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GROWTH IN THE SHADOWS: UNRAVELLING THE LINK BETWEEN INFORMAL ECONOMY AND SOUTH ASIAN GROSS DOMESTIC PRODUCT

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Abstract

The informal economy, long overlooked, has recently grabbed the attention of policymakers and development experts, particularly in South-Asian developing nations. While gauging this "hidden" realm is no easy feat, statistics reveal a surprising truth: it's a hotbed of job creation, outpacing the formal sector in the region and even the world. Yet, despite its dynamism, South Asia's GDP growth lags behind in the global race, casting doubt on the informal economy's true impact. Driven by this conundrum, a study embarked on a mission to understand the intricate dance between the informal economy and GDP growth in eight South-Asian countries. Mining data from diverse sources, researchers employed powerful statistical tools to unravel the relationship. Their findings painted a fascinating picture: a clear and positive correlation between the thriving informal sector and economic growth. This disclosure unlocks a path forward. Policymakers and development practitioners must now turn their gaze towards the often-neglected informal sector entrepreneurs. By fostering their ingenuity and removing roadblocks like limited access to finance and legal hurdles, they can unleash the full potential of this hidden engine, propelling South Asia towards sustained economic expansion and prosperity.

Keywords: Informal economy, GDP growth, Development, Job creation, Policymakers, Economic expansion.

Introduction

The informal economy, ubiquitous in developing countries across Asia, America, and Africa, often hides in plain sight. Despite being the engine of many economies, it remains largely unrecognized and unsupported. The International Labour Organization's Kenya Report aptly states, "casual sector activities are largely ignored, rarely supported, often regulated, and sometimes actively averted by the Government." As a result, informal workers face harsh realities: minimal wages, long hours under difficult conditions, and lacking social security. Micro and small entrepreneurs in this sector struggle to access formal financing, further hindering their growth potential.

This "hidden economy," also known as the shadow economy or underground activities, has come into focus due to its significant impact on economic growth and policy decisions. The World Bank (2016) found that the informal sector comprises at least 4% to 6% of GDP in developed countries and a staggering 50% in least developed countries (LDCs). South Asia, despite experiencing economic growth, paints a concerning picture: widespread illiteracy, high child mortality rates, limited access to safe drinking water, and a rising poverty rate exceeding those living on $1.25 per day (Ahamed et al., 2019; Pasha et al., 2021). While sectors like manufacturing and services see some job growth, agriculture and informal work remain the predominant modes of employment. The formal sector, offering regulated and protected work, remains minuscule. This translates to low wages, low productivity, and poor working conditions for a significant portion of the workforce (SARTUC, 2018).

Recently, the informal economy has garnered renewed interest worldwide. This surge can be attributed to its global expansion, particularly during the recent recession (Horn, 2009). It's now crucial to focus on boosting the productivity of informal enterprises and incomes of informal workers, especially the working poor. Targeted interventions like financial services, enterprise support, and training, alongside broader infrastructure improvements, can empower this invisible workforce to compete effectively (Chen, 2012).

This study sought to answer a crucial question: "is there a connection between the informal economy and GDP growth rates in South Asian developing countries?" Through a survey across eight South Asian nations, the findings revealed a statistically significant and relevant relationship between informal employment creation and GDP growth. In essence, the study sheds light on the untapped potential of the informal economy as a driver of economic prosperity in the region.

Literature Review

The study anchors itself in various theories relevant to our variables. Notably, we explore the concept of the informal economy**.** This, the oldest form of economic activity, encompasses sectors that operate outside the formal framework of rules and regulations set by the government. Often born from traditional self-entrepreneurship, these sectors contribute significantly to employment within an economy. While numerous definitions exist, a widely accepted one states that the informal economy comprises "all currently unregistered economic activities that contribute to the officially deliberated Gross National Product" (Hassan, 2011). Essentially, it encompasses the broader network of businesses, jobs, and workers that function outside the regulated and protected sphere of a nation. This notion primarily applies to self-employment in small, unregistered enterprises, though it has expanded to include contract work in unprotected settings (WIEGO).

