

Evidence-based Employment Scenarios

Informal Employment in South Africa

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INFORMAL EMPLOYMENT IN SOUTH AFRICA

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Executive summary

Employment policy in South Africa has paid only limited attention to issues of the informal economy. In this note, I argue that for a number of reasons, any feasible and reliable scenarios of employment in South Africa needs to pay due attention to the informal economy.

Based on an analysis of Statistics South Africa's (Stats SA's) September Labour Force Surveys for the period 2000 through 2005, it is clear that there are significant numbers of South Africans who are not working in formal jobs. In absolute terms, four million informal economy workers were recorded at national level in 2000 and 3.7-million in 2005 for the informal economy. This constituted 34% and 31% of the labour force in 2000 and 2005, respectively.

The figures above include those working in informal enterprises, domestic work and informal agriculture. Although figures fluctuate, informal enterprises have been an area of employment growth in the post-*apartheid* period. However, two notes of caution should be raised on interpreting these trends as an unequivocal growth in informal employment in South Africa.

First, the increase in informal employment reflects both a real increase and the fact that Stats SA has been better able to capture informal employment – some proportion of which may have existed for a long period but may not have been captured by the national survey data.

Secondly, there is a tendency in South Africa to overstate the growth of informalisation and flexibilisation, and to see these developments as recent. Though new forms of informalisation and flexibilisation are beginning to emerge, the labour market in South Africa has historically been characterised by high levels of flexibility and informality – a key characteristic of the *apartheid* system and the racial pattern of South Africa's industrialisation was the highly flexible system of contract and migrant labour.

A further focus should be the definitions applied to informal work. The International Labour Organisation (ILO) has recently introduced the concept of the informal economy, which is a wider conceptualisation of informal work and covers all work that is not covered by formal arrangements – own account work, employment in the informal sector and employment in the formal sector that is not regulated or protected. Given the spread of part-time and casual forms of employment in the formal sector and the high incidence of low-waged work in South Africa, this portion of the labour force in South Africa is probably growing significantly.

Since it is clear that informal employment has grown substantially in the post-1994 period, a critical consideration is whether further growth is possible and indeed desirable?

A key aspect of the debate here – and an important consideration for employment policy – is why the informal economy in South Africa remains relatively small (unlike in most other developing countries) with high levels of unemployment.

We offer some suggestions about different interpretations of this ‘problem’ and the implications for employment scenarios.

The available evidence shows that the unemployed are significantly worse off than those that are employed in the informal economy. This contradicts the argument that is sometimes made that the unemployed choose to remain unemployed.

However, the unemployed face significant barriers to entry into the informal economy, including licensing and restrictive by-laws; the large size of South African firms; labour legislation which is often extended to non-parties in the small medium and micro-sized enterprise (SMME) sector; poor access to capital, land and credit; crime; the risk of business failure and high transport costs.

We argue that while these barriers are important, the conceptual approach views the ‘puzzle’ only from the side of labour market considerations, and therefore identifies barriers to entry as the key consideration. Instead, in research we are conducting, we apply a general equilibrium framework and identify the relationship between the formal and the informal economy as the key issue. Our approach suggests that the formal economy in South Africa has deep reach into consumer markets, including among poor households, and is able to exploit economies of scale to out-compete the informal sector. Where the informal sector is able to function, it offers certain niche products. Thus we argue that the informal sector in South African is small precisely because the formal sector is so large. Any policy attempts to ease entry in the informal economy will have to address demand considerations, and specifically the relationship between the formal and informal sectors.

The formal and informal economy are often seen as two distinct and unconnected components of the economy. The informal economy is deemed to be made up of very small economic units which operate outside the purview of regulations and statistics, and their output is therefore unrecorded. Also, these economic units are deemed to operate independently of formal sector economic units – that the formal and informal economies are not connected in any substantial fashion.

We argue that the formal and informal economies are integrally connected so that developments and cyclical factors in the formal economy are likely to have a significant impact on the informal economy and vice versa (albeit less strongly).

But how do we characterise the nature of the linkages between the formal and informal economy? Is the integration complementary in that there are extensive and facilitative subcontracting arrangements between the formal and informal economy? Or is the informal economy in South Africa adversely integrated with the formal economy, where the relationship is competitive and possibly even exploitative? While there are complementary relationships, on balance there seems to be sufficient evidence that large numbers operating in the informal economy are adversely integrated.

