

# The informal urban sector in Latin America<sup>1</sup>

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## The origins of the informal sector

The most striking feature of the development process in Latin America in recent decades has been the slow expansion of productive employment opportunities in spite of fairly rapid economic growth. This phenomenon is to be explained in part by the path that development has followed in the region. Urban-based production units were set up in the first place to satisfy a small and highly diversified demand for consumer goods. Moreover, Latin American industry grew up to a large extent during a period of world-wide expansion by giant corporations, of which many Latin American enterprises were in fact subsidiaries, and this left its mark on the type of goods produced and on the technology employed. Finally, while the technical advances introduced were ostensibly capital-saving, their net effect was actually labour-saving.

All this resulted in an oligopolistic type of market in which incomes were highly concentrated and the modernisation process, far from encouraging economic integration and harmonisation, appears actually to have accentuated the heterogeneity of the production system.

Moreover, very largely owing to rural-urban migration, the supply of labour in Latin America increased much faster during the postwar period than it did in the more developed economies, and a considerable proportion of this growing labour force had no alternative but to create low-productivity jobs for itself. In this way an economic sector has grown up in which the demand for labour depends not on its own capacity for capital accumulation but on the labour surplus in the "organised" sector of the employment market and on the possibilities of producing and selling anything that will generate an income.

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<sup>1</sup> This article is based on a paper with the same title presented by the authors to the Seminar on Employment Problems in Latin America organised by the Working Party on Employment and Unemployment of the Latin American Social Science Council (CLACSO) at La Plata, Argentina, from 5 to 8 March 1975.

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The urban labour market is thus divided into two sectors. On the one hand there is the formal sector, in which organised economic activities are concentrated, and on the other the informal sector, consisting of workers who as a rule are not employed by organised enterprises and correspond in fact to the "surplus" labour force.

The fact of distinguishing these two sectors in the urban economy does not mean that we shall adopt a dualistic analytical approach; there are links between the two, and even varying degrees of homogeneity. They share the same urban market, and the degree of structural heterogeneity *within* the sectors, especially in the formal sector, is in any case such that it precludes the use of a single analytical category for each. The concept of a stratified formal labour market makes it possible, in fact, to view the informal sector as merely the bottom layer in the hierarchy of activities corresponding to the structural heterogeneity of the urban economy. Nevertheless, as will be seen below, it is convenient to analyse it separately.

### **Characteristics of the informal sector**

Because the informal sector owes its origin to the existence of a labour surplus, it may be postulated that for a variety of reasons connected with technology and the structure of the market, access to it is generally fairly easy. The sharp division between those providing capital and those providing labour, so characteristic of the formal sector, hardly applies here, and indeed wages are not the most common form of remuneration in spite of the fact that production is intended mainly for the market. There is instead a multitude of tiny enterprises operating virtually without capital or formal organisation and using very simple technology.

Enterprises or individuals classifiable as belonging to the informal sector either have access to the competitive sections of the market or constitute the base of the supply pyramid in an oligopolistic system. In both cases there is such fragmentation of supply that the producers are in no position to fix prices or make exceptional profits. It follows from these various characteristics that the sector offers little scope for the accumulation of capital and thus has little capacity for expansion.

### **Its share of urban income and employment**

It is no easy matter to identify the population employed in the informal sector; in general recourse must be had to indirect indicators. Nevertheless, for purposes of quantification the sector may be defined as comprising all those engaged in domestic service, casual labourers, the self-employed, and employers, white-collar, blue-collar and family workers in enterprises with a total staff of not more than four persons. This definition tends to overestimate the size of the informal sector, and an alternative is to define it in terms of all persons whose income is below a certain minimum level—usually the legal minimum

wage—on the assumption that the low-productivity activities typical of the informal sector also generate low incomes.

In order to estimate future trends in the per capita income of workers in the informal sector, one needs to know how the total income generated by it is progressing. Unfortunately, with rare exceptions, adequate information on income trends is not available. The few studies which do permit measurement of incomes in the sector mostly relate to fixed points in time and are all recent. The PREALC surveys of Asunción and San Salvador suggest that the share of the informal sector in total urban income was about 33 per cent in the first of these cities and 25 per cent in the second <sup>1</sup>, while an estimate for Lima indicates a share of 30 per cent.<sup>2</sup> The Lima study seeks to measure changes in this share over time and demonstrates that it remained constant between 1950 and 1970.