Portes et al. (1989) describe informal sector activities as being "unregulated by the institutions of society, in a legal and social environment in which similar activities are managed." Key characteristics of this realm include ease of entry, reliance on local resources, family-owned enterprises, small-scale operations, labour-intensive practices, adapted technology, skills acquired outside formal education, and unregulated, highly competitive markets. As stated by the ILO (1993), the informal economy is broadly understood as a collection of units involved in the production of goods and services primarily for the purpose of generating employment and income for those involved.

Informal Employment:

Informal employment refers to the job opportunities created by the informal economic sector. This includes individuals like vendors selling various goods, hawkers, marketers, small shop owners, artisans, and even cross-border traders. In today's world, a staggering 60% of total employment hinges on the informal sector, highlighting its significant contribution to global workforce participation (Calbreath, 2010; Pasha et al., 2019). This "hidden zone" within the economy thrives on individual initiative, operating outside the reach of government taxation and monitoring. Imagine a vibrant tapestry woven from the threads of countless lives, each one striving for a better tomorrow. This is the world of informal employment, a hidden sector humming with activity just beneath the surface of the formal economy. Here, under the watchful gaze of the sun or the dim glow of a streetlamp, vendors hawk their wares, artisans weave their magic, and hawkers navigate the bustling crowds with practiced ease.

These are the foot soldiers of the informal army, the ones who Calbreath (2010) tells us make up a staggering 60% of the global workforce. They are the cobblers who mend broken shoes, the street food vendors who tantalize taste buds, and the cross-border traders who bridge the gap between communities. Their stories are etched in the lines on their faces, the callouses on their hands, and the unwavering determination in their eyes. This "hidden zone," as it's often called, thrives on individual initiative and resourcefulness. It operates outside the confines of government regulations and taxation, a testament to the human spirit's ability to carve its own path. But this independence comes at a cost. Informal workers often lack the safety nets of formal employment, such as health insurance, social security, and unemployment benefits.

The challenges they face are as varied as the individuals themselves. In some cases, it's the constant struggle to secure a steady income, often at the mercy of unpredictable markets and fickle customers. In others, it's the lack of access to basic necessities like clean water and sanitation facilities. And then there's the ever-present threat of exploitation, where unscrupulous individuals take advantage of the vulnerabilities inherent in the informal sector. But despite these challenges, the spirit of the informal worker remains unbroken. They are the backbone of communities, providing essential goods and services to those who might otherwise go without. They are the innovators, constantly adapting and evolving to meet the ever-changing needs of the marketplace. And they are the dreamers, always striving for a better future, not just for themselves, but for their families and their communities.

The story of informal employment is a complex one, with no easy answers. It's a story of struggle and resilience, of hardship and hope. It's a story that deserves to be told, not just in dry statistics and academic journals, but in the vivid language of human experience. So next time you walk past a street vendor or a bustling market, take a moment to appreciate the invisible engine that drives this hidden economy. Remember, these are not just workers; they are the very fabric of our society, woven together in the threads of informal employment.

GDP Growth:

Gross domestic product (GDP) refers to the monetary measure of the market value of all final goods and services produced within a specific period, typically annually (BEA, and F & D, 2019). It provides a snapshot of a nation's economic activity, and its total value can be further broken down to understand the contribution of different industries or sectors (Dawson, 2006). To gauge the economic well-being of a region's population, we often turn to per capita GDP, also known as the mean standard of living**.** This is calculated by dividing the region's GDP by its average population. As noted by Lepenies (2016), GDP reigns supreme as the world's most widely used statistical indicator for measuring national development and progress. The informal employment chart is given below:

Table 1

Formal and Informal Employment

Year	Informal Employment	Formal Employment
2022	58.007	41.993
2021	58.171	41.829
2020	57.706	42.294
2019	57.843	42.157
2018	57.858	42.142
2017	58.153	41.847
2016	58.277	41.723

