INTERNATIONAL JOUNAL OF: AFRICAN SUSTAINABLE DEV. RESEARCH

TIMBOU-AFRICA ACADEMIC PUBLICATIONS
INTERNATIONAL JOURNAL, AUGUST, 2021 EDITIONS
VOL. 6 NO. 2 ISSN: 2067-4112

EMPIRICAL ANALYSIS OF THE ROLES OF INFORMAL SECTOR IN UNEMPLOYMENT REDUCTION IN NIGERIA. (1980-2018)

SALISU BABA MANU; MUSA ALIYU USMAN; MAMUDA ABDU; & USMAN MA'ULE

Department of Economics, School of Arts & Social sciences, A.D. Rufa'I College of Education, Legal and General Studies, Misau. P.M.B. 004 Misau, Bauchi State Nigeria

ABSTRACT

This study empirically examined the roles played by informal sector in the quest for reducing unemployment in Nigeria between the period 1980 and 2018. Secondary time series data for 38 years were used in this study. Data on the variables include formal unemployment, informal sector growth and Gross capital formation. Unit root test based on ADF & PP techniques were

Introduction

All over the world today, the concept of informal sector has been applied to analyse the employment situation and policy option in most developing countries including Nigeria. Particularly characterized by this dichotomy is the urban labour market, (Engelbrecht, 2013). The cardinal differences between the formal and informal sectors can be seen in the light of the segmentation between the different parts of labour market in Nigeria. The sophistication in operations and skilled requirement for labour in the formal sector attract higher remuneration than their informal sector counterparts, that covers all semi-organized and unregulated small scale activities largely undertaken by self-employed or those employing only a few workers, excluding farming and pastoral activities (Odekunle, 2000).

conducted to check for the unit root properties of the time series data used in the model. The result revealed that one variable (INFS) was found to be stationary at level I(0), while the remaining variables (UFs, L & GCF) were found to be stationary at first difference. Co-integration test based on JJ techniques was used to check for the long-run relationship among the variables. The result confirm the presence of long-run relationship. Having found the long run relationship, a short-term relationship which also revealed it presence. We therefore conclude that, informal sector has not substantially reduced the growth of unemployment rate in Nigeria, though it helps in improving living standards and poverty reduction. We therefore recommend that, the central government should formulate a policy which could make informal sector instrumental in unemployment reduction in Nigeria.

Keywords: *Unemployment, informal sector, economic growth, employment*

According to Akerele, (2002), the dimension of u nemployment in Nigeria transcends the normal inadequate job opportunities and resource underutilization; it includes the gross mismatch between job expectation and the actual job availability. The problem has become severe to the extent while many household members don't have any stable source of income; others are merely striving for survival. Research has shown that about 70% of the people live below the poverty line (NBS, 2012); it is no doubt that unemployment is a major contributor to this. The concept of the informal sector was introduced into international usage in 1972 by the International Labour Organization (ILO) in its Kenya Mission Report, which defines informality as a ,,way of doing things' characterized by ease of entry; reliance on indigenous resources; family ownership; small scale operations; labour intensive and adaptive technology; skills acquired outside of the formal sector; unregulated and competitive markets. Informal sector constitutes a significant segment of the Nigerian economy. The sector thereby contributes to the Gross Domestic Product (GDP)

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and employment and contributes significantly to economic development of Nigeria in general (Omisakin, 1999). The informal sector plays an important and controversial role. It provides jobs and reduces unemployment and underemployment, it also helps alleviate poverty but in many cases the jobs are low-paid and the job security is poor. It bolsters entrepreneurial activity, but at the detriment of compliance with state regulations particularly regarding tax and labour regulations. The size and role of the informal sector in an economy increases during economic downturns and periods of economic adjustment and transition. IYMC (2005) observes that studies on industrial development of different countries have shown that the informal sector constitutes an integral part in the overall industrial sector and plays an active role in the growth and development of these countries.

