  
*Ruperto P. Alonzo*
- Chapter 4 The Informal Sector in Sri Lanka: Dynamism and Resilience  
*Nimal Sanderatne*
- Chapter 5 The Informal Sector in Thailand  
*Nipon Poapongsakorn*
- Chapter 6 “Informality” in Development: The Poor as Entrepreneurs in Bangladesh  
*Muzammel Huq and Mahreen Sultan*
- Chapter 7 The Informal Sector’s Search for Self-Governance  
*A. Lawrence Chickering and Mohamed Salahdine*

# Preface

In many developing countries, where jobs in officially licensed enterprises are scarce, much of the population makes a living by working outside the official tax and regulatory systems. These people, who make up the informal sector, are innovators, skilled at surviving, and sometimes prospering, in a highly regulated environment. Although the informal sector is an important source of jobs, income, and even housing, its participants lose their full rights as citizens by operating outside the legal economy.

In April 1989, economists from Bangladesh, Egypt, Morocco, the Philippines, Sri Lanka, and Thailand traveled to Peru to observe the work of Hernando de Soto, whose 1989 book *The Other Path* brought international attention to the plight of informal sector participants. The International Center for Economic Growth then asked these six economists to analyze the informal sector in their own countries, examining the relevance of de Soto's approach. The results, except for the study of Egypt, which could not be completed in time for publication, appear in *The Silent Revolution*. This executive summary presents the main findings of that volume.

The contributors' conclusions provide important lessons for policy makers in developing countries. The country studies show how governments, which often view the informal sector as a problem to be solved by law enforcement and regulation, actually ensure its continuation through misguided policies.

If developing countries are to advance along the development path, they must bring the informal sector participants into the legal economy, to share in both the benefits and the costs of formal economic activity. We

expect *The Silent Revolution* to bring a new understanding of the relationship between the informal sector and the development process to both scholars and policy makers.

Nicolás Ardito-Barletta  
General Director  
International Center for Economic Growth

September 1991  
Panama City, Panama

# Summary of Conclusions

Since the beginning of the 1970s, the informal sector—or underground economy, as it is commonly known in the industrial countries—has been a subject of increasing attention for scholars and policy makers searching for answers to the challenges that face many developing countries. The initial studies portrayed the large numbers of individual workers and firms that do business “off-the-books,” outside of the official, formal economy, as essentially dysfunctional—a problem that needed fixing. Since then, economists have acknowledged the failure of the bureaucratic model of development that prevailed until the 1970s, and still prevails in some countries.

Hernando de Soto’s 1987 study of the informal sector in Peru, *El Otro Sendero* (published in English in 1989 as *The Other Path*), set off a heated debate about the role of the informal sector in developing countries. De Soto argued that government institutions and policies, supported by an implicit coalition of traditional conservatives and socialists, were systematically excluding the poor from full participation in the economic and social life of Peru. He argued that people in the informal sector were being prevented from employing their entrepreneurial skills to improve their own lives and that they represented a resource that could make an important contribution to economic and social progress.

The contributors to *The Silent Revolution* attempt to assess whether de Soto’s arguments about the informal sector in Peru can be applied to other countries as well. They examine the informal sector in Bangladesh, Morocco, Sri Lanka, Thailand, and the Philippines. Here are some of the principal conclusions drawn from the evidence they present:

1. In all five of the countries studied, the informal sector is enormously important, both economically and socially. The case studies in the book present estimates of informality exceeding 50 percent of the labor force and producing 40–60 percent of GDP. This suggests that it is probably just as important in most, if not all, developing countries.
2. Although overwhelmingly poor, the informal individuals and firms described in the book have almost none of the dysfunctional and pathological qualities that traditional development theories take to be the cause of their poverty. On the contrary, the informal workers show themselves to be among the most extraordinarily entrepreneurial groups in their societies. If encouraged and given real opportunities, they could make an even greater contribution to economic and social progress.
3. If the poor's incapacities are not the ultimate cause of their poverty, we must rethink both the causes of poverty and strategies for escaping from it. If poverty is not caused by technical deficiencies such as lack of skills, what is the problem? According to most of the contributors, the problem is that the poor lack opportunities. The most fundamental problem is the lack of jobs in the modern, formal, capital-intensive sector. Bad economic policies, which inhibit the growth of export sectors, retard employment opportunities, forcing people to scramble for work in the informal sector. Only Nipon Poapongsakorn's study of Thailand tells a different story. That country has implemented good policies and has had strong growth, which has resulted in a steady decline in the informal sector there.
4. The challenge presented by the informal sector arises out of the postwar history of development, which focused on institutions and policies that would build a modern, industrial sector. This sector was capital-intensive in countries that were labor-intensive in their resources, and its concen-

tration in urban centers encouraged a large migration of people from the countryside to the cities in search of work. As a result, four different sectors have emerged in developing countries:

