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# CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	<b>SMART SKILLS: BRIDGING THE SKILL GAP FOR YOUTH EMPLOYMENT</b> <i>DR. MANJARI AGARWAL &amp; K. K. PANDE</i>	1
2.	<b>THE NEED TO FOCUS ON HRD CLIMATE IN HIGHER EDUCATIONAL INSTITUTIONS: AN EMPIRICAL ASSESSMENT</b> <i>DR. PRAVEEN CHOUGALE &amp; DR. GURUNATH J. FAGARE</i>	8
3.	<b>PERFORMANCE OF INDO-RUSSIAN TRADE DYNAMICS: AN APPRAISAL FOR THE YEAR 2003-2006</b> <i>MANMOHAN SINGH &amp; S. P. KAUSHIK</i>	13
4.	<b>KNOWLEDGE AND PRACTICE OF GENERAL PRACTITIONERS REGARDING PSYCHIATRIC DISORDERS IN VADODARA CITY</b> <i>GAURAV JD &amp; NIRAJ P</i>	16
5.	<b>EDUCATIONAL STATUS OF SCHEDULED TRIBES IN COIMBATORE DISTRICT</b> <i>DR. R. ANNAPOORANI &amp; M.SHANTHI</i>	19
6.	<b>REVEALED COMPARATIVE ADVANTAGE AND TRADE FLOWS AMONG SAARC COUNTRIES: AN ANALYSIS</b> <i>DR. B. P. SARATH CHANDRAN</i>	24
7.	<b>FINANCIAL INSTITUTIONS AND WOMEN ENTREPRENEURSHIP IN KERALA AND TAMIL NADU</b> <i>DR. SANTHA S.</i>	31
8.	<b>CORPORATE GOVERNANCE AND BUSINESS ETHICS IN IT SECTOR: SOME REFLECTIONS</b> <i>DR. BADIUDDIN AHMED, SYED HAMID MOHIUDDIN QUADRI &amp; MOHAMMED ABDUL LATEEF</i>	38
9.	<b>WORK-LIFE BALANCE (WLB): A CAUSE OF CONCERN IN BANKING SECTOR</b> <i>RITU ATHEYA &amp; DR. RENU ARORA</i>	42
10.	<b>PRIVATIZATION – IS IT A SOLUTION TO PRIORITIZATION?</b> <i>DR. JEEMON JOSEPH &amp; SHIBU ITTY MATHEW</i>	46
11.	<b>A STUDY OF STRESS AMONG FACULTY MEMBERS IN COLLEGES OF JALANDHAR</b> <i>MEGHA JAIN &amp; DR. INDERPAL SINGH</i>	49
12.	<b>HRM PRACTICES IN THE NEW ECONOMY</b> <i>THOTA AMRUTHA VALLI &amp; DR. P. ARUNKUMAR</i>	55
13.	<b>THE IMPACT OF TOURISM DEVELOPMENT ON THE ECONOMIC, CULTURAL, ENVIRONMENTAL AND SOCIAL DIMENSIONS: PERCEPTION OF RESIDENTS' OF GONDER AND ITS NEARBY RURAL COMMUNITIES IN ETHIOPIA</b> <i>DR. GETIE ANDUALEM IMIRU</i>	57
14.	<b>THE NATIONAL CHALLENGES AND POLICY OPTIONS OF ETHIOPIAN EDUCATIONAL SYSTEM TOWARDS THE ACHIEVEMENT OF EFA GOALS: A FOCUS ON PRIMARY AND SECONDARY SCHOOL</b> <i>DR. BIRHANU MOGES ALEMU</i>	63
15.	<b>ROLE AND CHARACTERISTICS OF THE URBAN INFORMAL SECTOR IN ETHIOPIA: A STUDY BASED ON NATIONAL HOUSEHOLD SURVEY</b> <i>CHALACHEW GETAHUN DESTA</i>	73
16.	<b>GROWTH AND PERFORMANCE OF AREA, PRODUCTION AND PRODUCTIVITY OF NATURAL RUBBER IN INDIA</b> <i>M. KANNAN</i>	80
17.	<b>EMPLOYMENT GENERATION AND COMMON PROPERTY RESOURCES IN EAST SIANG DISTRICT OF ARUNACHAL PRADESH, INDIA</b> <i>TOKU CHOKIO</i>	85
18.	<b>LOVE, COMPASSION AND SPIRITUALITY: A TRULY RELEVANT ETHOS IN MANAGEMENT AND BUSINESS ORGANISATIONS</b> <i>GEETU SHARMA</i>	90
19.	<b>CLAUSE 49: AN ATTEMPT TO DISCIPLINE CORPORATE</b> <i>SUVIT DAS</i>	92
20.	<b>SOCIO-ECONOMIC STATUS OF STUDENTS STUDYING IN GOVERNMENT EDUCATIONAL INSTITUTIONS - WITH SPECIAL REFERENCE TO BELLARY DISTRICT</b> <i>KOKILA H S &amp; PRASHANTHA RAMACHANDRA HEGDE</i>	98
21.	<b>THE CLIMATE OF COOPERATION IN SWEDEN</b> <i>VINCENT DODOO</i>	101
22.	<b>GREEN FINANCE IS ESSENTIAL FOR ECONOMIC DEVELOPMENT AND SUSTAINABILITY</b> <i>TASNIM UDDIN CHOWDHURY, RAJIB DATTA &amp; HARADHAN KUMAR MOHAJAN</i>	104
23.	<b>INSTITUTIONAL CREDIT AND AGRICULTURAL DEVELOPMENT</b> <i>DR. R. GOVINDASAMY</i>	109
24.	<b>A COMPARATIVE STUDY OF PRIMARY HEALTH CENTRES IN INDIA AND HARYANA</b> <i>ANNU</i>	112
25.	<b>IMPACT OF MICRO FINANCE IN POVERTY ALLEVIATION AND ECONOMIC DEVELOPMENT OF SHGS</b> <i>M. ANNAM</i>	115
26.	<b>FACTORS INFLUENCING THE PROGRESSIVE USE OF PUBLIC LIBRARIES BY ITS PATRONS</b> <i>BIMAL CHANDRA NAIR</i>	120
27.	<b>QUALITY EDUCATION: ISSUES, CONCERNS AND CHALLENGES</b> <i>BHAVNA JOSHI</i>	123
28.	<b>THE INTERNATIONALIZATION OF HIGHER EDUCATION AND ITS EFFECT ON STUDENT MOBILITY</b> <i>MUNEEB HUSSAIN GATTOO &amp; MUJEEB HUSSAIN GATTOO</i>	126
29.	<b>CONTRIBUTION OF COMMERCIAL BANKS IN HOUSING FINANCE IN HARYANA: A COMPARATIVE STUDY</b> <i>HARDEEP &amp; SATISH KUMAR</i>	132
30.	<b>REGULATION OF INDIAN MUTUAL INDUSTRY</b> <i>MONIKA SAINI</i>	135
	<b>REQUEST FOR FEEDBACK</b>	145

