

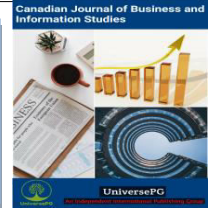


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## The Relationship between Informal Economy and GDP Growth: A Study on South-Asian Developing Countries

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### ABSTRACT

The informal economy has gained increased attention of the policy-makers and development practitioners, especially in the context of South-Asian developing countries. Though measuring the friendly economy is difficult, statistics shows the rate of employment creation by the relaxed sector in this region is higher than the rest of the world. But the GDP growth rate in this region is still emerging in the global economic competition that indicates its effectiveness in the South-Asian region. The study was carried out to identify the relationship between the friendly economy, and GDP growth rate in South-Asian developing countries. The target population was economies of 8 South-Asian countries, which were also taken as the sample size. Data was collected from secondary sources and analyzed using multiple regression analysis. Results indicated that there is a significant positive relationship between the informal economy, and GDP growth rate in South Asian developing countries. Therefore, it is necessary for the policy-makers and development practitioners in this region to give emphasis on the informal sector entrepreneurs to ensure constant economic extension, and development.

**Keywords:** Informal economy, Informal employment, GDP growth, Policy-makers, and Developing countries.

### INTRODUCTION:

The informal economic zone is a common phenomenon in developing countries regardless of Asia, America or Africa. It usually has the biggest contribution in the total economy but is least recognized. The ILO Kenya Report puts in, “casual sector activities are largely ignored, rarely supported, often regulated, and sometimes actively avert by the Government.” Therefore workers in this area face several employment problems like as minimum wage, lengthy hours of work under difficult conditions, and don’t get any type of social protection. Micro and small entrepreneurs under this economic sector fail to have ingress to formal sources of finances. Informal area, also known as the friendly economy, shadow

economy or underground activities, etc. has been recognized as an important issue, which affects economic growth and the responding policies. In accordance with to the World Bank (2016) research, the informal sector comprises at least 4% to 6% of total GDP in developed countries and more than 50% in those low developing countries (LDCs).

The overall state of social enlargement in the South Asian region as a whole is not comforting (Ahamed *et al.*, 2019). The region, despite posting expansion of significance, currently: a) hosts hundreds of millions of illiterates, b) has a giant child mortality rate, c) access to safe drinking water is unavailable to all, and d) about a quarter living in poverty and those number

increasing when compared with those earning \$1.25/day. Although, some rise in the manufacturing and services area employment and overall rising exports notwithstanding, still agricultural sector and casual mode of employment account for a majority of opportunity in the region. The formal sector area employment having some form of rules, and regulations governing employment is pitifully tiny. Thus, lesser well paid, and low productive work currently affects a significant proportion of the employed. Deficient working conditions in necessary workplaces are also not uncommon (SARTUC, 2018).

At present, there is restore interest in the informal friendly worldwide. This is because the demotic economy has grown worldwide, and also appeared in the new period, and in unexpected areas. In part, this stems from the reality that casual employment enlarged significantly during the recent large recession (Horn, 2009). Now the attempts should be made to increase the productivity of informal enterprises and the incomes of the relaxed workforce, especially the working poor. Standard approaches include targeted measures such as financial services, enterprise support, and training; and general measures of state support, such as infrastructure services. The informal workforce needs productive assets, technical and business skills, and infrastructure services to better compete in the markets (Chen, 2012).

This study searches for the answer of the question that is there any relationship between the friendly economy and GDP growing rate in South Asian developing countries? A survey was controlled on 8 (eight) South Asian developing countries for the study to find the relationship. The results indicated that the effects of employment creation by informal economic sector on GDP growth rate respect to South Asian developing countries are relevant and statistically significant. The objective of the study was to identify the relationship between informal economy and GDP growth in South Asian developing countries and to explore the average effects of Employment Creation by Informal Economy on GDP growth rate respect to South Asian developing countries.

