Implicit Models and Policy Recommendations: Policy towards the 'Informal Sector' in Kenya

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As social scientists have probed deeper into the employment problem in developing countries they have found themselves redefining both the nature of the problem and the scope of their analysis. At the former level they have shifted their focus from the shortage of '*modern sector*' (*i.e. enumerated*) employment opportunities to the shortage of *income-earning opportunities* broadly defined; at the latter level they have abandoned partial models which treated the labour market in isolation from the rest of the economy and political system in favour of broader interdisciplinary models which give a more realistic picture of the constraints which attend measures to relieve the problem. But usually these more general models have been implicit rather than spelled out, and set in a historical vacuum; as a consequence, some concepts and relationships commonly used in such models remain vague to the point where policy recommendations based on them risk having results opposite to those intended. In this paper these points are argued with particular reference to the report of the ILO employment mission to Kenya (ILO 1972), and above all with reference to the concept of the 'informal sector' used in that report.[1]

An attempt has been made by Green (1975) to uncover the analytical assumptions of the ILO report's recommendations. In his version there are eight key steps in the model, crudely represented in Figure 1:

1. As a result of discrimination in the markets for, in particular, land, labour and education in the colonial period, giving rise to a structure of privilege which has been taken over largely intact by the post-colonial regime, income is unequally distributed before and after taxation, leading to a consumption pattern dominated by high quality consumer goods, which must either be imported or manufactured locally by capital-intensive techniques;
2. These local manufactures require the importation of foreign technology and (because tax rates are so low and the propensity to consume so high) foreign capital;
3. In the directly productive sector this is sought via private foreign investment, and in the infrastructural sector via public foreign aid with a variety of political and economic concessions made to increase the incentives to supply knowledge and finance;
4. The resulting process of economic growth is one which may generate a high rate of surplus over social subsistence and a high growth rate of GDP but has very high leakages into elite consumption, foreign firms' profits on sales of inputs and technology as well as in local subsidiaries, and high cost/advanced technology capital investment;
5. This process is self-reinforcing, as political stability demands, in the perception of the ruling elite, the constant creation of new leakages out of that surplus—high wage 'Africanised' jobs in the modern sector, pieces of land in the former scheduled (European) areas, income opportunities in trade and transport protected by licence—as foci for the economic aspirations of educated people in particular;
6. This stability is however—even in the short run—highly vulnerable to external shocks—e.g. oil crises, declines in the prices of export staples—and to misjudgments as to just how many leakages of this sort have to be created to sustain that stability—misjudgments, that is, about what constitutes an acceptable division of surplus among the elite;
7. It is even more vulnerable in the long term, since what one may call the 'easy phase' of employment creation—that made possible by the straight transfer of settler land, Asian shops and expatriate jobs to Africans—will soon end;
8. Hence it is only possible to avert a collapse of the system either by a progressive increase in foreign dependence or alternatively—and this is the option recommended by the report—by

[1] The concept of the 'informal sector' is due to Keith Hart (1972). Its elaboration in formal economic models is, however, primarily due to John Weeks, a member of the ILO mission to Kenya, whose successive reformulations of the problem appear as Technical Appendix 22 of ILO (1972) and Weeks (1975)

