International Labour Review, Vol. 124, No. 6, November-December 1985

The informal sector in Indonesia: Policies and prospects

S. V. SETHURAMAN *

I. Introduction

As national economies grow, a greater proportion of the labour force tends to be absorbed in non-agricultural activities. Indonesia is no exception: the share of agriculture in total employment dropped from 65 per cent in 1971 to 56 per cent in 1980. What is striking, however, is that most of this non-agricultural workforce is not in the "formal" but in the "informal" sector. A conservative estimate based on the 1980 population census suggests that over half the people engaged in non-agricultural activities – more than 12 million out of 23 million – were in the informal sector. This estimate includes all self-employed persons, temporary workers and family workers engaged in non-agricultural pursuits (see the table). It does not include very small enterprises with one or more regular wage employees, which are normally considered as belonging to the informal sector. If they are counted, the share of informal sector in total non-agricultural employment is even larger.

The informal sector, consisting chiefly of very small units engaged in the production and distribution of goods and services, has played a vital role in the Indonesian economy in absorbing labour. In fact it may be said to provide the main alternative for people who are unable to find employment in agriculture (which absorbed less than a third of the additional workforce during the 1970s), but the fact that such opportunities are concentrated mainly in the cities has caused some concern. The urban population grew at an average annual rate of 4 per cent during the 1970s compared with 2.6 per cent during the 1960s. Over half this growth was due to internal migration. Employment in urban areas grew by 5.7 per cent per annum as against only 1.6 per cent in rural areas.

Another significant feature of the informal sector, especially in urban areas, is the predominance of tertiary activities. The table shows that 55 per cent of informal sector employment in urban Indonesia in 1980 was in trade,

* International Labour Office. This article is based on the technical report of a consultancy mission to Indonesia in March-April 1985.

Copyright © International Labour Organisation 1985

Estimated volume and composition of informal sector employment, 1980: Non-agricultural activities[1]

Branch	All Indonesia No. ('000)	All Indonesia % of branch concerned	All Indonesia % of total informal sector	Urban Indonesia No. ('000)	Urban Indonesia % of branch concerned	Urban Indonesia % of total informal sector
1. Mining and quarrying	203	52.39	1.66	17	17.57	0.48
2. Manufacturing	2 283	48.78	18.66	304	22.32	8.36
3. Electricity	9	13.39	0.07	4	8.86	0.11
4. Construction	533	32.15	4.36	149	27.39	4.10
5. Trade and restaurants	6 023	90.18	49.24	1 987	82.64	54.68
6. Transport, storage and communication	656	44.64	5.36	271	37.04	7.46
7. Finance and related services	23	7.59	0.19	12	5.48	0.32
8. Public services	2 266	31.72	18.52	845	25.26	23.24
9. Others	7	31.61	0.06	3	25.30	0.08
10. Unknown	229	73.38	1.88	43	55.24	1.18
Total	12 232	53.84	100.00	3 635	53.40	100.00

[1] Self-employed, family workers and others.
Source: Population Census of Indonesia, 1980.

restaurants and related activities and about a quarter in various kinds of services. It also shows, by comparing the composition of informal sector employment in the country as a whole with that in the cities, that in rural areas a greater proportion was in manufacturing, i.e. cottage and home industries. Productivity and earnings in tertiary activities are generally lower than in manufacturing so that their predominance in the urban informal sector is cause for concern.

While there is a general awareness of the contribution which the informal sector makes to generating employment and income for the poor, and various studies have indicated that earnings in this sector often compare favourably with those in the formal sector, the fact remains that a substantial proportion of informal sector participants have a very low level of income. Urban authorities are thus worried by the growing size of the informal sector and the possible repercussions on the urban environment.

Against this background the question naturally arises whether the informal sector has the capacity to absorb more labour during Repelita IV, the fourth Five-Year Plan (1984-89). Relying on projections of resource availability and economic performance, the Plan expects over 3 million new jobs to come from the informal sector. But unless new policies or support measures are adopted the employment trends observed in the past are likely to continue and thus aggravate the problems noted above. Indeed the opportunities for earning a living in the informal sector might even diminish. This will depend largely on the growth of the formal sector, and its spillover effects on the informal sector, and on the role assigned to the latter in the country's general development policy.

II. Some policy considerations

Development experience during the 1970s suggests that both the extent and the pattern of formal sector growth have a significant influence on the opportunities available in the informal sector. In areas around Jakarta and other big cities in Java, for instance, where much of the development effort was concentrated, employment in agriculture seems to have declined, with a corresponding increase in informal sector employment opportunities.[1] Policy decisions on the location of investment in the formal sector are therefore instrumental in determining where opportunities for employment in the informal sector are likely to grow. This obviously has important implications for regional development.