We can postulate a cyclical relationship between the formal and informal economy but is this relationship pro-cyclical or anti-cyclical? That is, does the informal economy absorb workers displaced from the formal economy as the formal sector contracts? Or does the informal economy grow when the formal sector grows due to the extensive subcontracting arrangements that may exist? Again, both of these effects probably occur at the same time, but we do not have any conclusive evidence to suggest which of these may be the stronger relationship.

Structural changes in the economy over time are also likely to have significant impacts on the informal economy, but how might the relationship between the formal and informal economy change? An important consideration here is that retailing forms a large component of the informal economy. As the large formal retail establishments increasingly penetrate the 'township' market, will this displace large numbers of informal retailers? On the other hand, will higher incomes flowing into the township stimulate further growth in informal trading?

Unless we give some consideration to both trends in the informal economy and to the structural relationship between the formal and informal economy, we are likely to have an incomplete picture of employment at present and of future employment trajectories.

1. Introduction

Employment policy in South Africa has paid only limited attention to issues of the informal economy. For a number of reasons, any feasible and reliable scenarios of employment in South Africa needs to pay due attention to the informal economy.

The informal economy has since the early 1990s grown considerably. Notwithstanding this growth, unlike most other developing countries, the informal economy in South Africa continues to be small. The debates about why South Africa continues to have a small informal economy with high levels of unemployment is an important consideration for employment policy.

The formal and informal economy are often seen as two distinct and unconnected components of the economy. The informal economy is deemed to be made up of very small economic units which operate outside the purview of regulations and statistics, and their output is therefore unrecorded. Also, these economic units are deemed to operate independently of formal sector economic units –that is, the formal and informal economies are not connected in any substantial fashion.

In fact, the formal and informal economies are integrally connected so that developments and cyclical factors in the formal economy are likely to have a significant impact on the informal economy and vice versa (albeit less strongly). More important, structural changes in the economy over time are also likely to have significant impacts on the informal economy.

2. Informal employment in South Africa

Since Stats SA introduced the six-monthly labour force surveys (LFSs) in 2000, South Africa has had comparatively good labour market statistics. The statistics presented below are based on an analysis of the September Labour Force Surveys for the period 2000 through 2005. Table 1 represents the population by employment status and sector for South Africa.

Table 1 – South Africa: population 15+ by employment status and sector

	2000	2001	2002	2003	2004	2005
Formal agriculture	686,219	678,910	826,343	845,182	639,194	591,772
Formal other	6,865,361	6,927,409	7,075,966	7,512,036	7,739,645	8,075,451
Domestic work	1,215,165	1,070,362	1,053,834	1,204,010	1,085,946	1,080,341
Informal agriculture	1,083,211	412,193	576,781	394,515	474,304	381,087
Informal other	1,802,050	1,797,722	1,590,343	1,779,371	1,800,332	2,340,984
Don't know	110,516	119,032	60,288	39,875	52,488	35,457
Unspecified employed	206,752	28,562	29,123	17,254	19,606	42,422
Unemployed	4,088,846	4,541,111	4,846,492	4,578,243	4,143,553	4,501,277
Not economically active	12,657,110	13,591,432	13,740,966	15,747,509	15,392,429	14,751,856
Total	28,714,426	29,166,734	29,800,137	32,117,995	31,347,498	31,800,646

Source: LFS

Table 2 presents the same information as the previous table, but this time in terms of percentages, and restricted to the employed.

Table 2 – South Africa: distribution of employed by sector (%)

	2000	2001	2002	2003	2004	2005
Formal agriculture	6	6	7	7	5	5
Formal other	57	63	63	64	66	64
Informal other	15	16	14	15	15	19
Informal agriculture	9	4	5	3	4	3
Domestic	10	10	9	10	9	9
Total	100	100	100	100	100	100

Source: LFS

From these tables it is clear that there are significant numbers of South Africans who are not working in formal jobs. In absolute terms, four million informal economy workers were recorded at national level in 2000 and 3.7-million in 2005 for the informal economy broadly defined, that is, including those working in informal

enterprises, domestic work and informal agriculture.¹ This constituted 34% and 31% of the labour force in 2000 and 2005, respectively.

