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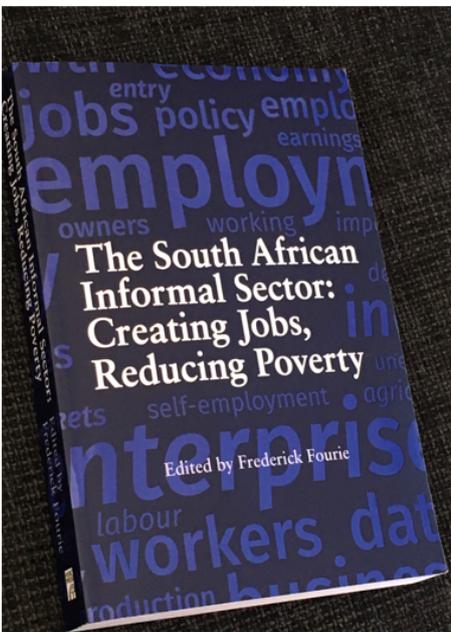
Creating jobs, reducing poverty I: Why the informal sector should be taken seriously and enabled properly

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In the first extract from a new REDI3x3 book on the role of the informal sector in job creation and poverty reduction, a compact picture of the size, texture and impact of the sector is provided. One in every six South Africans who work, work in the informal sector. Several policy-relevant features are highlighted, such as industry, spatial and gender dimensions. This provides the backdrop for the second extract on the employment-creating performance of the informal sector.

Preamble

This is the first in a short series of edited extracts from a new REDI3x3 book: *The South African Informal Sector: Creating Jobs, Reducing Poverty*. The research findings reported in the book address a significant knowledge gap in economic research and policy analysis.



 A REDI3x3 book

***The South African informal sector:
Creating Jobs, Reducing Poverty***

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A prerequisite for good policy-making for this part of the economy is good analysis. ... This volume embodies analytical excellence. I look forward to its impact on policy-making in South Africa and the world.

Ravi Kanbur (Cornell University)

The book flags the importance of explicitly addressing the informal sector in policy initiatives to boost employment and inclusive growth and reduce poverty. Its last chapter – from which the extracts are drawn – generates a synthesis of key findings on the informal sector and develops the outlines of a constructive policy approach.

This first extract presents a compact picture of the size and contribution of the South African informal sector, also highlighting key policy-relevant features. Forthcoming extracts will consider the employment-generating performance of the sector; the barriers and constraints faced by informal enterprises and workers; and a proposed policy approach to strengthen the informal sector and boost its role in job creation, poverty reduction and the provision of livelihoods (including a constructive way to approach possibly ‘formalising’ the informal sector¹).

The book is the collective output of twenty authors from ten universities as well as NGOs and government institutes. Since the chapter from which these extracts are drawn partly is a synthesis chapter, it draws on inputs from all the chapters as well as contributions at several workshops. I wish to acknowledge all these contributions. I wish to thank Caroline Skinner in particular for fruitful interactions on framing the chapter, for adding ideas and acting as a critical reader. I also wish to thank Mike Rogan, Paul Cichello, Philippe Burger and David Neves for useful comments and inputs on an earlier draft of the chapter.

Introduction

It is not uncommon to find researchers and commentators viewing informal-sector participants as being without aspirations or entrepreneurial skills, or as having no meaningful role to play in generating employment or reducing poverty.

The evidence presented in this book shows that the informal sector is a significant component of the economy that provides employment, livelihoods and income for millions of workers and business owners. This has, however, largely been overlooked by economic analysts and policy-makers in South Africa (and elsewhere). The informal sector has remained forgotten or, at best, in the margins of economic analysis and policy consciousness.

This findings on employment creation as well as enterprise entry suggest that the lack of attention paid to this segment of the economy is a significant oversight and a missed opportunity. This relates to its employment potential as well as its role in inclusive growth and poverty reduction.

¹ The idea of formalising the informal economy has received prominence due to the International Labour Organisation’s International Labour Conference 2014 and 2015 deliberations, resulting in Recommendation 204 concerning ‘the transition from the informal to the formal economy’ (ILO 2015).

The significance of the South African informal sector: A compact picture

It is crucial to analyse the informal sector as an integral (and complex) part of the economy and economic policy. The empirical evidence robustly demonstrates the informal sector's potential in terms of its contribution to employment, but also to poverty reduction and the economy as a whole.