The pattern of investment in the formal sector affects the composition of informal sector employment, both directly and indirectly. In Indonesia, however, the massive growth of manufacturing and construction in the formal sector, especially in the cities, does not seem to have had much impact on employment in informal sector manufacturing and construction. In urban Indonesia only 8 per cent of informal sector employment in 1980 was generated by manufacturing and only 4 per cent by construction (see table). The primary source of informal sector employment continues to be tertiary activities. These findings are consistent with those of most informal sector studies, which suggest that the informal sector has few direct linkages with the formal sector (e.g. through subcontracting); most of its output is directed towards household consumption. The main link it has with the formal sector is the indirect one represented by the purchasing power of the latter's employees, so that opportunities for employment in the informal sector necessarily occur in locations where formal sector production takes place. Before making any move to shift informal sector employment opportunities out of the cities – one of the policies that have been mooted from time to time – consideration should therefore be given to alternative locations for investment in the formal sector.

Labour naturally responds to opportunities, wherever they exist. This explains the rapid rate of urbanisation and the growth of informal sector employment in the cities. However, as noted earlier, many people in the urban informal sector earn extremely low incomes. In so far as this is due to a malfunctioning of the labour market there is a clear need for policies to ensure greater mobility between the formal and the informal sectors.

There is perhaps an even greater need to ensure mobility *within* the informal sector. To what extent is the concentration of informal sector employment in trade and services due to market imperfections impeding mobility from one type of activity to another? What prevents a trader in the informal sector from moving into small manufacturing? Lack of necessary skills and access to suitable training? Lack of information about alternative opportunities? Lack of credit facilities at reasonable rates of interest? Administrative bottlenecks, such as licensing? Most studies in this area have shown that the informal sector units operate under such handicaps, especially restricted access to training, credit, know-how and raw materials.

These market imperfections often distort the profitability of informal sector activities and make some of the truly productive ones unattractive. An informal sector trader may prefer to remain where he is rather than enter manufacturing, which will yield a return of 20 per cent on the capital invested, because he has to borrow from local money lenders at exorbitant rates of interest (often ranging from 10 to 50 per cent per month). Similar problems arise with regard to access to certain raw materials. The elimination of such market imperfections could make it easier for informal sector operators to move into activities that yield higher incomes through higher productivity.

Some administrative policies and procedures can also render informal sector activities less profitable as, for example, in the case of units operating in "unauthorised" locations, or certain types of income-generating activities may simply be banned, such as *becak* (cycle rickshaw) driving, primarily because of traffic congestion. Lack of legal recognition may in some cases, by cutting off access to certain markets, make the operator dependent on intermediaries, entailing higher operational costs. The attempts made at times by the authorities to provide proper infrastructural facilities for the informal sector have not always produced the expected results because unrealistic pricing placed the facilities beyond the reach of informal sector units. Inappropriate policies at the national, regional or local level can thus adversely affect the profitability of informal sector activities and prevent an optimum allocation of resources.

However, examples can also be cited of macro policies which have had a positive effect on informal sector activities, e.g. by allocating to this sector greater credit resources through formal institutions, providing sheltered markets for certain informal sector products, establishing stronger direct links with formal sector firms and government institutions (particularly through subcontracting and marketing of informal sector output), or giving preference to the purchase of products from the informal sector.

One of the strengths of the informal sector has been its ability to generate capital from within and to expand despite a generally unfavourable market and policy environment. Where government policy results in greater profitability for informal sector units they will obviously be encouraged to accumulate capital and improve their productivity. Government policy can also help to dispel uncertainty about their future and encourage them to save and invest. By lifting the constraints on their operation it can make investment in skills more attractive and encourage informal sector operators to seek more training.

Needless to say, such policy measures, important as they are, will not alone suffice to promote employment in the informal sector where, as we have seen, over half of all non-agricultural employment was already concentrated in 1980. While it seems feasible to promote certain types of informal sector activities in an autonomous fashion without conflicting with the development of the formal sector, it may well prove necessary in some areas, especially manufacturing and construction, to establish policy guide-lines for a harmonious development of the two sectors; such guide-lines should aim at ensuring a judicious balance between the advantages of higher employment in the informal sector and of higher productivity in the formal sector.

III. Current government policies and programmes

Though the importance of the informal sector as a source of employment was recognised during the third Five-Year Plan (1979-84), a comprehensive approach for developing or assisting it did not emerge. Nevertheless the sector continued to receive the attention of national, regional and local policy-makers in a number of fields.