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2015	58.62	41.38
2014	58.831	41.169
2013	59.055	40.945
2012	59.331	40.669

Source: https://www.ilo.org/shinyapps/bulkexplorer48/?lang=en&id=SDG_0831_SEX_ECO_RT_A

Table 1 shows the formal and informal employment rates in overall worldwide from 2012 to 2022. The informal employment rate is the percentage of the workforce that is not employed in the formal sector, which is typically defined as jobs with regular wages, benefits, and social security. The formal employment rate is the percentage of the workforce that is employed in the formal sector. The table shows that the informal employment rate has been declining in recent years, while the formal employment rate has been increasing. This suggests that there is a shift from informal to formal employment in the country. The informal employment rate was highest in 2012 at 59.33%, and it has declined to 58.01% in 2022. The formal employment rate was lowest in 2012 at 40.67%, and it has increased to 41.99% in 2022. The decline in the informal employment rate has been gradual, but it has been consistent over the past decade.

But how do we gauge the pace of development? That's where GDP growth rates come in. These rates tell us how quickly an economy is expanding, typically measured by comparing a country's GDP in one quarter to the previous quarter. In simpler terms, GDP essentially acts as a thermometer for a nation's overall economic activity (Amadeo, 2019).

Table 2

GDP in USD Billion

Country	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Afghanistan	20.2	20.91	21.65	22.37	23.1	23.82	24.52	25.21	25.85	26.44	26.73
Bangladesh	141.95	154.22	167.77	182.73	200.25	221.08	244.49	268.53	290.16	324.54	364.46
Bhutan	5.09	5.4	5.72	6.07	6.44	6.84	7.27	7.74	8.24	8.75	9.3
India	1867.22	1980.77	2112.79	2277.2	2465.87	2660.78	2881.54	3148.05	3015.7	3471.09	3870.53
Maldives	2.96	3.18	3.42	3.68	3.96	4.25	4.56	4.89	4.1	4.74	5.24
Nepal	20.06	21.2	22.46	23.81	25.24	26.75	28.35	30.02	31.16	34.4	38.73
Pakistan	249.09	264.01	282.52	302.95	325.2	346.21	369.29	394.9	272.05	343.59	379.54
Sri Lanka	79.05	83.69	88.71	94.1	99.76	105.74	112	118.65	85.42	86.14	92.9

Data source: World Bank Open Data.

Table 2 showcases the Gross Domestic Product (GDP) of eight South Asian nations from 2012 to 2022, providing a glimpse into their economic performance over the decade. India dominates from all the countries. India takes the lead with the highest GDP throughout the period, exceeding $1.8 trillion in

2012 and exceeding $3.8 trillion by 2022, demonstrating significant economic growth. There is a gradual but consistent economic growth. Most countries exhibit a steady upward trend in GDP, indicating ongoing economic expansion. Notable examples include Bangladesh, Nepal, and Bhutan. In the year 2020 marks a dip in GDP for several countries, likely due to the global COVID-19 pandemic's economic repercussions. Pakistan, for instance, experiences a notable drop before recovering in subsequent years.

In case of Bangladesh, it shows an impressive upward trajectory, nearly doubling its GDP from $142 billion in 2012 to $364 billion in 2022. This rapid growth could be attributed to factors like its thriving garment industry and focus on infrastructure development. Afghanistan maintains a relatively stable GDP throughout the period, hovering around $20-26 billion. This could be due to ongoing political and security challenges impacting economic activity. Maldives despite its small size, exhibits consistent GDP growth, reaching $5.24 billion in 2022. This could be attributed to its thriving tourism industry. Pakistan also shows steady economic growth Sri Lanka faces some fluctuations, with a significant drop in 2020 followed by a gradual recovery. This might be due to economic mismanagement and the pandemic's impact. This table presents nominal GDP, not adjusted for inflation, so the actual growth might be slightly different when inflation is factored in. GDP provides a general indication of economic size, but it's not the only measure of well-being. Other factors like income inequality and poverty rates should also be considered.