- * *Definition: Informal enterprises are enterprises, with or without employees, that are not incorporated and not registered for taxation. The informal sector comprises all informal enterprises, their owner-operators/employers and all employees, paid and unpaid, in all economic sectors. (For more on this, see the Appendix below).²*

The informal sector mostly comprises very small enterprises (frequently fewer than five individuals) that often are based in poor neighbourhoods and generates quite low earnings for enterprises and individuals. In terms of gross domestic output, the informal sector is estimated to contribute about 6% to GDP (gross domestic product) (2013 data; Stats SA 2014: 9).³

Still, these are economic activities that put income in the hands of millions of people. Supporting and strengthening these activities holds the potential to inject resources into poorer households and areas and should be a central part of broad economic empowerment and the pursuit of inclusive growth.

Employment in the informal sector

GDP is only one measure of contribution. Across the country the informal sector in South Africa is a significant source of employment. Approximately 2.3 million people worked in the non-agricultural informal sector in 2013, a year central to our quantitative analysis. (In 2018 it reached 2.9 million.) At about 17% of total employment, one in every six South Africans who work, work in the informal sector. In the NDP (National Development Plan) the sector (together with domestic work) is projected to generate almost two million new jobs by 2030. The NDP has no specific plans or proposals for the sector, though (see Fourie, Chapter 15 in this volume).

² The book is about the informal *sector* and informal-sector employment (as an enterprise-based concept). Thus it is not about the broader concepts of the informal *economy* and informal *employment* (which combine all forms of employment that are not characterised by formalised employment contracts, conditions and benefits such as legal or social protection; these could be in the informal sector but also, notably, in the formal sector and households). It is important to clearly distinguish these concepts, since the potential confusion between them is an important one, notably from a policy perspective (see the Appendix below and Fourie, Chapter 1 in the book).

³ The accepted definition of the informal sector excludes illegal business activities like the production and sale of drugs. Approaches that use the concept of the 'shadow economy' or 'underground economy' often include illegal activities, tax evasion, etc. as well as the informal sector. Such approaches may erroneously suggest that the informal economy is equivalent to the shadow economy and thus overestimate the size of the informal economy/sector significantly.

Almost 80% of the approximately 1.4 million informal enterprises are one-person firms (also called own-account workers). Yet about 1.1 million people – *about half of the people working in the sector* – work in enterprises that have employees (i.e. are multi-person firms). Most of these employing enterprises are in construction, retail trade, and services, but also in manufacturing and communication. The proportion of employing firms has been growing steadily since 2000, as has the propensity to employ. In 2013 the employing firms provided about 850 000 paid jobs for owner-operators and employees. What is striking is that the number of *paid* jobs in the informal sector (850 000) is almost double the direct employment in the formal mining sector (approximately 450 000 in 2013).

Thus, while the informal sector in South Africa is small compared to other developing countries and also sub-Saharan Africa (see the comparative analysis of Grabrucker et al., Chapter 3 in the book), its role as a source of employment and livelihoods for millions of people must be properly appreciated. Moreover, the sector is not homogeneous or comprising only own-account workers (often assumed to be street traders and hawkers) – various dimensions of heterogeneity characterise the world of informal enterprises and shape its functioning. The annual entry of new enterprises is quite high, as is the number of informal enterprises that grow their employment. There is no shortage of entrepreneurship or desire to grow.

This picture is not intended to romanticise work in the informal sector. Working in and running enterprises in the informal sector is anything but easy. Working hours are long, working conditions are often difficult. Earnings and returns are very low for all but a few. Both the mean and median earnings for the informal sector are less than half that of the formal sector (Rogan and Skinner, Chapter 4 in the book). In 2014 the typical worker in the formal sector earned about R4 300 per month (mean earnings), while the typical informal-sector worker earned only R2 000. Earnings of the self-employed in the informal sector are higher than those of employees, particularly for men (whose *average* earnings as self-employed workers are more than R6700 per month).⁴

Owners and employees of enterprises across the size spectrum take risks, face many barriers and struggle to be viable, with the likely consequences of failure for the involved households severe. But, compared to being unemployed the informal sector is an important vehicle for gainful employment and earning income. Given the high levels of unemployment and poverty – and the NDP objective of almost 2 million more jobs in the informal sector – the policy goal, at least in the short to medium term, should not be to shrink or eliminate the informal sector, but to grow and strengthen it – to create a larger, more dynamic informal sector with more