Both public and private banks have been aware for some time of the *credit* needs of the informal sector. The Bank of Indonesia has launched a programme to extend credit to the "weaker groups" of the economy, i.e. enterprises with fewer than 20 workers and a capital of less than Rps. 100 million.[2] Given the difficulties of reaching very small units with one or two workers, however, it is not surprising that such programmes have been largely confined to the small units in the formal sector. Other difficulties encountered are the cost of administering very small loans (e.g. of the order of Rps. 50,000), monitoring and recovery of loans, and provision of collateral. Perhaps the only bank scheme that comes close to meeting the needs of the informal sector has been the so-called *candak kulak* programme (for very small traders), managed by the Bank Rakyat Indonesia, which grants individual loans of about Rps. 50,000, mainly to traders in rural areas. Between 1978 and 1984 roughly Rps. 150,000 million of loans were chanelled through this programme. For some years private banks in certain provinces have also been providing loans of less than Rps. 50,000. Sometimes known as market banks, these have adopted a more flexible and unconventional approach as regards both the granting and the administration of the loans. Recognising the low level of incomes of borrowers, they have, for example, made arrangements to recover loans on a daily, weekly or monthly basis.

Partly as a result of the banking system's limitations in reaching the lowest echelons in the economy, some efforts have been made to channel credit through non-banking institutions. The Ministry of the Interior, for example, has attempted to channel resources, through the regional government authorities, to the poorest subdistricts, or *kecamatans*, in order to promote employment and incomes in the informal sector under provincial development programmes. At the same time some of the regional government authorities, out of concern for employment or other problems (such as the displacement of *becak* drivers), have also earmarked small sums for assisting the informal sector.[3] Experience so far indicates that there is considerable demand for such credit.

Co-operatives too make small loans for specific types of activities such as handicrafts, but since most informal sector units are run as individual businesses their impact has been limited. Various kinds of small enterprise organisations have also begun to channel credit under the auspices of the Indonesian Chamber of Commerce. Here again the problem seems to be that the bulk of the informal sector falls outside such organisations. As we shall see later, several private voluntary organisations have adopted innovative approaches to financial assistance for the informal sector. On the whole, however, despite the many different efforts to remedy the situation, the informal sector's access to credit continues to be seriously limited by both the delivery system and the resources available.

The sector has virtually no access to formal sources of *training*. Few skills are required for entering small-scale trade and services and those that are needed are usually acquired on the job. Many of the traditional small industries, including handicrafts, have generally relied on informal methods of passing on skills. The Ministry of Manpower has endeavoured, through its vocational training centres in various provinces, to impart training in non-traditional occupations, particularly for school-leavers and drop-outs. Since most of these trainees go on to formal sector wage employment, however, the programmes have done little to develop skills for the informal sector. Under the provincial development programmes promoted by the Ministry of the Interior at the *kecamatan* level, efforts have been made to provide some training in addition to the small credit facilities mentioned earlier. The regional government authorities in West Java, for example, have set up mobile units for training young people in rural areas and for retraining *becak* drivers in the Bandung area for other occupations. These programmes have had little impact.[4] Other programmes have been set up to provide small entrepreneurs with training in marketing and management, as in Jakarta; some 500 persons, mainly from the upper fringe of the informal sector, were trained under such a programme in 1982-83.

Some programmes are geared to specific sectors (e.g. manufacturing) and are intended not only to facilitate credit and impart training but also to provide *technical support*. A case in point is the Project for the Guidance and Development of Small Industries (BIPIK). Small industry, for the purposes of this programme, includes all units with a capital of up to Rps. 70 million. Though the average size of these units is only about three workers, the amount of their capital and the fact that they are run by professional entrepreneurs suggest that most of them do not belong to the informal sector.

Moreover, the programme seems to have had little or no impact on the very small units.[5]

A unique feature of the programme is the technical assistance it provides to small industries in clusters or mini-estates through such common service facilities as the Small Industries Villages and Settlements or the Small Industries Facilities Centres and the technical service centres. While on the whole the common service facilities are making a positive and useful contribution, individual performance tends to be somewhat uneven since some entrepreneurs suffer from inadequate equipment, insufficient knowledge of machine maintenance, limited access to machine utilisation, and so on. The same holds true by and large for the technical service centres. The poor performance of industrial estates and clusters, for their part, is often due to poor infrastructural facilities (or inappropriate pricing policies) and management shortcomings within the enterprises themselves. A beneficial effect of the programme is that, by bringing technology institutions such as the Metal Industry Development Centre closer to small industries, it has facilitated technical adaptations for them. The results so far suggest that access to know-how and technologies can be as critical to the small units' survival and success as credit is.

In November 1980 the Government issued a Decree for the promotion of small industries, identifying 129 products to be manufactured exclusively by small units, but its provisions have not been implemented fully. Two Presidential Decrees issued in 1980 and 1981 also give graded preference, depending on the value of purchase, to goods and services of the "economically weaker" units, that is the small-scale sector.