- a modern manufacturing sector, which is both government owned and private
- an infrastructure sector, which includes public utilities and financial services, and is also both government owned and private
- an agricultural sector, which is mostly private
- a sector made up of small- and medium-scale enterprises, which are also private

Most developing countries have focused nearly all of their attention on encouraging and subsidizing the first two sectors, while ignoring the agricultural and small enterprise sectors. The result has been the emergence of a dual economic and social structure—one is the modern formal sector of industrial, urban enterprise; the other is the traditional informal sector of agricultural, largely rural enterprise. The first is legal and privileged. The second is off-the-books and poor.

5. The informal sector holds the key to the search for economic and political transformation in many developing countries and developed Marxist countries. The informal sector represents the sociological bridge between traditional values and culture and modern individualism and entrepreneurship.
6. Informality is sustained by problems of information and political accountability. First, there is a lack of information on how various policies affect different groups. Such information is the first step in getting informal workers to organize to press for reform. Second, there are few

institutions that allow for feedback and accountability. In many countries, excessive power rests with administrative agencies, which are not accountable to voters.

7. The informal sector may exert its most powerful influence on the debate about development by forcing a rethinking of the entire vocabulary used to talk about the subject, even words such as “capitalism,” “socialism,” “left,” and “right.” In the traditional view, capitalism was associated with the old, oligarchic sectors of society, and socialism represented the forces of justice, pushing for opportunities for the poor. It is clear from the studies in the book that the ruling classes in most of these countries are mercantilist, not capitalist, and that the socialists are doing almost nothing for the poor. In all of these countries, the poor—the informal workers—must be included among the true entrepreneurs and capitalists of the country.
8. To create opportunities for informal workers and reduce the appeal of the informal sector, governments can pursue the following policies:
  - Recognize and accept the informal sector, which holds important keys to solving the economic and political problems of developing countries.
  - Eliminate institutions and policies that discriminate against the informal sector, such as difficult procedures to register or operate a business, to establish title to land, or to get a permit to build; burdensome regulations on economic activity; and policies that indirectly discriminate against the informal sector such as promotion of large enterprises, strict interest rate regulations, and trade restrictions.
  - Prepare for greatly increased demand for government provision of basic services once the informal sector has been integrated into the society. One way of doing this

is to have government oversee competition in the private sector to provide them.

- Create institutions guaranteeing citizens' rights, including the right to comment on and criticize government rule making, and effective mechanisms to review violations of rights.
  - Encourage establishment of institutions that will facilitate economic, social, and political self-governance. The aim here is to decentralize power and authority, giving local governments and communities the power to govern their own lives.
  - Encourage institutions that will support economic self-governance. The Grameen Bank in Bangladesh is one celebrated model of how small amounts of credit can empower even the poorest people to work for economic independence.
9. Private voluntary organizations (PVOs) can be powerful vehicles to encourage cooperation and participation by the informal sector in the economic and social life of many developing countries. PVOs, which often recognize only the contributions of official commercial and government sectors to the economic growth of a country, must begin by recognizing the creativity and economic vitality that exist in the informal sector. Then, there are a number of specific actions they can take to help informal workers:
- Develop models of social service institutions that respond to low-income people's articulated needs.
  - Target assistance programs for microentrepreneurs, such as information services on basic skills necessary to operate a business.
  - Develop nonacademic training programs for informal workers.

- Identify activities and organizational models that allow informal workers to organize themselves around shared interests.
  - Develop models of institutional feedback that permit informal workers to respond to government rule making.
10. If aid agencies are committed to encouraging development, what higher calling could they have than to encourage institutions and governments to promote the self-governance of poor and disadvantaged groups? To help the informal sector, aid agencies can take the following actions:
- Aid PVOs that encourage and help the informal sector, by measuring their success not only in terms of the number of poor people served, but also by the number who achieve independence and no longer need aid.
  - Reduce the bureaucratic maze associated with many aid programs, to make it easier for local PVOs receiving aid to comply with administrative procedures.
  - Continue to sponsor studies of the informal sector, especially in Central and Eastern Europe and Africa, where the need for economic and political reform is great, the informal sector is large, and the role of aid agencies in the reform process is potentially extensive.
11. Several important questions about the informal sector deserve more study in the future:
- What is the cost of staying in business for formal enterprises in developing countries, and to what extent is it a cause of informality?
  - What is an appropriate level of government regulation in a developing country? In other words, how much

regulation genuinely serves the public interest, and how much is just an excuse to protect monopolists and avoid competition?