If we turn our attention to those employed in informal enterprises; although figures fluctuate, this has been an area of employment growth in the post-*apartheid* period. This is reinforced in Casale, Muller and Posel (2004), who recalculated Stats SA data to ensure comparability of years for the period 1997 to 2003. Using figures from the October Household Survey, they calculated that in 1997 there were 1,161,300 people reported to be working in informal enterprises. The comparable figure according to our calculations for 2005 is 2,340,984 people.

Two notes of caution should be raised on interpreting these trends as an unequivocal growth in informal employment in South Africa. First, the increase in informal employment reflects both a real increase and the fact that Stats SA has been better able to capture informal employment – some proportion of which may have existed for a long period but may not have been captured by the national survey data. We are unable to distinguish between these two effects.

Secondly, there is a tendency in South Africa to overstate the growth of informalisation and flexibilisation, and also to see these developments as very recent, and unconnected to historical trajectories in the labour market. Though new forms of informalisation and flexibilisation are indeed beginning to emerge in South Africa, and are segmenting the workforce in new ways, it is important to note that the labour market in South Africa has historically been characterised by high levels of flexibility and informality. A key characteristic of the *apartheid* system and the racial pattern of South Africa's industrialisation was the highly flexible system of contract labour and migrant labour (see, amongst others, Wolpe, 1972 and Legassick, 1974).

Several micro-level studies in the early 1980s have suggested extremely high levels of informal economy activity. In KwaNgele, near Durban, Cross and Preston-Whyte (1983) found that over half of the households relied on both the formal and informal economy for their incomes. In another Durban area, KwaMashu, Wellings and Sutcliffe (1984) found that over half of the households had at least one member engaged in informal economy activities. Webster's (1984) study in Soweto reported that in one way or another, over 30% of households were engaged in the informal economy.

A further issue relates to the definitions applied to informal work. The data above are based on an enterprise definition of the informal sector: is the enterprise in which the worker is employed registered with the authorities? More recently, the ILO has introduced the concept of the informal economy, which is a wider conceptualisation of informal work. The informal economy is an employment-based definition which

¹ There has been considerable debate about the reliability of informal economy statistics (see Devey, Valodia and Skinner, 2006). It is informative that in the LFS surveys, where incentives have been given to fieldworkers to find informal work due to an additional survey being carried out, that significantly more informal work has been registered. Whether this suggests that there is overcounting in these surveys or undercounting in other surveys is not at all clear. This should be borne in mind when considering these figures.

covers all work that is not covered by formal arrangements, thus, own account work and employment in the informal sector and employment in the formal sector that is not regulated or protected.

Table 3 below shows the difference between the informal sector and the informal economy. Cell 2 is the critical part of the matrix, representing informal work that exists in the formal sector of the economy. Given the spread of part-time and casual forms of employment in the formal sector and the high incidence of low-waged work in South Africa (see Valodia et al, 2006), this portion of the labour force in South Africa is probably growing significantly.

Table 3 – Informal sector versus informal economy

Production units	Types of jobs	
	Formal employment	Informal employment
Formal enterprises	1	2
Informal enterprises	3	4

Key: Formal employment=1; Enterprise based definition of the informal sector= 3+4;
Informal employment i.e. employment based definition= 2+4

3. Small informal sector and high unemployment in South Africa

One of the important ‘puzzles’ about the South African labour market is the coexistence of high levels of unemployment and, by developing country standards, a relatively small informal sector (see Kingdon and Knight, 2001). Based on the work of statistician Jacque Charmes, we are able to get comparative estimates of the size of the informal economy. His work suggests that informal employment comprises 47% of non-agricultural employment in the Middle East and North Africa, 51% in Latin America, 71% in Asia and 72% in sub-Saharan Africa. By these standards, South Africa’s informal sector remains relatively small.

How then do we explain the coexistence of high levels of unemployment and a relatively small informal sector in South Africa? Table 4, showing unemployment rates by region, suggests that South Africa is an outlier compared to other regions, but not in relation to Southern Africa.