## Literature Review:

The study reviews different theories related to the variables as well as empirical evidence from different research articles and publications captured herewith.

**a. Theoretical Review:** This section mainly focused on theories that anchor the study in terms of variables.

**Informal Economy** - The most ancient form of economy is Informal economy that comprises the economic sectors not formed or organized under a set of rules and not regulated under the direct supervision of the government. Usually, these types of economic sectors are formed under traditional self entrepreneurship in the society with ensuring huge employments in the economy. There are a number of definitions about the informal economy but the most frequently-used definition of the demotic economy is “all currently unregistered economic activities, which contributed to the officially deliberated Gross National Product” (Hassan, 2011).

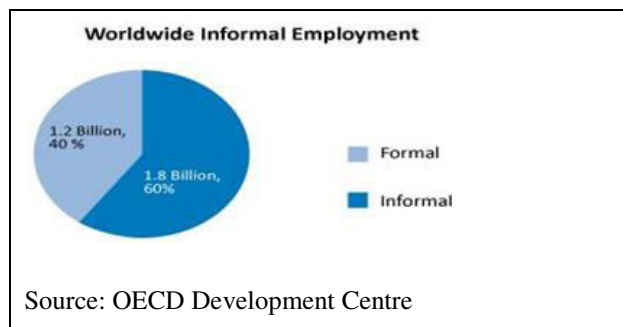
The casual economy is the expand set of economic venture, enterprises, jobs, and workers that are not regulated or protected by the nation. The idea mainly applied to self-employment in little unregistered enterprises. It has been expanded to include control employment in unprotected opportunities (WIEGO). Informal area activities are “unregulated by the institutions of society, in a legal and social environment in which alike activities are managed” (Portes *et al.*, 1989).

Informal activities are ‘a way of doing things’, characterized by ease of entry, reliance on indigenous resources, family ownership of enterprises, small scale of operation, labor-intensive, and adapted technology, a skill acquired outside of the formal school system, unregulated and very competitive markets. The casual economy is broadly represented as consisting of units occupied in the production of goods and services with the preliminary objective of generating employment and income to the persons bothered (ILO, 1993).

**Informal Employment** - Informal employment means number of employment opportunities create by the informal economic sector like vendors, such as people

selling various merchandisers such as vegetables, hawkers, marketers, vendors, artisans, small veranda businesses and cross border traders. At the present world’s total employment is greatly dependent on informal economic sector as it contributes more than 60% of the total employment since the informal economy, informal zone of the economy is the part of an economy that is easy to form with individual step and neither taxed nor track by any type of government (Calbreath, 2010).

**GDP Growth** - Gross domestic product (GDP) is a monetary estimate of the market value of all the final goods and services generated in a specific period of time, often annually (BEA, and F & D, 2019). Total GDP can also be broken down into the contribution of each industry or area of the economy (Dawson, 2006).



The ratio of GDP to the average population of the region is the per capita GDP and the same is called Mean Standard of Living. GDP is considered as world's most potential statistical index of national development, and progress (Lepenies, 2016). The GDP growth rates calculate the speed of the economy that how fast it is growing. It is done by comparing one-quarter of the country's GDP to the previous quarter. In a word, GDP measures the total economic output of a nation (Amadeo, 2019).

**Table 1:** Employment by informal economy and GDP growth rate in South-Asian countries.

S.L	Name of the South-Asian Countries	Employment creation by Informal Sector (in %)	Year	GDP Growth Rate	Year
1	Afghanistan	51.00	2017	3.00	2017
2	Bangladesh	91.30	2017	7.70	2017
3	Bhutan	76.40	2017	5.90	2017
4	India	81.00	2017	7.00	2017
5	Maldives	47.00	2016	4.10	2017
6	Nepal	77.60	2017	7.70	2017
7	Pakistan	71.21	2017	5.20	2017
8	Sri-Lanka	65.90	2016	3.00	2017