- What costs have the strategies of encouraging large firms and import substitution imposed on informal sector participants and the poor?
- What transaction costs do informal entrepreneurs face, and how do these costs affect them?

# An Overview of *The Silent Revolution*

The informal sector raises issues of great importance to developed and developing countries alike. Informal markets facilitate a cooperative entrepreneurship that allows the poorest people around the world to assert themselves economically and politically. This silent revolution is changing societies everywhere. It is confronting them with extraordinary challenges to expand opportunities by establishing institutions and policies that will permit full participation of their citizens in all aspects of economic, social, and political life.

## **Background**

The initial studies of the informal sector, beginning with a 1972 study by the International Labor Organization, saw the sector as essentially dysfunctional—a problem that needed fixing. But as the failure of the prevailing bureaucratic model of development became clear, a new attitude toward informal workers and their potential role in development began to appear.

The bureaucratic model sees development in Newtonian terms—to borrow an analogy from physics—viewing society as a machine and seeking to perfect the machine in an effort to make development happen. This theory has tended to focus on what it came to regard as the optimal economic conditions, related to resource endowments, demographic rates,

appropriate technology, and other economic variables. All attention to poverty and the poor focused on “what the poor lacked.”

According to this model, the poor in developing countries were a passive and dispirited people, whose dysfunction prevented real self-improvement. Their only hope, therefore, was for state or foreign aid that would provide social services for them, including training, health services, and housing. As confidence in this model declined, however, observers in developing countries began to notice something quite different. Faced with a lack of job opportunities in the formal sector, many of the poor were surviving by working for themselves or for family members. Operating outside the rules and regulations of the formal economy, these businesses were providing a wide variety of important goods and services. The reason for the poverty of these people did not seem to be lack of entrepreneurial initiative.

The effects of the bureaucratic model of development and the role of the informal sector became the subject of heated debate following the publication of Hernando de Soto's 1987 study of the informal sector in Peru, *El Otro Sendero* (published in English in 1989 as *The Other Path*). De Soto argued that government institutions and policies, supported by an implicit coalition of traditional conservatives and socialists, were systematically excluding the poor from full participation in the economic and social life of Peru.

The next obvious question was whether his analysis described that country uniquely or whether it represented an important new theory about developing countries generally. This study was initiated to help answer that question, exploring in several Asian and Near Eastern countries many of the issues and questions he raised in Peru.

*The Other Path* documents the existence of an enormous informal sector—50 percent of the labor working full-time, with another 10 percent working part-time, off-the-books. Together they produce nearly 40 percent of Peru's GDP. In analyzing why such a large fraction of Peru's labor force would choose to operate outside of and beyond the law, de Soto concluded that the reason was the excessive regulation imposed by the enormous bureaucratic state, which was effectively excluding Peru's informal workers from full participation in the country's economic life. He also concluded that another reason for informality is the difficulty of gaining title to

undeveloped land. This issue is important because the willingness to invest in and improve land is dependent on the owner's having secure title.

In choosing to be informal, people give up the benefits of formal institutions established to facilitate commerce. They lose access to formal credit markets; to courts, which can enforce impersonal contracts; and to formal insurance institutions and pension benefits. De Soto even concluded that since the Peruvian government collects more than half of its tax revenues from informal sources, the informal sector pays more taxes than the formal sector in that country.

The project that resulted in *The Silent Revolution* aimed at a preliminary investigation of the role of the informal sector in six Asian and Near Eastern countries. Inspired in conversations with the Asia–Near East Bureau of the U.S. Agency for International Development, the project was designed to review de Soto's methodology for use in other countries, to refine the methodology as necessary, and then to apply it to a cross section of countries in Asia and the Near East. The countries we chose are Bangladesh, Egypt, Morocco, the Philippines, Sri Lanka, and Thailand. All except Egypt are represented here. (The study of Egypt, by Samir Toubar, was not complete in time to go to press with the rest of the book. His findings, however, do contribute to the conclusions.)