Table 4 – Unemployment rates by region (%)

Country/Region	Year	Unemployment rate (%)
World	2003	6.3
Industrialised economies	2003	9.8
Transition economies	2003	9.4
Latin America	2002/2004	9.8
East Asia	2003	3.1
South East Asia	2003	7.1
South Asia	2003	4.8
Middle East & Africa	2003	11.9
Sub-Saharan Africa	2003	10.8
Southern Africa	2003	31.6
Botswana	2001	18.9
Cameroon	2001	11.0
Egypt	2002	10.2
Ethiopia	2004	23.4
Lesotho	1997	37.9
Mauritius	2004	8.4
Namibia	2000	33.8
Tunisia	2003	14.7
South Africa	2005	26.5

(Source: Altman, 2007)

Kingdon and Knight (2001) show that the unemployed are significantly worse off than those that are employed in the informal economy. This contradicts the argument that is sometimes made that the unemployed choose to remain unemployed. Further evidence for this is provided by Cichello et al (2001) who, using the KIDS² panel data, show that in the KwaZulu-Natal Province, informal workers have managed to increase their incomes over time.

Kingdon and Knight (2001) suggest that the unemployed must face significant barriers to entry into the informal economy. They identify a number of possible barriers: licensing and restrictive by-laws, the large size of South African firms, labour legislation which is often extended to non-parties in the SMME sector, and poor access to capital, land and credit. Cichello and his co-authors (2006, 2007) explore this issue further through surveys in Khayelitsha, Cape Town. Their data too suggest that there are barriers to entry into the informal economy. They identify the following: crime, the risk of business failure, poor access to credit, a lack of access to start-up capital, high transport costs and jealousy that successful informal entrepreneurs may face in the local community.

In recent work at the HSRC (see Davies et al, forthcoming), we argue that while these barriers are important, the conceptual approach applied by these studies approaches the 'puzzle' only from labour market considerations, and therefore identifies barriers to entry as the key consideration. Instead, we apply a general equilibrium framework and identify the relationship between the formal and the informal economy as the key issue. Our approach suggests that the formal economy in South Africa has deep reach into consumer markets, including among poor households, and is able to exploit economies of scale to out-compete the informal sector. Where the informal sector is able to function, it offers certain niche products, primarily selling in very small and convenient packaging, or selling goods at convenient locations. Thus we argue that the informal sector in South African is small, precisely because the formal sector is so large. Any policy attempts to ease entry in the informal economy will have to address demand considerations, and specifically the relationship between the formal and informal sectors.

² KwaZulu-Natal Income Dynamics Study

4. Linkages between the formal and informal economy

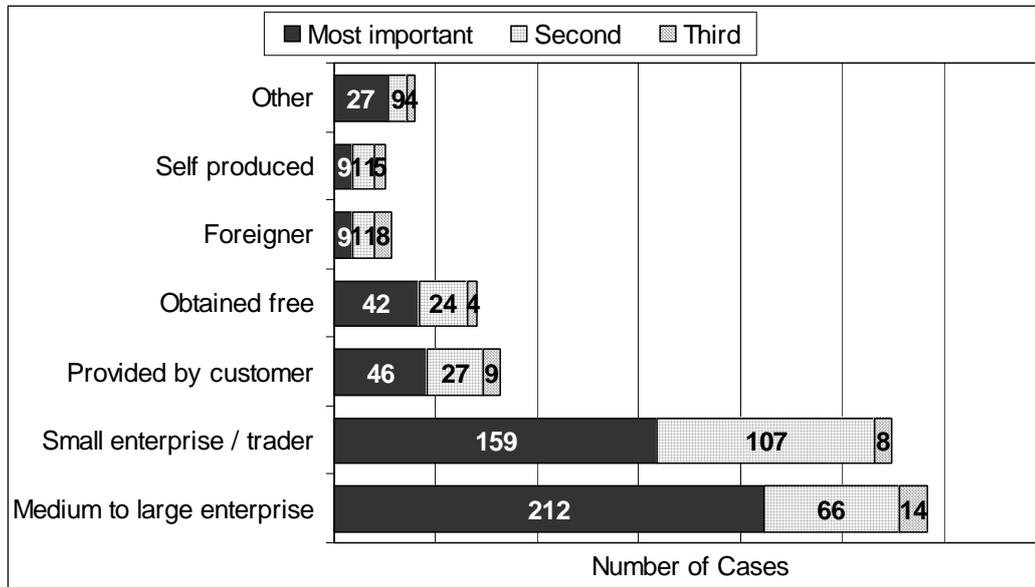
Until recently, the informal sector has been viewed in the literature as a separate and largely distinct component of the economy. This separation of the informal economy from the formal sector is consistent with early dualist notions of developing economies, which, it was argued, consisted of a modern capitalist sector and a traditional and backward sector.

