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Measuring Informal Sector Economic Activities in Nepal

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Measuring Informal Sector Economic Activities in Nepal

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Abstract

The informal sector activities account for a significant proportion of production, consumption and employment of the Nepali economy. However, the measurement of the informal sector activities has been problematic. The collection of the informal sector statistics is limited to the non-agriculture sector because of the difficulty in defining informal sector activities in the agriculture sector. The informal sector activities is defined only on the basis of the persons' main job in respect of those currently engaged in the non-agriculture sector. Other secondary job has not been incorporated because of the nature of the complexity of jobs to be counted in the informal sector. Information was collected on the number of regular paid employees and this information has been used in defining the informal sector. The criterion of the registration is not taken into account.

The collection of statistics pertaining to informal sector was attempted for the first time in Nepal through the Nepal Labor Force Survey 1998. There is no regular survey to specifically collect data related to informal sector. The information on the informal sector has been updated with the data collected through 2008 Nepal Labor Force Survey.

This paper compares and analyses the data on informal sector from the two NLFS surveys for the use of policy makers. It critically examines the methodology being used in the collection of informal sector statistics as well as identifies the gaps and weaknesses in the collection of informal sector statistics. Based on the reviews, the paper makes a number of recommendations for improving the collection of informal sector statistics in Nepal on a regular basis.

Introduction

Informal sector provides the means of livelihood to millions of people in Nepal. It employs more than 96 percent of the economically active population in the country. Employment is the main source of income among the poor and most of these poor are found to be engaged in informal employment. In most of the cases, however, the jobs are low-paid and the job security is poor. While the informal sector offers a cushion to workers during economic crisis, the benefits of informal employment may not be sufficient to achieve an acceptable standard of living, as informal employment rarely comes with social protection, good working conditions and adequate wages. It is

necessary that efforts to alleviate poverty must be focused to the needs and constraints faced by the working poor in the informal economy.

Informal sector plays crucial role in employing a significant part of the economically active population of the country. It nevertheless presents a challenge to the policy-makers with regard to issues like improvement of working conditions and legal and social protection of the persons employed in the informal sector; increasing the productivity of informal sector activities, training and skills development, development of appropriate regulatory framework, etc. Since a large number of women and children are employed in the informal sector, issues concerning contribution of women to economy of the country and child labor can be resolved only by an in depth study of the informal sector. Thus, statistics on the informal sector are needed as an important tool for policy making and advocacy, which in turn require an operational definition of the informal sector to develop such statistics.

The regular data collection system of the Central Bureau of Statistics (CBS) of Nepal does not cover the informal sector which comprises of households with at least some market production. These households or units have low levels of organization and technology. Moreover, the numbers of employees of these production units are usually lower than the threshold number for inclusion in the list of establishments. It is quite likely that these units are not covered by the regular establishment or enterprise surveys. And while these units might be covered by household surveys, the standard schedules for these surveys do not usually include questions pertaining to production. Because of these issues, informal sector statistics are not collected through the regular survey system of the CBS.

Since data on the informal sector and informal employment are not available regularly, if at all, the national accounts statistics of Nepal do not usually cover this sector, thereby resulting in distorted estimates of the structure of the economy. Besides, this lack of information hinders the understanding of policy makers about social and economic issues related to informal sector activities, such as lack of social protection, limited access to credit, training, and markets, and differentials in wages and working conditions. It is thus important that the visibility of informal workers in labor force statistics and other data used in formulating policies needs to be enhanced. The

government needs to collect statistics on the informal sector and informal employment following international standards. The collection of informal sector statistics is also necessary for poverty measurement and analysis.

Informal sector definition- an unresolved issue

The precise meaning of informal sector has nevertheless remained somewhat elusive and the subject of controversy, as the concept has been defined in different contexts with different meanings (Hussmann, 2004). It is a somewhat controversial subject because there are different view points from which one can observe the informal sector. In view of this, countries have the flexibility to adopt their definition which is appropriate to their needs and the system of data collection for the same. With a view to helping the member countries in providing comparable statistics of employment in the informal sector, the fifteenth International Conference of Labour Statisticians (ICLS) adopted a resolution on informal sector statistics which was subsequently endorsed by the UN Statistical Commission in February, 1993. To promote international standard for the compilation of national accounts as an analytical tool and the international reporting of the comparable national accounts statistics, the United Nations has been recommending guidelines in the form of Systems of National Accounts (SNA). The SNA 1993 endorses the concept of informal sector as recommended by the fifteenth ICLS.