The first issue in designing this project was one of definition. The history of concern about the informal sector has been greatly confused by multiple definitions of the term. The International Labor Organization, for instance, described the informal sector as a group of enterprises characterized by unobstructed, easy entry into markets; use of local resources; family ownership; small-scale operations; use of appropriate technology with high labor intensity; reliance on training provided outside the formal education system; and operation in unregulated, competitive markets. Many other studies have used similar multicriteria definitions. Still others define the informal sector according to the degree of complexity of their accounting systems or the size of the enterprise.

In general, definitions tend to focus on either functional attributes (size or complexity of operation, for example) or legal status. Those who choose functional attributes tend to worry about the informal sector as an expression of poverty, and their policy responses often focus on providing various forms of direct assistance to the poor. Those, like de Soto, who focus on

legal status—with enterprises operating outside formal legal and financial institutions defined as informal regardless of size or complexity—tend to worry about institutional issues. Most of the contributors to this study focused on legality rather than function. Muzammel Huq and Maheen Sultan, in their study of Bangladesh, also take into account firm size and income level.

## Country Studies

**Morocco.** In his study of the informal sector in Morocco, Mohamed Salahdine looks at the informal transportation industry and the informal construction industry, which builds primarily working-class housing. Both of these activities make important contributions to the Moroccan economy, highlighting the economic and social significance of the informal sector and the state's attitudes toward and policies on the sector.

In Morocco, informal transport, on trucks that operate without authorization, may be three times as great as official transport. The National Office of Transport (ONT) has an official monopoly over trucking, but in fact carries only about 19.3 percent of goods transported. Informal carriers dominate the transportation of foodstuffs and perishable foods. Freight transported by the ONT consists mainly of bulk materials. This specialization of the ONT, and its neglect of nonbulk loads, explains in part the importance of informal transport.

People who use the informal carriers praise the truckers' availability, flexibility, competitive prices, and the provisions for payment they extend to their regular customers. In fact, over 80 percent of the establishments in the food, wholesale trade, and retail trade sectors claim openly that they make regular use of informal carriers.

The attitude of the state toward informal transport is deliberately ambiguous. At times, local authorities seize the driver's licenses of illegal carriers; confiscate their vehicles, which cannot be recovered without payment of a fine; or put the highway patrol on their trails. The highway patrol then drains their profits by imposing fines and impounding trucks. At other times, there is a lull in the hostilities, and the informal carriers make their way without restrictions.

It is impossible to deny the usefulness of the informal carriers. There is an urgent need to update the legal framework to reflect the current reality in the transport sector. Such a process might begin by facilitating the granting of permits for circulation to transporters with suitable vehicles.

Morocco also has an active informal housing market. The country has a housing shortage of over 1 million units. Officially, about 50,000 must be completed annually, although, in reality, 200,000 units need to be completed annually to close the gap.

In response, clandestine informal construction has grown up, based on the sale of parcels of land lacking basic infrastructure (water, electricity, and sewage) to individuals who build permanent homes on them. But such real estate transactions are illegal, because legislation forbids the sale of lots judged not fit for the construction of dwellings.

As a result of informal construction, however, the amount of low-cost housing is growing in Morocco. In the city of Fez, for example, illegal dwellings housed 5 percent of the urban population in 1971 and now house 30 percent of the population.

The small-scale clandestine producers of housing serve the needs of a heterogeneous population having a small amount of savings and simultaneously employ an excess of manual labor at a low price. With remarkable flexibility, this microsector, a highly structured social organization, responds to an evolving and changing situation.

This informal sector is less productive than it could be, however, because the conditions and organization of labor are simple and embryonic. The technology used is unsophisticated, and the administrative impediments are numerous. Therefore, this sector is not an accumulator of capital.

If Morocco faces economic difficulties, it is not because of cultural limitations, or because the country is not ready for development, or because of an insufficient number of entrepreneurs or a lack of entrepreneurial spirit. It is because many laws and regulations have not been adapted to current realities. There is a great discrepancy between state legal norms and popular practices. Many laws are outdated and practically demand violation. This does not mean, however, that the informal sector is equivalent to anarchy. On the contrary, the informal sector is governed by its own logic and obeys flexible and effective laws that serve as the inspiration for the development of new regulations.