More recently there has been recognition that the informal sector is integrated into the formal sector. This integration is sometimes complementary though, for example, sub-contracting arrangements or where the two sectors compete for markets and for labour (see Gerxhani, 2004). In similar fashion, Kanbur (2007) in a recent paper conceptualises the informal economy as being marginalised because it may be weakly integrated, or adversely integrated, into the formal economy.

What evidence do we have of the integration of the formal and informal economy in South Africa, and how might we characterise this integration?

Perhaps the most comprehensive survey of informal enterprises is that reported by Skinner (2005) of informal enterprises in the greater Durban area, where some 507 detailed surveys with informal workers were conducted. Skinner's study provides some useful indicators of forward and backward linkages in the informal economy. Figure 1 below shows sourcing of raw material for informal enterprises in the Durban area. The most frequently cited source of supply is medium to large enterprises, with six in every 10 enterprise owners identifying this as a source. This suggests quite strong forward linkages into the formal economy. The second most cited source was a small enterprise or trader, with over five in every 10 respondents identifying this as a source. A portion of these are also likely to be in the formal economy. It is interesting to note the role of foreign-linked supply networks in the informal economy. One in 20 respondents stated they sourced their goods from a foreigner.

Figure 1 – Source of supply, n=503



As is to be expected, there are sectoral differences in these linkages. Table 5 shows that certain informal activities are more strongly linked into the formal economy than others. Apparel, spaza shops, shebeens and crèches tended to source their goods in medium and large shops. The responses from those working in traditional medicine indicate that a number of formal shops and foreigners were involved in supply. There are also more formal shops involved in the supply of crafts than would be expected from a segment of the economy that is often considered to be entirely informal. With respect to apparel, a group of those interviewed are likely to be dressmakers, as their supplies were provided by their customers.

Table 5 – Source of supply, informal enterprises, n=503

	Medium / large shop	Small shop/ trader	Provided by the customer	Foreigner	Obtained free	Self- produced	Other
Apparel	61%	70%	40%	4%	1%	2%	4%
Craft	43%	73%	1%	9%	13%	5%	5%
Traditional medicine	19%	54%	0%	18%	69%	15%	25%
Spaza shops	79%	48%	0%	0%	0%	2%	2%
Construction	56%	41%	51%	0%	5%	0%	3%
Metal work	79%	37%	30%	2%	0%	0%	5%
Shebeens	85%	46%	0%	0%	0%	2%	0%
Crèches	67%	36%	15%	3%	5%	13%	15%
Hairdressing	66%	51%	22%	5%	0%	0%	7%
	292	274	82	28	70	25	40

The overwhelming majority of respondents – 495 or 98.4% of those interviewed – sold their goods and services to private individuals or households. The forward linkages into other informal enterprises as well as the formal economy are thus not strong. Only 26 respondents (5.2%) said they sold to other informal enterprises. Only 15 enterprise owners (3%) reported that they sold to formal enterprises and only 11 owners (2.2%) said they sold to middlemen or agents. There also seems to be very little exporting, with only three respondents saying they sold to foreign businesses. There may be an undercount on this in certain sectors.

Budlender et al. (2001) provide some data on linkages between the formal and informal economy at an industry level. Drawing on data from Stats SA's national accounts section, they provide estimates of value added in the informal economy and the total economy. These estimates are shown in the table below. Table 6 confirms the relative importance of the informal economy in trade and construction. The contribution of the informal sector within agriculture is, unfortunately, unknown, as it is included in subsistence agriculture figures provided to Stats SA by the national Department of Agriculture.

Table 6 – Contribution of informal economy to value added, 1999 (R-million)

Industry	Informal	Total	Informal as % of total
Mining	89	44,186	0.2
Manufacturing	4,782	135,952	3.5
Construction	3,893	21,263	18.3
Trade	25,019	95,159	26.3
Transport	3,311	71,340	4.6
Business services	8,967	141,928	6.3
Community services	3,801	21,119	18.0

Using an input-output methodology supplemented by surveys, Naidoo et al. (2004) developed estimates of formal and informal output for the economy. Their estimates are shown in Table 7 below.