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## ROLE AND CHARACTERISTICS OF THE URBAN INFORMAL SECTOR IN ETHIOPIA: A STUDY BASED ON NATIONAL HOUSEHOLD SURVEY

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### ABSTRACT

*Despite availability of ample empirical evidence on economic role of the urban informal sector to low income households of developing countries in general, evidence is limited in the Ethiopian context, and development programs and plans have failed to integrate the sector into the overall development effort. This study used household survey data to explore the role & characteristics of the informal sector in urban centers of Ethiopia. Data were analyzed using simple descriptive statistics such as means and percentages, and the results show that 1) informal sector employment significantly increased, 2) some production activities increased while others decreased, 3) shortage of capital was found to be the major factor limiting work participation in the sector, and the financing of the sector mainly came from informal sources, 4) the level of income per person varied sharply among the various sectors, and finally, many of the findings are not consistent with the conventional theory on urban economy and employment in general and the informal sector in particular.*

### JEL CLASSIFICATION

E24, J21, O17

### KEYWORDS

Employee, establishment, informal sector, operator, urban center.

### 1. BACKGROUND TO THE PROBLEM

Review of works on the urban informal sector in a historical perspective shows that until about the 1960s, the sector was equated with the multitude of people whom one sees crowding the city streets, side walks, and back alley in the less developed countries [Reynolds (1969) cited in Mathur (1989)]. Its role in absorbing labor and its participation in wide range of activities were either ignored or not recognized by policy makers. However, subsequent research in the 1970s by WEP of ILO revealed that the sector was not a symptom of underdevelopment (Mathur, 1989; see also Bacchetta, 2009). According to Sethuraman (1981) cited in Mathur (1989), it was shown that first, the informal sector was quantitatively very significant in developing countries. Second, it was not a temporary phenomenon as postulated in the early migration and employment models. Third, it was not dominated by petty traders and shoeshine boys but rather consisted of diverse activities. Fourth, it was not a sector of last resort, in the sense that in many activities the incomes earned in the informal and formal sectors were similar.

As a result, the 1980s have seen the informal sector enter to a different phase with many governments adopting policies to enhance the efficiency of programs for the informal sector enterprises, including strengthening the small enterprises' abilities to negotiate for access to better inputs, markets, and prices (Mathur, 1989). According to Moser (1984) cited in Mathur (1989), there is now increasing recognition that the economic benefit of the urban informal sector far outweighs its costs. The issue that now confronts the governments of developing countries is not whether the informal sector exists, but rather what should be done to make it more efficient and productive, and to integrate it into the mainstream of the economic development process.

As a developing country, the Ethiopian urban economy is largely characterized by the informal sector. According to the Central Statistical Agency of Ethiopia (CSA hereafter) statistical report on the national labor force survey, 50.6 per cent of the total national urban labor force of the country is employed by the informal sector (CSA 1999; see also Alemayehu and Befekadu 2005 for similar report). As a result, the Ethiopian government has given sympathy to the sector, but there are still harassments prevailing against some informal sector operators such as street vendors, for example. In addition, employment is just one of the information needed for policy response; there are several other issues to be considered, which the abovementioned survey for Ethiopia has not included.

In this regard, Mathur (1989) provides a concise list of the information needed. He states that most of the information gathered in the literature of informal sector so far falls into two categories. The first comprises empirical studies on the sectoral composition of the informal sector, identified in terms of employment, output, or both. These studies focus almost entirely on the national or city levels. The second category is concerned with the branch specific activities of the informal sector. In any case of these two categories, at least five or perhaps six types of information needs are basic to developing any kind of policy or management response: the scale or size of the sector (amount of employment); the pattern of its production (output); the quantity, pattern and sources of investment; the levels of incomes and savings; the nature and extent of its linkages with the formal sector activities; and the nature of constraints within which the informal sector functions. Such empirical evidence is seriously lacking in Ethiopia and, in turn, this impedes appropriate policy responses.

### 2. OBJECTIVES OF THE STUDY

The general objective of this study is, therefore, to explore the role and characteristics of the informal sector in urban centers of Ethiopia in terms of size or amount of employment it provides; sectoral pattern of its production; quantity and sources of investment; levels of income generated; and the problems the sector faced. The paper does not try to explain causal connections; that is beyond the scope of this study.