**Source:** ILOSTAT- Informal Economy, World Economic Outlook-2017

From the above ILOSTAT dataset it can be calculated the average employment creation by informal economic sector in South-Asian countries. Results found that the rate is 70.18 percent which is higher than the rate of worldwide informal employment. It may have some reasons for the higher informality rate in this region; like- low education rate, low capital formation ability, higher mortality rate, lack of technological knowledge, easy formation, low govt. interference, family support, etc. But the surprising fact is that by doing such informal jobs they are contributing a huge to the nation’s economy. They are

uplifting their total GDP by ensuring a constant growth rate. Here, Bangladesh is a good example in South Asian countries which is continuing its GDP growth rate more than 6 percent in each year.

**b. Empirical Review:** The section highlights key readings relevant to the study. The Informal area is a very important area of the economy for any developing country; it is a growing in the occupational sector for the less skilled people, irrespective of rural or urban areas. A large number of employments are ensured by this zone. What is desire to the informal economy is the

absence of rights and social protection of the workers involved in it (Alam, 2012).

Informal markets exist all over the world and have motivated different studies on its size, its determinants and its effects on other relevant economic variables for developing and OECD countries. One main discussion point has been the relationship between GDP, and the size of the casual economy. Does a higher GDP encourage or discourage friendly activities? Do huge informal markets boost or hinder growth? (Duarte, 2014).

Informal economy has a significant impact on employment and income generation. Normally businesses which are not recognized, not recorded by the govt. authorities are regarded to be part of the informal zone. Businesses that are in the informal sector are small in size and their scope of operation is limited compare to formal businesses (Huda *et al*, 2009). The shadow economy is an obscure idea but it contains various economic transactions. It is a laborious task to calculate its size and dimensions, however, economists have developed reliable methods to forecast the size and impact of informal economy in a given country or economic region (Ela, 2013). The informal economy is mostly associated with low entry requirements, a low scale of operations and labor-intensive way of production and adapted technology. Based on these features and analysis by researchers on female-owned businesses are primarily starts a journey through the Informal economy (Becker, 2004).

Informal economy not only has come out in developing countries but also established itself as a dominant leader for firms around the globe. We accept that firm's informal economy gain a competitive benefit over competitors through its linkages with informal factor inputs, and related industries. The informal economy gives a means for firm's informal economy to capture the BOP market. It also inspires the entrepreneurship and fosters a new light to early-stage enterprises. We have argued that national economic factors, government policies, and context-specific factors also serve a significant role in the growth of informal economy (Dhir and Sushil, 2014). To ensure the size of the casual economy is decreasing with growth, policymakers need to take steps to

increase the cost associated with casual employment arrangements. Altering of the institutional settings regarding employment arrangements is pivotal to ensure that the casual economy is indeed decreasing with growth (Nordling, 2017). Government regulation, taxation, and institutional quality in a country have been traditionally regarded as the main causes of informality. Yet some alternative approaches have emerged to explain this widespread phenomenon by relying on the way market behaves and its frictions (Winkelried, 2005). The Indian labor force is becoming increasingly informal. Changes in employment pattern may reflect the intense competition, risk, and uncertainty, which both the employers and employees face due to globalization (Banerjee & Nabanita De, 2018).

Using the available literature on informal economies in general and secondary information from surveys of the informal zone in Nigeria, the paper observes as follows: first, the traditional or informal zone is continuously expanding in developing countries, and has been serving as a 'safety belt' in providing employment, and income to the teaming poor; secondly, informal sector activities, often described as obscure, unrecorded, unprotected, and unregulated by the public area are no longer confined to tiny activities but also included beneficial enterprises in manufacturing activities; third, the informal zone is largely characterized by poor entry requirements, small-scale operations, skills acquired outside of formal education, and labor-intensive methods of production; forth, the informal area is defined according to different classifications in terms of activity, employment category, zone of actors, and income and employment amplify potential (Onwe, 2013).