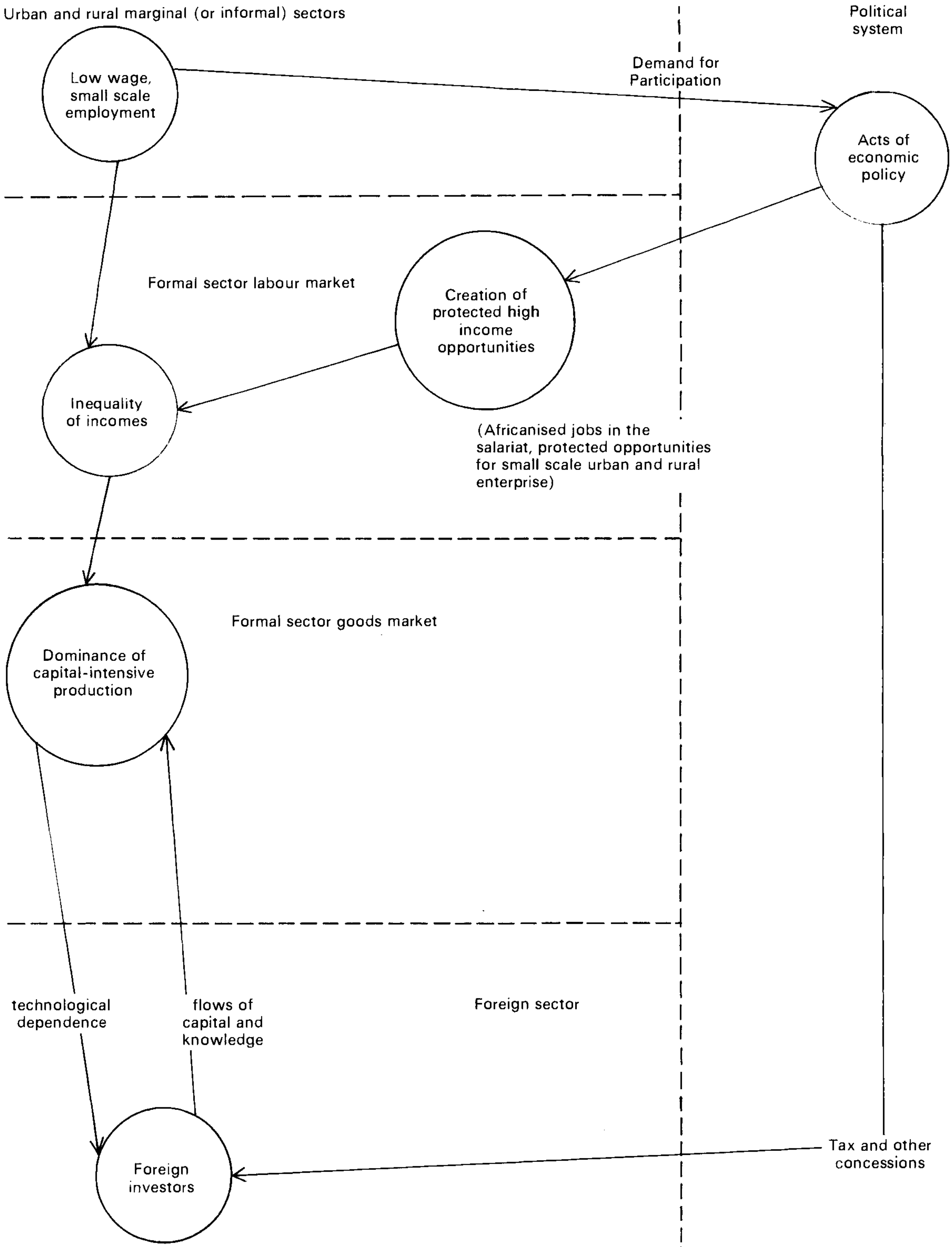

FIGURE 1: ILO REPORT 'IMPLICIT MODEL': CRUDE REPRESENTATION

redirecting resources into the so-called 'informal' or 'urban marginal' sector where labour intensity and dependence on the foreign sector for inputs and for markets is lower. In fact, the 'informal sector's' main market is likely to be the 'informal sector' itself—the urban and rural working poor. There is thus a real chance that a shift of government patronage towards—or at any rate of government harassment away—from the informal sector might bring about a self-sustained growth process within it, which would in turn substantially alleviate internal income inequalities.[2]

It must be conceded at once that this sort of approach uses a more sophisticated definition of unemployment, and a more sophisticated model, than a report on the unemployment problem in Kenya a mere 12 years previously, which had dismissed the entire unenumerated sector (estimated by ILO (1972: 225) as encompassing, at the end of the 1960s, some 125,000 people in urban areas alone, or one-third of urban recorded employment) in the characteristic moralising accents of the tidiness-loving, colonial bureaucrat:

> "Mention must be made of the *problem* presented by the large number of Africans who are seemingly unemployed, but who are frequently in self-employment, often of a kind which is perilously close to the borderline of legality. In Nyanza (province) in particular there are many itinerant hucksters who *take advantage*, for example, of the large quantities of produce being brought in by *gullible* peasants to act as middlemen and so *bedevil* the marketing of produce. They create, in effect, an inverted black market by depriving the producer of the full price to which he is entitled and themselves obtaining a handsome rake-off . . ." (emphases added) (Kenya Government 1960:9).