⁴ Median earnings for male self-employed in the informal sector were about R3 000 per month, but only R2 000 per month for informal-sector male employees (in 2014). Women in the informal sector earned about 70% of men's earnings, which is similar to the formal-sector ratio. This gender difference is particularly pronounced among the informal self-employed, where women's median earnings are only 50% of men's median earnings (i.e. R1 500 and R3 000, respectively, in 2014). See Rogan and Skinner (Chapter 4 in the book) for more earnings data.

viable, self-reliant enterprises and additional, better-quality employment.^{5,6} (Such a growing sector will probably need, and involve, selected elements of ‘smart’ formalisation, as discussed in forthcoming articles in this series.)

The role of the informal sector in poverty reduction

Linked to the role of the sector in job creation is the vital impact of informal-sector employment on *poverty alleviation*. The work of Cichello and Rogan (see Chapter 9 in the book and their [Econ3x3 article](#)) shows that informal-sector income is relatively effective in reducing poverty. This is because income from informal-sector work mostly flows to households that are poor. In terms of poverty impact, the destruction of 100 jobs in the informal sector is the equivalent of losing about 60 to 80 formal-sector jobs. From a poverty-reduction viewpoint this is a major finding for policy-makers: one cannot be cavalier about losing or destroying informal-sector jobs.

At this point we can already say that the overall policy goal must be to retain existing informal-sector employment (i.e. measures should do no harm), to improve the livelihoods, security and income of those already in the informal sector, and address barriers to entry and growth to create room for newcomers and employment expansion. In short, policy must *enable and support* enterprises and workers in the informal sector. The informal sector simply is, to borrow a phrase, ‘too big to fail’. Recognising the informal sector as an integral part of the economy, rather than ignoring it, is a crucial first step towards such a policy approach.

Key policy-relevant features of the informal sector

The analysis and findings from the different chapters suggest several factors that could guide the design of effective policies to support and develop the informal sector. They also point to the need for carefully designed and differentiated policies.

The sector is not homogeneous, but is spread across industries

For policy-making, disaggregation by industry is particularly important. The notion of the informal sector disguises significant heterogeneity. It is not a sector in the normal sense of the word, but comprises slices of almost all the industries, or branches of economic activity, in an economy. As is the case with the formal sector, different industries/sectors (or branches of economic activity) have very different constraints to viability and growth and thus different policy needs. Retail and wholesale trade is by far the largest industry in the informal sector. However, its share of enterprises has been declining, from approximately 70% in 2001 to 57%

⁵ The idea of eliminating the informal sector refers to a phrase used in the 2006 AsgiSA (Accelerated and Shared Growth Initiative for South Africa) policy initiative with regard to the ‘second economy’ (see section 1 of Fourie, Chapter 5 in the book). In the long term, somewhat idealistically, it would be preferable not to have much of an informal sector, but then only as long as there is no significant unemployment.

⁶ As highlighted by Skinner (Chapter 16 in the book), there are numerous cases of actual elimination of informal-sector livelihoods, especially in cities like Johannesburg and Durban.

(and 52% of persons) in 2013 (Chapter 5 in the book). Manufacturing displayed a declining share, while construction's share grew robustly; 'community and social services' as well as 'transport and communication' also grew substantially. Policy measures should not only be built around trade (which tends to be the policy preoccupation of local authorities in particular).⁷ The employment potential of a sector such as construction holds promise: in townships this sector and its craft-based services are less vulnerable to formal-sector competition compared to tradeable⁸ products. Construction may also be very responsive to growing income levels and a growing middle class. In addition, housing maintenance and upgrading could play a major role in enhancing the quality of township living environments. Nevertheless, the needs of the trade sector with regard to security of tenure, suitable premises and location, utilities and security remain important – it employs up to half of informal-sector workers. Trade workers are also particularly vulnerable to police harassment.

Gender and the position of women

Changes in trade also highlight changes in the gender composition of the informal sector. The share of women in overall informal-sector employment (including enterprise ownership) declined significantly between 2008 and 2014. While, traditionally, informal trade has been a bigger component of informal-sector employment for women relative to men, much of the overall decline in female informal-sector employment occurred in trade (notably food vendors). A decline in women's participation in the informal sector is a source of concern, given the importance of money in the hands of women in securing household well-being and the corresponding implications regarding poverty alleviation.