Informality remains an extensive challenge in developing countries. On average, 7 in 10 non-farm labors in countries in sub-Saharan Africa and Southern and south-East Asia are in the friendly economy, and the scale of the challenge has been increasing in many areas. Many workers in the casual economy are in a mostly precarious economic situation.

Women are disproportionately 'at the bottom of the pyramid' and face the largest challenges. Because processes of translation are unlikely to absorb the

informal workforce in the near term, we call for policy measures which will arrive at informal workers. Policies to target self-employed workers could include enhancing access to capital and technology, supporting cross-border trade and improving infrastructure in the workplace, including for house-based workers. To choose wage workers, we highlight a minimum wage policy that has benefited those working informally. Under ubiquitous policies, we argue for pensions and health coverage, support for worker organization and expertise upgrading (Stuart *et al.*, 2018). When the formal areas become larger in those countries, more entrepreneurs become creditworthy and the maximum pressure in the credit market increases the interest rate. This reduces future capital collection. We show some factual evidence consistent with these predictions (Massenot and Straub, 2011). In come into being countries, casual firms account for up to half of economic pursuit. They lay out a living for billions of people. Yet their potential in economic development remains controversial (Porta & Shleifer, 2014).

Widespread informality - with regard to employment, enterprises, and productive activities - is frequently recognize as a barrier to full participation in the economy and as a impediment to long-run economic development and poverty depletion. In part, this is because the connection between, informality, growth, and comprehensiveness is not clearly understood. 'Inclusive growth' has been defined as growth that occur in a context in which economic opportunities (including employment opportunities) expand, the poor's entrance to these opportunities improves, and inequalities are decreased (Heintz, 2012). Definitions vary, but important the casual and economy means economic activity that occurs outside formally regulated structures. Generally, friendly economic enterprises are low, often based on all sides families. Workers in all likelihood do not pay income taxes, nor do they benefit from social protections. While their activities are not necessarily illegitimate, they are not covered by the framework of national laws in a given country. Necessarily, there is not always a proper divide between formal and informal economies; for example, sometimes people may work credit in hand for formal, registered businesses. So, defining casual economic activity can be laborious (Boyd, 2017).

Measurement of the casual economy is laborious because of its nature and composition. The casual economy makes up of (i) households with at least little market making; and (ii) production units with poor levels of organization, and technology, and with an unclear divergence between worker and capital or between household and making operations. Other classic characteristics of these units are high mobility, and turnover, seasonality, lack of recognizable features for identification, and disinclination to share information (UNDP, 2013).

### **METHODOLOGY:**

The study has applied descriptive research design. The target population was 8 South Asian Countries. The sample size was the same as the target population for the study. Data were collected from secondary sources like-ILO, World Bank, and ADB reports. Data was analyzed using simple linear regression analysis. The regression model is given below:

$$Y = \beta_0 + \beta_1 X_1 + e$$

Where:

Y = GDP Growth Rate

$\beta_0$  = Constant

$\beta_1$  = Beta coefficients

$X_1$  = Employment Creation by Informal Economic Sector (%)

e = Error Term

### **ANALYSIS and FINDINGS:**

**Linear Regression Analysis** - This section shows a discussion of the results of inferential statistics. The researcher introduced a simple linear regression analysis so as to determine the relationship between Employment by Informal Economy, and GDP Growth Rate respect to South Asian developing countries.

The researcher used the statistical package SPSS-23 to enter and compute the measurements of the linear regression for the study and the P-value was incorporated in reference to the significance level of 0.05. Findings are presented in the following tables;

**Table 2:** The model summary table presents correlation between dependent, and independent variable.

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Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	0.840 <sup>a</sup>	0.705	0.656	1.14369	0.705	14.351	1	6	0.009

a. Predictors: (Constant), Employment Creation by Informal Economic Sector (%)

**Table 3:** The ANOVA<sup>a</sup> table presents multiple regression analysis between the dependent & independent variable.