The average employment creation within South Asia's informal sector. The results were striking: 70.18% of jobs arose from this sphere, exceeding the global average**.** Several factors might contribute to this high informality rate. Low education levels, limited capital formation, higher mortality rates, and lack of technological knowledge play a role. However, interestingly, these informal jobs significantly contribute to national economies. By boosting overall GDP, they sustain steady growth rates. Bangladesh, with its consistent GDP growth exceeding 6% annually, serves as a prime example in the region.

b. Empirical Review - Exploring Existing Research:

The informal sector holds immense significance for any developing nation. It serves as a growing occupational space for less-skilled individuals, in both rural and urban contexts. While it generates immense employment, a major concern lies in the workers' lack of rights and social protection (Alam, 2012). Scholars across the globe have explored the informal sector's size, determinants, and impact on various economic variables, leading to a key debate: how does GDP impact informality? Does economic growth encourage or discourage such activities? Do large informal markets fuel or hinder overall development? (Duarte, 2014)

Research consistently highlights the informal sector's vital role in employment and income generation. Businesses that fall under this category are typically small and operate with limited scope compared to their formal counterparts (Huda et al., 2009). Despite the challenges in accurately measuring its size and impact, economists have devised reliable methods to estimate the informal economy's presence within a specific country or region (Ela, 2013).

Several key characteristics define the informal sector: low entry barriers, small-scale operations, labour-intensive production methods, and adapted technology. Research suggests that female-owned businesses often begin their journey within this sphere (Becker, 2004).

Interestingly, the informal economy has transcended its association with developing nations and established itself as a dominant force for firms globally. Studies suggest that informal firms gain a competitive edge through their links to informal factor inputs and related industries. They provide a means to capture the base-of-the-pyramid market and foster entrepreneurship, particularly for earlystage enterprises. However, national economic factors, government policies, and context-specific details also play a significant role in the informal economy's growth (Dhir & Sushil, 2014).

To truly reduce the size of the informal sector, policymakers need to take measures that increase the cost associated with informal employment arrangements. Adjusting institutional settings surrounding employment practices is crucial to ensure that informality indeed decreases with economic growth (Nordling, 2017). Government regulation, taxation, and institutional quality within a country have traditionally been considered the main drivers of informality. However, alternative approaches have emerged, focusing on market dynamics and frictions (Winkelried, 2005). The Indian labour force, for instance, is experiencing a rise in informality. This shift in employment patterns reflects the intense competition, risk, and uncertainty faced by both employers and employees in the wake of globalization (Banerjee & Nabanita De, 2018).

By analyzing available literature and surveys, researchers have observed several key aspects of the informal economy:

- Continuous expansion: It serves as a safety net for developing countries, providing employment and income for vulnerable populations.
- Diversification: Beyond the traditional image of small, unrecorded activities, the informal sector now encompasses profitable enterprises in manufacturing.
- Distinct characteristics: Low entry barriers, small-scale operations, informal skill acquisition, and labor-intensive production methods remain defining features.
- Varied definitions: Classifications in terms of activity, employment categories, actors, and income-generating potential highlight the complexity of defining and measuring the informal sector.

Addressing the widespread challenge of informality in developing countries requires targeted policy measures. Encouraging access to capital and technology, supporting cross-border trade, and improving workplace infrastructure, including for home-based workers, can empower self-employed individuals. Minimum wage policies have proven beneficial for wage workers in the informal sector. Additionally, advocating for universal pensions, health coverage, worker organization support, and skill upgrading initiatives are crucial steps towards achieving inclusive growth and poverty reduction (Stuart et al., 2018).

The relationship between formalization, creditworthiness, and interest rates raises another interesting point. As formal sectors expand, increased pressure in the credit market can push up interest rates, potentially hindering future capital accumulation (Massenot & Straub, 2011). In developing countries, informal firms can constitute up to half of all economic activity, providing livelihoods for billions. Yet, their role in fuelling development remains a subject of debate (Porta & Shleifer, 2014). Widespread informality, encompassing employment, businesses, and production activities, is often seen as a hurdle to full economic participation, long-term growth, and poverty reduction. This difficulty in driving development stems partly from the unclear relationship between informality, growth, and inclusivity (Pasha et al., 2019).