For instance, government purchase contracts worth up to Rps. 20 million may be awarded to local small suppliers directly while contracts worth up to Rps. 50 million may be awarded on the basis of tenders, but limited to small suppliers. For purchases of up to Rps. 100 million the economically weak units are given preference even if their prices are 10 per cent higher. These provisions apply not only to manufacturing but also to construction and transport services. Two recent Decrees have tightened control over government expenditures in furtherance of these requirements, though there is some doubt about the extent to which they have been applied in practice and the impact they have had on small-scale activities. Government enterprises have also been called upon to allocate raw materials (iron and steel, chemicals, etc., which are in short supply) to small industries, particularly those organised in clusters.

The BIPIK programme now covers some 1,500 clusters of small industries out of a total of 6,000 in the country, its capacity being limited by the number of trained extension workers. Lack of resources has limited the number of common service centres in operation though there has been an increase in recent years as a result of World Bank assistance. Under the fourth Five-Year Plan steps are to be taken to encourage private investment in centres that can be run on a commercial basis.

Another programme – the *bapak angkat* or "foster parent" programme – has been set up to promote small industries through subcontracting. However, the obligations of the parent firms and the subcontracting units have never been clearly spelt out so that the links between them have taken different forms. In many cases they are commercial rather than production links, the purpose being to overcome marketing constraints, i.e. to facilitate the supply of inputs to the units and the marketing of their output. The parent firms seldom assist the subcontractors in design development or provide them with technical advice. No machinery has been set up for monitoring and evaluating performance, and the programme seems to have had a very limited impact on the development of small industry.

Apart from the Presidential Decree providing for preferential access to credit for small units, the Government has not adopted any policy or support measures regarding *construction* in the informal sector. However, some efforts are being made to devise technologies adapted to the small-scale production of building materials, such as bricks and tiles, with the help of the Ceramics Research Institute. This should make it easier for informal sector units to manufacture such products using common service facilities, simple technologies and indigenous raw materials.

Some attempts have been made to facilitate *trade*, the predominant activity in the urban informal sector, by setting up market centres in suitable urban locations. In Jakarta a constant effort has been made to relocate *kaki lima* traders in various parts of the city and "legalise" their existence. However, besides failing to reach more than a small fraction of those concerned, measures of this sort have had some questionable effects. For instance, in the market-places built for the benefit of informal sector traders the rent charged (including service charges) for the stalls is often beyond the reach of the very small units, thus preventing a large majority of the traders from using them. The relocation of *kaki lima* traders has helped to ease the problem somewhat since they are provided only with an authorised parking space for their vehicle, and this is much less expensive. Most traders are able and willing to pay the official rate of Rps. 300 daily for the space. Owing to excess demand, however, the traders may find themselves being charged as much as three times the official rate. Most of those who are unable to pay the price continue to operate nearby, even if "illegally".

Informal sector *transport* has been the subject of considerable controversy. While it is generally recognised to be an important source of employment and income for the very poor, most urban authorities have taken steps to phase out *becak* transport, though the time allowed for doing so varies from one city to another. In Jakarta a policy of restricting *becak* operations to certain hours of the day and to certain areas has been applied since 1972. The restrictions imposed have encouraged clandestine operations, with all the risks they entail, and narrowed income opportunities. Furthermore, the Jakarta authorities, pursuant to a government decision in the early 1970s, decided to stop issuing further *becak* licences in April 1985.

The average daily earnings of a *becak* driver come to around Rps. 3,000 (over and above the rent he pays to the owner of the vehicle, amounting to between Rps. 750 and 1,500 depending on the number of hours he uses it) – which is not a small sum. Since there are at least 40,000 *becaks* in Jakarta alone (and a similar number in Bandung) the decision to abolish them is bound to have appreciable repercussions. A daily loss of income of Rps. 3,000 would mean a yearly loss of Rps. 1 million per *becak* driver (and one can imagine how much capital would be required to generate that order of income for 40,000 persons or more). Its loss will have a significant multiplier effect on many other informal sector activities as well since most of the drivers' daily income is spent on goods and services produced by other workers in the sector, especially prepared food.[6] This highlights the importance of providing for alternative employment. In Bandung moves have been made to train *becak* operators for other occupations and to supply funds for motorising the *becaks*. More commonly the solution put forward by the authorities has been migration to the outer islands, though such jobs as garbage collection and street maintenance have been proposed as alternatives too. Interestingly enough, a study on *becak* operators in Bandung revealed that fewer than 5 per cent of them were willing to accept these alternatives; a large majority were prepared to undergo training for another occupation, though some preferred to move into trading.

