

ASSESSMENT ON THE INFORMAL SECTOR AND ITS
IMPACT TO THE ECONOMY IN TANZANIA: THE CASE
OF ARUSHA MUNICIPALITY

Nicodemas Christopher Lema (MSc. Economics)*

Abstract

The main objective of this study was to assess the informal sector and its contribution to the Tanzanian economy having Arusha municipality as the case study. The study attempted to find out the level of contribution the informal sector is making to the economy by looking at a number of factors, which were entrepreneurial skills, capital, production technique, and legal status. The study employed mainly qualitative approach in data collection and analysis after which the researcher identified a number of factors that affect contribution of informal sector to the economy. They included lack of permanent centers for doing business, lack of entrepreneurial skills, absence of market, market pressure resulting to low commodity prices, too high taxes established as well as unstable weather conditions. It also went further into suggesting the possible recommendations/policies to the government and policy makers in order to improve the current situation that included provision of entrepreneurship training, establishment of permanent business places, formation of small groups for easy accessibility to loans and education pertaining to formalities in obtaining those loans from financial institutions.

Key words: Assessment, Informal Sector, Contribution, Economy and Tanzania

* Assistant Lecture, Department of Economics and Statistics, The University of Dodoma, Dodoma Tanzania

1.0. Introduction

The concept of informal sector in Tanzania has gained its popularity after the Tanzanian economy underwent gradual fundamental transformations in the mid-eighties, in which it re-defined the role of government and private sector in the economy. Under the old rule and regulation, the Government was undertaking most of production or business activities and providing services to the public such as processing, marketing function plus regulatory system as well as health services, education, sanitary water supply and public security.

The economic reforms that took place in the mid-eighties were a result of pressure from donor communities that resulted from poor performance of the economy and increased external debt burden. Hence, due to this pressure from donor countries, the process of reforming the economy started under Structural Adjustment Programme (SAP). The structural adjustment program in Tanzania began in 1986, with additional agreements signed in 1987, 1991 and 1996. As agriculture is by far the most important sector in terms of employment (over 80%), contribution to GDP (over 60%) and foreign-exchange earnings (75%), much of the programme's policy interventions focused on that sector. As a result, Tanzania has become ever more dependent on foreign aid (Ross, 2005).

The economic reforms especially privatization that took place because of structural adjustment programmes gave rise and growth of the informal sector in Tanzania where by the population affected by retrenchment programme started small and medium scale businesses, which constitute the informal sector in Tanzania.

However, the non-formal sector, or informal sector, differs significantly from country to country, and even within a country. The differences tend to stem from the context of the non-formal sector, the support given to it by governments and other relevant entities. The attitudes of the society towards it, the market that it addresses, the level of competencies of those engaged in it, the recognition it is given within the total economy, and the degree to which it is encouraged within the society as a whole, are other factors encountering to its variability.

Informality is probably the most important and least well-understood issue in the developing world today; and it seems to be getting worse as opposed to better and it is probably underestimated. Informal economic growth in the developing world harms the infrastructure needed to support businesses. Unchecked increases in development of this sector may crash any growth cycle, starting a vicious poverty cycle.

Seich (1995) gives a rough estimate of the size of the informal sector businesses as 15,000 of which 8,000 are retail stores in the north. The informal sector has become an alternative avenue for employment due to the stagnation in productive wage employment. Despite that, informal sector's contribution to the economy of Namibia is still very small, with retailing and distribution dominating the operation of the sector rather than manufacturing activities.

Characteristically in India, the informal sector broadly consist of units engaged in the production of goods and services with the primary objectives of generating employment and incomes to the persons concerned. These units typically operate at low level of organization, with little or no division between labour and capital as factors of production and on a small scale, thus, makes productivity in the informal sector and its contribution to the economy of India very low despite the fact that it employs the majority in the economy. (Jauch, 2004).

Therefore, the main objective of this study was to assess the informal sector and examine its contribution to the Tanzanian economy. Specifically the study seeks to determine the impact of entrepreneurial skills of owners of firms in the informal sector, to the national economy; to assess the effect of amount of capital invested in business in the informal sector to the economy of Tanzania; to examine the types of production techniques used in informal sector and their effects to the national economy; to examine the impact of absence of taxation in the informal sector on the national economy.

2.0. Literature Review

2.1. Informal Sector and its meaning.

Rondinell and Kasarda (1993), defined informal sector as “small scale, mostly family operated or individual activity that are not legally registered and usually do not provide their workers with social security or legal protection.”

