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# The Informal Sector of Nigeria's Economy: A Potential Hub for Sustainable Economic Development

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**Abstract:** *This paper examines the sector of the economy that is not regulated in any way by the government, otherwise known as the informal economy or informal sector. The methodology adopted in this study is Analytical Descriptive Survey (ADS). This technique enables one to make comparisons between and across variables over time. Just like (de soto, 1989), this paper concludes that the informal sector is very important for employment generation (especially among youth in the Global South) and consequently, sustenance of peace and security.*

**Keywords:** *Informality, Employment, Economic Development*

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## 1.0 INTRODUCTION

The *informal sector* or *informal economy* as defined by governments, scholars, banks, etc. is the part of an economy that is not taxed, monitored by any form of government, or included in any gross national product (GNP), unlike the formal economy (de soto, 1989). In developing countries, some 70% of the potential working population earns their living in the informal sector. They would define this economy or sector in other words: not in what it is *not*, but what it is: the only way to earn a living for people who are *self-employed* outside the formal economy and not on anyone's payroll. Most of them live and work in this sector not because it is their wish or choice, but because they have no chance to be hired by an employer from the formal sector except for a few hours or days, with no legal right to be hired again.

In describing this sector, one should bear in mind that the informal economy is not a deviation of the formal economy, if only because all economic activities started informal and formed the basis from which the formal economy sprang, with firms and annual accounts, taxes, chambers of commerce, etc. Although the informal economy is often associated with developing countries, where up to 60% of the labour force (with as much 40% of GDP) work, all economic systems contain an informal economy in some proportion. The term *informal sector* was used in many earlier studies, and has been mostly replaced in more recent studies which use the newer term. The English idioms *under the table* and *off the books* typically refer to this type of economy. The term *black market* refers to a specific subset of the informal economy in which *Contraband* is traded, where contraband may be strictly or informally defined.

Informal economic activity is a dynamic process which includes many aspects of economic and social theory. By its nature, it is necessarily difficult to observe, study, define and measure. No

single source readily or authoritatively defines informal economy as a unit of study, although the work of economic anthropologist *Keith Hart* (Hart & Redfield, 1973) was integral in defining the term. To further confound attempts to define this process, informal economic activity is subject to permanent adaptation to changing circumstances. External regulations (and degrees of enforcement) change frequently, sometimes daily. The wish to preserve this source of income requires adapting with even minor changes in policy. Given the complexity of the phenomenon, the simplest definition of informal economic activity might be: any exchange of goods or services involving economic value between people outside the scope of 'normal and formal 'business (Chen, 2001).

Governments have tried to regulate (formalize) aspects of their economies for as long as surplus wealth has existed which is at least as early as *Sumer*. Yet no such regulation has ever been wholly enforceable. Archaeological and anthropological evidence strongly suggests that people of all societies regularly adjust their activity within economic systems in attempt to evade regulations. Therefore, if informal economic activity is that which goes unregulated in an otherwise regulated system then informal economies are as old as their formal counterparts, if not older. The term itself, however, is much more recent. The optimism of the school of *modernization theory* school of development had led most people in the 1950s and 1960s to believe that traditional forms of work and production would disappear as a result of economic progress in developing countries (Marilyn & Chen, 2001). As this optimism proved to be unfounded, scholars turned to study more closely what was then called the traditional sector. They found that the sector had not only persisted, but in fact expanded to encompass new developments. In accepting that these forms of productions were there to stay, scholars started using the term informal sector, which is credited to the British anthropologist *Keith Hart* (Hart & Redfield, 1973) in a study on Ghana in 1973 but also alluded to by the International Labour Organization in a widely read study on Kenya by the International Labour Organization in 1972 by Mana Rohan (ILO, 2002).

Since then the informal sector has become an increasingly popular subject of investigation, not just in economics, but also in sociology and anthropology. With the turn towards so called post-fordist modes of production in the advanced developing countries, many workers were forced out of their formal sector work and into informal employment. In a seminal collection of articles, *The Informal Economy. Studies in Advanced and Less Developed Countries*, Alejandro Portes (Portes & Haller, 2005) and collaborators emphasized the existence of an informal economy in all countries by including case studies ranging from New York City and Madrid to Uruguay and Colombia.