Table 7 – Formal and informal economy production

Sector	Total production	Total formal production	Total informal production	Informal as a % of total production	% of informal
Agriculture	30,503	27,626	2,878	9.4	5.7
Mining	51,358	51,277	81	0.2	0.2
Manufacturing	236,782	230,380	6,402	2.7	12.7
Elec Gas Water	26,551	26,551	0	0	0
Construction	35,597	27,839	7,758	21.8	15.4
Trade	100,056	83,460	16,596	16.6	33.0
Transport	46,695	43,659	3,037	6.5	6.0
Finance	71,045	60,605	10,440	14.7	20.7
Other	32,844	29,689	3,155	9.6	6.3
Total	631,431	581,084	50,347	8.0	100

Valodia et al. (2006) explore the issue of linkages by examining the movement of workers between formal and informal work. They use the panel component of the LFS over the period February 2002 to March 2004. The data show that there is a surprising level of churning within the labour market, with the status of more than half of the workers having changed at least once over the period February 2002 to March 2004. As is to be expected, for those workers whose status remained unchanged, most tended to be employed in the formal sector, or remained economically inactive. Only 1.3% of the 5,587 workers that remained in the panel continued to work in the informal economy over the period under consideration, thus showing that there is extensive movement from informal work to other labour statuses.

Table 8 – Labour market status, February 2002 - March 2004, n=5587

Type of worker	Frequency	%
Remained in the formal economy	1,175	21.0
Remained economic inactive	1,077	19.3
Remained in commercial agriculture	99	1.8
Remained as a domestic worker	89	1.6
Remained unemployed	74	1.3
Remained as informal worker	71	1.3
Worker status changed	3,002	53.7
	5,587	100.0

Source: Valodia et al 2006

A number of other studies locally and internationally stress the importance of linkages between the formal and informal economy (see Rogerson, Valodia and Devey, 2007; Gerxhani, 2004; and Guha-Khasnobis et al., 2006).

5. Policy implications

What then may be the policy implications of having to consider developments in the informal economy in employment scenarios for South Africa? I suggest that there are a number of important policy considerations:

- Quite clearly, informal employment has grown significantly in the post-1994 period. A critical consideration is whether further growth is possible and indeed desirable? A key aspect of the debate here is why the informal economy in South Africa remains relatively small, and what policies may be required to assist the development of informal enterprises.
- How do we characterise the informal economy in South Africa? Is it, as de Soto, Maloney (2006) and others argue, essentially made up of entrepreneurs seeking to evade too onerous legislative formalities which curb growth? Or is the informal economy in South Africa instead made up of survivalists who opt to participate in informal work because they have little prospect of finding work in the formal economy? While there are probably at least some seeking to evade legislation, the evidence suggests that the informal economy in South Africa is made up primarily of survivalists. This has important policy implications. As Altman (2007) suggests, where formal and informal firms are indistinguishable except for compliance with legislation, policy should focus closing the regulatory net, both by easing the regulatory burden and by enforcement. On the other hand, where informal enterprises operate over a wider spectrum, policy should focus on support to enable the “accumulation of assets, skills and productivity” (Altman, 2007:7).
- There are clearly extensive linkages between the formal and informal economy. Importantly, how would we characterise the nature of these linkages? Is the integration complementary in that there are extensive and facilitative subcontracting arrangements between the formal and informal economy? Or is the informal economy in South Africa adversely integrated with the formal economy, where the relationship is competitive and possibly even exploitative? Again, while there are complementary relationships, on balance there seems to be sufficient evidence that large numbers operating in the informal economy are adversely integrated.
- We can postulate a cyclical relationship between the formal and informal economy but is this relationship pro-cyclical or anti-cyclical? That is, does the informal economy absorb workers displaced from the formal economy as the formal sector contracts? Or, on the other hand, does the informal economy grow when the formal sector grows due to the extensive subcontracting arrangements that may exist? Again, both of these effects probably occur at the same time, but we do not have any conclusive evidence to suggest which of these may be the stronger relationship.
- There are very important structural considerations too. Over time, and as the economy grows, how might the relationship between the formal and informal

economy change? An important consideration here is that retailing forms a large component of the informal economy. As the large formal retail establishments increasingly penetrate the 'township' market, will this displace large numbers of informal retailers? On the other hand, will higher incomes flowing into the township stimulate further growth in informal trading?

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