The major research questions set for investigation include:

- How many persons were engaged in the informal sector activities? Was this proportion increasing or shrinking between the years considered?
- What type of goods and services (in terms of industrial activity) were produced by the informal sector? Was there a change in these between the years considered?
- What were the investment levels in the informal sector? What were the sources of investment? Were the sources formal or informal? Were there changes between the years considered?
- What were the levels of income in the informal sector? Did incomes vary between industries? Did levels of income per person relate to the level of employment by the given industry? What possible changes were observed over time?
- What were the problems faced by the informal sector activities? Were these problems constantly persistent overtime or were they changing in type and extent?

### 3. SIGNIFICANCE OF THE STUDY

This paper is significant in the following ways:

- Firstly, as has been discussed in the background statement to the problem, studies of urban informal sector in Ethiopia are limited. The present study is hoped to add to the empirical literature in the urban informal sector and contribute to the scientific efforts being done.

- Secondly, the study is significant to document data that would serve as a spillover for those who are interested in further research undertaking on the subject. Comprehensive studies of urban informality in Ethiopia are generally absent. It is hoped that the present study will provide useful information and serve as a baseline for further research.
- Thirdly, the study will be significant to provide policy makers and planners with data and information and assist them make informed decisions.
- Fourthly, it is hoped to trigger discussions on the efficiency and aptness of the development programs and plans of the Ethiopian government.

#### 4. DATA AND METHOD

This study was based on data from the 1996 and 2002 household survey on the urban informal sector by the Ethiopian CSA.<sup>1</sup> In a national sample survey; the agency has collected demographic and socio-economic data regarding the urban informal sector from all urban areas of the country in 1996 and 2002. In the survey, sample sizes were determined using a proportional allocation technique for each urban area, based on the 1994 population and housing census report. Furthermore, it is reported that all other sampling procedures and data gathering techniques were carefully considered in the survey. The agency reports that the total figures relating to the various attributes of the urban informal sector were estimated for each urban area and for the national level as a whole based on the sample survey data. There has not been any other survey done on the urban informal sector in Ethiopia by the time this paper was written; thus this study is limited to the years 1996 and 2002.

In this study, national level data are used as estimated by the Ethiopian CSA based on the sample survey data. The statistical technique used to analyze the data is simple descriptive statistics. Data have been tabulated, and the results are discussed using means, percentages, or counts as appropriate. Tables from survey reports have been also used, but for the purpose of meeting the need of this study, various tables in the survey reports have been combined together. Data have been recomputed to serve the purpose of this study. Both theoretical and empirical literature is integrated into and used in the discussion of the results, rather than presented separately.

### 5. RESULTS AND DISCUSSION

#### 5.1 SCALE OR SIZE OF EMPLOYMENT

The first point that is raised in a study of informal sector activities is the size or scale of employment provided by the sector. In this study, scale of the activity is measured by level of employment (see Table 1).

TABLE 1: INFORMAL SECTOR EMPLOYMENT BY SEX: 1996 AND 2002

Sex	Operators					Employees					Total				
	1996		2002		% Change	1996		2002		% Change	1996		2002		% Change
	N <sup>o</sup>	%	N <sup>o</sup>	%		N <sup>o</sup>	%	N <sup>o</sup>	%		N <sup>o</sup>	%	N <sup>o</sup>	%	
	Male	201400	34.4	328808	41.1	63.3	54909	37.7	70276	35.5	28.0	256309	35.1	399084	40.0
Female	383511	65.6	470545	58.9	22.7	91059	62.3	127751	64.5	40.3	474570	64.9	598296	60.0	26.1
Total	584911	100	799353	100	36.7	146058	100	198027	100	35.6	730969	100	997380	100	36.5

Source: Computed by author from Central Statistical Agency of Ethiopia (1997, Table 3.1, P. 23 and 2003, Table 3.1, P. 19).

The table depicts that between 1996 and 2002 informal sector employment increased both as total average and as operators and employees, respectively by 36.5, 36.7 and 35.6 percent. This is, however, in contrast to the ILO-WTO joint study report which states that incidence of informality in Ethiopia has rapidly decreased (Bacchetta, 2009).

Theoretically, the causes for an increase in informal sector employment could be many (see Djankov and Ramalho, 2008; Satchi and Templey, 2008; Gundogan and Bicerli, 2009). A few of the anticipated causes may be a downward mobility of labour from the formal sector to the informal one caused by a drop in formal employment usually following economic crisis (Oberai, 1993); employment policy changes which could be through favoring capital over labour, or through privatization - cutting public sector employment (Oberai, 1993); and rural-urban migration that results in an increase of unemployed population (Acharya and Cervantes, 2009).

Empirical investigations suggest that during the economic crisis of the 1980s in many developing countries, labour market responded by shifting employment from the formal to the informal sector, and this was a basic element in the response of labour markets to labour supply pressures (see e.g. Krishnan et al, 1998 and the references therein, for the case of Africa). The studies indicated that the role of the informal sector as employment provider, though at declining wages relative to the formal sector, significantly increased in all countries considered (Oberai, 1993; see also Schteingart (1989). However, in Ethiopia, whether there was a downward mobility of labour caused by economic crisis in 2002 (when there was larger number of informal workers than in 1996) is a matter for investigation, but there are empirical evidence suggesting that informal employment generally increased due to privatization of some public employments following the 1991 change of government (see Krishnan et al, 1998; and Geda and Degife, 2005).