There are also theoretical reasons why incomes in the informal sector should not show a noticeable upward trend proportional to the growth of employment. These reasons have to do with the role of small enterprises (in the present case very small ones) in a process of economic growth characterised by the concentration of markets. In highly concentrated oligopolistic markets small enterprises cannot go on increasing the volume of their business indefinitely, and in the long run, despite registering some small temporary gains, they tend to lose markets steadily even if almost imperceptibly. In competitive conditions the informal sector's market grows as a result of rising incomes in that sector or in the economy as a whole, but in most cases its activities are competitive because the size of the market in absolute terms does not yet warrant the establishment of large enterprises.

As regards the income level of those working in the informal sector, it might be said to constitute an adjustment variable between the size of the informal sector's market and the number of persons competing in it. It should also be noted that the total market for the sector shows no clear signs of growing. This is why it is important to consider the evolution of labour supply in the informal sector. Supply depends on a number of factors, the most important of which are the rate of growth of the labour force, developments in the rural labour market and the formal sector's capacity of absorption.

The figures given in table 1 are based on the definitions indicated above and are taken from censuses or household surveys, which are not the most satisfactory of sources for our present purposes. In the case of the Dominican Republic, Ecuador, El Salvador and Paraguay the data base is more detailed because in-depth studies of the informal sector have been carried out there.<sup>3</sup>

<sup>1</sup> Both surveys tend to overestimate this proportion because they refer to total personal income only.

<sup>2</sup> R. Webb: *Income and employment in the urban traditional sector* (Princeton University, 1974; unpublished).

<sup>3</sup> See ILO: *Generación de empleo productivo y crecimiento económico: el caso de la República Dominicana* (Geneva, 1975); and PREALC: *Situación y perspectivas del empleo en Ecuador* (Santiago, 1975); *Situación y perspectivas del empleo en El Salvador* (Santiago, 1975); *Situación y perspectivas del empleo en Paraguay* (Santiago, 1975).

**Table 1. The informal sector share in the urban labour force of selected Latin American countries (%)**

Country and city	Income share	Employment share
Brazil (1972)		
States of Rio de Janeiro and São Paulo	24	.
Chile (1968)		
All cities	.	39
Dominican Republic (1973)		
Santo Domingo	50	.
Ecuador (1970)		
Guayaquil	48	.
Quito	48	.
El Salvador (1974)		
San Salvador	41	46
Mexico (1970)		
Federal District and State of Mexico	27	.
Paraguay (1973)		
Asunción	.	57
Peru (1970)		
All cities	.	60
Venezuela (1974)		
All cities	.	44
Caracas	.	40

Sources: PREALC, on the basis of official data (the population census in the case of Mexico and household surveys in the other countries). For Peru see Webb, *op. cit.*, and for Venezuela H. Pereira and M. Zink: *El empleo en el sector informal urbano en Venezuela y la política de empleo* (Caracas, Instituto Latinoamericano de Investigaciones Sociales, 1976).

Attempts to analyse the development of the informal sector over time are plagued by even greater statistical deficiencies. For this purpose one must use indirect indicators such as the share of self-employed persons and unpaid family workers in the non-agricultural labour force. As can be seen from table 2, this proportion remained fairly constant during the 1960s in most of the countries considered.<sup>1</sup>

In some countries PREALC studies have provided a more detailed picture of the sector's development. In the city of Asunción (Paraguay), for example, where the labour force grew at an annual rate of around 4.1 per cent during the period 1962-72, the PREALC study shows that employment in the organised sector of the labour market expanded at no more than 2 per cent per annum.

Similarly, the data for El Salvador during the period 1961-71 indicate that the informal sector maintained its share of urban employment—no mean

<sup>1</sup> The most notable exceptions are Brazil, where the proportion declined, and Argentina, where it rose. In both cases there are methodological grounds for doubting whether the labour force data from the 1960 and 1970 censuses are truly comparable.

**Table 2. Share of self-employed and unpaid family workers in the non-agricultural labour force of selected Latin American countries (%)**

Country	Census figures around 1960		Figures around 1970	
Argentina	11.7	(1960)	16.6 <sup>1</sup>	(1970)
Brazil	23.8	(1960)	18.7 <sup>1</sup>	(1970)
			20.2	(1972)
Chile	18.2	(1960)	17.9 <sup>1</sup>	(1970)
Colombia	22.2	(1964)	23.2	(1967)
			23.1	(1970)
Mexico	21.3	(1960)	21.1 <sup>1</sup>	(1970)
Venezuela	22.5	(1961)	24.3 <sup>1</sup>	(1970)
			22.2	(1971)

<sup>1</sup> Census figures for 1970. Other figures are based on household surveys.  
Source: PREALC calculations based on official national statistics.

achievement in view of the country's high rate of population and urban labour force growth and its vigorous economic development throughout the decade. Nearly all El Salvador's modern industry was in fact established during this period with a view to exploiting the enlarged market opened up by the process of Central American economic integration.