## **2.0 Literature Review**

Arguably the most influential book on informal economy is Hernando de Soto's *El otro sendero* (1986), which was published in English in 1989 as *The Other Path* (de soto, 1989) with a preface by Peruvian writer Mario Vargas Llosa. De Soto and his team argue that excessive regulation in the Peruvian (and other Latin American) economies force a large part of the economy into

informality and thus prevent economic development. While accusing the ruling class of 20th century mercantilism, de Soto admires the entrepreneurial spirit of the informal economy. In a widely cited experiment, his team tried to legally register a small garment factory in Lima. This took more than 100 administrative steps and almost a year of full-time work. Whereas de Soto's work is popular with policymakers and champions of free market policies like *The Economist*, many scholars of the informal economy have criticized it both for methodological flaws and normative bias (Feige & Edgar, 1990).

In the second half of the 1990s many scholars have started to consciously use the term "informal economy" instead of "informal sector" to refer to a broader concept that includes enterprises as well as employment in developing, transition, and advanced industrialized economies (Feige & Edgar, 1990).

The informal economy under any governing system is diverse and includes small-scaled, occasional members (often street vendors and garbage recyclers) as well as larger, regular enterprises (including transit systems such as that of Lima, Peru). Informal economies include garment workers working from their homes, as well as informally employed personnel of formal enterprises. Employees working in the informal sector can be classified as wage workers, non-wage workers, or a combination of both (Shneider, 2002).

The above definition does not include criminal activities that are irregular by nature. Crime cannot be included because such acts have no regulated counterpart against which they may be compared. (Of course, by their nature, informal economic activities escape regulation but that does not necessarily imply that they are unlawful or criminal.) Domestic labor, such as childcare and cooking, is in general not included when performed in the natural course of daily living 'These activities are either formal or informal' (Beneira et al, 2006).

Statistics on the informal economy are unreliable by virtue of the subject, yet they can provide a tentative picture of its relevance: For example, informal employment makes up 48% of non-agricultural employment in North Africa, 51% in Latin America, 65% in Asia, and 72% in sub-Saharan Africa (World Bank, 2010). If agricultural employment is included, the percentage rises, in some countries like India and many sub-Saharan African countries beyond 90%. Estimates for developed countries are around 15%. In developing countries, the largest part of informal work, around 70%, is self-employed, in developed countries, wage employment predominates. The majority of informal economy workers are women. Policies and developments affecting the informal economy have thus a distinctly gendered effect (ILO, 2006).

2.1 A report from World Bank estimates the informal economies of 162 countries for the years of 1999 to 2007 (World Bank, 2010).

### **Estimated size of countries' informal economy**

The table below shows the estimated values of the size of the informal economy in 110 developing, transition and OECD countries.

The average size of the informal economy, as a percent of official GNI in the year 2000, in developing countries is 41%, in transition countries 38% and in OECD countries 18%.

<b>Country</b>	<b>Informal economy (billions of current USD) 2000</b>	<b>Informal economy in % of GNP 1999/2000</b>
Georgia	2.1	67.3
Bolivia	5.4	67.1
Panama	6.0	64.1
Azerbaijan	3.0	60.6
Peru	31.1	59.9
Zimbabwe	4.2	59.4
Tanzania	5.2	58.3
Nigeria	21.3	57.9
Thailand	63.4	52.6
Ukraine	16.1	52.2
Guatemala	9.7	51.5
Uruguay	9.9	51.1
Honduras	2.9	49.6
Zambia	1.4	48.9
Belarus	14.4	48.1
Armenia	0.9	46.3
Russia	114.5	46.1
Benin	1.0	45.2
Nicaragua	1.0	45.2
Moldova	0.6	45.1
Sri Lanka	7.1	44.6
Philippines	34.4	43.4
Senegal	1.9	43.2
Kazakhstan	7.4	43.2
Uganda	2.7	43.1
Niger	0.8	41.9
Mali	0.9	41.0
Ethiopia	2.6	40.3
Malawi	0.7	40.3
Mozambique	1.4	40.3
Côte d'Ivoire	3.4	39.9
Latvia	2.9	39.9

Brazil	226.8	39.8
Kyrgyzstan	0.5	39.8
Madagascar	1.5	39.6
Colombia	30.8	39.1
Burkina Faso	0.8	38.4
Ghana	1.9	38.4
Tunisia	7.1	38.4
Nepal	2.2	38.4
Bulgaria	4.3	36.9
Pakistan	21.9	36.8
Morocco	11.8	36.4
Jamaica	2.6	36.4
Bangladesh	16.7	35.6
Egypt	35.0	35.1
Ecuador	4.3	34.4
Romania	12.5	34.4
Kenya	3.5	34.3
Algeria	17.3	34.1
Lebanon	5.9	34.1
Bosnia and Herzegovina	1.6	34.1
Uzbekistan	2.5	34.1
Venezuela	40.1	33.6
Botswana	1.8	33.4
Albania	1.3	33.4
Croatia	6.3	33.4
Cameroon	2.7	32.8
Turkey	64.5	32.1
Dominican Republic	6.0	32.1
Malaysia	25.6	31.1
Lithuania	3.4	30.3
Mexico	168.5	30.1
Yugoslavia	2.5	29.1
Greece	32.9	28.6
South Africa	34.8	28.4
Poland	43.3	27.6
Korea, South	125.1	27.5
Yemen	2.0	27.4
Slovenia	4.9	27.1
Italy	288.0	27.0
United Arab Emirates	0.0	26.4
Costa Rica	3.8	26.2
Argentina	70.5	25.4

