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Leapfrogging

The potential of more rapidly formalising the informal sector

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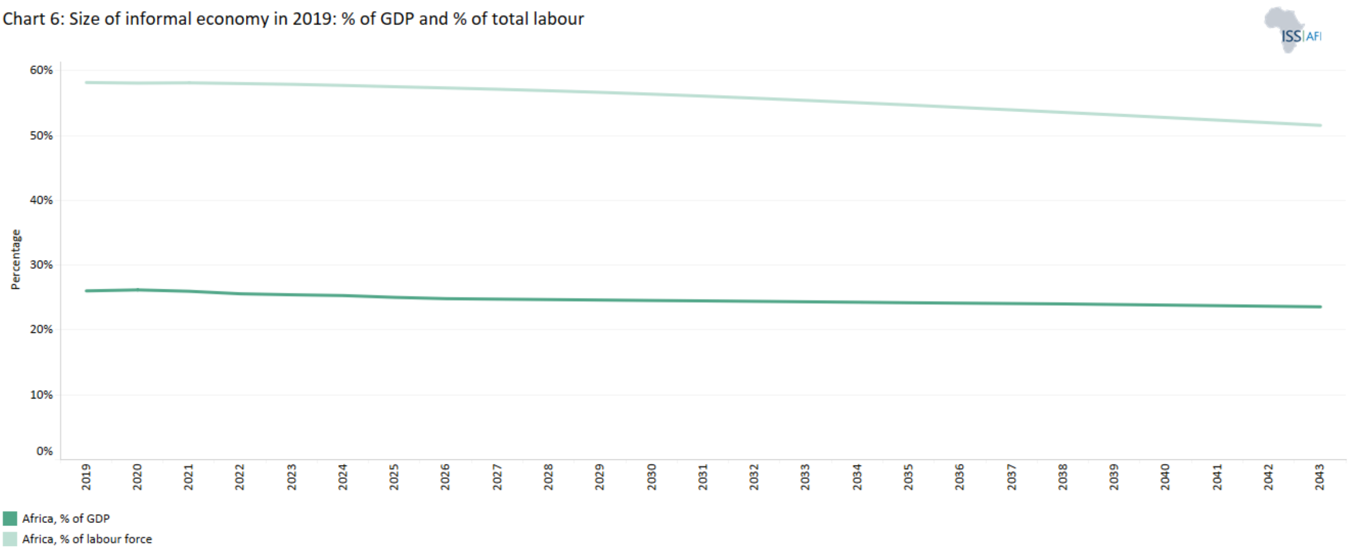
The potential of more rapidly formalising the informal sector

The theme on jobs/employment deals with, at some length, the relationship between the formal and informal sectors and examines the potential benefits that the more rapid formalisation of the informal sector would have on Africa's economic and developmental prospects.

For the International Labour Organization (ILO), the transition to formality is 'a central goal in national employment policies.' All things being equal, reducing the size of the informal sector has distinct advantages as long as it does not detract from economic activism, is carefully managed, incentivises employment and does not stunt growth. The informal sector is important in providing employment and income for millions of poor Africans and will continue for many future decades.

Chart 6 presents the IFs estimate of the portion of GDP considered informal and the portion of the informal labour as a portion of the total labour force globally in each African country and group. Note that the size of the informal sector within IFs is often a modelled estimate given data limitations.