Indeed, a good deal of the ILO's energy in relation to the informal sector went into arguing that, contrary to this view, informal employment was in fact productive. However, I wish to argue that their picture of the informal sector (assumption 8 of the implicit model set out on page 4) falls short of adequacy as a basis for policy both in its loose definition and in its assumptions that informal sector incomes are lower, labour-intensity higher and the product range less import-dependent and more attuned to the needs of low income consumers than in the formal sector. Following on from this, I propose, in the light of historical evidence, a tentative re-definition which points the way to policy recommendations much less ambitious than theirs.

First: what is the informal sector? It is symptomatic that both the ILO report and the various glosses on it that have appeared[3] delimit it in impressionistic fashion, on the implicit grounds that, like the proverbial elephant, it may be difficult to define but is instantly recognisable. But is it? There are at least four working definitions of 'informal' economic activity in circulation, listed here in increasing order of abstraction:

1. the *accounting definition:* those activities falling outside the net of official and company register statistics;
2. the definition according to *size of firm:* self-employment, or employment in an establishment with less than five employees;
3. the definition according to the *pattern of industrial relations* practised in the firm: 'informality' could here denote involvement in an establishment not subject[4] to, for example, minimum wage legislation, unionisation, restrictions on the use of child labour;
4. the definition according to *the relationship of the producing unit vis-à-vis the State:* this, of course, is an extension of (3), since it connotes belonging to an establishment which, quite apart from not being subjected to the protective legislation described under (3), also benefits from discriminatory measures designed to protect the market position of particular firms—i.e. tariff and quote protection, tax rebates, tax holidays, low interest rates from parastatal credit organisations, work permits for expatriates, licensing, etc.

Until some sort of comprehensive statistical evidence is available on the cross-correlation of these attributes it will not be possible to do much more than speculate on how far these four attributes of informality co-vary. But this we lack by definition: since the moment an establishment comes to be sucked into the range of, at any rate, the official statistical services, it disappears *ipso*

2 The measured Gini coefficient (a measure of income inequality which varies on a scale from 0 for perfect equality to 1 for perfect inequality) for Kenya in 1969 was 0.57, one of the highest in the world; the comparable figure for Britain in the same year was 0.29. For discussion see Mosley (1978) Ch. 4.

3 In particular, Weeks (1975) and Leys (1974, 1975).

4 Conceptually, we mean subject *de facto*. In practice, we are only going to be able to measure subjection *de jure*.

facto from the informal sector under definition (1). Yet there are obvious areas where the definitions do not match: domestic service, much retail trading and a good deal of small-farm agricultural employment, for example, are included in the formal sector under definition (1), but are equally clearly in the informal sector under definition (4). Given this, statements about the informal sector *en masse* need to be based on similar definitions of the informal sector if a coherent argument is to be built up out of them. There is no evidence that the ILO team have in fact done this: thus, when they surmise that there are 100,000 to 125,000 Africans in 'informal sector' employment (ILO 1972: 225) they are clearly using definition (1), and when they suggest that a redistribution of government contracts in favour of the 'informal sector' would improve the distribution of income (ILO 1972:7) they are equally clearly using definition (4). When they assert that it would increase labour-intensity as well (ILO 1972:21-22) moreover, they are in effect using a fifth definition[5], since the presumed labour-intensity of 'informal' operation is, inescapably, an expected rather than an empirically ascertained attribute; an attribute which was in fact found *not* to be characteristic of Indian small industry (our definition (2) of 'informality') by Dhar and Lydall (1961).

We seek to escape from this definitional quicksand in two steps. Initially, we aim at consistency in discussion by confining ourselves to definition (4) which in its attempt to stratify all establishments into an 'exploited' and a 'privileged' group seems intuitively the most plausible, and then, in the light of this discussion, we propose a new definition based on demand-categories.