In terms of the capital-labour ratio as a cause, however, the general policy in developing countries seems to be to use labor-intensive technique of production. Such an explanation has empirical support. For example, Rakodi (1993) states that since recently, policy statements in which governments attach great hopes on promoting the informal sector as a means of alleviating urban unemployment problems proliferate. Similarly, Mathur (1989) notes that several African countries have adopted support programs to strengthen the abilities of small enterprises to negotiate for access to better inputs, markets, and prices. There is increasing recognition that the economic benefit of this sector, which contributes directly to urban employment and output, far outweighs its costs. Seen in this context, an argument that informal employment in Ethiopia increased due to high capital-labour ratio seems implausible. It seems rather reasonable that more increase in informal sector employment was caused mainly by policies that promoted access to informal labour participation. As clearly indicated in the development policy and program document of Ethiopia, the government has started to encourage small enterprises and the informal sector activity as important providers of urban employment (see Ethiopian Ministry of Finance and Economic Development (MoFED hereafter), 2006). This is important to poor countries such as Ethiopia, where there is large proportion of unskilled labour supply, mainly due to rural-urban migration, which cannot be absorbed by the formal labour market (Fields, 2005; Acharya and Cervantes, 2009). Better information could have been obtained, however, if there were data for the formal sector employment so that the trends in its employment would have been analyzed.

Table 1 also depicts that the amount of employment increase varied by sex and by whether the informal sector worker was operator or employee. Thus, in the case of operators, the percentage increase was higher for males (63.3 per cent) than for females (22.7 per cent). This situation is reversed in the case of employees (40.3 per cent and 28.0 per cent for males). This means, males tended to be operators, and females tended to be employees. Whether this is caused systematically is difficult to investigate using the kind of data used here. However, Ethiopia's development policy focuses on females as primary targets in the small enterprises and micro-credit services and programs (see MoFED, 2006). In light of this, it seems implausible to argue that the difference in favour of males (being operator or employer rather than employee) is caused intentionally. Rather, it seems that though the intention was to provide pro-female services, the outcome was more of pro-male, the unintended, or that males had secured more financial resources as initial capitals to start the activities than had females. It is, generally, a well established fact that due to socio-economic and cultural reasons that have been prevailing, males have better financial power than females. It seems, here thus, that once males start operating the activity, they tended to employ more females than males. This might have been because of wage receipt differentials between males and females. Theoretical and empirical evidences are abundant regarding the fact that the type of jobs assigned to and the amount of wages received by females is generally inferior to and lower than that of males (see for example Oberai, 1993; Rakodi, 1993; Chen et al (2005) cited in Bacchetta et al, 2009).<sup>2</sup>



## 5.2 PATTERNS OF PRODUCTION

Another issue that needs to be raised in a study of informal sector activities is the patterns of production. In patterns of production, one of the questions for investigation is the types of goods and services produced by the sector.

Data on the patterns of informal sector production are extremely limited in the urban informal sector literature. Only a few studies mention specifically to the type of goods and services produced by informal sector enterprises (Mathur, 1989). According to Mathur (1989), a more detail classification of informal sector activities is available in a study by the National Institute of Urban Affairs (NIUA, 1987) of four Indian cities.<sup>3</sup> The NIUA study concludes that although the data on the pattern of production were very weak, they are not consistent with the assumption that the informal sector is dominated by hawkers and street vendors. Rather, the entire sector is much more diverse than is usually contended (NIUA, 1987 cited in Mathur, 1989).

In the case of Ethiopia, even such *weak* data are not available. However, it may be possible to find information on the general category of goods and services produced, by way of analyzing the general pattern of sectoral employments in the informal sector. Yet, it should be noted that this does not show the types of goods and services produced, which is the most highly needed information, but rather the category of goods and services proxied by the levels of sectoral employment. Here, emphasis is not placed on the level of employment; an issue already discussed, but on the sectoral distribution of goods and services proxied by the level of employment (see Table 2).

In 1996, the largest proportion of informal sector workers was engaged in the manufacturing sector, producing manufactured goods and services. This was followed by the commercial sector where workers were engaged in trade, hotels and restaurants goods and services provision. Employment provisions by the mining and quarrying, transport, construction, and also agricultural industries were very low. In 2002, the manufacturing industry was still the largest employer. This was followed by trade, hotels and restaurants, although there was a considerable decrease in the percentage employment for these two sectors relative to what was in 1996. However, there was a decline, both in terms of absolute number of employment and percentage employment for 2002 of workers engaged in the agricultural and mining and quarrying sectors. In terms of rate of change, community and personal services exhibited the largest employment rate of growth (205.2 per cent) followed by the construction industry (142.0 per cent) between the years. Although the manufacturing and the commercial sectors, which respectively exhibited the largest figures of levels of employment for 1996, also increased their employment level in 2002 in absolute numbers, rate of their growth was significantly small (28.5 per cent, and 25.2 per cent between the years). While employment in agricultural and mining and quarrying activities declined as indicated, the rate of decline was faster for agriculture.

**TABLE 2: INFORMAL SECTOR PRODUCTION BY INDUSTRIAL GROUP: 1996 AND 2002**

Major Industrial Groups	Year					
	1996		2002		Change	
	N <sup>a</sup>	%	N <sup>a</sup>	%	N <sup>a</sup>	%
Agriculture, hunting, forestry & fishing	27767	3.8	18301	1.8	-9466	-34.1
Mining and quarrying	1452	0.2	1154	0.1	-292	-20.1
Manufacturing	354905	48.6	456105	45.7	101200	28.5
Construction	8522	1.2	20621	2.1	12099	142.0
Trade, hotels and restaurants	295376	40.4	369872	37.1	74496	25.2
Transport	3993	0.6	12475	1.3	8482	2.1
Community and personal services	38947	5.3	118847	11.9	79900	205.2
Total	730962	100	997382	100	266420	36.5

Source: Computed by author from Central Statistical Agency of Ethiopia (1997, Table 3.5, P. 27 and 2003, Table 3.5, P. 24).