Also the ILO conference, 96th session (2002), termed the informal economy as preferred to informal sector because the workers and enterprises in question do not fall in any of the sectors of the economic activity but cut across many sectors of the economy.

The fifteenth Internal Conference of Labor Statisticians (ICLS) 1993 adopted an operational definition of the informal sector that is irrespective of the kind of workplace, the extent of fixed assets, the duration of the activity of the enterprises and its operation as a main or secondary activity. Within the household sector, the informal sector comprises: (i) Informal own-account

enterprises that are single member or partnership household units that do not hire workers on a continuous basis. (ii) Enterprises of informal employers are household units owned and operated by employers, singly or in partnership, which employ one or more employees on a more or less continuous basis. For operational purposes, the latter may be defined in terms of either, the size of unit below a specified level of employment or, non-registration of the enterprise or its employees.

2.2. Contribution of the informal sector to the Tanzanian economy.

Taking informal sector as comprised of SME's and SMME's, we can analyze its contribution to the economy. The Tanzanian government has developed a national policy called "SME's Development policy 2000/2001" which aimed at unleashing the potential of small medium and micro-enterprises through private sector led growth. The Tanzanian government report showed that SMME's contribute about 50% of the industrial product in the GDP. The SMME's development policy recognizes the SME's as a tool to increase the share of business growth and employment creation. SMME's are labour intensive, at a relative low level of investment per job created and SMME's serve as training ground for entrepreneurial and management development. World Development Report (2000/2001) indicates that the growth rate of the formal labour force between the 1980/90 and 1990/99 periods dropped from 3.3% to 2.6%. The Tanzania government believes that a third of the GDP originate from the small and medium enterprises (SME) sector. The SME's operating in the informal sector alone consist of more than 1.7 million businesses engaging about 3 million people or about 20% of the Tanzanian labour force. The government estimated that there are about 700,000 new entrants into the labour force annually. According to the recent report "close to 60%" of Tanzanian business comes from informal economic activity. However, in 1990, the informal sector was estimated to be contributing only 33% to the GDP of Tanzania. (URT, 2001).

2.3. The linkage between formal and informal sector.

Few studies have attempted to understand the extent to which the informal sector is intergraded into the national economy and particularly its relationship with the formal sector. There are forward linkage (to markets beyond the border of the formal economy) and backward linkage (in the form of inputs from outside the informal economy).

Meagher (1974), observed that linkage between formal and informal economy in developing countries warrant further research especially when the informal economy became a refuge from the formal economy.

May and Stavrou (1975), argued that the formal economy depends on the informal economy to act as a source of goods and services and provides market for its own produce.

Bullock (1977), study found that, some sectors of the formal economy in Tanzania and Kenya like manufacturing, service and agriculture are linked to the informal economy through production and consumption. The Tanzanian SME policy(2000/2001) state that the informal economy complement large industries by performing certain operations, providing raw material for the latter and utilizing their output to provide other products. In addition, many large enterprises serve as a training ground for entrepreneurial and management development. In the garment and textile industries, companies have found it easier to subcontract work to women who work at home.

Motala (1980), study on garment trading in the informal economy found that the formal economy traders provide storage facilities to the informal traders on the property. It also found that: - formal manufactures are important supplier of goods to the street traders; formal input firms supply-imported goods to the street traders and some formal CBD (Central Business District) traders rely directly and almost exclusively on informal sector for their live hood.

2.4. Entrepreneurial skills.

Entrepreneur is an individual who, rather than working as an employee, runs a small business and assumes all the risk and reward of a given business venture, idea, or a good or service offered for sale. The entrepreneur is commonly seen as a business leader and innovator of new ideas and business processes. Entrepreneurs play a key role in any economy. These people have the skills and initiative necessary to take good new ideas to the market and make the right decisions to make the idea profitable. The reward for the risks taken is the potential economic profits the entrepreneur could earn.

Peter (1970), defined entrepreneurship as taking risk. The behavior of the entrepreneur reflects a kind of person willing to put his or her career and financial security on the line and take risks in the name of an idea, spending much time as well as capital on an uncertain venture.

Business and entrepreneurial skills are the backbone for success to any business. It is difficult and rather impossible for a businessperson to excel in business if he/she does not have the required skills for running the business and attain profit.