Let us begin with the list of activities and products characteristic of the informal sector, according to the ILO report (1972: 507 and Weeks 1975:4):

maize milling	making of simple agricultural tools
saw milling	transport (bus, pirate taxi, donkey-cart)
brickmaking	retail trade
brewing ('African' beer)	handicrafts
furniture making	repairs
tailoring	
domestic service	

5 For an attempt to develop this fifth definition by presenting the formal and informal sectors as alternative models of production, see Davies, 1975.

On the suggestion that a redistribution of demand and of official patronage in favour of these product-groups would help alleviate the 'spiral of dependency' summarised on page 9 and Figure 1 above, there seem to be three possible comments:

The first point has been made so eloquently by Leys (1975, especially Chapter 8) that we will do no more than summarise it here. This is that the recommendations of the ILO mission had very little political possibility of being implemented: for they recommended, to a group whose high standard of living depended on the continuance of certain monopoly privileges (guaranteed markets, restricted import permits, restricted trade licences and so on) that they should abandon those privileges: a suggestion put forward five years earlier by an opposition party (the Kenya People's Union) which had been outlawed and its leading members locked up in late 1969. In particular, the suggestion that the government should turn from harassing to fostering the 'informal sector' and place orders with it was in effect a request that:

"the sort of links which the monopolistic, mainly foreign sector had *not* previously found it profitable to have with small-scale African firms, should now be added to the more fundamental links which existed between foreign capital and the government on the one hand, and the rest of the economy on the other." (Leys 1975:268)

—a policy which, even if it could be carried through in defiance of the interests on which the government depended, could only be accomplished by switching business from privileged to under-privileged firms amid an atmosphere of control—i.e. by incorporating a new stratum into the ranks of that privileged group of employers already dependent on government patronage. In other words, the mission's recommendations, to the extent that they were not politically impracticable, implied a mere extension of the structure of privilege, not any real attack on inequality: a formalisation, in fact, of a part of the informal sector. As with the 'accounting' definition (1) of the informal sector, so with this political definition, we come to perceive the sector's evanescence: its tendency to vanish, like some shy animal, the moment the government's gaze falls upon it. Once this is grasped, "government aid to the informal sector", as proposed by the ILO report, appears as a contradiction in terms.

Secondly, a basic hypothesis underlying the ILO model (assumption 8 of this paper) suggests that if income were more equally distributed, those who gained by the redistribution would spend the increase on labour-intensive, informal sector products and thus bring about an 'evolutionary', local-demand based increase in employment. This seems not to be consistent with the empirical evidence. Table 1 offers an abstract from the results of two recent budget surveys, one carried out for three major towns in Kenya (Nairobi, Mombasa and Kisumu) in 1968/69 and the other, which is included as a check on these results, carried out by Johnson in 1962 in the tribal trust lands of former Southern Rhodesia. It classifies products according to their income-elasticity of demand, i.e., the aggregate propensity of the respondents to spend income increases on particular products.

It is immediately apparent that, in both countries, there was a tendency for 'informal' products to cluster in the left-hand columns of the table. In other words, it appears that, given an increase in income, Kenyan urban Africans (and Rhodesian rural Africans) would spend a rather small, and in some cases (maize flour, 'African' beer) even a negative proportion of their income on 'informal' sector products, and would prefer to switch to formal sector products—bottled beer for example. That is, there is little hope that any substantial part of an income stimulus given to the informal sector itself would spill back into it. The informal sector, in other words, seems on the evidence of the available budget surveys to produce a large proportion of goods which by the economist's definition are 'inferior': i.e. not goods which are in any sense shoddy, but goods so basic that only a very small, possibly a negative, part of any income increase can be spent on them. Hence there is little hope that a once-for-all injection into the informal sector would be in any sense self-sustaining.