**Philippines.** Like the other countries studied here, the Philippines has a sizable informal sector. According to Ruperto P. Alonzo, one study estimates that the informal sector accounted for between 26 and 49 percent of GNP in 1987. Another claimed that the informal sector employed 73 percent of nonagricultural workers in 1983.

Alonzo presents case studies of several informal industries: the jeepney industry, the tricycle industry, the housing industry, and commercial trade. Estimates indicate that the share of informal enterprises in the transport sector's employment grew from 62 percent in 1961 to 86 percent in 1983.

Some of the jeepneys operate, for instance, by carrying license plates meant for private vehicles. Others operate by attaching the public utility license plates (required for all public transport) of a legally authorized vehicle to another, unauthorized one. Both of these systems are responses to the high cost of procedures for acquiring a franchise to operate a public transport vehicle.

Both the jeepney industry and the tricycle industry are highly organized sectors that have developed different institutions in response to the legal treatment they face (although both sets of institutions basically seek to minimize the costs imposed by government regulations).

After examining these sectors, Alonzo determines that the fixed costs of starting a business and complying with all the legal requirements are a serious strain on the meager resources of the small entrepreneur. The costs of staying in business, imposed by various government rules and regulations, similarly impose a heavy burden. While the financial and fiscal incentives offered to formal enterprises are substantial and, on paper, nondiscriminatory, they are often outside the reach of the small businesses, because of the high cost of complying with the documentation requirements.

Alonzo's main conclusion is that government rules are overly strict. In certain cases, regulation is necessary, for chaos would prevail if jeepneys and tricycles could ply any route and vendors could locate anywhere they chose. Enforcement, however, has generally been lax and sporadic. As a result, the informal sector has grown large, often with the complicity of the law enforcers themselves, who are paid to look the other way. But the threat of prosecution remains, keeping the informal workers from expanding their operations.

The pursuit of institutional reforms will, of course, depend on how the rules are made. In the Philippines, for almost fifteen years before 1986, almost every law was issued by presidential decree or executive order. The parliament served merely as a rubber stamp for the president. The 1987 Constitution reintroduced the system prevailing before martial law, wherein an independent bicameral legislature coexists with the executive and judiciary branches. Some significant policy reforms have been instituted under the new political framework. But the new institutions still have to establish roots, and much more remains to be done.

**Sri Lanka.** Informal economic activities, says Nimal Sanderatne, are an integral part of the Sri Lankan economy. Informal enterprises sell food; construct housing; make clothing; act as subcontractors in manufacturing; provide transport, educational and tutorial services, and financial services such as credit; serve as brokers of various goods; and participate in many other activities. Although a precise estimate is impossible to make, Sanderatne estimates that the informal sector activities are equal to about 50 percent of GDP.

The law in Sri Lanka allows a person to carry on a business under his or her full name, without any additional requirements. Therefore, an informal enterprise need not go through the process of registration even though this process is simple, cheap, and quick. There are several reasons why Sri Lanka's informal firms remain informal. Registration, compliance with administrative rules, maintenance of proper accounts, strict observance of labor laws, and payments of taxes and other fees would add a great deal of complexity and cost to many simple operations, resulting in a loss of comparative advantage for informal firms. In addition, bureaucratic procedures and formalities are an incomprehensible burden to many informal entrepreneurs. Tax avoidance is a less important consideration for very small informal enterprises, but more prosperous informal entrepreneurs do not relish having to pay municipal taxes, business turnover taxes, and income taxes. Finally, most informal actors perceive the supposed advantages of the formal sector, such as access to banking facilities and credit, as unavailable to them, even if they were to enter the formal economy.

Yet there are disadvantages to informality as well. Some businesses and government departments do not, or legally cannot, contract with

individuals or unregistered enterprises. To get orders, a firm needs printed letterhead, a telephone, a recognized reputation, and previous fulfilled contracts. An unregistered business enterprise cannot open a bank account. Formal bank credit is difficult to obtain without a banking relationship, audited accounts, and proof of tax payments, so the informal firms opt for informal finance, which is easier to get and has more flexible terms but is decisively more costly. Certain concessions in duties on imported raw materials for manufactures are available only to registered firms, and so informal enterprises pay higher import prices. Finally, informal enterprises, by the nature of their activities and locations, often transgress health and hygiene laws, traffic rules, and zoning and construction regulations. Such transgressions often provide officials and police opportunities to harass informal entrepreneurs and obtain bribes and benefits. Transgressions are often allowed to continue, with bribery adding to the cost of the informal enterprise.