2.5. Capital.

In classical economics, capital is one of three factors of production. The others are land and labor. Saleemi (1987) categorized capital in two categories: - (i) The liquid capital, which is fund available in money form, which is required for consumption purpose, but is set aside for further production. (ii) Fixed capital, which includes assets such as buildings, plants and machinery, furniture and so on.

Firms need cash to pay for all their day-to-day activities. They have to pay wages, pay for raw materials, pay bills and so on. The money available to them to do this is known as the firm's working capital. Thus, working capital is the same as net current assets, and is an important part of the top half of the firm's balance sheet. It is vital to a business to have sufficient working capital to meet all its requirements. Many businesses have gone down, not because they were unprofitable, but because they suffered from shortages in working capital. For example, a study done in India by Kolli R. and Suvendu H. in 1993, on the estimation of informal sector contribution in the net domestic product, came up with a number of setbacks in the informal sector capital being one of them.

2.6. Production technique.

The relative prices of factors of production in an economy will tend to reflect their relative scarcities. In a country with great deal of land and small population, for example, the price of land will be low while, because labour is in short supply, the wage rate may be high. In such circumstances, firms producing agricultural goods will tend to make lavish use of (cheap) land and to economize on (expensive) labour a production process will be adopted that is labour extensive and land intensive. However, in practice two major production methods or techniques that are at the firm's owner choice are labour intensive and capital intensive.

2.6.1. Labour intensive.

With this production technique, the firm decides to use more labour than capital in the production process. In practice, most of the firms in the informal sector prefer this type of production technique due to availability and its low cost to the firm.

The System of National Accounts (1993) characterizes the informal sector as consisting of units engaged in the production of goods or services with the primary objective of generating employment and incomes to the persons concerned. They form part of the household sector as unincorporated enterprises owned by households.

In India for instance, the informal sector provides jobs and incomes for an estimated 60,000-80,000 people. Labour relations, where they exist, are based mostly on casual employment, kinship or personal or social relations rather than contractual arrangements with formal guarantees, thus, making productivity in the informal sector and its contribution to the economy of India very low despite the fact that it employs the majority in the economy. (Jauch, 2004).

The modern or formal sector has not had the capacity to absorb all the new entrants to the labour market, especially in the developing countries. Thus, many new entrants find themselves engaged in the informal sector to have a means of survival. These activities provide an alternative to high open unemployment. It is estimated that more than 50% of the non-agricultural employment in Africa is found in the informal sector (ADB, 2001).

2.6.2. Capital intensive.

In this production technique, the firm decides to use more capital (machines) than labour in the production process. Most of firms in the informal sector do not prefer this type of production technique due to difficulty in its availability and high costs to the firm.

2.7. Taxation

A tax can be defined as a pecuniary burden laid upon individuals or property to support the government i.e. a payment exacted by legislative authority. A tax is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority and is any contribution imposed by government, whether under the name of toll, tribute, tallage, gabel, impost, duty, custom, excise, subsidy, aid, supply, or other name. (Parkin and Michael, 2006).

The portion of a country's economy, that lies outside of any formal regulatory environment or informal sector activities, are rarely reflected in official statistics on economic activity for

example, the country's gross domestic product (GDP). Informal sector encompasses the economic activities that are not regulated by labour or taxation laws or monitored for inclusion in gross domestic product estimates e.g. water sellers, street vendors, buskers, shoe-shiners.

The study assessed the proportion of the informal sector that pays tax to the authorities believing that, the more the proportion of the informal sector that pays tax, the more the contribution of the sector to the economy.

3.0. Data and Methodology

The study was a case study and it was conducted at the Arusha Municipal Council since there are lot of petty traders and other small firms and businesses, which constitute the informal sector. The sampling list included firms, businesses and individuals who are in the informal sectors. The study employed several data collection methods including questionnaire, interview, observation and documentary review.

Data obtained from the field; was subjected to manageable units and presented in descriptive manner. In order to address the research problem and be able to fulfill the research objectives, the data collected was organized, analyzed and presented to make them meet the objective of the study. Due to the qualitative nature of the data collected, a descriptive method of data analysis was used. The whole concept was to analyze data and make presentation in simple and easily understandable way to the majority.

4.0. Results and Discussion

4.1. Contribution of the informal sector to the economy.

This section presents an analysis of the grand objective of the study, i.e. the contribution of the informal sector to the economy. It also gives the analysis of the specific objectives as stated earlier.