The ANOVA <sup>a</sup> table presents multiple regression analysis between dependent, and independent variable.						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	18.772	1	18.772	14.351	0.009 <sup>b</sup>
	Residual	7.848	6	1.308		
	Total	26.620	7			

a. Dependent changeable: GDP Growth Rate (%)

b. Predictors: (Constant), Employment Creation by Informal Economic Sector (%)

**Table 4: Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-2.196	2.058		-1.067	0.327
	Employment Creation by Informal Economic Sector (%)	0.109	0.029	0.840	3.788	0.009 <sup>b</sup>

a. Dependent changeable: GDP Growth Rate (%)

b. Predictors: (Constant), Employment Creation by Informal Economic Sector (%)

From the above **Table 1** Model Summary, Coefficient of determination explains the extent to which changes in the dependent changeable can be explained by the change in the independent changeable or the percentage of variation in the dependent changeable (GDP Growth Rate) that is explained by the independent changeable (Employment Creation by Informal Economic Sector). The independent variable that was studied, explaining 70.50 % of the difference in employment creation by informal the economic sector helps to boost the GDP growth rate in South Asian developing countries as represented by the R<sup>2</sup>. Therefore, this indicates that

other factors not studied in this research contribute 29.50 % of the difference in the dependent variable.

From the above **Table 2** ANOVA, results indicate the overall goodness of fit in terms of the extent to Employment Creation by Informal Economic Sector(in %) that explain the relationship with GDP growth rate of selected South Asian come into being countries that were studied. The P-value is 0.009, which is lower than the significant level of 0.05. Hence, the model is overall a good fit and Employment Creation by Informal Economic Sector (in %) is a good measure to explore the relationship on South Asian come into being countries studied.

From the above Table 3 Coefficients, the following regression function is extracted;

$$Y = - 2.196 + 0.109X_1$$

Where, Y= GDP Growth Rate,  $\beta_0$  = Constant,  $X_1$  = Employment Creation by Informal Economic Sector (%). The beta coefficients indicate the change in GDP Growth rate attributed to a unit change in the predictor variable if all other factors held constant. Hence, a unit changes in Employment Creation by Informal Economic Sector (%) causes a 0.109 change in GDP Growth rate, while all other factors held constant with P-value 0.009. Therefore, the above scenario stipulated that there is a significant positive connection between GDP Growth rate and the informal Economy of South Asian developing countries.

### CONCLUSION:

The informal financial system is very significant for the economy of any developing country. Since in South-Asian countries the informal economy represents a huge portion of the total employment, the informal economy plays a significant role in boost the economic development with a constant GDP growth rate. But this sector is still undernourished. Casual businessmen face various challenges that set back to reap maximum benefits from this zone. Therefore, it is quick to take casual economy-friendly initiatives at a macro-level to patronize this area for getting optimum profit from it (Mondol, 2017). For long, the agricultural area has been mostly informal, thereby; there was no need to use the informal paradigm with regard to the rural-agricultural employment. As noted above, this is also a consequence of exemption of the sector by labor law. It was only with regard to certain urban-industrial employment that the use of informal paradigm use became necessary when it was found that many jobs in the urban-industrial sector that were not expected in a modern urban-industrial economy and environment (Amin & Sultana, 2013). To the extent the friendly economy is the key source for the disadvantaged society to make a living in developing countries. This article studies the role of employment creation by informal economy and its aggregate effects on GDP growth rate as a determinant in South-

Asian developing countries. Since, the study found the significant relationship between informal economy, and GDP growing rate in South Asian developing countries, it is opined that the GDP growing rate of this region is vastly dependent on its size of informal economy, and its employment creation. Though, the informal economy in these countries is performing better than the formal economy, it requires more attention of the authority to keep its positive effects on the economic enrich and development of this region. Finally, the study concludes that the problems regarding informal economy need to be addressed properly for improving the status of the employee's who are involved in such activities for uplifting the GDP and GNP of this region.

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### CONFLICTS OF INTEREST:

The authors declared no prospective conflicts of the interest with respect to the present research work.

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