In Ethiopia, one of the changes in urban economy following the 1991 change of government was the rapid growth in the construction industry. Theoretically growth in the construction sector might have resulted as response to an increasing demand for buildings by expanding business activities, by more demand for residential housing, or as a means of raising income by owner of the building. In Ethiopia, this growth in the construction activities, together with the more labor-intensive production technique might have resulted in a rapid growth of employment by this sector. However, why employment in mining and quarrying activities declined while there was a tremendous rate of growth in construction activities that use as input the products of mining and quarrying, remains a matter for investigation.

## 5.3 THE QUANTITY AND SOURCES OF INVESTMENT

By definition, the levels of investment in informal sector activities are low. However, the quantity and pattern of investments varies significantly in the sector itself. For example, according to Mathur (1989) studies carried out in Kumasi show that the fixed capital requirement per worker ranged between 58 *cedis* in footwear and leather manufacturing, 396 *cedis* in blacksmithing, and 206 *cedis* in tailoring. Table 3a shows the level of informal sector investment in Ethiopia

**TABLE 3A: DISTRIBUTION OF INFORMAL SECTOR ESTABLISHMENTS BY INITIAL CAPITAL: 1996 AND 2002**

Year		Initial capital (in birr value)								Total
		≤250	251-500	501-750	751-1000	1001-2000	2001-5000	5001-10000	10000+	
1996	N <sup>a</sup>	379478	59761	19251	16836	31894	39583	16666	16254	579723
	%	65.5	10.3	3.3	2.9	5.5	6.8	2.9	2.8	100
2002	N <sup>a</sup>	550505	71637	21195	21817	25817	21417	5772	19111	737271
	%	74.7	9.7	2.9	3.0	3.5	2.9	0.8	2.6	100
% Change		45.1	19.9	10.1	29.6	-19.1	-45.9	-65.4	17.8	27.2

Source: Computed by author from Central Statistical Agency of Ethiopia (1997, Table 3.11, P. 38 and 2003, Table 3.11, P. 33).

The table reveals that 65.5 per cent of those establishments engaged in informal activities in 1996 had initial capitals less than 251.00 *birr*.<sup>4</sup> This is followed by 10.3 per cent of the establishments who had initial capitals between 251.00 and 500.00 *birr*. Thereafter, the number of establishments generally declines with increasing capital requirements. However, such a clear pattern is not easy to find in the data, since the number of establishments tended to increase with capital requirements of, for example, between 1,001.00 *birr* and 5,000.00 *birr*, and then drops again. In 2002, the percentage of establishments working in the informal sector activities with initial capitals of less than 251.00 *birr* was 74.7. Once again, the percentage generally declines with increasing capital requirements, but as for 1996, with lack of any clear pattern. In relation to what was in 1996, the number of establishments for 2002 declined for capital requirements of generally above 1,000.00 *birr* and less than 10,001.00 *birr*. In all other capital groups, they tended to increase in 2002 in relation to 1996. The highest rate of growth in the number of informal sector activities between 1996 and 2002 occurred among those with initial capitals less than 251.00 *birr*.

In capital requirements for informal sector activities, what matters most is the source of funding. According to Mathur (1989), the Kumasi study just mentioned reveal a majority coming from informal sources such as family and relatives. In Colombo, the share of the worker's own resources in the total investment was estimated at 70.3 per cent, while that of institutional sources was 14.05 per cent. The situation is also similar for Ethiopia. Table 3b indicates the financing of informal sector activities as suggested by source of initial capital by informal sector establishments. The table depicts that the predominance of the initial capital came from informal sources such as own saving. Borrowing from friends/relatives, and assistance from friends/relatives were also important sources of financing.

TABLE 3B: DISTRIBUTION OF INFORMAL SECTOR ESTABLISHMENTS BY SOURCE OF INITIAL CAPITAL: 1996 AND 2002

Year	Source of initial capital									Total
	Own saving	Borrowed from relatives/ friends	Assistance from relatives/friends	Borrowed from bank	Inherited	Borrowed from individual lenders	Assistance from Gov, NGOs, etc	Others		
1996	N <sup>o</sup>	199692	172904	152949	12277	894	7317	8988	28895	584916
	%	34.1	29.6	26.2	2.1	0.2	1.3	1.5	5.1	100
2002	N <sup>o</sup>	331979	176324	149499	9225	865	4424	7636	57307	737259
	%	45.0	23.9	20.3	1.3	0.1	0.6	1.0	7.8	100
% Change		66.3	2.0	-2.3	-24.9	-3.2	-39.5	-15.0	73.4	26.1

Source: Computed by author from Central Statistical Agency of Ethiopia (1997, Table 3.12, P. 39 and 2003, Table 3.12, P. 34).

The table reveals that while own saving as source of investment increased, borrowing and assistance from relatives/friends decreased between the years considered. This suggests that there was increasing reliance on own saving in 2002 than in 1996, for financing initial informal activities. This is important because increasing reliance on own saving reduces dependence and thereby increases autonomy and flexibility of working regimes. Moreover, in 2002, initial capital obtained from the remaining (*others*) sources was considerably lower than what was obtained from the same sources in 1996. Borrowing from micro-finance institutions as source of capital is subsumed within 'others' sources group and its contribution was generally insignificant.

#### 5.4 THE LEVEL OF INCOME EARNED

There is a wide spread assumption, in the theoretical literature, that the level of incomes and savings in the informal sector is low. There are also some empirical evidences in support of this assumption. For example, a report by the Government of Mexico (1976) (cited in Schteingart, 1989) indicates that 40 per cent of informal workers had income half of, or even less than half of the stipulated minimum wage for the formal sector. Similarly, the Abidjan study by ILO (1972) (cited in Mathur, 1989) points out that it was 73,300 (Franc CFA) or about one-tenth of income of a worker in the formal sector. However, many caution such assumption as being subject to important qualifications (see Mathur, 1989; Schteingart, 1989; Gugler, 1992). Gugler (1992) in particular argues that, first earnings vary greatly across the informal sector. Even for the same activity earnings may vary substantially according to type of clients. Earnings also vary between employers and employees in an enterprise, and between subcontracting firms down the subcontracting hierarchy. Second, average incomes are identical in the formal and informal sectors, and low incomes are also common among the formal sector. Many formal sectors employ substantial number of casual workers at low wages, without fringe benefits, and unprotected by social security (Gugler, 1992).