Hungary	11.1	25.1
Belgium	53.1	23.2
India	104.7	23.1
Portugal	23.3	22.6
Spain	124.8	22.6
Israel	23.2	21.9
Chile	13.5	19.8
Taiwan	61.6	19.6
Indonesia	27.7	19.4
Jordan	1.6	19.4
Syria	3.1	19.3
Czech Republic	9.6	19.1
Norway	30.6	19.1
Sweden	42.9	19.1
Iran	17.7	18.9
Slovakia	3.6	18.9
Mongolia	0.2	18.4
Saudi Arabia	32.0	18.4
Finland	21.9	18.3
Denmark	29.1	18.2
<i>Hong Kong, China</i>	27.5	16.6
Canada	110.1	16.4
Germany	303.1	16.3
Ireland	12.7	15.8
Vietnam	4.9	15.6
France	199.6	15.3
Australia	58.0	15.3
China	139.6	13.1
Singapore	12.9	13.1
Netherlands	47.8	13.0
New Zealand	5.9	12.7
United Kingdom	178.6	12.6
Japan	553.8	11.3
Austria	19.0	10.2
Switzerland	22.3	8.8
United States	864.6	8.8

(Source; World Bank,2010).

### **3.0 Gender**

Women tend to make up the greatest portion of the informal sector, often ending up in the most erratic and corrupt segments of the sector (ILO, 2002). Sixty percent of female workers in developing countries are employed by the informal sector. The reasoning behind why women

make up majority of the informal sector is two-fold. Firstly, it could be attributed to the fact that employment in the informal sector is the source of employment that is most readily available to women. Secondly, a vast majority of women are employed from their homes (most likely due to the large number of women who are involved in care work) or are street vendors, which both are classified in the informal sector. Furthermore, men tend to be overrepresented in the top segment of the sector and women overpopulate the bottom segment (World Bank 2010). For example, very few women are employers who hire others and more women are likely to be involved in smaller scale operations. Labour markets, household decisions, and states all propagate this gender inequality. The gender gap in terms of wage is even higher in the informal sector than the formal sector.

#### **4.0 Nigeria's Informal Economy**

Previously hindered by years of mismanagement, economic reforms of the past decade have put Nigeria back on track towards achieving its full economic potential. Nigerian GDP at purchasing power parity more than doubled from \$170.7 billion in 2005 to \$374.3 billion in 2010, although estimates of the size of the informal sector (which is not included in official figures) put the actual numbers closer to \$520 billion [8]. Correspondingly, the GDP per capita doubled from \$1200 per person in 2005 to an estimated \$2,500 per person in 2009 (again, with the inclusion of the informal sector, it is estimated that GDP per capita hovers around \$3,500 per person). It is the largest economy in the West Africa Region, 3rd largest economy in Africa (behind South Africa and Egypt), and on track to becoming one of the top 30 economies in the world in the early part of 2011 (World Bank, 2010).

#### **4.1 Issues from within**

Workers in the informal sector earn less income, have unstable income, and don't have access to basic protections and services (Merilyn & Chen, 2001). Informal businesses also lack the potential for growth, trapping employees in menial jobs indefinitely. On the other hand the informal sector can allow a large proportion of the population to escape extreme poverty and earn an income that is satisfactory for survival [10].

From the viewpoint of governments, the informal sector can create a vicious cycle. Being unable to collect taxes from the informal sector, the government may be hindered in financing public services, which in turn makes the sector more attractive. Conversely, some governments view informality as a benefit, enabling excess labor to be absorbed, mitigating unemployment issues (Merilyn & Chen, 2001).

#### **4.2 Expansion**

The informal sector has been expanding as more economies have started to liberalize. This pattern of expansion began in the 1960s when a lot of developing countries didn't create enough formal jobs in their economic development plans, which lead to the formation of an informal sector that didn't solely include marginal work and actually contained profitable opportunities (World Bank, 2010). In the 1980s, the sector grew alongside formal industrial

sectors. In the 1990s, an increase in global communication and competition lead to a restructuring of production and distribution often relies more heavily on the informal sector. Over the past decade, the informal economy is said to account for more than half of the newly created jobs in Latin America. In Africa it accounts for around eighty percent. Many explanations exist as to why the informal sector has been expanding in the developing world throughout the past few decades. It is possible that the kind of development that has been occurring has failed to support the increased labour force in a formal manner. Expansion can also be explained by the increased subcontracting due to globalization and economic liberalization. Finally, employers could be turning toward the informal sector to lower costs and cope with increased competition.