However, Rogan and Skinner (Chapter 4 in the book) also report that, in this period, own-account work became a smaller component of women's total informal-sector employment, while a larger proportion became paid employees or employers.⁹ This signals a *significant reconfiguration of the composition of the informal sector*: for women, a move away from own-account work towards working in multi-person firms as either employers or employees (amidst a decline in total informal-sector employment for women); for men in multi-person enterprises, a move towards being employers rather than employees. QLFS (Quarterly Labour Force Survey) data also show that more women have moved into managerial positions. This suggests that the position of some women in the informal sector has in fact improved.

⁷ For example, in the GIBUS (Gauteng Informal Business Upliftment Strategy) of 2015 the discussion, especially of municipal policies, is almost exclusively about informal traders.

⁸ This term is used to indicate goods and services that can be transported readily and traded in a location distant from the one where it was produced. Goods can have different levels of tradeability, depending on the cost of transportation.

⁹ Still, male owners are more likely to have employees than female owners: being male is associated with a significantly higher propensity to employ (Chapter 5 in the book).

Spatial dimensions and townships

There are major differences between provinces and between the metropolitan areas, with rural areas again different. Calculations from recent QLFS data that include all eight metros show that, generally, the share of the workforce that works in the informal sector is

- lowest in Gauteng and the Western Cape, highest in the poorer provinces of Limpopo, Mpumalanga, Eastern Cape and KwaZulu-Natal (with the latter two provinces and the Free State showing large decreases in 2008–2013);
- higher in non-metropolitan than metropolitan municipalities;
- higher for those living in traditional communal areas and in urban informal settlements than in urban or rural formal settlements; and
- highest in Mangaung and lowest in Cape Town and Tshwane, with a middle group comprising Johannesburg, eThekweni, Ekurhuleni and Nelson Mandela Bay.¹⁰

Such patterns and concomitant trends reflect complex social changes related to demography, poverty, unemployment, urbanisation, migrant work and so forth. Generally, it would appear that the higher the poverty level of areas, the higher the proportion of people working in the informal sector.

Clearly, different provinces face different informal-sector policy challenges, as do different metropolitan areas, non-metropolitan cities (secondary cities) and towns. Dealing with small or shrinking informal sectors (amidst high unemployment) may require different policies compared to areas with comparatively large informal sectors, requiring careful analysis of specific factors that constrain entry, viability and employment expansion locally. Thus, it is important that national informal-sector policies allow, enable and support differentiated provincial and local-government policies.

Looking deeper into the situation within township areas, where the informal sector is mostly found, Charman and Petersen (Chapter 10 in the book and their [Econ3x3 article](#)) identified striking spatial patterns in the location of informal enterprises. Using small-area censuses of selected Cape Town townships, they find that informal enterprises are located throughout townships and informal settlements, notably in residential areas rather than in commercial or main-street areas. In these townships, only 24% of informal enterprises are on the ‘high street’, the main thoroughfare and commuter pedestrian area – a broadly consistent pattern.¹¹ Several business categories have a strong preference for residential areas, for

¹⁰ Average share of the informal sector in total employment for 2015 and 2016: Mangaung (almost 19%) and Buffalo City (17%), Cape Town and Tshwane (about 11%), Johannesburg, eThekweni, Ekurhuleni and Nelson Mandela Bay (14%–15%). Also see Rogan and Skinner (Chapter 4 in the book), who used 2014 data.

¹¹ For two townships in Midrand in Gauteng, Charman (2017: 5, 7) finds that 32% and 34% of enterprises are on the high street – higher than in the Western Cape sites, but still quite low.

example grocery retailers (spaza shops), take-away food businesses and liquor retail outlets – their primary competitive advantage is their proximity to residential customers.¹²

Understanding the texture, spatial interactions and dynamics of the informal sector in townships is particularly relevant for local government policies. For example, zoning restrictions or permissions (licences) as well as the provision of services and premises must be sensitive to the economic logic of why enterprises have chosen to be located where they are, including local and sector-specific peculiarities, demand and income levels. The study indicates the inappropriateness of simply applying ‘standard’ modernist city planning and zoning approaches in the township context, including restricting businesses in residential areas. At the same time, one must be equally aware that negative externalities could arise in such circumstances due to, for example, noise, crowding and pollution that affect households and other enterprises negatively, both in township and formal business areas.¹³

The finding that a large majority of enterprises are located at owners’ homes may reflect something else, though. It is likely that most of these enterprises are still largely integrated into the household, i.e. in terms of operation, labour and finances they are not differentiated from the family. While this integration may be largely explained by economic, social and family imperatives, it could have important implications for the functioning of the enterprise. The potential significance of the institutional differentiation between household and enterprise (or lack of it) for the developmental status, viability and employment behaviour of informal enterprises is discussed in a forthcoming extract.