The figures for Ecuador point to a similar conclusion despite a high rate of economic growth, particularly in the modern sectors.

Finally, in the case of Venezuela, a World Bank study concluded that employment in the informal sector in Caracas expanded at an annual rate of 4 per cent between 1961 and 1974, while the growth rate in the formal sector was slightly lower at 3.8 per cent.

### **Characteristics of the informal sector labour force**

In all the cases investigated by PREALC <sup>1</sup> there was found to be a much higher rate of female employment in the informal than in the formal sector. At first sight this might seem to be due to the inclusion of domestic service among informal sector activities, but in fact the finding remains true even if this occupation is excluded.

It was also observed that in all cases the informal sector contained a high concentration of younger and older workers. In Asunción and San Salvador, moreover, it was found that the former were generally domestic servants or

<sup>1</sup> The data used in this section are taken from PREALC studies on Asunción, Guayaquil, Quito, San Salvador and Santo Domingo. In the first and fourth cases the criterion adopted was the individual's occupational status, the only difference being that self-employed persons with at least 13 years' education (i.e. university graduates exercising liberal professions) were excluded from the figures for San Salvador. In all other cases the criterion was income.

blue-collar workers in small enterprises, whereas the latter tended to be self-employed.

Despite these findings, however, there was not shown to be any concentration of "secondary" manpower in the informal sector; in fact it proved to contain a higher proportion of heads of families than the economy as a whole. This suggests that the informal sector employs a high percentage of young and/or female heads of families.

In addition, it was noted in all cases that the informal sector contained a high proportion of the least educated or functionally illiterate (i.e. with up to three years of schooling); in Asunción 78 per cent of such persons were employed in it, while in San Salvador the figure was 73 per cent. In Quito and Guayaquil the functionally illiterate accounted for a third of the sector's labour force, as against about a fifth of all workers.

Finally, in all the PREALC case studies the informal sector was found to be largely made up of people who had migrated to the cities—at various times—from depressed rural areas or provincial towns, for whom it constituted the gateway to the urban labour market. The fact that the informal sector is commonly regarded as a means to an end does not, however, imply that employment in it is necessarily of short duration; indeed the reverse often appears to be the case. In San Salvador, for instance, it was observed that the proportion of migrants who had been resident more than ten years and were engaged in informal activities was still as high as 50 per cent compared with nearly 70 per cent of those who had arrived during the past year and 39 per cent for natives of the city. In Asunción the corresponding figures were 55, 82 and 54 per cent. In Guayaquil only a third of those working in the informal sector had been born in the city.

### **Its employment structure by branch**

In all five studies it was observed that the informal sector provided employment for a high proportion of workers in almost every branch of economic activity, the sole exception being financial services. The informal sector's share was over 50 per cent in nearly all branches in Asunción and over 40 per cent in more than half of them in San Salvador.

Employment in the informal sector is concentrated in manufacturing industry, commerce and personal services. Between them, for example, these branches account for 80 per cent of all informal sector employment in Ecuador and 85 per cent in San Salvador, manufacturing and commerce being particularly important in the latter case. More specifically, informal sector employment in manufacturing is concentrated in food, clothing, footwear and furniture.

### **Its income levels**

The characteristics of informal sector workers indicated above help to account for the fact that their average income is significantly lower than that of

**Table 3. Greater Asunción: average income by educational level and type of sector, 1973**  
(Guaraníes per week <sup>1</sup>)

No. of years' education	Informal sector	Formal sector		All workers
		Public	Private	
0-3	980	1 907	2 409	1 220
4-6	1 396	.	2 713	1 938
7-12	2 389	2 908	4 066	2 724
13 and over	4 798	.	9 797	6 642
<b>All workers</b>	<b>1 745</b>	<b>4 416</b>	<b>4 536</b>	<b>2 622</b>

<sup>1</sup> 126 guaraníes = US \$1.  
Source: PREALC: *Situación y perspectivas del empleo en Paraguay*, op. cit.

persons employed in the formal sector; indeed, in Asunción and San Salvador it does not even reach 40 per cent of that level.<sup>1</sup> However, in addition to differences of personal characteristics, there are structural factors which contribute to these income disparities. In order to identify and measure these factors, workers were classified according to educational level and the sector in which they were employed. Table 3 shows clearly that, in the case of Asunción, average income rises with educational level, but also that at each educational level it is always higher in the formal sector. Table 4 indicates that this is also true of San Salvador, and for the most part remains so even when the information is broken down by type of occupation.

