National and International Economic Systems:

Entrepreneurs in the Informal Sector

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**Entrepreneurs in the Informal Sector**

 Those in informal economy possess immense entrepreneurship skills that would allow them to compete in markets with those functioning in a formal economy, but with the limited banking system their businesses are forced to grow solely within the informal economy. Instead of advancing the state of the country’s economy as a whole, the poor are solely affecting an economy that is not seen by the world. Microenterprise solutions among the poor offer only a limited aid to informal entrepreneurs because it falls short of being an adequate bridge into the formal economy it.

**Introduction to Economic Systems**

 Ledgerwood explains financial system as: The financial system (or financial sector, or financial infrastructure) includes all savings and financing opportunities and the financial institutions that provide savings and financing opportunities, as well as the valid norms and modes of behavior related to these institutions and their operations. Financial markets are the markets—supply, demand, and the coordination thereof—for the services provided by the financial institutions to the nonfinancial sectors of the economy.” (Krahnen and Schmidt 1994, 3). Ledgerwood goes on to explain that the financial system is then divided into the formal, semi-formal and informal sectors-*the distinction between formal and informal is based primarily on whiter there is a legal infrastructure that provides recourse to lenders and protection to depositors.* Formal sectors requires accountability from the government, provide services only to private clients and institutions. Semiformal institutions are regulated by government agencies but are not accountable to banking authorities. Informal services function individually from all government supervision. This separation of formal and informal economies creates a dichotomy between the rich and the poor, as it requires them to function in different economies, therefore in different worlds. The division is so vast that the poor live so differently than the rich in their respective countries.

 Jacobs questions important economic theories that have shaped economics today but that still stem from same, unquestioned assumptions. In essence, Jacobs argues that economies should not be categorized by nations but rather by class and labor status. To group an entire nation into one economical category destroys any opportunity for the poor to be seen, to be heard, or be united across the world. This organization of economic entities was created by a imperialistic worldview where nations were competing against each other for economic gain. During this time period, economic success was measured by the number of colonies, export products, and gold.

"The assumption is about four centuries old, coming down to us from the early mercantilist economists who happened to be preoccupied with the rivalries of European powers for trade and treasure during the period when Portuguese, Spanish, French, and English Dutch were exploring and conquering the New World and the lands and seas that lay along the trade routes around Africa to the Indies and beyond. These early mercantilists assumed that the national rivalries unfolding before them were the very keys to understanding what wealth itself is and how it arises, how it is maintained, how lost. According to the theory they propounded, wealth consist of gold, and gold is amassed as a nation manages to sell more goods than it buys, in the process of piling up national treasure. Indeed, the failure of national governments and blocs of nations to force economic life to do their bidding suggests some sort of essential irrelevance. Once we remove the blinders of the mercantilist tautology and try looking at the real economic world in its own rig rather than as a dependent artifact of politics, we can't avoid seeing that most nations are composed of collections or grab bags of very different economies, rich regions, and poor ones within the same nation. Any settlement that becomes good at import-replacing becomes a city. And any city that repeatedly experiences, from time to time, explosive episodes of import-replacing keeps its economy up-to-date and helps keep itself capable of casting forth streams of innovative export work."

According to Jacob's economies are only measured through nations to essentially feed a competitive ego amongst them. Jacobs is the first author to challenge me as I learn deeper about economic systems to see the bigger picture of economic organization. What matters are the people, not the nations that host those people. After reading Jacob's arguments I have began to question why even organizations seeking to aid the poor are also organizing economies according to their countries rather than to groups of people in same economic scales.

**Biased Worldwide Banking System**

 In her writings, Otero begins by questioning the many standardized notions about the relationship between the poor and banks. These biased notions have influenced the way banks serve the poor and function in society as a whole. The author's conviction to support microfinance economic systems stem from these statements: private banks are geared to serve the rich, if banking institutes want to move into a long-term operating service they would be wise to start with entry-level customers and journey with them through their economic development, poor and rich entrepreneurs possess similar set of skills, small-scale projects among the poor change the entire economy of the country, partnering with the poor is not the same as charity, talent and energy should not be wasted. In this compilation the author seeks to showcase the leading arguments for banking systems to invest among urban poor communities.

 But in the eyes of Otero, micro-entrepreneurs have shattered the conventional wisdom of banking. Risks tied in microfinancing were resolved with nontraditional approaches such as peer group lending and the promise of ongoing-increasing access to credit. Administrative techniques were simplified to allow the poor to have access and the group programs made the loaners themselves responsible for their groups. Micro-enterprises are better equipped to work with micro-entrepreneurs as they offer a formal system to meet with the informal systems those in poverty are working with. Microenterprises in all *serves as a vehicle for financial deepening.*