These enterprises contribute significantly to the employment generation and output growth of different developed and developing countries. Maryland (2004) indicates that the informal sector generates about 6.2 percent of the aggregate employment in the United States, 22.3 percent in China, about 80 percent in India, as well as about 50 percent employment in Israel. In Nigeria, this sub-sector accounts for about 70% of the total industrial employment. This implies that the informal sector given the needed support and regulatory framework could be a major player in combating unemployment in Nigeria, as well as in other developing countries. The informal sector has shown some dynamism in creating new jobs. The Federal Office of Statistics (FOS) estimates that job creation in the informal sector may average 25,000 to 35,000 a year. This study has decided to investigate informal sector growth, capital formation, and labour force as an independent variables in determining unemployment in Nigeria. Other variables included in this study have been previously tested in other studies but with inconsistent findings. Therefore this study aimed at empirically examining the impact or roles of informal sectors in unemployment reduction in Nigeria over the period of study.

EMPIRICAL LITERATURE REVIEW

The informal sector denotes economic activities that obtain outside the formal standard of economic transaction established by the state and formal business practices, although it may not be illegal. The term applies to micro or small business that starts as individual or family self-

employment business. It ranges from production and processing as well as cross country trading. Some of these activities involve lack of appropriate business permit tax evasion, non-compliance with labour regulations, governing contracts and work conditions and the non-existence of legal guarantees between suppliers and clients (Bromley 1978). The term informal sector has been generally criticized because of the confusion and inconsistency encountered in the definition. Peattie (1987) based this on the fact that \informal sector is viewed differently by the various interest groups- academic development communities, the business cycle and policy makers. He therefore suggested that it should be discarded. Bromley (1978) however, agreed that the confusion is a result of lack of theoretical consensus on the meaning of the term "informal economic activity" and lack of reliable conceptual models can be used to ascertain whether they are entrepreneur or distinguish workers.

The notion that labour markets may be dualistic in developing nations date back at least to the work of Lewis (1954) who expresses the view that the rural sector constitute a stock of potential, workers for the urban, formal sectors where jobs pay higher wages. This view is formalized in the model of Harris and Todaro (1970) where urban wages are assumed higher than rural wages. Rural workers who choose to search urban jobs run the risk of becoming unemployed. In equilibrium, the mass of workers who choose to search is such that expected wages are equated across sectors. Fields (1975) expands on the Harris-Todaro model by assuming that urban workers can choose to become informally employed rather than search for higher paying formal jobs. Ranch (1991) marks the next major break in the modelling of informal economic activities.

The model builds on Lucas (1998) span of control model in which agents are endowed with different managerial ability levels. Agents can operate strictly concave technology that transforms labour into the consumption good either in the formal sector or the informal sector. Agents who choose to operate informally can choose to pay workers below the minimum wage but they are constrained to operate below a certain detection threshold. This formalizes the view articulated by Desoto

(2015) that producers in developing nations weigh the regulatory cost of operating formally against the benefits, in this case the ability to operate on a more efficient scale. This yield a model that is conceptually consistent with the correlation between the regulation burden and the importance of informal activities and can replicate many salient aspects of the organizations of production in developing nations. For instance, it provides a natural explanation for the fact that firms tend to be either very small or very large in those nations.

