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DEPARTMENT OF ECONOMICS

A comparative analysis of the different measures used  
to determine the size of the informal sector of the South  
African economy

by

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## ABSTRACT

Since the concept of informal sector was first introduced in a 1971 analysis of the Kenyan economy, there have been debates about the appropriate definition of informal economy, as well as the methods to estimate the size of the informal economy. In recent years, there seems to be a universally accepted definition of informal economic activity, which refers to enterprises that are unregistered, as well as registered enterprises containing workers with inferior working conditions and weak employment relationships. However, there is still lack of consensus regarding the method to estimate the size of the informal economy, as well as which aspect of the informal economy should be measured (for instance, informal employment, or informal economic activity as proportion of GDP).

In South Africa, the informal economy is expected to play a significant role mainly because informal employment is relatively high (as proportion of formal employment). The economy is characterised by a slow pace of employment creation in the formal sector and high unemployment. Yet, recent studies found that the country is an international outlier with regard to the size of informal employment as proportion of total non-agricultural employment. There are criticisms that informal employment is under-estimated due to the shortcomings in the method of Statistics South Africa. Furthermore, there is a lack of South African studies investigating the nature, reasons behind as well as the contribution of the informal economy to GDP. Hence, various researchers suggested that other approaches to measure the informal economy should be considered.

As informal economy is important to absorb the unemployed who are retrenched and those who are unable to find formal employment due to reasons like skills mismatch, economic recession, and there are important linkages between formal and informal economies. This study provided a critical evaluation of the various methods to estimate the size of the informal economy and of the results of the empirical evidence using these methods on both the South African and other (developed and developing) countries. It was found that there is no indication that the informal economy has diminished as a country develops. In contrast, it was found that, in general, in both developed and developing countries, the size of the informal economies showed an upward trend throughout the years.

The results indicate that, in the South African context, the informal economy does play a significant role to generate employment and contribute to GDP. However, the method used by

Statistics South Africa seems to have under-captured informal employment. There needs to be more research focusing on estimating the size of informal economy as proportion of GDP.

**KEYWORDS:** Informal economy, informal sector, informal employment, labour market trends, South Africa