 Even Yunus, hailed as the father of microeconomics, begins by challenges the systems of banking, truly asking why it actively rejects the poor. In *Banker to the Poor*, the author recounts his upbringings in Chittagong a commercial city in Bangladesh. Upon returning back home from studying in America and his political involvement he was disappointed by the aftermath of the independence he had believed in. He accepted a post as the Economics Department chair at Chittagong University. He was shocked to see the disparity in his homeland and sought to find answers to the famine and poverty that plagued most of the surrounding communities around the university. He started researching various reasons for ongoing droughts and famine and funded various programs that would ensure ongoing production of food and land use. Through working with landowners he became aware of the disparities among the destitute that didn't even have land. As he came to know about the slave-like loaning system that ran rapid through the destitute poor he became compelled to intervene. Seeking resources for the poor he sought help from a nearby bank but was shocked to realize how biased and limited the banking system was in actuality. "They were poor because the financial institutions in the country did not help them widen their economic base. No formal financial structure was available to cater to the credit needs of the poor." Out of this, Yunus, without knowing created and launched a Micro-finance system that freed many, gave dignity and opportunities to those that were living in perpetual slavery.

**Formal & Informal Sector Divide**

 In *The Other Path: The Economic Answer to Terrorism. The Costs and Importance of the Law,* De Soto contrasts the life of formality with one of informality. In seeking to understand informality he learned first that *informals, as Soto names them,* did not choose to live outside the *rules, formality, or social status* but were first excluded from this formal system. After all, formal living has a high cost and so Soto attempts to document this cost. Soto examined *four specific areas in which informality is a major social problem: industry, housing, trade, and transport.* In the effort to compare differences in industry among formal/informal an experiment was conducted through a simulation in which a control group and a standard procedure group underwent the bureaucratic process of creating a new business. After conducting research on these four topics: industry, housing, trade, and transport Soto argues that remaining formal impacts the way businesses are run, exclusively, ineffectively, with biased. On the other hand, the costs of informality comes at greater personal expense.

"Formal and informals alike waste tremendous resources. The unnecessary costs of formality derive fundamentally from a bad law; the costs of informality results from the absences of a good law. As we gradually confirmed the existence of the costs of formality, we came to grasp not only why informals operate outside the law but also the real significance of the extralegal system. If informals wanted to establish a new set of laws, it was because they had lost something by operating outside and even in defiance of the law. We had to examine what they were in fact losing…We gradually discovered that informality is not the best of all possible worlds, that it involves tremendous costs, that people try to offset these costs in all kinds of novel and inadequate ways, that law-breaking is not, on balance, desirable and that the apparent chaos, waste of resources, invasions and everyday courage are the informals' desperate and enterprising attempts to build an alternative system to the one that has denied them its protection. This discovery enable us to devise a complementary concept: the costs of informality."

Soto argues that this cost is suffered because the informal system has denied informals its protection and access. They run costs of avoiding penalties as they run informal businesses and conduct informal trade. *Informals* also pay the cost of net transfers done with formals so as to keep their place in the informal sector. There is also a costs of evading taxes and labor laws but most importantly the highest cost *informals* faces is the absence of good laws such as property rights.

 Microfinance services grew out of the need to include the poor in a formal economic system when the formal system refused to serve them. Microfinance loans are only one service offered by microfinance systems. Ledgerwood explains Micro Finance Institutions as a formal financial institution that provides various financial services that target low-income individuals because who are often excluded from mainstream loan options. Although getting the poor to borrow takes more work, they have a higher repayment rate. The author points out that in order to develop loan relationships with the poor they must first seek social intermediation among the groups of the poor, provide enterprise development services for those rising entrepreneurs, as well as social services (health care, education, and literacy training). Although these prerequisites take money and time it serves as an entry point to the loan process relationship these institutions can make with a community that can last years. Even though, these services can be well welcomed in a community, MFI's need to be cautious not to wound the community in the long run. As MFI partner with different NGO's and financial institutions communities may be taken advantage of, as different agendas are being sought. A new breed of NGO's has emerged out of micro finance institutes-business NGO's. They provide four broad services-financial intermediation, social intermediation, enterprise development services, and social services. MFI either use the minimalistic approach or the integrated approach when engaging in the community according to their objectives and circumstances. Ledgerwood notes that all MFIs provide credit services, financial products, savings, insurance, and payment services.

**Untapped Resources**

 Filipinos are resourceful and the repurpose a lot of things we would normally just throw away. I am living in Payatas now, known for hosting one of the biggest dumpsites in all of the Philippines. Everyday thousands of garbage trucks haul the city's waste there. Surrounding *smokey mountain* as it is referred to because of the never ending smoke coming from the dumpsite, are thriving communities that make a living out of sifting through the garbage and collecting useful resources. There are hundreds of junk shops that are thriving in the area. They are meeting a need and demand by reproducing goods that some have deemed worthless. Their resources are never-ending and demand for thier products continues to grow at a steady rate as their product enters the city market. However, because these entrepreneurs are urban poor individuals, their businesses can only grow so much as they do not hold sufficient capital to sustain their business. As noted by De Soto, *informals*, pay a higher cost of living and business than those protected in the formal economy. The microfinance loans they can receive from MFIs can only take their businesses so far as MFIs require their business to remain within the informal economy. Thus, instead of breaking into the formal market and directly affecting the economy of the Philippines as a whole, *informals* are launching into entrepreneurial endeavors which remain small and stagnant.

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