Recently the state has recognized the informal sector as a means of expanding production and increasing employment. The government is therefore implementing programs to provide more land to the landless and is designing credit schemes for craftsmen and small enterprises and initiating self-employment projects. It has made other attempts to help informal workers in previous decades. Some of these interventionist policies, such as the provision of marketing facilities and development of infrastructure to assist the informal sector, have been a success. Others have been failures, owing to government misperception of the informal entrepreneurs' needs.

Interventionist policies designed to help informal entrepreneurs should be pursued with caution, as inappropriate and overregulatory policies detrimental to informal workers may result. The best ways to encourage and assist informal businesses would be to improve the efficiency of government organizations, by minimizing bureaucratic regulations and controls; to improve economic infrastructure; to provide training in skills that could be useful for informal enterprises; to improve marketing facilities; and to facilitate access to resources.

**Thailand.** Nipon Poapongsakorn points out that in Thailand, at least 50 percent of the urban labor force works in the informal sector. Although the size of the sector has gradually declined over time because of rapid

economic growth and government policy, the number of informal actors in certain industries, such as motorcycle transport and street vending, has increased.

Nipon conducted a study of informal motorcycle transport in Bangkok. In the past two decades, informal transport has played an increasing role in Bangkok. The number of motorcycles jumped drastically, from fewer than 100 in 1976 to about 16,000 in 1987. Nipon estimates that informal motorcycle operators provide transport for 1.4 million people per day.

The hired motorcycle serves several purposes. It transports millions of people who live along side streets that cannot be traveled by public bus. It provides rapid transportation during rush hours. And it provides messenger service and other services, such as delivering lunches to office workers. In spite of its increasing role, however, motorcycle transport has not yet been legalized.

Nipon perceives at least four reasons why a large number of people in Thailand choose to be informal. Perhaps the most important reason is that the law does not allow certain activities or does not allow them in certain places. For instance, laws prohibiting selling on public streets cause street vendors to remain informal. Another reason is the cost of registering a small business, even though the government has reduced the cost in both time and money of getting a permit to do business. In addition, high import duties have stimulated smuggling activities for a number of products. Finally, it is difficult for small-scale informal enterprises to comply with labor regulations, because their average labor productivity rate is much lower than the large-scale enterprises.

To help the informal sector, government policy should do several things. First, Thailand needs more powerful, decentralized local governments, which can better serve the interests of the local population. Second, liberalizing the financial markets and setting up credit programs for small firms without collateral would be helpful. Third, the procedures for registering a business can still be improved. Fourth, the government should act to reform policies that currently discriminate against small-scale firms and the informal sector. Fifth, encouraging small entrepreneurs to form local trade or industry associations would create a channel for technical assistance to them. Finally, legal reforms should create laws characterized by

transparency, certainty, flexibility, legality, and simplicity. More popular participation in the process of legislation is also required.

**Bangladesh.** Bangladesh is one of the poorest countries in the world, with an annual per capita income of about US\$165. More than 50 percent of the population lives below the poverty line. Ten million of the country's 18.5 million families are landless and without assets. The able-bodied labor force represented by these families is largely unemployed, underemployed, or without stable or regular sources of income. The women are mostly without paid employment, and the men work primarily as casual agricultural or nonagricultural workers. They have no prospects of employment in the formal sector of Bangladesh's economy.

In their chapter on Bangladesh, Muzammel Huq and Maheen Sultan examine one method of helping the informal sector participants there. They focus on the Grameen Bank, which offers small amounts of credit to poor people without assets.

They point out that informality existed even before being discovered and labeled by economists and social scientists. It is one of the socio-economic phenomena that have existed from time immemorial: people undertaking various activities to survive and earn a living, without coming under the purview of any regulation or restriction imposed by the state.

While some people regard the informal sector as an anomaly or an anachronism, which should disappear with modernization, or as a problem, others have recognized the positive contribution it makes, not only in keeping people alive, but also to the national economy and to overall development. Furthermore, the informal sector has the potential for contributing even more if some of the constraints facing it can be removed. This is the Grameen Bank's perspective.

Many of Hernando de Soto's concepts regarding informality, developed in Peru, apply equally well to Bangladesh. For instance, both de Soto's analysis and the Grameen Bank's experience have shown that the poor should not be viewed as passive victims, but as fighters with basic survival skills and vast potential.