The third point is, in a sense, the converse of the second. It is that a number of those informal sector outputs which do not fall prey to static demand, from the point of view of the ILO team's stated values become articles or services of elite (or indeed foreign) consumption which from a *redistributive* point of view it is irrational to subsidise. This cannot be proved from the evidence of the budgets of the poor and middle income Africans so far surveyed, for the simple reason that most poor and middle income Africans do not consume them, but it is transparently the case not only with a large number of handicrafts, but with services of every sort including the selling of newspapers, portering, much panel-beating and repairing, and, pre-eminently, domestic services.

Taking the second and third points together we perceive the 'informal sector' not as a unity so far as the destination of its outputs is concerned,

Table 1: Kenyan urban Africans (1968/69) and Rhodesia rural Africans (1962/63): Analysis of expenditure by income elasticity groupings.

Income Elasticity of Demand		
Low (Under 0·5)	**Medium (0·5 to 1·0)**	**High (Over 1·0)**
Maize flour * (—)	Groundnuts (R)	Paraffin (R)
Building materials * (R)	Meat	Soap
Chibuku (millet beer) * (R) (—)	Furniture *	Clothing (R)
Milk	Building materials * (K)	Bottled beer
Bread	School fees	Other household goods
Rice *	Bus fares * (R)	Bus fares * (K)
Sugar	Rent	Remittances
Tea	Clothing (K)	

Definition: The income elasticity of demand for a particular item is the extent to which expenditure on that item increases across a sample of households as their disposable income increases; i.e. in the estimated regression equation

$$\log E_i = a + b \log Y + c \log N$$

where E_i = expenditure on good i, Y is household income, N is household size (children under 16 get a weight of one-half), b is the income elasticity of demand for good i.

Symbols: * product or service largely produced in informal sector according to ILO report

(—) negative income elasticity of demand

(R) Rhodesian Africans only

(K) Kenyan Africans only

Sources: Kenyan data only: Kenya Government (1969). Figures for Nairobi only are used
Rhodesian data only: Johnson (1970)

but as sharply bifurcated between a very low-income goods sector with little dynamic potential (but a potential refuge in time of hardship) and a very high-income goods and services sector with considerable growth, but very little redistributive potential. This view gains considerable support from the historical evidence, to which we now turn.

Rural manufacturing and trade were pre-colonial traditions in most African communities[6] in which the roots of the present-day informal sector should be discerned[7]. While initially very hard-hit by competition from mass-produced imports, the former activities received a boost, it seems from the *decline* in real incomes during the First World War and the 1930s as a consequence of the substitution of cheap informal for relatively dear formal products at this time. The desperate nature of such expedients in the former period is well illustrated by the Rhodesian Chief Native Commissioner in his annual report for 1919:

> "The high cost of all goods has, to a certain extent induced the nations to attempt manufacturing several articles previously purchased by them. In Lower Gwelo reserve hats are being made from palm leaves, native-made pipes are also replacing the imported article, and skins are being more generally used in the place of blankets."
>
> (Southern Rhodesia Government 1920:4.)

A similar response in the latter period is documented by Newman (1975) for the case of Kenyan petty commodity producers and traders; however, the Rhodesian data for this period are much more detailed, offering us a quantitative picture not only of the time trend, but also of the cross-sectional position in any given year. We quote *in extenso* from a typical report, that for 1932:

"The following figures, which show details of the natives in the Colony engaged in earning their own livelihood in trades and businesses, have an indicative value:

Baker	1	Mechanics	2
Barber	1	Midwives	4
Blacksmiths	9	Musicians	2
Bootblacks	5	Painters	33
Bricklayers	70	Photographers	2
Builders	394	Plasterers	3
Butcher	1	Charcoal burners	3

Carpenters	201	Rickshaw owners	32
Plumbers	34	Sieve makers	11
Clerks	41	Tailors	83
Cobblers	281	Taxi owners	23
Cycle repairers	36	Eating house keepers	27
Dairymen	4	Tennis court maker	1
Thatchers	36	Fence erector	1
Upholsterers	29	Transport riders	22
Watch menders	7	Hat and basket makers	21
Market gardeners	62	Well sinkers	61
General dealers	7	Wire workers	34
Hawkers	145	Wood sellers	22
Herbalists	20		
Kaross (leather bed-cover) makers	20		
Laundrymen	43		

The total is 1.884, as compared with 1,586 last year and 864 in 1930." (Southern Rhodesia Government 1932: 7.)