In order to discount income disparities that might be due to the aggregation of data for different occupational categories, the incomes of white- and blue-collar workers in the non-domestic informal sector were compared with those of similar workers in the private formal sector and were still found to differ considerably. The differentials observed ranged up to 3.9 times in the lowest educational category and 3.5 times in the case of white-collar workers with a university education. Much the same results were found when the sample was restricted to male white- and blue-collar workers. Finally, where the sample was sufficiently large, as in industry and commerce, a comparison was made between workers employed in the same branch of economic activity: this exercise led to the same conclusions and broadly similar income differentials as before.

### **The need for an employment policy for the informal sector**

Given the situation described above, the development of specific policies for the informal sector is of fundamental importance. There are three main

<sup>1</sup> In the Dominican Republic and Ecuador informal sector incomes are of course lower than those in the modern sector by definition.

**Table 4. San Salvador: average remuneration by educational level and type of occupation**  
(Colones per week <sup>1</sup>)

No. of years' education	All workers		White-collar workers <sup>2</sup>				Blue-collar workers				Workers in industry				White-collar workers in commerce	
			All workers		Men only		All workers		Men only		White-collar		Blue-collar			
	I <sup>3</sup>	F <sup>3</sup>	I	F	I	F	I	F	I	F	I	F	I	F	I	F
0-3	20	44	14	55	22	58	21	37	25	39	.	76	.	38	8	70
4-6	28	53	35	69	44	77	27	40	30	42	22	95	29	41	29	58
7-9	66	70	41	75	38	80	42	35	42	37	.	58	29	34	29	83
10-12	132	108	51	114	41	136	.	49	.	55	.	132	.	41	38	96
13 and over	212	237	64	227	82	280	.	.	.	.	.	267	.	.	65	210
<b>All workers</b>	<b>38</b>	<b>100</b>	<b>38</b>	<b>108</b>	<b>43</b>	<b>124</b>	<b>27</b>	<b>39</b>	<b>30</b>	<b>41</b>	<b>40</b>	<b>121</b>	<b>28</b>	<b>39</b>	<b>30</b>	<b>97</b>

<sup>1</sup> 2.5 colones = US \$1.    <sup>2</sup> Excluding domestic service.    <sup>3</sup> I = informal sector, F = formal sector.

Source: PREALC: *Situación y perspectivas del empleo en El Salvador*, op. cit.



reasons why this is so, the same ones that justify analysis of the sector as a separate unit within the urban economy. The first is that, given the high percentage of the labour force working in it, the informal sector is important from an employment point of view and will continue to be so for a long time to come. The second is that, by virtue of the types of work it offers and the characteristics of those who work in it, the informal sector is bound to contain a high concentration of the poorest population groups. The third reason is that the workforce in the informal sector remains beyond the reach of most of the conventional income and other protective measures applied by the public authorities. It follows that policies should be expressly designed for it.

### **Some policy premises**

Clearly, any attempt to improve incomes in the informal sector must fit into the framework of a development strategy that envisages co-ordinated measures affecting the other sectors too.

The basic problem confronting workers in the informal sector is their low level of income. Since only a small proportion of them receive fixed wages the scope for using wage policy as a remedy is very limited.<sup>1</sup> Clearly, a policy designed to raise per capita incomes in any given branch of activity should increase the total income of the branch and/or reduce the number of persons working in it. The latter alternative appears to be impracticable because the sector will have to go on absorbing new arrivals. Any effort to raise per capita incomes in the sector will therefore have to take this foreseeable increase in over-all numbers into account, even if workers have to be redeployed in other activities.

Measures to increase the informal sector's productivity and total income can be grouped under two headings: those intended to increase economic efficiency and those designed to increase output. If to these is added the redeployment within the sector of persons employed in activities that have become saturated and offer no further hope for expansion, three types of policy can be defined. As will be explained below, the nature and emphasis of the policy to be adopted will depend on the kind of activity to which it is directed.