A few other government policies have some relevance for the informal sector, such as the general measures adopted to promote *exports* (e.g. support for handicrafts). Import substitution policies, by providing for a larger share of indigenous components in manufactured products, have helped to promote the growth of certain small industries, though they are unlikely to have had much impact on very small units in the informal sector. The Investment Priority List has probably had an indirect impact on the informal sector, particularly in large cities like Jakarta, since it forbids certain industries to be located in specified areas (e.g. 16 types of industries are not allowed in the Jakarta region and the manufacture of 74 different products is prohibited in Java). Policies to promote migration to the outer islands have to some extent helped to expand informal sector opportunities in Java. Certain export policies, on the other hand, have had unintended negative effects on the informal sector; the government policy of promoting the export of raw leather, for instance, has resulted in a shortage of leather on the domestic market and caused its price to rise, thus adversely affecting informal sector leatherworking.

IV. Action by voluntary organisations to promote the informal sector

Supplementary to the government measures a number of small-scale projects have been carried out by private voluntary organisations to assist specific informal sector activities in various parts of the country. What sets them off from the macro policies is that the assistance they provide is tailored to the needs of the informal sector and sometimes accompanied by technical advice. These agencies have also endeavoured to organise informal sector units into co-operatives, pre-cooperatives or "clusters" to which assistance may be channelled more easily. Such efforts, however, are few and far between and mounted with shoe-string budgets, and their impact remains negligible in quantitative terms. In qualitative terms, on the other hand, they may have some lessons to teach. Such voluntary organisations as the Institute for Development Studies and Bina Swadaya take a broader approach to the problems facing the informal sector, emphasising the need to organise the units in a suitable manner and to promote not only employment and income generation but also group self-reliance. They also attempt to improve the access of informal sector units to other basic facilities like health and education. Others, such as the Institute for Social and Economic Research, Education and Information, follow the BIPIK approach and consider that the co-ordination and delivery of credit, training, know-how and marketing assistance are what informal sector units most need.

To remove the credit bottleneck these organisations have tried to promote innovative loan schemes, mainly by mobilising small savings from within the informal sector itself. They have succeeded in liberalising access to credit and lowering the cost of small loans, thus reducing the informal sector units' production costs. Though a few attempts have been made to impart technical training on the job, their impact on productivity and incomes has been limited. Efforts to counter market imperfections through the organised supply of raw materials and improved access to markets where the output is sold have met with some success in raising incomes. One of the main stumbling-blocks so far has to do with technology. The application of simple technologies using relatively inexpensive equipment and easy-to-learn skills has helped to diversify activities and improve products and thus to widen markets. But access to technology institutions for obtaining the know-how suitable for small units is restricted. Some encouraging efforts have nevertheless been made, such as the experiments carried out in Bandung with the support of the Bandung Institute of Technology which have shown that technological innovations coupled with suitable forms of organisation can more than double the income of participants in the informal sector. In fact a pilot project on garbage recycling generated the equivalent of some US$8.5 million in income through the utilisation of simple technologies and a reorganisation of working practices.

Because of the limited funds at their disposal, these voluntary organisations have been obliged to design their programmes as self-paying propositions, though some enjoy the support of local government bodies. Despite these limitations, the fact that such organisations have been able to expand their activities suggests that the informal sector units do have the capacity to pay for the services they receive and are willing to do so if there is a good chance that they will result in higher incomes. The real question therefore is whether such efforts can be carried out on a wider scale and, if so, what kind of institutional framework will be needed. While access to credit is certainly an important factor, it is not the only one that determines the success or failure of a project.

V. Prospects under the fourth Five-Year Plan

The fourth Five-Year Plan explicitly recognises the need to develop the informal sector since at least a third of the additional labour force during the 1984-89 period must be absorbed by it. The Plan sets out a number of measures for policy and action to this end but these take the form of guide-lines without any specific indication of how they are to be implemented. Training, advice and credit on soft terms are to be extended to the economically weaker groups. Marketing organisations, including co-operatives, are to be utilised for raising these groups' incomes. Preference in the allocation of credit is to be given to labour-intensive activities. The network of credit institutions is to be expanded and their effectiveness improved so as to make credit through banks more readily available. Provision is made for both leadership and entrepreneurship training for the economically weak sectors. A particular effort will be made to equip young persons with the skills they need to become self-employed. These training policies are to be implemented through government and private institutions as well as companies. The latter are expected to provide apprenticeship and on-the-job training.

But it is not clear to what extent these efforts are intended to serve the needs of the informal sector. Training through government job-training centres is expected to benefit some 650,000 persons during the period covered by the Plan. Notwithstanding the proposals to expand training centres and steer their activities more towards available employment opportunities and regional needs, it seems unlikely that these measures will contribute significantly to employment creation in the informal sector. Owing to institutional and resource constraints, the number of individuals able to benefit is bound to be limited. Consequently the tendency has been to ration out the available training capacity to selected individuals, generally on the basis of their level of education. A drawback of this approach in the past has been that it was oriented towards wage employment in the formal sector rather than self-employment in the informal sector. However, with the emphasis placed by the Plan on self-employment for youth as well as for women, some retargeting of the training programmes may be expected.[7]

VI. The challenge ahead

In 1980 the informal sector provided employment to over 12 million persons as compared with 29 million in agriculture. Since then the trend for agricultural employment to decline and informal sector employment to increase has probably continued. If the informal sector is to absorb more labour in the years to come, it is essential that productivity and incomes there should rise.