#### **4.3 Poverty**

The relationship between the informal sector and poverty certainly isn't simple nor does a clear, causal relationship exist. An inverse relationship between an increased informal sector and slower economic growth has been observed though [11]. Average incomes are substantially lower in the informal economy and there is a higher preponderance of impoverished employees working in the informal sector (ILO, 2002).

#### **4.4 Possible improvements**

Ways to improve the informal sector include formalizing informal jobs through regulation by the state. The issue with this policy is that so many different types of informality exist. It would be extremely difficult to create solutions to meet so many diverse circumstances (UNRISD, 2010). Another possible improvement would be to provide better protections and benefits in the informal sector, but creating protection programs could lead to a disconnect between the labor market and protections, which may not actually improve informal employment. It might also be possible to create other methods of generating income through microloans or land rights when access to the formal sector is limited. This is not a satisfactory solution to effectively combat the issues underlying the informal sector though (Chen, 2001).

#### **5.0 CONCLUSION**

According to the World Bank [9], the informal sector of Nigeria's economy ranks 8<sup>th</sup> out of the informal economies of 162 countries surveyed for the years of 1999 to 2007. The countries cut across developing, transition and OECD countries. The size of the informal economy of Nigeria is 57.9% of GDP. This is a huge potential. If such potential would be harnessed in the primary products subsector, i.e. (Agriculture and Mining), it could provide adequate raw materials and other factor inputs (like Labour) for the Small-Scale and Medium-Scale industries. If the industries could operate at full capacity and produce more processed output, it would promote export which has the tendency of generating more foreign exchange earnings for the domestic economy. Such trend would stimulate the effective demand for tertiary products (engineers, architects, doctors, lawyers, professors, accountants, etc) within the domestic economy. Such linkages have the propensity of transforming the Nigerian economy from a developing one to a developed one. The case of the Asian Tigers (China) and the Asian dragons (India) is a good



example (Bebeira et al, 2006). For the informal economy of Nigeria to truly transform into a hub for sustainable economic development, Nigeria should restructure her revenue collection system because it has very low capacity to collect taxes from her citizens. States cannot function if they are unable to collect taxes and account for them. However, as *Moore* (1998) has noted if citizens are not taxed they have little or no incentive to hold the government accountable (Merilyn & Chen, 2001). Regulation of business activities for corrupt practices is also important. Some businesses get into corrupt practices in the society for survival because of the unfavorable economic environment. There is need to resolve the fundamental impediments facing the economy. Thus, Nigeria should institute reforms that could improve social institutions and governance, reduce corruption, increase productivity, and spur economic growth and development.

In addendum, Nigeria should invest in social infrastructures. For instance, how can the private sector function without electricity, without access to financial capital, and without good road network, and without good operating environment? For the economy to function well the environment must also support small and medium scale firms that create employment. This will help reduce the rising youth unemployment and crime rates in the society. The nation should also improve access to clean water and improve sanitation and invest bountifully in information technology. Economic growth should be tied to activities in non-oil sector and agricultural productivity because resources from the oil sector alone wouldn't grow the economy. The provision of functional institutions and necessary tools for production will improve the capacity utilization of industries and the economy. The nation's capacity utilization is currently poor. Sadly, as *Charles Soludo* noted, "The economy operates at only 25 per cent capacity" (Daily Independent, November 6, 2006).

Also, education is an important factor in economic growth and development. But the nation's educational system has been facing myriad of challenges, which prevent the system from performing its basic objectives. The problems include inadequate funding and lack of planning and management, poor governance and infrastructure, lack of teaching materials and enough good quality teachers at all levels, among others. When such propositions eventually materialize and economic growth and development ensued, the informal sector is actually the hub or the springboard for such a feat.

## **5.1 RECOMMENDATION**

The government should come up with the following measures in order to support and boost the informal economy in Nigeria:

- i. Credit Facilities
- ii. Training in craft and entrepreneurial skills
- iii. Basic education on laws of the land
- iv. Basic education on their rights as citizens

- v. Establishing Bureau of the informal sector which aims at addressing the challenges of the operators in the sector

When the aforementioned steps are taken, the informal economy is a springboard for sustainable economic development.

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