The informal sector in the rural economy

The situation of the informal sector in rural towns presents another spatial complexity. A case study by Neves and Du Toit of a rural KwaZulu-Natal town (Chapter 13 in the book) provides many insights (even though the variation between rural towns is likely to be large). A vital question relates to how the town’s economy, and its informal sector in particular, links with surrounding commercial farming activities. The answer is: not much. Modern commercial agriculture largely leapfrogs the local non-farm economy of small towns and deals with corporate suppliers and buyers in large towns and cities, consolidating a significant rural–urban divide. Business activity and employment in a rural town’s informal sector may not be driven by agriculture.

The main inflows of income into many towns are government salaries and welfare grants, in some cases also transport and tourism. The scope for the informal sector (and the town

¹² Research on food security in poorer households shows a preference for frequent purchases due to lack of refrigeration as well as irregular income.

¹³ This also applies to informal enterprises in non-residential areas, especially in formal commercial areas in cities as well as towns. In small towns the ‘formal’ business areas may gradually degrade and become informal as informal traders, for example, increasingly occupy pavement areas around formal businesses. Essentially, in policy-making the interests of the informal sector and the formal sector, including formal residential areas, must be harmonised.

economy) is fundamentally constrained by low incomes, limited demand and limited scope for multipliers to generate additional rounds of spending. The phenomenon of the bustling ‘month-end market’, when social grants and salaries are spent on consumables, presents a vital opportunity for informal-market participants. Yet it indicates unevenness and discontinuity in local spending and thus business activity, both formal and informal.

The policy challenge is to support sectors and activities in the rural economy that can grow or sustain employment (only some of which may involve agriculture). The local agro-food retail sector remains an important candidate. The needs and challenges will vary considerably across farming regions and ecological conditions. Nevertheless, the size and prevalence of existing informal markets in rural towns suggest that the provision of basic infrastructure (e.g. vending sites, storage facilities and basic utilities) could make a significant difference to many in the informal sector. Local government has an important role to play in this respect.

Beyond the towns, a key component of the rural economy is informal-sector agriculture¹⁴ (which is usually omitted from informal-sector analysis due to data and policy conventions). In path-breaking work, despite severe data difficulties, Cousins (Chapter 14 in the book) estimates the size of informal-sector agriculture at 400 000 to 500 000 persons. This adds significantly to the size of the South African informal sector, inclusively defined. Informal-sector farmers frequently suffer from limited funds to finance production inputs.

The markets that they typically supply also are distinctive. Bakkie traders, hawkers and farm-gate buyers constitute valued customers. Transport of produce to town markets is a key constraint. Sales to formal supermarkets are largely ruled out by procurement practices and quality standards (a constraint also faced by informal producers in urban areas, as discussed below). The markets typically supplied by informal-sector farmers are very different from the supermarket-led value chains that are the focus of many interventions to support smallholder agriculture. In designing interventions, informal-sector agriculture must be understood on its own terms. The fortunes of informal-sector farmers are also closely tied to those of traders in small towns. Both groups would benefit from municipalities helping to strengthen informal markets for fresh produce and livestock.

Next extract: The employment-generating potential of the informal sector

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The edited extracts are from:

Fourie FCvN (2018) Enabling the forgotten sector: Informal-sector realities, policy approaches and formalisation in South Africa. Chapter 17 in Fourie FCvN (ed) *The South African Informal Sector: Creating Jobs, Reducing Poverty*. HSRC Press, Cape Town.

¹⁴ Informal-sector agriculture is conceptually distinguished from subsistence agriculture by the farmer regularly selling a substantive amount of output in informal or formal markets. Making the distinction in practice is extremely difficult – in the real world, these analytical distinctions are blurred.