4.1.1. Entrepreneurial Skills.

During the interview, the respondents were asked as to whether they have participated in any entrepreneurship training. Among the interviewed there was none (i.e. 0%) who participated in the training. However all of the businesspersons pointed out their opinions regarding the idea of participating in entrepreneurship training which could be summarised as follows:-

- A businessperson cannot excel in business without any entrepreneurship training since it is important for the success of any business.
- Since their families depend on them, they cannot afford to trade their time in business for entrepreneurship training.
- Despite of the fact that one knows the importance of entrepreneurial skills, he/she is not motivated to attend due to unsettled business i.e. being moved from one place to the other by the authorities.
- Others are willing to attend the training but fail due to reasons such as short of funds especially when the training is conducted far from where their businesses reside.

Despite the comments regarding the entrepreneurship training, all the interviewed businesspersons realise its importance to their businesses such as increasing the efficiency of the business, helps in taking the loan and its management, it helps in expanding their businesses, increasing the profit and decreasing the cost of operation i.e. profit maximization and cost minimization.

The fact that none of the respondents had entrepreneurship training it's obvious that the performance of businesses in the informal sector is poor.

4.1.2. Capital.

The interviewed businesspersons were also asked about the capital they initially invested in their business. The researcher wanted to know the source as well as the amount of their capital. The source of their capital was grouped into four categories namely Bank, NGOs, Personally raised and other ways. The study observed the following as far as capital is concerned:-

- Due to the fact that everything depends on money especially on activities other than business itself, it occurs that a number of business owners do use some of their capital even before the start of the business and thus reduce the amount available for business.
- Others do not have enough capital at the start, but as their business grows their capital grows as well to the point that their businesses acquire self-sustainability.
- Some believe that their initial capital was the foundation to their businesses and thus led to their success.

- Due to fluctuations in business and loss of purchased commodities for sale for example rotting of food products, some feel that the capital invested was not enough since it may be lost at the start of the business.
- Most small businesses set their targets at the start of their business to satisfy the needs of their families like taking their children to school of which to some extent affects efficient utilization of capital.
- Insecure nature of some of the businesses like those of perishables like vegetables, affects the amount of capital that one is willing to use initially.

Despite the fact that capital is one of the most crucial element for the success of any business, it was observed that, in the informal sector, both initial and working capital are still very low and insufficient for the excellence of the business, as a result of sectors' poor performance, as a result the sector has low contribution to the national economy.

4.1.3. Production Technique.

a) Labour.

The study revealed that 74% of business-persons in the informal sector have employed workers whereas the remaining 26% have not. All the workers are employed temporarily when a need arise and paid soon after the work is accomplished. Despite the fact that the informal sector employs the biggest proportion of the population, it is mostly self-employment i.e. one is not ready to employ another person due to lack of enough funds to finance it.

b) Machines.

It was noted that about 34% of informal business persons, are using tools mostly simple hand tools that are mainly for the purpose of simplifying their work and increasing efficiency of their business, whereas remaining of the interviewed business-persons encountering to 66%, do not use any tools or machines in their businesses. As it was in the case of labour, the machines and tools used by most of these business-persons are hired and returned after use.

The study found out that, the production technique used by most of the entrepreneurs is labour intensive technique. On the other hand most of the machines used in the informal sector are mostly hand tools which are used just to simplify work.

4.1.4. Taxation.

The study found out that almost 100%, of the interviewed businesspersons are paying tax. However the interviewed businesspersons had their views concerning the tax imposed on them by the authorities of which could be summarised as follows:-

- One of the respondent said, they are paying sales tax to the authorities but yet they do not have defined places for conducting their businesses.
- A number of respondents realise the importance of paying tax to the authorities on the grounds that, the cleanliness of their business places is being done effectively and properly since they believe the tax they pay contributes in cleanliness expenses.
- Others do believe that since the places they use for business is not theirs i.e. belongs to the authorities (government), then it is right to pay for them in the form of tax.
- Authorities provide security services to the business-persons holdings that remain in the market that have to be sold the next day. Thus, the business-persons feel that they have to pay for it in the form of tax.
- Not only that, but also some of the interviewed business-persons are disturbed by the authorities and moved from place to place thus they do not see the necessity of them being taxed by the authorities.