"Inclusive growth" refers to economic expansion where opportunities, particularly employment, become more accessible to the poor, leading to a decrease in inequality (Heintz, 2012). While definitions vary, the informal economy generally comprises economic activity operating outside formal regulations. These businesses are often small, family-based, and lack income tax contributions or social protection benefits for their workers. Though not necessarily illegal, these activities fall outside the framework of national laws. It's important to note that the divide between formal and informal economies isn't always clear-cut; individuals may even work informally for registered businesses. Thus, defining and measuring informal activity can be complex (Boyd, 2017).

The nature and composition of the informal economy further complicate measurement. It encompasses:

- Households with some market activities.
- Production units with low levels of organization, technology, and a blurry distinction between labour, capital, and household operations.

Other typical characteristics include high mobility, turnover, seasonality, lack of identifiable features, and a reluctance to share information (UNDP, 2013). This lack of transparency and structure makes accurately measuring the size and impact of the informal economy challenging. However, despite these hurdles, understanding its true influence on development and formulating appropriate policies are crucial steps towards a more inclusive and equitable future.

Methodology

The study employed a descriptive research design**,** meaning it aimed to describe and analyze the existing relationship between variables without manipulating or controlling them. The target population for this investigation encompassed eight South Asian countries. Given the manageable size and accessibility of this group, the entire population became the sample, eliminating the need for further randomization or selection procedures. To gather relevant data, researchers turned to secondary sources such as reports from established institutions like the ILO, World Bank, and Asian Development Bank (ADB). These datasets were then analyzed using simple linear regression, a statistical technique suitable for investigating the potential linear relationship between two variables: in this case, informal economy employment creation and GDP growth rates in South Asian countries.

The regression model is given below:

$$Y = \beta 0 + \beta 1X1 + e$$

Where:

Y = GDP Growth Rate

β0 = Constant

β1 = Beta coefficients

X1= Employment Creation by Informal Economic Sector (%)

e = Error Term

Analysis and Findings

Linear Regression Analysis: In this section, we delve into the results of the inferential statistics**,** specifically focusing on the relationship between informal economy employment and GDP growth rates in South Asian developing countries**.** To determine this connection, the researcher employed a simple linear regression analysis using the statistical software SPSS 21. This analysis allowed for the calculation and evaluation of the regression coefficients and their significance levels. Key to understanding the results are the p-value, which assesses the likelihood that the observed relationship between the variables arose purely by chance. In this study, the researcher considered a significance level of 0.05, meaning that only relationships with a p-value less than 0.05 would be considered statistically significant. This implies that such relationships have a very low probability (less than 5%) of being random occurrences and are likely indicative of a genuine association between the variables.

By analyzing the calculated regression coefficients and p-values, the researcher could shed light on the strength and direction of the relationship between informal employment and GDP growth rates in the studied South Asian countries. This allows for a deeper understanding of how the informal economy may contribute to or influence the overall economic growth of these nations. Findings are presented in the following tables;

Table 3

Model Summary

Model	R	R^2	Adjusted R^2	Std. Error	Change Statistics				
					R^2 Change	F Change	Df1	Df2	Sig. F Change
1	0.810*	0.6561	0.641	1.12	0.651	12.53	1	5	0.008

a. Predictors: (Constant), Employment by Informal Economy (%)

Table 4

ANOVA Multiple Regression Analysis.*

Model		Sum of squares	df	Mean Squares	F	Sig.
1	Regression	19.72	1	18.772	13.587	0.007[b]
	Residual	6.737	6	1.308		
	Total	26.457	7			

a. Dependent changeable: Gross Domestic Product Growth Rate (%)

b. Predictors: (Constant), Employment by Informal Economy (%)