In the present study, however, comparison of income levels between the formal and the informal sectors is not possible since there is no data on the income level of the formal sector. So here discussion has been made regarding the income contribution of the informal sector alone (see Table 4).

Table 4 consists of three components: gross value of income by industrial group, percentage of employment by each industrial group, and gross value of income per person engaged. The percentage of employment has already been discussed, but here, it is used to calculate gross income per person. The remaining two components indicate the amount of gross income earned by each informal sector employment, at sectoral level and at the level of persons engaged.

Thus at the total sectoral level, the amount of gross income generated by informal sector activities was 1,977,423,007.00 birr for 1996, and 4,225,843,211.00 birr for 2002. Of this, the largest amount of gross income was generated from the commercial sector followed by the manufacturing sector, for both 1996 and 2002. This was though manufacturing offered the largest level of employment in both years. In terms of per person engaged, the total amount of income per person was 16,210.00 birr for 1996 and 28,693.00 birr for 2002. Interestingly, the amount of income per person engaged varied sharply among the various sectors. Thus, first, although manufacturing activities provided the largest percentage of employment for both 1996 and 2002, this sector contributed the least to the amount of income per person in 1996 and third to the last in 2002. By contrast, agricultural activities provided lower percentage of employment in 1996, and the percentage even further declined in 2002. However, this sector contributed for the second largest amount of income per person (next to commercial activities) in 1996, and the largest amount of income per person in 2002.

Another interesting point is that although community and personal services represented the highest rate in providing employment over the period, their contribution to income per person is second to the last in 1996, and only last in 2002. By contrast, although construction provided a very low percentage employment (but with very high rate of growth), it contributed to the third largest amount of income per person in both 1996 and 2002.

TABLE 4: GROSS VALUE OF INCOME FROM INFORMAL SECTOR EMPLOYMENT BY INDUSTRIAL GROUP: 1996 AND 2002.

Major industrial groups	Gross income by industrial group (in birr value)					Percentage of persons engaged			Gross income per person engaged (in birr value)				
	1996		2002		% Change	1996	2002	Change	1996		2002		% Change
	N <sup>o</sup>	%	N <sup>o</sup>	%					N <sup>o</sup>	%	N <sup>o</sup>	%	
Agriculture, hunting, forestry and fishing	69194430	3.5	181015699	4.3	161.6	3.8	1.8	-34.1	2492	15.4	9891	34.5	296.9
Mining and quarrying	2968842	0.2	2429407	0.6	-18.2	0.2	0.1	-20.5	2046	12.6	2107	7.3	3.0
Manufacturing	579789941	29.3	1086167079	25.7	87.3	48.6	45.7	28.5	1634	10.1	23815	8.3	45.7
Construction	20071004	1.0	62822338	1.5	213.0	1.2	2.1	141.9	2345	14.5	3046	10.6	29.9
Trade, hotels and restaurants	1230633530	62.2	2677013508	63.4	117.5	40.4	37.1	25.22	4166	25.7	7238	25.2	73.7
Transport	7151582	0.3	30796910	0.7	330.6	0.6	1.3	212.6	1791	11.1	2468	8.6	37.8
Community and personal services	67613678	3.4	185598270	4.4	174.5	5.3	11.9	205.2	1736	10.7	1562	5.4	-10.0
Total	1977423007	100	4225843211	100	113.7	100	100	36.5	16210	100	28693	100	77.0

Source: Computed by author from Central Statistical Agency of Ethiopia (1997, Table 3.16, P. 47 and 2003, Table 3.16, P. 41).

#### 5.5 PROBLEMS FACED

In this study, the problems faced by informal sector activities can be seen at two stages: at the starting stage and at the operational stage. At both stages, the type and extent of the problems changed over time (see Tables 5a and 5b).

TABLE 5A: DISTRIBUTION OF INFORMAL SECTOR ESTABLISHMENTS BY TYPE OF FIRST MAJOR DIFFICULTIES FACED WHEN STARTING THE ACTIVITY: 1996 & 2002

Year & responses		Type of difficulties										
		Lack of premises	Lack of access to raw materials	High price of raw materials	Problem of regulations	Inadequate skill	Lack of sufficient capital	Lack of credit	Lack of collateral	No problem	Others	Total
1996	N <sup>o</sup>	69036	16753	17230	10821	46133	291396	4777	----	----	35201	491347
	%	14.1	3.4	3.5	2.2	9.4	59.3	1.0	----	----	7.16	100
2002	N <sup>o</sup>	49196	13119	5635	11984	78574	303538	1099	1464	281626	51042	797277
	%	6.2	1.7	0.7	1.5	9.9	38.1	0.1	0.2	35.3	6.4	100
% Change		-28.7	-21.7	-67.3	10.7	70.3	4.2	-77.0	----	----	165.8	62.3

Source: Computed by author from Central Statistical Agency of Ethiopia (1997, Table 3.17, P. 49 and 2003, Table 3.17, P. 46).

Table 5a indicates that 59.3 per cent of the establishments in 1996 rated lack of sufficient capital as the first major difficulty faced when starting the activity. This was followed by lack of premises (14.1 per cent) and inadequate skill (9.4 per cent). In 2002, these same types of problems continued to persist, but with a somewhat decreased extent. There are, however, some differences here. First, rather than lack of premises, inadequate skill was second in importance as a major difficulty faced in starting the activity (9.9 per cent). Lack of premises, which was the second most important problem rated as the first major difficulty in 1996, was third in importance in 2002. It seems that the problem of lack of premises has significantly decreased by 2002, but that of lack of skills persisted. Second, 35.3 per cent (very high proportion) of the establishments in 2002 indicated they faced no problem in starting the activity, but no data was available for 1996 to compare.