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1. Analysing the informal sector in South Africa: Knowledge and policy gaps, conceptual and data challenges – *Frederick Fourie*
3. The informal sector in sub-Saharan Africa: A comparative perspective – *Katharina Grabrucker, Michael Grimm & François Roubaud*
4. The size and structure of the South African informal sector 2008–2014: A labour-force analysis – *Mike Rogan & Caroline Skinner*
5. Informal-sector employment in South Africa: An enterprise analysis using the SESE survey – *Frederick Fourie*
9. Informal-sector employment and poverty reduction in South Africa: The contribution of ‘informal’ sources of income – *Paul Cichello & Michael Rogan*
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Appendix

Background on the book and the extracts

When the [REDI3x3 project](#) was launched in 2012, the informal sector was identified, in [founding and framing documents](#), as a significant ‘knowledge gap’. A sub-project called ISEP (Informal-sector employment project) was launched in 2013, with the author as convenor and Caroline Skinner of UCT as co-convenor. The multi-disciplinary, data-intensive research and workshop interactions of more than twenty researchers and experts culminated in a 500-page, seventeen-chapter collective work.

The objective of the volume is to provide the groundwork for a more informed, meaningful debate and focused research on evidence-based policy options. Given an era of increased pressure for evidence-based policy-making, the work is strongly evidence- and data-driven, with quantitative contributions combined with qualitative research and case studies. The chapters reflect various methods of analysis to understand a complex phenomenon from a range of paradigmatic, disciplinary and methodological perspectives, often using new data. One aim has been to partly bridge the divides between economics and other disciplines – and, within economics, between labour economists, poverty and development analysts, and macroeconomists.

The definition of the informal sector

A key analytical distinction is that between informal-sector employment and informal employment, and between the informal sector and the informal economy. The potential confusion within these two pairs of concepts is an important one, notably from a policy perspective. In recent South African debates and analysis, one sometimes finds an imprecise use of these two concepts, an indiscriminate mixing of them, or treating them as if they are synonymous.

The formal statistical definitions can become quite technical, also reflecting practical and data collection considerations as well as differences between countries. A good reference point is the deliberations and documents of the ICLS (International Conference of Labour Statisticians), which has set international standards on official labour statistics (see Hussmanns 2003). Stats SA has adopted these standards in its QLFS, but uses a slightly different definition in the SESE. Here it suffices to formulate them in basic conceptual terms, as follows:

- Informal enterprises: enterprises, with or without employees, that are not incorporated and not registered for taxation. Sometimes the definition is limited to unregistered enterprises that have fewer than five employees (see chapters 4 and 5 in the book).
- Informal sector: all informal enterprises, their owner-operators/employers and all employees, paid and unpaid, in all economic sectors (manufacturing, retail, etc., including agriculture⁸). It excludes domestic workers and also subsistence agriculture, which is defined as not producing for the market but rather for own use (see Cousins, Chapter 14 in the book).
- Informal-sector employment: an enterprise-based concept, comprising those working in the informal sector as either owner-operators/employers or employees, paid and unpaid. Its focus is employment in informal enterprises.
- Informal employment: an employee-based concept which comprises all employees or workers that do not have formal employment contracts or benefits in *both* the informal and formal sectors as well as households (see discussion later). Its focus is employment conditions and unprotected work.
- Informal economy: all forms of informal employment: 'all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements' (ILO 2002: 25).⁹ Thus, the informal economy comprises all informal-sector employment plus informally employed workers in the formal sector and households. It is premised on the analysis of employment conditions rather than employment opportunities and employment creation.

The broad concept of 'informal employment' was adopted by the ILO's 2003 international labour conference (ILO 2003a, 2003b). The introduction of the broad concept of informal employment has been important in drawing attention to unprotected workers in the informal sector, the formal sector and households. However, it is evidently important to use a definition suited to the research question and the phenomena that are being examined. The two definitions refer to different things and should not be conflated. As noted by Hussmanns (2003: 2) of the ILO Bureau of Statistics:

'Employment in the informal sector' and 'informal employment' are concepts which refer to different aspects of the 'informalisation' of employment and to different targets for policy-making. One of the two concepts cannot replace the other. They are both useful for analytical purposes and, hence, complement each other. However, the two concepts need to be defined and measured in a coherent and consistent manner, so that one can be clearly distinguished from the other. Statistics users and others often tend to confuse the two concepts because they are unaware of the different observation units involved: enterprises on the one hand, and jobs on the other.

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