For statistical purposes, the informal sector is regarded as a group of production units that form part of the household sector as household enterprises or equivalently, unincorporated enterprises owned by households. It is defined irrespective of the kind of work place where the productive activities are carried out, the extent of fixed capital assets used, the duration of operation of enterprise (perennial, seasonal or casual) and its operation as a main or subsidiary activity of the owner. Given the widely differing characteristics of the operating units in activities of manufacturing, trade, transport and services in the non-agricultural sector of an economy, the operational definitions would vary in different countries. In many Asian countries such as India, Indonesia, Philippines for the purpose of data collection, the un-organized segment of an economic activity (sector) is defined to comprise those operating units whose activity is not regulated under any legal provisions and/or which do not maintain any regular accounts (Sharma

and Chitkara 2006). This definition helps to demarcate the formal from the informal. In fact, developing countries, like Nepal, quite often use the terms 'unorganized' and 'informal' interchangeably.

In most of the developing countries, many economic units escape the administrative, legal or statistical framework in force. It is often tempting to label such units as the constituents of "informal sector". The major weakness of such a definition is that it is country-specific, depending on the prevailing administrative, legal or statistical framework; the sector will expand or contract with a change in the underlying yardstick over time. Somewhat along the same vein, the informal sector is sometimes considered as that sector which falls outside the scope of planned development effort and thus remains uncared in terms of productivity, social security and, of course, statistics (Sharma and Chitkara 2006).

The intrinsic definition of the informal sector, underlying much of the research activities in various developing countries has rested on the scale of operation. Informal sector has been broadly conceived as consisting of units established, owned and operated by one or a few individuals, who neither possessed adequate capital, skills and know-how nor had free access to them, as orthodox thinking would suggest. The reasons underlying this preference for establishing one's own unit notwithstanding the constraints mentioned above are many. Besides profitability considerations, many are also motivated by lack of alternative employment opportunities in sectors where development effort is concentrated or lack of access to such opportunities owing to inadequate qualifications for entry (UN, et al 1993).

In Nepal, the organised sector comprises of enterprises for which the statistics are generally available from various government reports including the budget documents, annual reports or survey reports. On the other hand, the unorganised sector refers to those enterprises whose activities or collection of data is not regulated under any legal provision and / or which do not maintain any regular accounts. Unlike in other statistically developed countries of the region, the CBS has not yet conducted nation-wide survey of informal sector. To meet the challenges of the informal sector and resolve the policy issues as mentioned earlier, it is indeed necessary to monitor the

informal sector regularly. It was formerly believed that the informal sector units and their activities couldn't be measured and that collection of data in the sector was impossible. Accordingly, the data pertaining to the employment and value added in the sector were mostly gathered through application of indirect methods for macroeconomic estimates or comparative analyses of data from various sources. Such indirect methods, however, are subject to criticism because they are approximate and based on various assumptions. The studies have proved that access to the detailed reliable and comprehensive data in the informal sector is only possible through the direct measurement, namely through conduct of surveys.

Measurement of Informal Sector

A number of approaches can be adopted to estimate the size of employment in the informal sector and its contribution to the economy. One is to identify the informal sector enterprises by conducting economic census during a regular interval of time. Other approaches would be to estimate total employment in informal sector through the population census or large scale household surveys. The economic census in particular is an extremely useful source for the compilation of statistics related to informal sector. However, the CBS has not yet conducted any economic census. The population censuses, on the other hand, are conducted every ten years. The census schedules, nevertheless, do not include adequate questions concerning informal sector. It is usually thought that a long questionnaire is likely to place response burdens on the respondents. The other alternative would be to conduct specific surveys related to informal sector. The CBS is one of the few national statistical agencies in the region that has never conducted specialized surveys on informal sector.