Past studies (Fields, 1975; Desoto, 1989; Dessy and Pallage, 2003; Akerele, 2000) have shown that the modern formal sector is unable to cope with the increasing numbers of the poor, unskilled, illiterate and hungry. However, it has been demonstrated that the informal sector is capable of absorbing large proportion of the new entrants into the labour force. The informal sector thus, constitutes the final destination of an ever increasing number of job seekers. Between 1990 and 1994, Africa's urban employment was put at ten (10) percent but employment in the sub-Saharan informal sector was 6.7 percent. In 1995, employment in sub-Saharan informal sector was 60 percent of the urban labour force. The informal sectors continuously attract new entrants because in all of its sub-sector, it offers ample scope for the entrepreneurship and build-up of technological capacity (Akerele, 2001). Ranch (2003) emphasizes the fact that like traditional dualistic models, his model predicts those labour markets are segmented along formal/informal lines. Formally employed workers earn more than similar workers who are unable to find formal jobs. But this framework (together with Desoto's thought-provoking 1989 monograph) also paves the way for a drastic change in the perception of informal activities. In recent papers, the informal sector is most often modelled as the optimal, rational response of economic units (produces) to government-induced distortions rather than disadvantaged end of dualistic labour markets. Loayza (2000) illustrates this view by describing a model where labour-market segmentation plays no role. Producers can choose to avoid taxation but must then bear an exogenous cost of informality. Similarly Sarte (2005) and Choi and Torn (2005) he described environments where the option to operate

informally mitigates the distortions introduced by a rent seeking bureaucracy.

In Dessy and Pallage (2007) the productivity differential between the formal and informal sector depends on the amount of taxes levied which makes the emergence of economies with high tax rates and large informal sectors endogenous. Quintin (2008) and Antunes and Cavalcanti (2005) explicitly model the cost of informality as the lack of access to contract, enforcement and quantity the effects of the tax burden and limited enforcement on the size of the informal sector via calibrated numerical stimulations. Straub (2010) studies the impact of limited enforcement on informal activities in a model that explicitly considers the role and quality of informal credit mechanisms. Ihrig and Moe (2011) quantify the importance of various aspects of tax policy on the size of the informal sector. The theoretical debate over whether a satisfactory model of informal activities should assume or imply some wage segmentation has important implications for policy. One natural policy response to wage segmentation is to introduce a formal sector wage subsidy (Ray, 2011).

Ibitoye (2013) identified lack of honesty as one of the major causes of small business failure in informal sector. Most of the informal economic operators do not keep their money in the conventional bank but use an informal system referred to as "Esusu". This is a system of daily contribution of an agreed amount of money, which the depositors would collect at the end of the month or at the stated period without interest. Some informal sector operators have lost all deposits as a result of dishonest "Esusu" operators. This would invariably lead to the end of the depositors business. Ibitoye therefore suggested that the formal banking sector should adapt this system, for the benefit of the informal sector operators especially in the rural areas. Soneye (2013) in his studies opined that three major factors contribute to business failure among the informal sector operators. These are lack of inappropriate technical know-how, poor financial management and indiscipline. He therefore suggested that prospective informal sector operators should be trained before embarking on any project, the training should include technological acquisition, cash and business management.

Methodology and design

This study utilises the secondary time series data. The data series used in the study for analysis includes; formal unemployment (Uf), informal Sector Growth (Infs), Gross Capital Formation (Gcf) and Labour Force (L). All the data were sourced from CBN Statistical bulletin of 2020. The data series covered the period between 1980 and 2019.

Model specification

The model is specified in a functional or mathematical form as;
UF = f (INFS, L, GCF) where, UF = Formal Unemployment, INFS = Informal Sector and L = Labour force (measured as proportion of workers between 15-64 years), GCF= Gross Capital Formation. The model can now be specified econometrically as

$$\ln Uf_t = \beta_0 + \beta_1 \ln INFS_t + \beta_2 \ln L_t + \beta_3 \ln CGF_t + \varepsilon_t$$

Where, β_o to β_3 are coefficient of the variables in the model and μ = is the error term. With respect to the method of analysis, the unit root test based on ADF & PP were conducted to check for the stationarity of the time series data. Johansen- Juselius co-integration test was also used to check for the long run relationship among the variables in the model. Other diagnostic tests for normality, autocorrelation, multicollinearity, Cusum and Cusum squared tests were conducted.