Chart 6: Size of informal economy in 2019: % of GDP and % of total labour

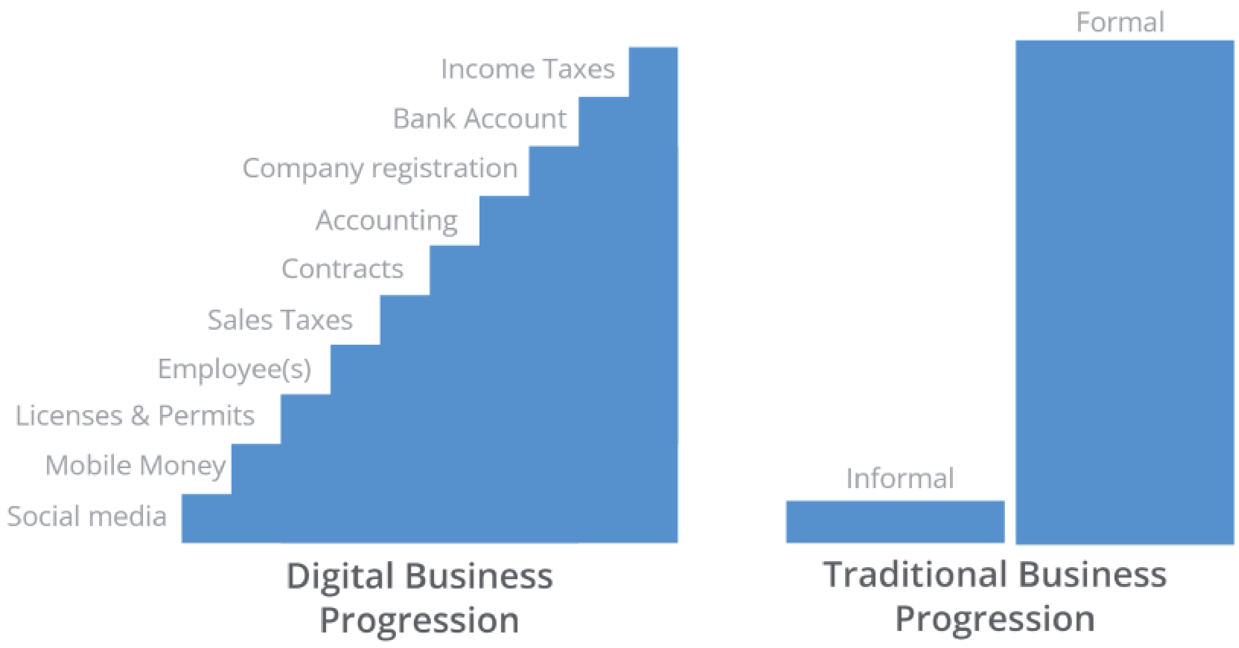


Source: IFs 7.84 initialising from ILOSTAT data

Internet access, mobile phones, and digitisation allow African governments to break down the barriers between the formal and the informal sectors and to facilitate the incremental move from the one to the other. Normally, as GDP per capita increases, the size of the informal sector decreases. Modern technology allows the crowding in of the informal sector at lower income levels, as shown in Chart 7 - and in contrast to the sharp step change from informal to formal, also depicted.

The effect of digitisation is to lower the entry point for private capital in poor areas.

Chart 7: The informality staircase



Source: Source: A Ng'weno and D Porteous, Let's be real: The informal sector and the gig economy are the future, and the present, of work in Africa, 15 October 2018.

The first step towards formalisation is the provision of digital ID systems. According to the World Bank, Africa is home to roughly half the estimated one billion people who cannot prove their identities. Nearly every African country with a stable government now has active biometric ID programmes in place or underway, according to ID4Africa, an NGO advocating identity-for-all. Biometric IDs in South Africa and Nigeria are among the most developed.

The provision of digital identification unlocks access to banking, government benefits, education and other critical services. In the words of a recent study on digital ID and payment, digital technology enables 'the precise identification of all parties to an interaction; low-cost communications; and accurate, accountable, and convenient payment processes.' A study of seven focus countries (Brazil, China, Ethiopia, India, Nigeria, the UK and the US) by McKinsey found that extending full digital ID coverage to citizens could unlock economic value equivalent to 3–13% of GDP in 2030—if the digital ID programme enables multiple high-value use cases and attains high levels of usage. According to the UN Economic Commission for Africa (UNECA), countries implementing digital identity could unlock value equivalent to 3 to 7 per cent of GDP on the continent by 2030.

In its report on 'Digital solutions for the urban poor' that draws on the work of Ng'weno and Porteous, among others, the GSMA notes that pay-as-you-go (PAYG) models, as one example, allow low-income customers to make small incremental payments towards otherwise unaffordable goods. This has demonstrated excellent results when applied to rural electrification and is now also unlocking a range of urban services such as water, clean cooking gas, and sanitation. PAYG leverages the ubiquity of mobile money to make goods and services more affordable in low-income communities, particularly in urban areas with a higher density of mobile money agents than rural areas and where populations are more likely than their rural counterparts to use mobile Internet.

The associated policies need to be done incrementally and carefully. Zimbabwe, which has seen its formal economy collapse through bad policy, mismanagement and corruption, introduced a large 2% transfer tax in 2019 that proved hugely unpopular, followed by Cameroon at a much lower rate of 0.2%. From 1 May 2022, Ghana introduced an e-levy of 1.5% to electronic transactions above US$13, but only after the debate in parliament had come to blows, with opposition members of parliament staging a walkout.

Formalisation is positive because workers in the formal sector in African countries are four to five times more productive than those in the informal sector. Using the IFs forecasting platform, we find that the size of Ghana's economy increases by roughly US$1 billion (in PPP) over ten years for every 1% decrease in the size of the informal sector as a portion of GDP. And the benefits keep on growing after that. In other words, if Ghana could use digitisation to draw people into the formal sector and, hence, reduce the size of the informal economy as a portion of GDP by five percentage points from 2023 to 2033, its economy would be US$5 billion larger in 2033. Because the size of the informal labour as a proportion of total labour is about 22 percentage points higher than the GDP share, the intervention reduces the size of informal labour more rapidly.

A larger economy translates into higher average incomes. The result of a one percentage point decline in the informal sector in Ghana is an increase of US$31 GDP per capita above the Current Path forecast by 2033. That is an enormous improvement. Other livelihood improvements that follow are decreases in poverty and inequality.

Therefore, modern technology provides the opportunity to formalise additional parts of the informal sector incrementally.

In the following scenario, we include formalisation as a powerful component of leapfrogging.

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Dr Jakkie Cilliers is the ISS's founder and former executive director of the ISS. He currently serves as chair of the ISS Board of Trustees and head of the African Futures and Innovation (AFI) programme at the Pretoria oce of the ISS. His 2017 best-seller Fate of the Nation addresses South Africa's futures from political, economic and social perspectives. His three most recent books, Africa First! Igniting a Growth Revolution (March 2020), The Future of Africa: Challenges and Opportunities (April 2021), and Africa Tomorrow: Pathways to Prosperity (June 2022) take a rigorous look at the continent as a whole.

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