As we have seen, despite some attempts to develop the informal sector, so far it has received few resources in the form of credit, training or technical advice. The lack of resources is often compounded by the absence of a suitable institutional network for channelling assistance to the sector. Even where the institutional facilities do exist, informal sector participants, unlike their formal sector counterparts, may not take advantage of them owing to ignorance of the procedures involved. An educational effort is clearly needed to make them aware of, and encourage them to use, the facilities available to them.

The organisation of a national workshop on urban informal sector development and guidance in February 1985 under the auspices of the Department of Manpower reflects the Government's concern about the sector and its intention to take concrete action. Some of the conclusions reached by the workshop are worth mentioning here. In addition to noting the difficulties involved in implementing programmes for this sector because of institutional shortcomings and inadequate resources, the workshop considered that the operation of the informal sector was still hindered by an unsatisfactory policy environment, which acted as a disincentive. It stressed the need both for protecting the sector and, given the low level of education, skills and motivation of most of its participants, for tackling its development from the bottom up. The sector should be given a legal status that would facilitate the granting of official assistance so that the units could eventually become more self-reliant and participate more effectively in national development. Specifically, there was a need for greater recognition of the sector and its integration into urban master plans; provision of market facilities; expanded sources of credit; greater marketing links with the formal sector; organisation of the units along pre-cooperative lines; and, for the implementation of these policies, closer co-operation between government departments and voluntary organisations. However, no attempt was made to answer the question whether operational programmes should be organised around the place of business or residence or around the type of activity. As a follow-up to the workshop it was decided to establish an interdepartmental task force to suggest pilot projects and policies for the benefit of the informal sector.

How should the goal of employment promotion best be pursued? Employment in the informal sector has grown in the past even in the absence of a policy framework. The essence of informal sector activities is that individuals, rather than remain unemployed, create jobs for themselves whether they have access to training and credit or not. But they respond to market opportunities and the jobs they choose within the informal sector are often determined by the access they have to information on potential activities, to training, to credit and to know-how. A unique characteristic of the informal sector is that many of its workers were previously agricultural workers or unemployed. Since they have little or no access to technical training in non-agricultural occupations they naturally seek jobs for which few or no skills are required. In Africa, in contrast, a well-developed system of apprenticeship training exists within the informal sector that facilitates entry into small-scale manufacturing and repair activities, for example. In Indonesia, as we have seen, the greatest share of urban informal sector employment is in trade and services, partly because these activities are accessible with little or no training or capital; manufacturing is important mainly in the rural informal sector, where skills in traditional occupations are acquired informally on the job.

Policies to promote employment in informal sector trade and services should include, inter alia, the provision of premises in suitable locations at reasonable prices and easy access to credit, which in turn will contribute to higher incomes, encourage savings and business investment, and thus attract more people to these activities. But obviously these measures alone can have only a limited impact: not everyone engaged in trade and services can benefit simultaneously unless the overall market for informal sector goods and services also expands. Consequently, the growth of employment in informal trade and service activities will largely depend on the growth of the formal sector.

Another feature of interest to policy-makers is that employment growth in informal trade and service sectors seems to have a strong multiplier effect, as illustrated by the example of *becak* drivers and small food vendors given earlier. It is of course true that the small food vendors also cater to the needs of other groups such as low-paid employees in the formal sector. Policies to promote informal trade and service activities should therefore take into account these inter-relationships.

Another, perhaps even more important policy consideration is the need to select and promote activities with a potential for growth. While informal trade and service activities do offer employment and income opportunities, they afford little scope for improving productivity through technological change, capital accumulation and skill development. From a long-term perspective it would therefore seem necessary to promote manufacturing, construction and transport subsectors, which have greater potential for productivity and income growth. Besides encouraging new entrants to the labour force to enter these subsectors through appropriate training and other support measures, an effort should be made to motivate those who are young and engaged in tertiary activities to enter other productive activities. Hence the need for developing a programme of vocational guidance and appropriate follow-up measures. For instance, information could be compiled and disseminated on more profitable and productive activities and then backed up by appropriate training, credit and extension facilities.