Result presentation and Discussions of findings

The descriptive analysis and unit root test of the variables was carried out to determine the stationarity and distribution properties of the four variables under consideration. Unit root test result is presented in the table below;

DESCRIPTIVE ANALYSES

Table1: Summary Statistics of the included variables

VARIABLES	Unemployment	Informal Sector	Labour	Gross capital Formation
MEAN	9.788	64.924	53.069	12.745
MEDIAN	6.550	66.140	53.247	11.920

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ISSN: 2067-4112

MAXIMUM	27.400	73.900	53.781	34.020
MINIMUM	1.700	53.620	52.090	5.467
Std. DEV.	7.807	6.323	0.598	6.227
SKEWNESS	0.871	-0.331	-3.395	1.741
KURTOSIS	2.536	1.882	1.650	6.386
JARQUE-BERA	4.611	2.389	3.465	33.440
PROB.	0.099	0.302	0.176	0.000
SUM	332.810	2207.4	1804.34	433.33
SUM.SQ. DEV.	2011.760	1319.4	11.831	1279.9
OBSERVATIONS	34	34	34	34

Table 2: Unit Root test using Augmented Dickey Fuller (ADF) and Philips Perron (PP)

Variables	Level				First Difference			
	ADF		PP		ADF		PP	
	Constant	Constant & trend	Constant	Constant & trend	constant	Constant & trend	Constant	Constant & trend
$lnUf_t$	-1.928 (0.316)	-2.019* (0.570)	-1.966* (0.299)	-2.246* (0.450)	-5.658* (0.000)	-5.580* (0.000)	-5.660* (0.000)	-5.583* (0.000)
$lnINFS_t$	-3.928 (0.004)	-4.490 (0.005)	-3.869 (0.005)	-5.519 (0.000)	-5.971* (0.002)	-5.873* (0.000)	-13.540* (0.000)	-13.843* (0.000)
lnL_t	-0.677* (0.839)	-1.447* (0.827)	-1.118* (0.697)	-2.032* (0.563)	-3.262* (0.025)	-3.140* (0.114)	-3.144* (0.032)	-2.966* (0.156)
ln GCF_t	-2.735* (0.078)	-2.133* (0.509)	-2.723* (0.079)	-2.154* (0.498)	-5.669* (0.000)	-6.821* (0.000)	-4.899* (0.000)	-6.042* (0.000)

*Note: ***, ** and * denote significance at 1%, 5% and 10% level of significance respectively.*

Table 3: Johansen–Juselius Co-integration Test

Null Hypothesis	Test Statistics		Critical Values (5%)	
	Trace	Max Eigen	Trace	Max Eigen
None*	84.707	50.070	47.856	27.584
At most 1*	34.637	24.561	29.797	21.131
At most 2	10.075	6.785	15.494	14.264
At most 3	3.289	3.289	3.841	3.841

Note: * denotes rejection of the hypothesis (no cointegration) at 0.05 significant level.

Table 4: Long-Run Relations

Estimate	Constant	LINFS	LGCF	LL
JJ	123.127	5.696	0.252	25.360
OLS	-179.839 (-4.717)	3.957 (3.879)	0.103 (0.409)	41.553 (4.275)

Table 5: Error Correction Model of Formal Unemployment

$DLUF_T$ = -0.043 + 0.053$DLUF_{t-1}$ + 0.213$DLUF_{t-2}$ + 0.334$DLUF_{t-3}$ + 1.847$DLINFS_t$–
(0.633) (0.223) (0.407) (0.159) (0.0446)
1.618$DLINFS_{t-2}$ + 0.175$DLGCF_{t-3}$+ 16.477DLL_{t-2} - 0.506ECT_{t-1}
(0.139) (0.640) (0.627) (0.024)

Adj-R^2 = 0.403 JB = 1.593 (0.450)

F-Stat = 1.589 LM = 0.429 (0.125)
N = 35 RESET = 2.375 (0.142.)
CHSQ = 1.102F (7.10) = 0.429

To begin the estimation process, it is crucial to show the descriptive statistics of the variables under investigation. The result for the descriptive statistics is presented in Table 1.The descriptive statistics for the 34 sample observations were analysed to explain the means and standard deviations of the dependent and independent variables of the study. The results indicated that unemployment and gross capital formation were fairly distributed, although, informal sector and labour reveal some level of negative skewness but the J.B statistics indicated that all observations were normally distributed.