Given the absence of comprehensive informal surveys, the CBS has nevertheless attempted a number of statistical methods for estimating the contribution of informal sector in the overall economy of the country. In order to determine the changes in employment rate in the informal sector in terms of number and characteristics of individuals employed in the sector and their working conditions, the existing population censuses, and household surveys are useful devices. These methods are found useful not only in compiling some information on informal sector, but also in reducing the cost of data collection. Therefore, in order to compile information

related to informal sector, the questionnaires of the regular household surveys are modified so that relevant information could be compiled. The existing statistical sources to collect data on the informal sector include Nepal Labor Force Surveys (NLFS). Examination of the results of these surveys indicate that this could a practical approach for the collection of informal sector statistics in a country like Nepal where there does not exist any formal survey for the collection of such data.

The collection of statistics pertaining to informal sector was attempted for the first time in Nepal through the Nepal Labor Force Survey 1998. However, only limited questions were included in the questionnaire for collecting information related to informal activities. As a result, detailed information could not be compiled. But the information on the informal sector was updated with the data collected through 2008 Nepal Labor Force Survey, which included additional questions on the informal sector (see annex). The following table provides distribution of the estimates of the informally employed economically active population by sectors:

Table 1: Persons aged 15 years and above currently informally employed by all industries

Industry	Informally employed (000)	Percentage informally employed
Total	11332	100
Agriculture and forestry	8674	76.54
Fishing	3	0.03
Mining and quarrying	27	0.24
Manufacturing and recycling	721	6.36
Electricity gas and water	99	0.87
Construction	352	3.11
Wholesale and retail trade	684	6.04
Hotels and restaurants	191	1.69
Transport communication and storage	166	1.46
Financial intermediation	15	0.13
Real estate renting and business activity	67	0.59
Public administration and social security	24	0.21
Education	147	1.3
Health and social work	40	0.35
Other community social and personal services	87	0.77
Others	35	0.31

Source: Labor Force Survey 2008, CBS

The NLFS 2008 estimates that more than 11 million persons aged 15 years and above are employed in the informal sector, the share of which to the total employment comes around 96.2 percent. Besides, the above table also shows that of this total informally employed population, more than 76 percent are engaged in the agricultural sector, where as about 24 percent are employed in non-agricultural informal sector. Agriculture and forestry, mining and quarrying sector has the highest percent of informally employed persons followed by wholesale and retail trade, fishing, and hotels and retail trade industries.

The following table compares the estimates of the informal employment between NLFS 1998 and NLFS 2008. Even though strict comparison between these two years are not possible because of limited coverage and contents of the questionnaire, the employment in the non-agricultural informal sector seems to have increased by more than 29 percent.

Description	1998	2008
Currently employed (15 and over aged in non-agriculture informal sector	1657	2142
Percentage of currently employed (15 and over aged in non-agriculture informal sector	17.5	18.2
Non-agriculture: Informal Sector Workers: own business with no employees	759	969
Informal employment in all industries	n.a.	11332

Source : *Nepal Labor Force Surveys (1998 and 2008)*

The NLFS 2008 does not provide estimates of the informal industrial production by sector. Hence the estimates of informal sector value added is derived using the information on per unit labor cost and gross value added from various surveys such as small scale manufacturing establishments, benchmark surveys (some 30 surveys covering different industries for benchmarking national accounts estimates) conducted by CBS in 2006. The rates and ratios estimated from those surveys are used to arrive at the estimates of the share of informal sector in GDP as provided in the following table:

Table 3: Estimated Share of informal sector to total GDP

Year	2008
Value added per labor (Rs.)	41357

Informal sector employment (000)	11332
Estimated GVA in informal sector (Rs. Millions)	468654
Estimated GVA from informal sector (Rs. Millions)	910523
Contribution of Informal sector to GDP (%)	51.47

The estimates of overall unit labor cost were made using data from the small scale manufacturing and business surveys. The estimates were carried forward / interpolated using GDP deflators for the remaining years. The overall unit labor cost and contribution of informal sector in GDP was computed as:

Informal sector GVA = No of informally employed persons * Value added labor ratio*(per labor cost).

As per the estimation based on the value added per labor and the total number informally employed persons, the share of informal sector to total GDP is estimated to be around 51. 47 percent. Thus it is evident that the contribution of informal sector to the total economy of Nepal is highly significant.