There are also important differences, however, stemming from the different historical experiences of the two countries. First, Peru is a highly urbanized country, while Bangladesh is a predominantly agricultural one.

Poverty and industrialization are at different levels in the two countries. Second, Bangladesh is, on the whole, not as highly regulated a society and economy as Peru. Most regulation in Bangladesh is restricted to large industries. Informal entrepreneurs do face a certain amount of harassment from government authorities in their attempts to obtain permits and basic facilities, such as electricity, gas, water, and telephones; however, informal activities are more seriously constrained by other obstacles and conditions, such as difficulty of access to institutional credit and government policies that cater to the trade lobby and favor export-oriented growth, thus unfavorably affecting the poorest segments of the population.

The Grameen Bank began in 1976 when Dr. Muhammad Yunus started to design a comprehensive banking system to bring the rural poor within the framework of viable financial institutions. In 1983, the Grameen Bank Project was transformed into an independent bank by a government ordinance. At present, the government provides 25 percent of the paid-up share capital of the bank, while the remaining 75 percent is held by the borrowers of the bank.

Borrowers are landless men and women who must form themselves into groups of five in order to receive loans, for which no collateral is required. The bank also encourages its members to participate in savings schemes. The vicious cycle of "low income—low savings—low investment—low income" can be broken by injecting credit into the cycle, which then becomes "credit—more income—more savings—more investment—more income."

The bank is also having an important impact on women. As of December 1990, 91 percent of the Grameen Bank's borrowers were women. Through their activities related to the bank, women are becoming more economically independent and more mobile; they are gaining self-confidence and a sense of solidarity.

Huq and Sultan draw several lessons from the experience of the Grameen Bank. First, the bank has shown that placing a strategic input—credit—within the reach of the poor, who are generally part of the informal sector, enables them to unleash their creative energies and productive power by engaging in or expanding self-employment opportunities. Second, poverty-focused programs are often misconceived or mistargeted, so they fail to help the very people they hope to help. If one has to deliver

anything to the poor, the delivery mechanism must be designed and operated exclusively for them. Third, to make microenterprise programs for the poor realistic and effective, it is imperative that the gap be bridged between the designers and implementors on the one hand and the clientele on the other hand, and that the myths about what the poor can and cannot do be exploded. Microenterprise programs for the poor can be meaningful and effective only within a supportive national policy framework. Finally, informality in development and the microenterprises of the poor are not problems to be addressed by policy makers and program implementors. They are part of a solution that the poor have found for themselves and by themselves. Given appropriate resources and support, the poor are able to help themselves, at very little cost to the government or society as a whole.

## **Conclusion**

The informal sector holds an important key not only to economic and social progress, but also to political legitimacy for many developing country governments.

The challenge for developing countries is ultimately to stop their policies of discrimination, which are perpetuating the dual economic and social structure that defines their development dilemma. The challenge is to open their societies and expand opportunities for those in the informal sector, who are some of the most dynamic entrepreneurs in those countries.

In reality, the question is not whether they will expand opportunities, but when. Economic and political participation and self-governance represent the highest aspirations of development. Real development cannot happen without them.

## About the Contributors

A. LAWRENCE CHICKERING is associate director and founder of the International Center for Economic Growth (ICEG) and executive director of the Institute for Contemporary Studies' Project on Economic Growth in the Soviet Union. He has written widely on issues related to economics and politics and was the editor of *The Politics of Planning: A Review and Critique of Centralized Economic Planning* (1976).

MOHAMED SALAHDINE has been a professor of socioeconomy at the University of Fez in Morocco since 1981. He received his doctorate from the University of Paris in 1981. From 1982 to 1989 he directed a research group on labor, training, and small-scale enterprises. Salahdine has been a consultant to the World Bank on female economic activities in agro-industrial production and to the U.S. Agency for International Development on the informal sector. He is the author of three books and numerous articles.

RUPERT P. ALONZO is professor of economics at the School of Economics, University of the Philippines. He served as chairman of the department from 1986 to 1988. In spring 1991 he was a visiting research scholar at the Center for Southeast Asian Studies, Kyoto University. From 1981 to 1990 he was editor of the *Philippine Economic Journal*. In 1987 he was named Outstanding Young Scientist for Economics by the National Academy of

---

These individuals contributed to the volume *The Silent Revolution*, from which this executive summary is taken.