Some national, regional and local policies for the development of the informal sector are already being implemented. Policies at the local level – especially those relating to location, licensing and other regulatory procedures – have often tried to reconcile conflicting interests. As the informal sector workshop pointed out, compromises are possible; master plans, for example, can make provision for the informal sector. Similarly, attempts have been made to retrain persons whose jobs have been done away with by administrative measures, like the *becak* drivers, in order to facilitate their entry into other activities; but it is essential that these efforts be followed up by other measures such as the provision of credit and premises so as to ensure that the employment and incomes of those affected are not prejudiced. Policy-makers should take a realistic view of the time required to bring about the necessary adjustments and should accept the need for a gradualistic approach.

Some formal sector projects offer greater scope for informal sector involvement than others, so that the allocation of investments in the formal sector can play an important part in determining the type and volume of employment generated in the informal sector. Besides promoting regional development policies based on decentralised investment in the formal sector, greater attention might be paid to linking informal manufacturing activities in rural areas with agricultural development and construction projects. One way of fostering the development of the informal sector, especially in urban areas, is to strengthen its links with the formal sector in providing services and materials, for example through the production of building materials for low-income housing projects. In other words, the national and regional authorities should explore possibilities for widening the market for informal sector goods and services. A step in the right direction would be to ensure that the Decrees enacted for the purpose in the early 1980s are implemented in full, and also perhaps to broaden their scope so as to benefit the informal sector more directly. Similarly, formal sector investment projects should be so designed as to forge stronger links with small-scale activities. In the past the informal sector derived few direct benefits from massive investments in the formal sector; and even now the share of informal sector employment in manufacturing and construction continues to be quite small. The *bapak angkat* programme was to some extent conceived with this in mind but, in the absence of any specific guide-lines to be followed or machinery for monitoring its implementation, has apparently had little effect on the growth of small industry. The Government could give a boost to employment opportunities in the informal sector by offering incentives to formal sector enterprises to subcontract to small-scale units.

Consideration should also be given to the possibility of extending the BIPIK approach and of expanding the informal sector's market share for specific products where both sectors compete for the same market, while of course bearing in mind the trade-offs between employment and productivity; policy guide-lines would no doubt vary from one product market to another.

Policy conflicts can also arise over the supply of raw materials and other inputs, as we have seen in the case of leather exports. Some macro policies therefore need to be reviewed in the light of their effects on informal sector employment. The BIPIK programme has already taken a step in this direction by calling on government enterprises to make special allocations of raw materials to small industries.

The earmarking of funds for the informal sector is another matter requiring attention. The fourth Five-Year Plan provides for an investment of only Rps. 142,000 million (4 per cent of the total) for small industry as against Rps. 3,154,000 million (96 per cent) for medium and large industry, and yet small industry is expected to create 930,000 additional jobs. Moreover, few informal sector activities are included under the heading of small industry so that virtually no resources are available to the informal sector. If it is to create over 3 million additional jobs during the period of the Plan thought must be given to the minimum resources it requires.

If the key to informal sector development is increased productivity, there is clearly a need not only to gear its composition towards more productive activities but also to upgrade the production technology available to it. Technology institutions such as the Metal Industry Development Centre and the Leather Research Institute, which have not paid much attention to the informal sector in the past, could direct more efforts to it in the future.

As regards skills, it has to be recognised that most people engaged in the informal sector not only have little education but cannot afford to be away from their jobs even for brief periods of training. Training must be given on the job and impart skills that can be put into practice at once. The advantage of training not given in institutions is that no ceiling needs to be placed on the number of persons to be trained or arrangements made for apportioning admission. But there is a need for extending such training geographically and for developing a more effective delivery system along the lines of the mobile training units. At the same time it is important to ensure that training inputs are matched by complementary credit and technology inputs.

In this connection there is also a need to devise more innovative approaches for credit delivery, which might well be patterned on the current experience of the Bank of Indonesia's small credit programme. Since the private banks have shown that it is possible to reach very small units through more flexible arrangements, these should be followed up on a larger scale. Outside urban areas the limited number of banking outlets will remain a bottleneck in credit delivery for some time so that ad hoc arrangements may be needed to fill the gap. Consideration might also be given to channelling credit in kind – e.g. equipment and raw materials – through hire-purchase and instalment payment systems. Lessons learnt from the BIPIK programmes should be taken into account in the programme design.

* * *

One of the weaknesses of past efforts to promote the development of the informal sector has lain less in the absence of policies than in shortcomings in their implementation. This is partly because the policies have been stated in very general terms, leaving the door open for different interpretations. For instance, the term "weaker groups" can be interpreted in different ways by the executing agencies in different regions. In some cases shortcomings in implementation have arisen because no single agency was made responsible for carrying out the policy and monitoring and evaluating its impact. Since the informal sector consists of a wide range of heterogeneous activities, the steps involved in both implementation and follow-up are bound to vary from case to case. To be effective, the policies should be spelt out in detail, and the responsible agency clearly identified. For instance, how exactly are the Presidential Decrees providing for preferential purchase contracts for small construction enterprises, or the policy to extend credit to economically weak groups, to be carried out and followed up? Through what machinery are national policies to be implemented at the provincial or local levels? How are the general guide-lines to be interpreted in specific cases?