As the Commissioner says, these figures only have an indicative value—they exclude not only everything that a prudish administration could class as illegal, e.g. prostitution and liquor brewing, into which large numbers of Africans were driven in periods of depression,[8] but also the informal sector's important role at the bottom end of an urban housing market that was coming under increasing pressure.[9] However. they do illustrate certain important trends and structural features. The first of these is indicated by the fact that the number of Africans recorded in self-employment more than doubled in the two years 1930-32, only the second period of falling real wages in the colony's history. Once again we see a *part* of the informal sector fulfilling the same role as it had filled in the 1920/21 depression, i.e. that of economic asylum in time of adversity. As the time series of Figure 2 indicate, this counter-cyclical tendency continued into the late 1930s. Thereafter, however, it is reversed. We interpret this in terms of a second trend, namely, the tendency for the 'luxury goods and services' part of the informal sector (as identified by our income elasticity analysis) to grow at the expense of the 'basic needs' part. Symbolically, the number of 'tennis court makers' had increased to over 20 by 1945, and the number of those involved in food processing of various types had declined.

6 For a comparative account of several such communities see Gray and Birmingham (1971)

7 For a detailed account of an important part (capital-goods) of the present-day Kenya informal sector, tracing its roots back to pre-colonial Kikuyu ironworking, see King (1974).

8 This pressure is even mote evident during and immediately after the Second World War, according to a couple of sample surveys of the conditions of urban Africans being conducted at this time. For an excellent summary of their findings see Gray 1960, part 2, Ch. 2.

9 On this see Clarke 1975, Ch. 8, and Mosley 1978, Ch. 4.

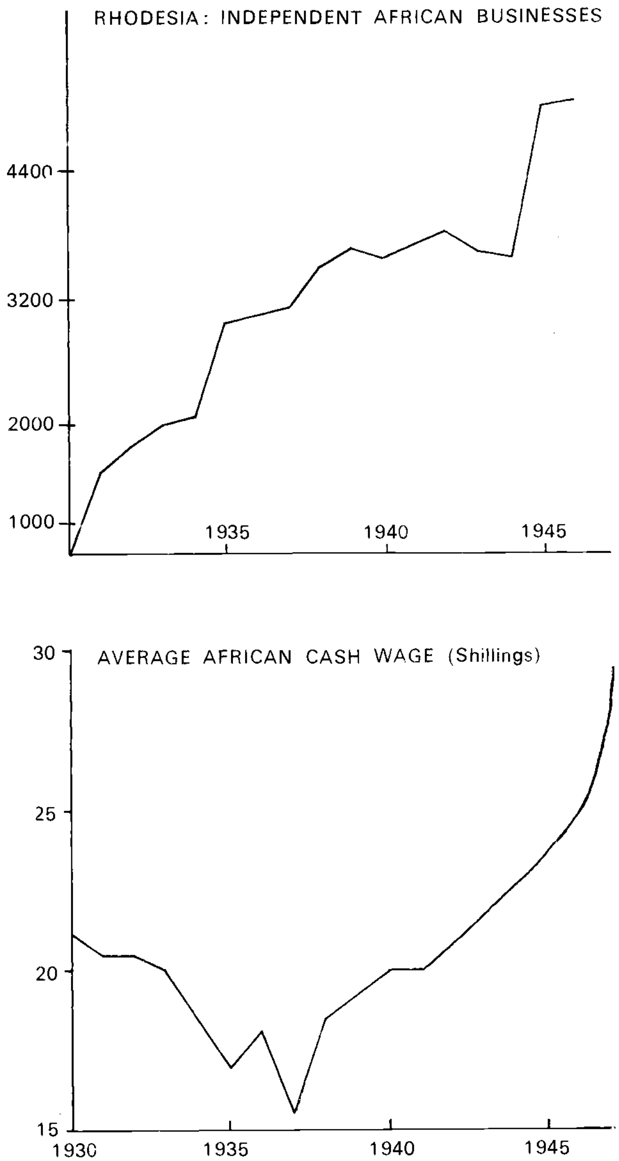

Figure 2: Time Series of Independent African Businesses (i.e. Africans in self-employment in the Reserves) against Average Modern Sector Cash Wages, Southern Rhodesia, 1930-45.