Table 5b shows the problems faced at operational stage. Here, too, capital was an important limiting factor. In 1996, shortage of working capital was rated as the most important difficulty faced at operational stage. However, rather than lack of premises and inadequate skill that followed in importance as in the case for when starting the operation, it is limited market for goods and services produced and family responsibility that followed as the second and third most important problems. A similar trend was exhibited in 2002, but here shortage of working capital, though the highest percentage, had significantly decreased relative to what was 1996. However, the problem of lack of market for goods and services produced rapidly increased over the period.

TABLE 5B: DISTRIBUTION OF INFORMAL SECTOR ESTABLISHMENTS BY TYPE OF FIRST MAJOR OPERATION DIFFICULTIES: 1996 AND 2002

Year & responses		Type of difficulties									
		Health problem	Family responsibility	Limited capacity	Shortage of working capital	Limited market	Lack of premises	Lack of raw materials	No problem	Others <sup>5</sup>	Total
1996	N <sup>o</sup>	----	59253	24432	262130	126052	28006	16659	----	68373	584905
	%	----	10.1	4.2	44.8	21.6	4.8	2.9	----	11.7	100
2002	N <sup>o</sup>	43708	28037	11860	237987	237769	32564	24744	120176	61907	798752
	%	5.5	3.5	1.5	29.8	29.7	4.1	3.1	15.1	7.8	100
% Change		----	-52.7	-51.5	-9.2	88.6	16.3	48.5	----	-9.5	36.6

Source: Computed by author from Central Statistical Agency of Ethiopia (1997, Table 3.18, P. 51 and 2003, Table 3.18, PP. 45-43)

From the results, it seems possible to conclude that capital – both for starting and running the activities - is the dominant limiting factor both in 1996 and 2002. This fact is important because it seems to be inconsistent with the theoretical literature which characterizes informal sector activities as having low capital requirements in investment. The implication of the theoretical characterization of the informal sector regarding this is that capital is not a major factor limiting entry into and operation of informal sector activities. Earlier, it was pointed out that more than 65 per cent of the informal sector establishments in 1996 and more than 74 per cent of those in 2002 invested less than 251.00 birr when starting the operation. However, this does not mean that they had such low capital requirements. While investment levels can be low, 'it does not follow that capital requirements are also low' (Mathur, 1993).

At the starting stage, lack of premises as a problem significantly decreased in 2002. Perhaps, this is due to increasing number of temporary structures of small retailing shops and workshops made available by municipalities to the various types of informal activities particularly for the young and women. However, the problem of inadequate skill had not changed overtime. At operational stage, the importance of inadequate skill had significantly dropped as a problem (1.2 per cent in 1996, and 0.4 per cent in 2002). Nevertheless, such low percentage may be the result of the effect of new indicators of problems used rather than actual reduction in importance as a problem. Once again, this challenges the theoretical literature which holds that the skill requirement of informal sector activities is low.

In the preceding sections, it was discussed that sectors that employed the largest proportion of the informal sector workers tended to contribute for lower amount of income per person than those that employed relatively low proportions. At this point, it is possible to ask *Why did workers not engaged in sectors that yield the highest amount of income per person?* One possible answer for this question is lack of information, skills training, or entry difficulty. More research is needed at this point.

## 6. FINDINGS AND CONCLUSION

This paper discussed the role and characteristics of the urban informal sector in Ethiopia, based on a household survey data by the Central Statistical Agency of Ethiopia for 1996 and 2002. The major findings of the study are summarized as follows:

Firstly, the size of the sector significantly increased between the years considered. Among others, policies favoring the sector seem to have been adopted and have encouraged employment in the informal sector. However, data need to be available to analyze the contribution of each potential cause for the growth in size of this sector. However, the amount of employment increase varied by sex and by whether the informal sector worker was operator or employee.

Secondly, some sectoral production activities (proxied by the level of employment) declined while others increased: The largest proportion of workers produced manufactured goods and services, followed by the trade, hotels and restaurants activities both in 1996 and 2002, but there was a considerable percentage decrease in these activities in 2002. Production activities by the mining and quarrying, and also by agricultural industries were low in 1996, but in 2002 these further declined both in percentage and absolute terms; the rate of decrease was faster for agricultural activities. However, the construction industry exhibited growth. It seems that expansion of business activities and the housing sector together with the more labor intensive production techniques resulted in a rapid

growth of the construction sector. However, the decline in the mining and quarrying activities is difficult to explain. Whether this is a problem in the data used or in the economy itself, is impossible to conclude with the type of data used here.

Thirdly, the largest proportion of informal sector establishments had smaller initial capitals both in 1996 and 2002, and the highest rate of growth in the number of informal sector activities between the years occurred among this capital group. The number of establishments generally decreased with increasing capital requirements, but this pattern is not as such smooth. Appropriate data need to be available to explore the theoretical evidence that suggests that the quantity and pattern of investments significantly varies by industrial group in the sector itself. Moreover, the financing of informal sector activities mainly came from informal sources such as own saving, borrowing from friends or relatives, and assistance from friends or relatives. There was more reliance on own saving in 2002 than in 1996 for financing initial activities, and this is important because increasing reliance on own saving lowers dependence and thereby increases autonomy and flexibility of working regimes.