The result of these two tests presented in Table 2, revealed that INFS is integrated of order zero – I (0) while other variables- Uf, GCF and L are integrated of order one –I (1). The mixed nature of the order of integration of the variables justifies the fitness of the VECM approach to this estimation. Therefore, a cointegration test was carry out to confirm and determine the existence of long – run relationship among the variables as specified in the equation

The cointegration result presented in Table 4 shows that there is a long-run relationship between formal unemployment (UF) and other variables captured in the model. The result indicates two co-integrating equation(s) at 5 per cent and 1 per cent levels.

The conclusion drawn from the result is that there exists unique long-run relationship between LOG (UF), LOG (GCF) and LOG (LL).Therefore we conclude that there is a co-integrating vector between the variables where both test result reject the null hypothesis of no cointegration with one co-integrating vector.

Having found a long-run relationship between the series under study, an estimate of the long-run relationship was conducted to obtain the long-run coefficient of the model in which the results are presented in Table 4. The results indicate that, INFS is positive and statistically significant at 5%. This means that, informal sector has significant positive relationship with unemployment. That is to say, growth of the informal sector accelerates the rate of unemployment in Nigeria. To be more précised, a 1% increase in INFS leads to 5.69% increase in unemployment rate in Nigeria. Although, this finding may sound counter-intuitive but, it is still in line with some past literatures for Nigeria. This finding is consistent with Tanzi (1999), Buehn and Schneider (2008) and Uduh et al (2008) where a direct relationship between unemployment and informal sector growth. According to Uduh et al (2008), one important implication of the above results is that, increase in the size of the informal sector following increase in the labour supply is an indication that resources have been shifted from the formal sector to informal sector. The SOLS results presented in the same Table 4, which was employed as a diagnostic checks also conforms this our findings that informal sector growth has a significant and positive relationship to unemployment.

Table 5 presents the results of the short-run model, as shown in the table, informal sector growth (INFS), also has a significant and positive relationship with unemployment as found in the long-run. This implies that informal sector growth has an increasing relationship with unemployment in the short-run, i.e. an increase in the informal sector activities lead to an increase in unemployment rate. This result is in conformity with Uduh et al (2008), and further supported the long-run

result that, there exist a positive relationship between unemployment and informal sector. The coefficient of gross capital formation is positive but insignificant, which implies that gross capital formation could not reduce the rate of unemployment in the short-run. The coefficient of labour in this case, is also negative and insignificant in the short-run. The strong significance of the coefficient of the error correction mechanism (ECM) supports the earlier argument that the variables are indeed co-integrated. The ECT coefficient (-0.506) shows a relatively high speed of adjustment of the variables 'convergence to equilibrium of 50.6%. The adjusted R2 shows that about 48 per cent of the total variation in unemployment rate is determined by the changes in the explanatory variables. Thus, it is a good fit. The F-statistics (1.15834) indicates that all the variables are jointly significant at 5 per cent level. To check the efficiency and reliability of the models, I have conducted diagnostic tests which are presented in the same Table 6. As it is well known that serial correlation is a major time series' problem. These results reveal that the model has passed serial correlation, normality test, heteroscedasticity test and specification error tests. As such their null hypothesises could not be rejected. Therefore, the models could produce a reliable outcome having passed these major diagnostic tests.

From the findings, we can conclusively say that, the informal sector has not substantially reduced the growing rate of unemployment in Nigeria. From the foregoing, it shows that the informal sector plays a pivotal role in the socio-economic advancement of Nigeria but it is yet to have any meaningful impact in terms of unemployment reduction in Nigeria. However, enough mechanism has not been put in place to encourage it through funding, capacity building, infrastructural facilities since its impact to the wellbeing of the citizens vis-à-vis overall national economy deserves more than effort being put so far to sustain it

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