Source: Mosley 1978. Ch. 4

It cannot be claimed that these historical fragments prove any case one way or the other. They do, however, offer modest support for a view of the informal sector (in all senses of the word), and of its developmental possibilities, rather different from that envisaged by the ILO report. In the first place we see the sector, not as the homogenous huddle of poor artisans depicted by the report, but as in essence *two* sectors with sharply differentiated demand prospects, the one catering for such a low-income market as to experience its greatest stimuli in times of *declining* real income, and hence capable of self-sustained but strictly *involutionary*[10] growth; the other catering for a very high-income market and hence, unlike the other, capable of evolutionary growth at times of rising real incomes, but dependent for that growth on extraneous stimuli such as increases in foreign or in elite consumption. In the second place, stimuli to the informal sector, to the extent that they arise from a purposive state action, have the effect not of enriching it as such, but of changing its status—of formalising it in both the statistical sense and in the sense of its relation to the State (see Appendix). This being so, the ideas, implicit in the ILO's model, that the *entire* informal sector, or even the major part of it, could be expected to benefit from an income increase among the low income groups, and that the State could switch its patronage to the informal sector without destroying its very informality, need to be severely re-examined, if not abandoned, and the ILO's proposed measures themselves should be seen as having less radical import for the pattern of dependency summarised in Figure 1 than their originators expected. A necessary prerequisite for such a re-examination is a far more rigorous delimitation of the 'involutionary' and the 'dynamic' parts of the informal sector than has here been attempted, based on a thorough analysis of demand patterns; this paper is intended as no more than an impressionistic prelude, and stimulus, to such analysis.

APPENDIX: MODELS OF INTER-SECTORAL RELATIONS

Weeks (in ILO 1972, Technical Appendix 22, and especially Weeks 1975) offers us a most valuable framework in which to illustrate these points. He writes the demand function for informal sector outputs as

$$X_2 = a_{21}X_1 + a_{22}X_2 + a_{23}X_3 + a_{24}X_4 + X_{2F}$$

(ILO 1972, p. 507, or Weeks 1975, p. 5)

where X_1, X_2, X_3, X_4 are the outputs of peasant agriculture, informal sector, formal sector and government respectively, and a_{21}, a_{22}, a_{23}, a_{24} are the

10 'Involutionary' refers to the re-orientation of a static (or declining) quantum of demand towards simpler products. 'Evolutionary' refers to the re-allocation of a *rising* real income.

respective propensities of those sectors to demand the output of the informal sector (i.e. the value of informal-sector output demanded per unit of each sector's output). X_{2F} is 'final' consumer demand for informal-sector products.

The ILO's suggestions seem to be that

(a) a reduction in inequality of income distribution will boost X_{2F}

(b) any re-orientation of demand towards sectors with a high propensity to demand informal-sector outputs (high $a_{2\cdot}$'s) will improve the distribution of income,

(c) the government should as a deliberate policy step raise a_{24} by changing its purchasing and 'standards' policy.

We can now see that:

effect (a) will be a weighted average of a small and possibly negative effect in favour of that part of the informal sector which has low income elasticity of demand, and a strongly positive effect in favour of the 'high income elasticity' part; the former part will suffer from substitution of formal for informal output. On account of this, the overall effect may be exaggerated;

effect (b) is likely to be a short-run affair since the sectors in question may well have a discontinuity in their demand function: i.e. they have a high propensity to demand informal-sector outputs at low levels of sectoral income but switch their purchases to formal sector enterprises when they get richer. If this hypothesis is correct, *measured* $a_{2\cdot}$'s would exaggerate sectors' *likely future* propensity to purchase from the informal sector.

effect (c) is likely to be self-liquidating inasmuch as the very fact of a_{24} being increased is likely to mean, not an increase in informal sector output (X_2) but rather the co-option of the firms affected into the protected 'formal' sector and thus a rise in X_3.

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