Fourthly, at the total sectoral level the largest amount of gross income by informal activities was generated from the commercial sector followed by the manufacturing sector. However, at the level of per person engaged the amount varied sharply among the various sectors, which is consistent with both the theoretical and empirical literatures. Very generally, sectors that provided the highest level and/or rate of employment tended to generate lower amount of income per person engaged than those that provided the lowest level and/or rate of employment. It may be concluded, from this, that either the decisions on the sectoral choice of employment by informal sector workers were not well informed regarding income differentials among sectors; or entry into a particular, productive industrial sector might have been difficult due to some reasons; or a combination of these or some other factors might have been involved. This needs to be investigated with appropriate data.

Fifth, lack of sufficient capital was rated as the first major difficulty faced both when starting the activity and during operation. This seems to be inconsistent with the theoretical literature. At the starting stage, lack of working premises and inadequate skill were found to be second and third in importance (after capital) as major problems faced, but during operation, it is limited market for goods and services produced and family responsibility that were the second and third most important problems. During operation, the importance of inadequate skill as a problem had significantly decreased. However, not all indicators were consistently used both at the starting stage and at the operational stage, and this is the major difficulty in analyzing the problems faced.<sup>6</sup> Hence, for example, the decrease in the importance of inadequate skill as a problem may be the result of the effect of new indicators of problems used rather than actual decrease in its importance, and thus may challenge the theoretical literature which holds that the skill requirement of informal sector activities is low.

Sixth, it was discussed that based on empirical evidence, several authors and specialists in the informal sector caution on the widespread postulate that the informal sector has the obverse characteristics of the formal sector. The Ethiopian CSA has used considerable theoretical postulates in the literature to define the informal sector.<sup>7</sup> However, the definition itself seems to contradict with several terms used as indicators of problems of the informal sector in the survey, since some of the terms used typically describe formal-sector activities (see Table 5a and 5b). This clearly indicates how actually difficult is the task of defining the informal sector.

Finally, many of the findings are inconsistent with the conventional theory on urban economy and employment. The greater role the informal sector plays in the urban economy need to be increasingly acknowledged by the urban and regional development policy makers.

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## NOTES

<sup>1</sup> The agency is a national institution responsible for collecting, managing and disseminating both survey and census data in the country.

<sup>2</sup> The rate of wage the males demand is higher than what the females receive for a similar type of work done. Males may either prefer to start their own operation using advantage of their financial superiority as pointed out in the text earlier, or they may accept open unemployment than work as employee at a very low wage rate.

<sup>3</sup> According to this study, informal activities engaged and types of goods and services produced included: 1) manufacturing of food products, cotton textiles, wood and carpentry products, leather products, chemical and plastic products, non-metal products, basic metal products, structural stone goods, and bangles; 2) trade and commerce in eggs and milk products, fruit, vegetables, and exchange of goods; 3) services and repairs including hair-cutting, domestic services, laundering and ironing of cloths, rag picking, tailoring, automobile and scooter repair, shoe repair, and miscellaneous repair; 4) transport such as rickshaw pulling, and auto-rickshaw driving; 5) construction activities such as concrete mud mixing, and the transportation of bricks.

<sup>4</sup> The term birr refers to the name of Ethiopian currency (ETB). In 2002, the average foreign exchange rate for 1.00 birr was 0.1229 USD. There has been a consistent decline in the value of the birr relative to the USD over the years. For example, the current foreign exchange rate for 1.00 birr on 09/29/2010 was 0.06105 USD.

<sup>5</sup> Includes problem with workers (0.3%, 1996 and 0.3%, 2002), difficulties of obtaining license (1.0%, 1996 and 0.4%, 2002), cultural problems (0.1%, 1996 and 0.1%, 2002), social obligation (0.8%, 1996 and 0.3%, 2002), inadequate skill (1.2%, 1996 and 0.4%, 2002), lack of clarity of regulations (1.2%, 1996 and 0.5%, 2002), sales on credit (1.2%, 1996 and 0.6%, 2002), restriction on free movement of goods and services (1.2%, 1996 and 1.2%, 2002), and others (4.6%, 1996 and 4.1%, 2002).

<sup>6</sup> As indicators of problems at initial stage, 'lack of collateral' and 'no problem' were reported in 2002 but not in 1996, and, as indicators of problems at operational stage, 'health problem' and 'no problem' were reported in 2002 but not in 1996. It is, therefore, difficult to understand to what extent health problem and lack of collateral played a role in 1996 relative to 2002. In addition, we do not know what proportion of the informal sector establishments would have responded as 'no problem' since this option was not included in the data gathering instruments in 1996, as if every establishment must have necessarily faced a problem. Indicators also varied between activity stages. For instance, 'limited market' and 'family responsibility' were used at operational stages but not at initial stages. It is thus difficult to understand to what extent limited market and family responsibility affected the start of informal sector activities. All these might have distorted the information.

<sup>7</sup> In this study, the term informal sector and the related terms are taken as they were defined in the survey by the Central Statistical Agency of Ethiopia for 1996 and 2003, as follows:

Informal sector –household type establishments/ activities which:

- are mainly engaged in market oriented production
- are not registered companies or cooperatives
- have no full written book of accounts
- have less than ten persons engaged in the activity
- have no license

A large number of economic activities are carried out by large numbers of people in the economy which generally go unrecorded in the official accounts. They are for the most part unregistered and operating on a very small scale and with a low level of organization. Most of them have very low level of productivity and income. They tend to have little or no access to organized markets, to credit institutions, to modern technology, to formal training, and to many public services and amenities. A large number of them are carried out without fixed location or in places such as small shops, outlets, or home based activities. They are not recognized, supported, or regulated by the government. They are beyond social protection, labor legislation, and protective measures at the work place.

A large portion of the population is engaged in this sector due to:

- ease of entry

- family ownership of enterprise
- labor intensive method of production
- small scale operation

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