Science and Technology of the Philippines. Alonzo has written many articles on the informal sector, public finance project evaluation, and the economics of human resources.

MUZAMMEL HUQ is director of Training and Special Programmes at the Grameen Bank in Bangladesh, where he has worked since 1982. Huq received an M.A. in political science from the University of Dhaka in 1965, a diploma in rural development in South Asia from Michigan State University in 1971, and an M.A. in political science from the University of Michigan in 1972. He taught political science at Gordon College in Pakistan from 1966 to 1970, was a research scholar at Oxford University from 1972 to 1977, and was a visiting fellow at the International Peace Research Institute in Oslo, Norway, from 1977 to 1981.

NIPON POAPONGSAKORN teaches in the Faculty of Economics, Thammasat University, Bangkok. He received his Ph.D. in economics from the University of Hawaii in 1979. He has written extensively on employment, education, and behavior in labor markets. His latest research has been on the structure and functioning of the rural informal credit market and, more recently, on-the-job training in the Thai manufacturing and service sectors. In 1985 Nipon was a research fellow at the Population Institute of the East-West Center. He has served as a consultant to the World Bank and the Asian Development Bank.

NIMAL SANDERATNE is senior research fellow at the Institute of Policy Studies in Colombo, Sri Lanka. He was formerly chairman of Sri Lanka's largest commercial bank, the Bank of Ceylon; chairman of the Merchant Bank of Sri Lanka; and director of several companies and government organizations. He has also served the Central Bank of Sri Lanka as director of economic research and director of statistics. He has published many articles on banking and credit, informal finance, agricultural insurance, agrarian reform, and economic policy issues. Sanderatne holds a Ph.D. in development studies and an M.S. in political science from the University of Wisconsin, an M.Sc. in agricultural economics from the University of Saskatchewan, and a B.Sc. in economics from the University of London.

MAHEEN SULTAN received a *licence en sciences sociales* from the University of Geneva and a postgraduate certificate from the Institut Universitaire d'Etudes de Développement (IUED) in Geneva in 1984. She worked as a research assistant at the University of Geneva for two years and studied social change and social movements. Since 1986 she has been working in Bangladesh in the field of development, first as a national professional in the local United Nations Development Program office and since 1990 as a senior principal officer with the Grameen Bank.

## ICEG Academic Advisory Board

- Abel G. Aganbegyan  
*Academy of Sciences of the USSR,  
USSR*
- Michael J. Boskin  
*Stanford University, USA (on leave)*
- Hakchung Choo  
*Asian Development Bank, Philippines*
- Rudiger Dornbusch  
*Massachusetts Institute of Technology,  
USA*
- Ernesto Fontaine  
*Pontificia Universidad Católica de  
Chile, Chile*
- Herbert Giersch  
*Kiel Institute of World Economics,  
Germany*
- Francisco Gil Díaz  
*Ministry of Finance, Mexico*
- Malcolm Gillis  
*Duke University, USA*
- Arnold C. Harberger  
*University of California, Los Angeles,  
USA*
- Helen Hughes  
*Australian National University,  
Australia*
- Shinichi Ichimura  
*Osaka International University, Japan*
- Glenn Jenkins  
*Harvard Institute for International  
Development, USA*
- D. Gale Johnson  
*University of Chicago, USA*
- Roberto Janguito  
*Banco Sudameris, Colombia*
- Yutaka Kosai  
*Japan Center for Economic Research,  
Japan*
- Anne O. Krueger  
*Duke University, USA*
- Deepak Lal  
*University College, London,  
United Kingdom*
- Ronald I. McKinnon  
*Stanford University, USA*
- Charles E. McLure, Jr.  
*Hoover Institution, USA*
- Gerald M. Meier  
*Stanford University, USA*
- Seiji Naya  
*University of Hawaii, USA*
- Juan Carlos de Pablo  
*DEPABLOCONSULT, Argentina*
- Affonso Pastore  
*Universidade de São Paulo, Brazil*
- Gustav Ranis  
*Yale University, USA*
- Michael Roemer  
*Harvard Institute for International  
Development, USA*
- Leopoldo Solís  
*Instituto de Investigación Económica y  
Social Lucas Alamán, Mexico*
- David Wall  
*University of Sussex, United Kingdom*
- Richard Webb  
*Pontificia Universidad Católica del  
Perú, Peru*
- James Worley  
*Vanderbilt University, USA*