Employment and Development
What Do We Know and What Can We Do?

International Conference convened by
Institute for the Study of Labor (IZA) and KfW Entwicklungsbank

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The following document is oriented on the discussion that took place in the workshops, while summarising and aggregating certain issues and themes that repeatedly came up during the day.

Introduction

At the start of the workshop, participants introduced the following key interests and questions that motivated their participation:

- Is productivity growth a means or an end for employment creation?
- How does the informal sector relate to issues of tax evasion?
- Should formalisation of the informal sector be a priority?
- What are the effects of formalisation on individual wellbeing?
- How can we unlock potential in the informal sector?
- What is the role of different public and private actors in the process of formalisation? Also what is the role of multilateral vs. bilateral donors?
- How do we include the informal economy in social security systems?
- What are the major constraints in the informal sector in improving the quality of employment?

The different backgrounds between researchers and practitioners as well as the heterogeneity among researchers created the need for defining different existing phenomena, such as informality, (good) employment and formalisation. Participants discussed and shared their understanding of informality and the connected phenomena while the discussion was not narrowed down to one clear-cut definition.

Short presentations

Jasmina Glisovic (CGAP), Natalie Chun (ADB) and Michael Grimm (ISS) gave small introductory notes after which the workshop participants made the following key insights:

- The informal sector should not be ignored by policy-makers due to its size in terms of employment creation, GDP contribution and relevance for poverty-reduction.
- Informality includes informal enterprises as well as informal workers.
- Most informal enterprises are micro and small in size, however altogether they account for nearly 50% of exports in Indonesia and provide for almost 90% percent of jobs in India (numbers given by participants).
- It became clear that while discussing the informal sector that there is great heterogeneity among enterprises as well as between workers participating in it. This makes it dangerous to make comprehensive statements and policy recommendations that ignore different levels of productivity among enterprises and workers as well as trends within sub-sectors. Targeting, prioritising and using a context-specific policy approach are crucial. Accordingly, different
segments of the informal sector have different needs and constraints. Constraints can be related to local infrastructure (transport, institutions, regulation, and electricity), access issues (such as finance, markets with effective demand, knowledge and technology), social and political reasons (political voice, norms, traditions, discrimination).

- The data shows that most informal MSEs are survival enterprises that would rather be wage-workers with a stable and regular job than be self-employed. This is because the majority of survival entrepreneurs have insufficient skills to be real opportunity entrepreneurs. However, there is potential in the informal sector that can be unlocked. Some MSEs have the potential to grow and become future employers. These “high-potentials” or “gazelles” constitute between 30-50% of MSEs (number based on Michael Grimm).

Based on these insights the following key challenges were identified:

1. Is formalisation enough and what are the costs and benefits of it? How do we induce innovation and create future markets for new entries in the formal economy (the micro-macro-challenge)?

2. How do we organise informal workers and give them a political voice to improve the quality of employment?

3. How do we identify “high-potentials” or future employers among informal MSEs? How do we support those who show potential?

These challenges were discussed in sub-groups with the aim of developing initial ideas for solutions. Key points in the discussions of the sub-groups are as follows:

**Challenge 1: How to formalise informal firms and how to create new markets?**

- Participants approached the issue of formalisation from a cost-benefit perspective.
- There was the impression that for many informal enterprises the cost of registration (such as time and money to invest in coping with authorities and paying taxes) outweighs the benefits of being formal – therefore many stay informal.
- The question was then rather whether forced formalisation results in enterprise growth. All participants agreed that formalisation per se is a far too short-sighted approach. Rather other issues such as skill, business knowledge and finance issues might play a role.
- In particular, knowledge in terms of coming up with an innovative business idea or improved product is the real challenge for many MSEs that participate in very competitive markets.
- Creating new markets and being innovative requires creativity, but also certain business skills. Only few entrepreneurs provide these qualities. Therefore franchising came up as a strategy to help high-potential MSEs to adopt new ideas in yet unsaturated markets.