### **Selection of activities for priority attention**

Because the informal sector covers a great diversity of activities, it is necessary to decide which are to receive priority attention. As a general principle, these should be the ones providing work for the largest number of people and/or those with the greatest expansion potential.

In branches where there is a differentiated market for the goods and services produced by the informal sector, or where different scales of operation

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<sup>1</sup> According to the surveys only 14 per cent of non-domestic workers in the informal sector were in receipt of fixed wages in San Salvador and about 20 per cent in Asunción.

result in only minor differences of productivity, economic policy should seek to reinforce the sector's position by helping it to enlarge its share of the market.

As for the branches in which conditions militate against free competition and the trend is towards market concentration, the disadvantages handicapping the informal sector may be the result of economic policy according preferential treatment to the formal sector through such means as subsidies, credit facilities and the general government machinery for the promotion of industry. In such cases, removal of these market distortions will help the informal sector to expand.

Finally, in cases where the handicaps of the informal sector stem from the functioning of the economy and the pattern of capital accumulation, support of the sector may mean sacrificing over-all growth to fuller employment. Any decision to adopt policies of this sort must therefore be based on rigorous social cost/benefit analysis. The selection of particular activities qualifying for protection should be made in the general context of the comprehensive planning system and specifically with the help of a model allowing various growth and income distribution assumptions to be tested. In the absence of such a model it would be possible to form an approximate idea of the cost of favouring a particular branch of the informal sector by estimating the difference in productivity between it and its equivalent in the formal sector, and by considering the strategic importance of the activity in question for the dynamism of the system as a whole.

If the informal sector is to compete with the formal sector in present circumstances, therefore, the difference in productivity must not be too great. The major advantage of large enterprises lies not so much in the concentration of resources as in their greater access to auxiliary services; this generally manifests itself in superior organisation. Nevertheless, the efficiency of the informal sector could also be significantly improved if measures were taken to organise small enterprises in such a way that these auxiliary services were available to them without any sacrifice of economic growth.

### **Enlarging the market**

Any steps to increase the demand for products of the informal sector must be taken in the light of the relationship between the informal and formal sectors in the field concerned. This relationship may be either complementary or competitive; most often a given informal activity complements certain formal activities and competes with others. A policy of enlarging the informal sector's market should be designed to reinforce its links with the formal sector in the former case and to strengthen its competitiveness in the latter.

In order to strengthen these links more cross-sector subcontracting should be promoted. This could be achieved by establishing subcontracting "pools" in the private sector by using the State's purchasing power to buy goods in whose production the informal sector plays a major part.

Improving the competitiveness of the informal sector should also help to slow down the trend towards market concentration. For this purpose it will be

important to create an adequate infrastructure for the informal sector. Up to now governments have of course subsidised the formal sector by their policy of providing infrastructural facilities at low cost: they could do the same for the informal sector, for example by the establishment of central agencies for purchasing the supplies needed by informal sector enterprises, as well as of central marketing organisations or a network of markets for small retailers. Where necessary, the possibility of administrative action to limit the expansion of the formal sector should not be excluded.

### **Improving efficiency**

Most studies agree that to a large extent the problem of low incomes in the informal sector is due to its deficiencies in respect of organisation and cost structure, which in turn relate to the very small scale of production. It is well known that the high cost of marketing and credit absorbs a large proportion of the gross earnings of small producers and retailers.

The first policy prescription must therefore be to organise the informal sector through the establishment of co-operatives or some other system that would enable the economic advantages of large-scale operation to be combined with massive employment creation. This would also enhance the beneficial effects of any other measures that might be adopted with a view to reducing the sector's marketing and finance costs.

In general, policy measures seeking to increase the sector's economic efficiency must be designed to initiate change both in products and in production methods and to establish an adequate infrastructure making it possible to realise and take full advantage of external economies.

Another very important matter is credit. One way of improving credit terms for the informal sector might be to set up a properly endowed lending institution exclusively for the purpose. New procedures should also be evolved to ensure that such loans really are available to the whole informal sector and that usury can be effectively dispensed with.

Consideration should also be given to the possible role of scientific and technological institutions in the development, adaptation and diffusion of appropriate technology for the informal sector. This could help to raise productivity, improve product quality and standardise production, all of which would have a beneficial effect on marketing prospects.

Finally, the need for manpower training measures in the informal sector should not be forgotten, by which is meant not only technical training as such but also, and in fact primarily, training in the organisation and running of small businesses.