Despite of the comments given by the businesspersons interviewed regarding taxation, all of the interviewed businesspersons pay tax. This shows that the informal sector contributes to the national economy through taxation despite the fact that this contribution could be low.

4.1.5. Income.

The monthly earnings of the business-persons in the informal sector were categorised into four categories as follows: - (1,000-10,000), (10,000-50,000), (50,000-100,000), (100,000-500,000) and (500,000 or more) all of which were in Tanzanian shillings. It was found that no businessperson was in category (1,000-10,000) i.e. (0%), in (10,000-50,000) was 54%, in (50,000-100,000) was 14%, in (100,000-500,000) there was 32% and no businessperson was in category (500,000 or more) i.e. 0%.

Thus it can vividly be seen that most of the businesspersons are having an average income between 10,000 and 500,000/= a month. This income is still very low as far as sectors' contribution to the economy is concerned.

4.2. Problems facing businesspersons in the informal sector in Tanzania.

The interviewed business-persons mentioned a number of problems that they face in running their business. They are as follows:-

- Lack of permanent centres for doing businesses as a result of both from the authorities from time to time.
- Loss of money and properties due to the absence of the established areas of doing business, and when they are forced to move by the authorities or even due to lack of security.
- Lack of entrepreneurial skills result into inability to apply for a loan as a result of shortage of capital and even if capital is obtained it is lost since the business-persons do not have skills for its management.
- Absence of market for most of the commodities sold by the business-persons in the informal sector some of which are decaying over time as a result of loss in business.
- Market pressure results into low prices offered by the customers as a result of low profit or even loss.
- Unstable weather conditions affects to large extent business-persons in the informal sector especially those engaged in agricultural products business like vegetables, cereals and so on.
- Taxes that are established by the authorities are too high compared to what they are able and willing to offer as far as the scale of their business is concerned.

Thus the foregoing outline gives a number of problems that the informal sector faces that affects its efficiency and thus the contribution of the sector to the national economy in Tanzania.

5.0. Conclusions and Recommendations

5.1. Conclusion

The purpose of this study was to present and evaluate the informal sector and its contribution to the Tanzanian economy as a case from Arusha Municipality. It can be summarised as follows:-

With regarding to entrepreneurial skills, all the interviewed businesspersons have never received any, meaning that in Tanzania the informal sector lacks entrepreneurial skills as a result of its poor performance.

Despite the fact that capital is one of the most crucial elements for the success of any business, the research found out that, in the informal sector, both initial and working capital are still low and insufficient for the excellence of the business, thus sector's poor performance.

This study found out that, the production technique used by most of the entrepreneurs is labour intensive technique. Despite the fact that the informal sector employs the biggest proportion of the population, it is mostly self-employment due to lack of enough funds to employ others.

On the other hand most of the machines used in the informal sector are mostly hand tools which are used just to simplify work as opposed to bulk production.

As far as taxation is concerned, most the businesses in the informal sector pay tax thus; it makes the sector one of the sectors that contributes to the national economy although in small proportion.

5.2. Recommendations and Policy Implications

As it has been highlighted earlier, there are some areas which need to be acted upon. In fulfilling the objective of research, the study is proposing alternative strategies towards efficient and effective use of the informal sector as one of the major employing sector in the economy. This study has come up with the following recommendations which in one way or the other will help improve and increase efficiency of the informal sector in Tanzania.

The current policy by the government of restructuring the towns and keeping them clean by forcing the business-persons mostly from the informal sector, to move to new areas. It has been found out that the new areas are not good for business due to lack of customers and being far from residences therefore it is suggested that, a visibility study to be done before businesspersons are moved to those areas.

Since all the interviewed business-persons are paying tax, then the government should be responsible to establish permanent business places for them so that tax collection can be effective and on the other hand the business-persons can do their businesses more effectively.

The government should therefore see the importance of providing entrepreneurial skills training through radio programmes, postals, and even through the local government business officials. This will enable the businesspersons in the informal sector to run their businesses more efficiently and thus increasing its effect to the National Economy.

In order for businesses in the informal sector to have enough capital, the government should encourage the businesspersons in the informal sector to form groups, in which it could be easier for them to obtain loans and other financial assistances from the banks, NGOs and the government itself. Furthermore, education should be provided on effective utilization and procedures set by the Banks, NGOs, and even the government on provision of loans.

Therefore, in order to increase the contribution of the informal sector to the Tanzanian economy and fight against poverty the aforementioned recommendations may be considered.

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