Limitations in the measurement of informal activities

From the point of view of national accounts, detailed structural data such as output, intermediate consumption, valued added, capital equipment, etc. are of vital importance for estimating the GVA of the informal sector. Given the very specific objectives of the household surveys such as labor force surveys, or the living standard surveys, it may not be entirely possible to collect such detailed information from these surveys. The labor force survey gives only partial information on labor and living standard surveys can provide some information on percentage of households running informal economic activities. To estimate the transactions combining both the surveys is found to be difficult because of differences in the reference period. It also has constrained the quality of the estimates.

The unorganised segment is basically labour intensive. In Nepal, it is typically viewed as a proxy to the household sector combined with NPISHs. Though the major component of the unorganised sector is the household enterprises, there exists sizeable number of manufacturing establishments including the private sector and

unincorporated enterprises/establishments, which are not covered by the surveys. Studies undertaken by CBS and the experiences of other countries prove that the mixed household and enterprise method is the most appropriate method by which all persons engaged in the informal sector whether with or without fixed location can be brought under coverage.

The criterion of registration for the operation of informal economic activities is not very practical. There is no effective follow up or enforcement system to get them registered for an establishment especially in rural areas. Because of the lack of an updated business register, formal establishments cannot be properly identified.

Household surveys which are the basis of the estimates of informal sector activities are not regular. The estimates, which are obtained by using constant ratios, are prepared on an ad hoc basis.

The estimates of the informal sector activities are limited to some aggregates because of lack of information on the details of the transactions. Therefore, a separate survey for this purpose preferably specially designed time use survey needs to be carried out for a comprehensive study of informal sector activities in Nepal.

Conclusion

The national income is a measurement of the output of goods and services produced in an economy or region - that is, the aggregate of all economic activities that generate goods and services. However, in developing countries like Nepal it is the informal sector that plays more important role in the country's economy. It is thus very important that regular surveys are conducted to capture the economic activities of the un-organized/informal sector on a regular basis. The informal sector generally consists of small-scale producers and their employees, including the self-employed. A large number of those active in the informal sector work at home. The household sector cannot be directly measured because many economic transactions are not observable. It is thus clear that measuring the unofficial sector is fraught with difficulty.