**Challenge 2: How to give political voice to informal workers?**

- It has been acknowledged that informal workers individually will not be able to improve their work environment. This includes the fact that most workers employed informally face an array of constraints concerning their rights.
- A main issue for informal workers is the collective action problem. Therefore approaches for organising their interests seem to be of vital importance in increasing their wages, as well as improving their work environment and access to social protection. Cooperatives and self-employed associations that are organised along sectors or even sub-sectors may increase negotiation power among informal workers.
- Unions may be helpful in organising the masses, but they may be too heterogeneous and too big to lobby for specific changes in certain sub-sectors. In addition, the bigger organisations become more difficult to run; particularly informal workers may struggle to provide the skills and the time to set up a negotiation process strategically. Furthermore, the lack of essential skills such as financial literacy and strategic thinking may constrain the
effectiveness of such organisations.

- Accordingly, within cooperatives, unions, or self-employed associations, skill development and training should be provided a) to make the organisation as such more effective and b) to empower informal workers by educating them on their rights.
- Setting up such an organisation is costly. Therefore public grants and other financial measures will be needed. It is also crucial that the local government has a strong buy-in for it, since the public sector might need to act as “protector” of the poor.

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Challenge 3: How to identify and support MSEs with growth potential?

- There is a group among informal MSEs that shows the motivation, skills and ideas to grow their business and hire more workers. How can their partly unused potential be tapped and the skills gap filled? These entrepreneurs tend to face different constraints and have different needs than “survival entrepreneurs”. Heterogeneity even exists within the group of high-potentials. Some entrepreneurs may need capital; others require some form of social protection at the household-level, or training. In terms of training, we firstly need to identify the different skill levels in informal firms. Secondly, we need to identify the right policies for enhancing the skills.
- Entrepreneurs with growth potential can be identified in various ways:
  - Through self-selection, although one might miss a significant number of potential gazelles.
  - Through surveys. One might identify entrepreneurs with a certain level of business skills and absorptive capacity to learn about new production processes, business strategies or ideas.
  - Through expert interviews. Experts might be better able to identify entrepreneurs with potential to grow their business while also understanding their specific needs and constraints in this growth process.
  - Peer group discussions may also help to identify high-potentials (similar to Anirudh Krishna’s stages of progress)
  - In cooperation with local MFIs entrepreneurs with constantly increasing credit volume (and repayments) can be identified as high-potentials
  - Also, competitions on business ideas for venture capital could be made available for informal MSEs.
- While some data on entrepreneurs and their skill set exists among microfinance institutions (for some countries and sectors) there is little systematic search for “champions”. This could be enhanced by collecting more comprehensive data on informal MSEs.
- As larger and formal entrepreneurs require more skills than survival entrepreneurs (e.g. in accounting and management), high-potential entrepreneurs need a different type of support that
focuses on improving their business development skills. In contrast, survival entrepreneurs tend to require vocational training and basic education alongside social protection.

Conclusions

Participants agreed on the following conclusions from the workshop:

- The informal sector has an enormous size; its importance in fighting poverty and providing employment can hardly be overestimated.
- At the same time, the informal sector is very heterogeneous. While a large group of informal entrepreneurs can be considered “survivalists” and would rather be employed in the formal sector, others have the potential to grow and create more employment.
- Formalisation does not pay off for many MSEs; forced formalisation does not result in enterprise growth. Rather than focusing on formalisation per se, support should concentrate on skills development and access to finance.
- In doing so, different types of informal entrepreneurs need to be identified as they require different policies/types of support (basic training and social protection for survivalists, business development skills for high-potentials). Franchising could help high-potentials to adopt new ideas.
- Unions, cooperatives, and self-employed associations may give voice to informal sector workers and help them to improve their working conditions, wages, and social protection. Skills development and training as well as funding are required to make such organisations effective; local governments play a crucial role in supporting the organisations.

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