There is a tendency in many countries, when it comes to policy implementation, to equate the informal sector with the formal sector. But, unlike the formal sector, the informal sector is made up largely of individuals with little or no education and little or no knowledge of how the various economic institutions operate, and thus cannot be expected to respond as readily to policy measures. Where the benefits that a specific policy will produce are forthcoming and clear, the response is usually good; where they are distant and difficult to perceive, it tends to be slow, and informal sector participants need to be motivated through additional information. It may often be necessary to bring the institutional support to their door, rather than expect them to approach the authorities. Here the strategy for developing the informal sector can take a cue from the strategy used to develop agriculture: the success of the Green Revolution, as we know, owes much to the profitability of the new seed-fertiliser technology and the fact that it did not require new skills. The success of efforts to develop the informal sector will depend largely on the income gains they are able to generate. Measures to provide easier access to training, credit and know-how will be successful if they result in lowering the units' operating costs, as will measures to expand the market for informal sector products if they result in substantial additional revenue. At the same time programmes to develop the informal sector should make due allowance for technological upgrading, which is essential for raising productivity and incomes in many activities, especially manufacturing. Unlike those in agriculture, however, the activities and the products here vary greatly so that the strategy adopted must identify the sources of cost savings and revenue increases, commodity by commodity.

Another feature that distinguishes the informal from the formal sector is that informal units are not run by entrepreneurs in the true sense of the term, with the result that each unit or group of units needs tailor-made technical advice, the provision of which makes programmes for the informal sector more costly. This is one reason why voluntary organisations are involved in assisting informal sector units in Indonesia and elsewhere. The limited experience in Indonesia suggests, however, that it is possible to recover the cost of providing technical advice to each unit and thus make the programmes self-sustaining. Another possibility is to utilise existing institutions (such as vocational training centres) but gear their activities more towards the needs of the informal sector. Such institutions can also serve as vocational guidance centres for new entrants to the labour force (or people already in trade and services) and help them to become self-employed.

Indonesian policy has up to now focused on promoting the secondary rather than the tertiary informal sector. But this is not without effect on the latter, since tertiary sector entrepreneurs who find it profitable to switch over to manufacturing and related activities create new income opportunities for those who remain behind in trade and services. From a practical point of view it would seem desirable to concentrate in the immediate future on promoting a few specific types of manufacturing – perhaps ten at most – and only expand the coverage when the necessary groundwork has been laid. These activities do not necessarily have to be identical everywhere: the choice in each case will depend on existing local skills, the institutional infrastructure (e.g. access to technology institutions), local resource endowments and markets. The scope of each programme will necessarily depend on the resources and qualified staff available. Even a well-established programme like BIPIK suffers from insufficient qualified extension workers to meet the needs of small industries. Looking to the longer term, there would be advantage in launching a few pilot projects with a view to formulating specific guide-lines for informal sector promotion work.

Notes

[1] G. Jones: "Linkages between urbanisation and sectoral shifts in employment in Java", in *Bulletin of Indonesian Economic Studies* (Canberra), Dec. 1984, pp. 120-157.

[2] In April 1985 the official exchange rate was 1,100 rupiahs (Rps.) to 1 US dollar.

[3] For instance, in West Java some Rps. 50 to 100 million is spent annually in granting small loans of under Rps. 25,000 at a rate of interest of 1 per cent per month. No difficulties have been encountered in recovering the loans. In Jakarta the authorities have been providing credit to *kaki lima* traders (vendors selling from vehicles on fixed sites); some 4,000 units received a total of Rps. 652 million (or an average of Rps. 160,000 per unit) in 1982.

[4] Altogether some 12,000 persons were trained under the programme in West Java between 1979 and 1985. One-sixth of the trainees apparently dropped out during the two-month training period. Since no evaluation of the programme has been made, it is hard to say to what extent its attraction was due to the daily allowance (Rps. 1,000) granted to the trainees. A positive aspect of the programme has been to provide follow-up assistance to trainees wishing to become self-employed.

[5] According to a study carried out in July 1983 on small industries' access to credit, the programme hardly touched the bottom layer consisting of cottage industries, barely 5 per cent of such units having benefited from it.

[6] A survey of 2,000 *becak* drivers in Bandung in 1978 showed that an overwhelming majority of them bought their meals from informal sector vendors.

[7] It is possible, though not certain, that some of the general measures envisaged by the Plan may also exert an indirect influence on the informal sector, such as the macro policies – ranging from monetary and fiscal to trade policies – it proposes for employment generation.