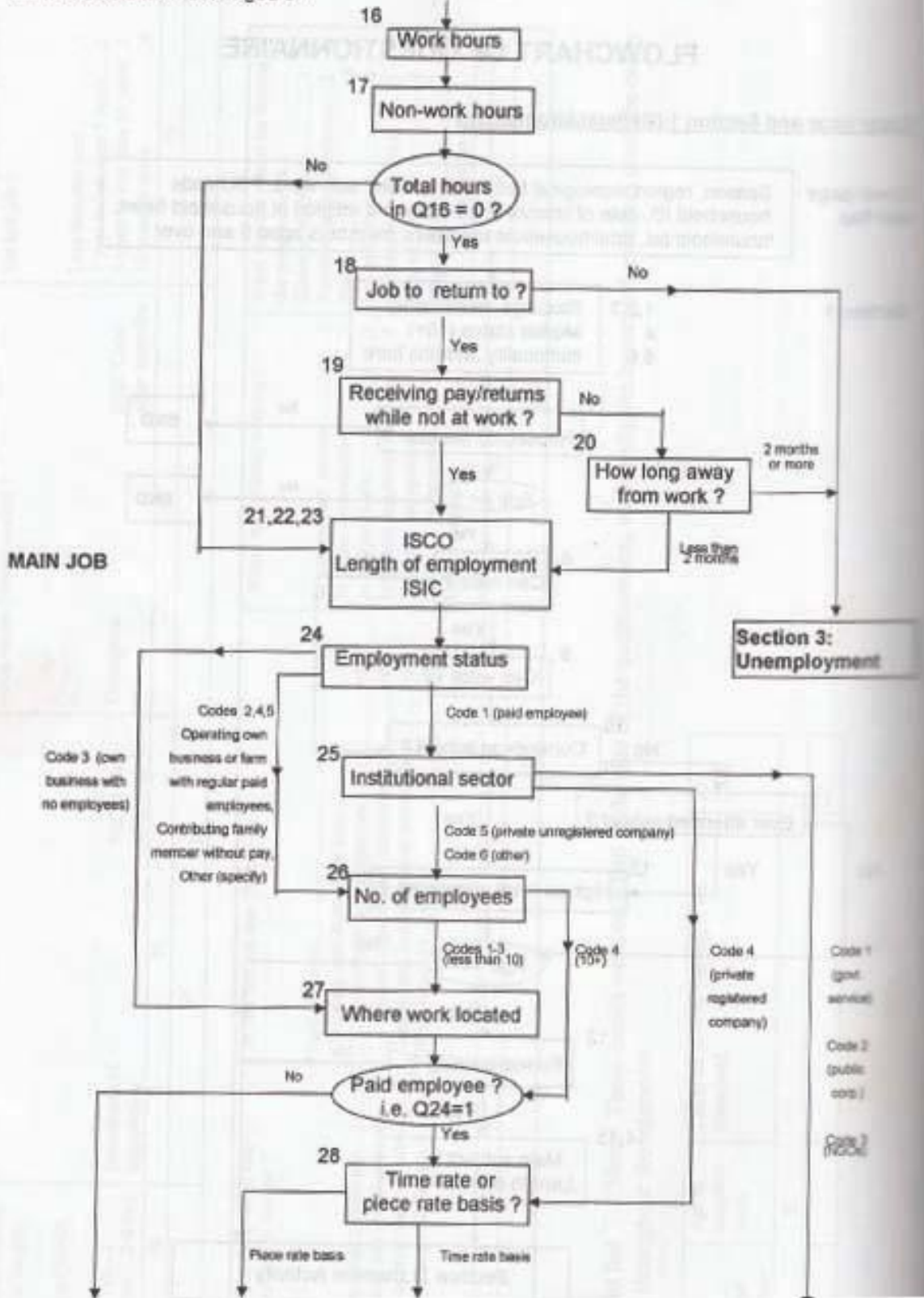
The non- measurement of the informal economy has implications for many aspects of government policies in Nepal. First of all, the official GDP estimates are significantly underestimated and hence the calculation of the rate of change of economic growth is equally inaccurate. Second, the Ministry of Finance loses billions of rupees as tax revenue each year. This either raises the tax burden on those who pay tax or it reduces the amount available for government to spend on public goods. For a poor country like Nepal, the lost revenue is crucial. Third, the social and regional policies of the government are adversely affected as inaccurate data leads to incorrect target spending. Lastly, since the informal sector is the employer of a large section of the population, the estimates of all employment related statistics are highly questionable. Hence, given its importance, there is an urgent need to measure the informal sector activities on a regular basis.

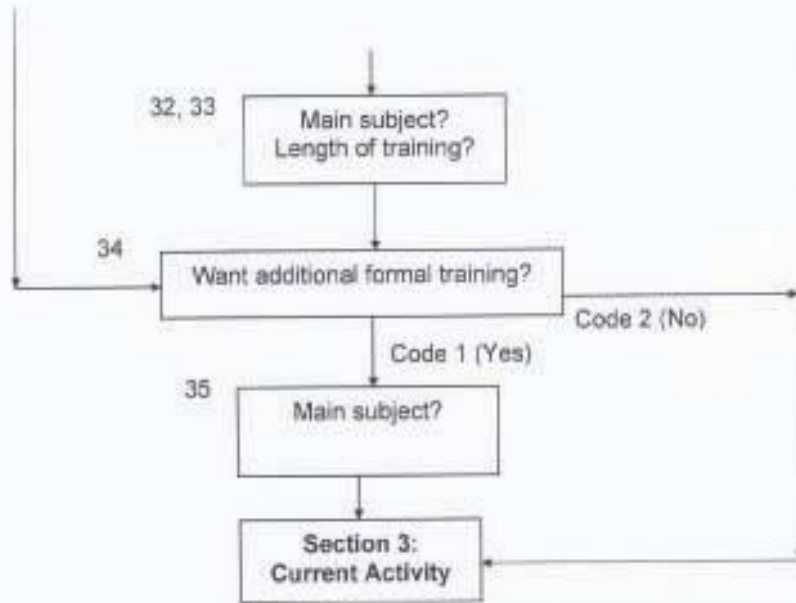
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Annex

Section 2: Current Activities
All household members aged 5+





Section 3: Current Activity
All household members age 5+