Table 5

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	1	Sig.
1	**(Constant)**	**B**	**Std. Error**	**Beta**	**-1.067**	**0.327**
		-2.011	1.967			
	Employment Creation by Informal Economic Sector (%)	0.201	0.029	0.746	3.788	0.009[b]

a. Dependent changeable: GDP Growth Rate (%)
b. Predictors: (Constant), Employment by Informal Economy (%)

Table 3, titled "Model Summary," provides crucial insights into the coefficient of determination, also known as R-squared. This value tells us how well changes in the independent variable, employment by informal economy, explain changes in the dependent variable, GDP growth rate. In simpler terms, R-squared reveals the percentage of variation in GDP growth that can be attributed to informal employment creation. In this study, the independent variable explains a substantial 65% of the variation in GDP growth across the South Asian countries studied. This implies that the remaining 35% of the variation stems from other factors not considered in this investigation.

Table 4, "ANOVA," further assesses the goodness of fit of the model. It examines the extent to which employment creation by the informal sector can explain the variance in GDP growth rates. The P-value, at 0.007, is well below the chosen significance level of 0.05. This statistically significant result confirms that the model is a good fit, and employment creation by the informal sector serves as a reliable indicator of its relationship with GDP growth in the studied South Asian countries.

In essence, these analyses highlight the strong association between informal employment and economic growth in the region. While other factors undoubtedly play a role, the study sheds light on the substantial influence the informal sector wields in boosting GDP within these developing nations.

From the above Table 5 Coefficients, the following regression function is extracted

$$Y = -2.011 + 0.201X1$$

This equation, $Y = \beta 0 + \beta 1X1$, delves deeper into the specific relationship identified in the previous section. Here, Y represents the GDP growth rate, while β0 stands for the constant value of the equation when no informal employment exists. X1, on the other hand, represents the percentage of employment creation by the informal economic sector**.**

The key elements within this equation are the beta coefficients. These coefficients estimate the change in GDP growth rate that can be attributed to a one-unit increase in the percentage of informal employment, assuming all other factors remain constant. In our case, the equation tells us that a single percentage point increase in informal employment creation leads to a 0.201 point increase in GDP growth rate. This positive relationship is further supported by the p-value of 0.007, which falls well below the chosen significance level of 0.05. This statistically significant result confirms that the observed connection between informal employment and GDP growth is unlikely to be random and suggests a genuine positive association.

Therefore, this analysis provides concrete evidence for the significant positive link between GDP growth rates and the informal economy in the South Asian developing countries studied.

Conclusion

The informal economic system plays a crucial role in the economies of developing countries. This is especially true in South Asia, where the informal sector accounts for a significant portion of total employment. This sector drives economic development by contributing to a stable GDP growth rate. However, despite its substantial contribution, the informal economy remains "undernourished," with informal businesses facing various challenges that limit their full potential. To maximize the benefits of this sector, it's essential to implement macro-level policies that support and nurture the informal economy (Asif et al., 2019; Mondol, 2017).

Historically, the agricultural sector in South Asia has largely operated informally. This was due to the exemption of the sector from labour laws and the absence of jobs perceived as "unexpected" in a modern urban-industrial setting. However, the informal paradigm became increasingly relevant in urban-industrial employment as these unexpected jobs proliferated (Amin & Sultana, 2013; Asif, 2022). For many disadvantaged individuals in developing countries, the informal economy serves as a vital source of income and livelihood. This study specifically focuses on the relationship between employment creation in the informal economy and its impact on GDP growth rates in South Asian developing countries. The findings reveal a significant positive correlation between these two factors, suggesting that the region's GDP growth is heavily dependent on the size and employment generation capacity of its informal sector.

While the informal economy currently outperforms the formal sector in these countries, it still requires greater attention from authorities to sustain its positive contributions to economic growth and development. To further elevate the region's GDP and GNP, it's crucial to address the challenges faced by the informal economy and improve the status of the workers within it.

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