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The Informal Sector in Africa -An Invisible Force with Visible Impact: Evidence from Botswana and Zimbabwe

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ABSTRACT: Domestic revenue mobilization in developing countries has gained increasing attention in policy deliberation. Many developing countries are faced with high unemployment challenges and the only remaining option is to support informal sector of the economy. This paper perused many publications on the subject of informal sector in Africa specifically Botswana and Zimbabwe. This paper has established that there are common challenges faced by SMEs in both countries that when addressed the vibrancy and impact of the sector will be visible. We concluded that governments (Botswana and Zimbabwe) must be patient about tax revenue potentials from this sector but rather develop pro-poor policy that will address its operational challenges and its visibility in a competitive world market.

KEYWORDS: informal sector, sector-driven tax model, economic sustainability, tax gap,

I. INTRODUCTION

Domestic revenue mobilization in emerging economies has gained increasing importance in policy deliberation (Braütigam, Fjeldstad & Moore, 2008; Munjeyi, 2017). This is due to the potential benefits of taxation in ensuring sustainability and ownership in the development process (Munjeyi, 2017). Governments in developing countries face great challenges in mobilising tax revenues from the growing informal sector, which results in a gap between what is due and what is actually collected.

Taxation is essential for sustainable development as it supports the basic function of a sound government and sets the framework for economic growth. In this environment governments are striving to mobilise better tax revenue domestically (Munjeyi, 2017). Many developing countries world over have renewed interest in the taxation of the informal sector on their path towards sustainable development. Mascagni, Moore and McClockey (2014) declare that tax revenue in most developing countries are below the international expected standard of above 15% of GDP, this means that governments must come up with strategies to improve tax revenue through the incorporation of informal sector into the tax net.

Generally, the issue of whether to collect tax revenue from the informal sector has been in the forefront of the debate in developing countries over few years. The controversy has been premised on whether taxing the informal sector should, in fact, be a major primacy for developing country governments, with the revelation that the potential revenue yields are low, administrative costs are high, tax incidence which is likely to be regressive, and the broader growth and governance gains remain without firm evidence (Joshi et al, 2012). However there

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are more indirect benefits of informal sector taxation in relation to economic growth, equity, tax morale, and governance among others (Masairambi, 2013).

Extant literature show that worldwide, the informal sector activities made an estimated revenue of around US\$10 trillion in 2013 (Schneider, 2013) and in Zimbabwe, the informal sector's income has been estimated at US\$7.4 billion and employed 5.7 million (Fin Mart, 2012). Joshi *et al.* (2014:1325) affirm that informal sector represents a potentially significant source of tax revenue for a cash-strapped government thus taxing the informal sector is vital to sustain tax morale and tax compliance among firms in the formal sector. These assertions suggest that ignoring the collection of tax revenue from this sector will trigger serious operational problems for the government and increase the tax burden on a few compliant taxpayers in a bid to raise the much needed tax revenue (CAGE2013; Dalu, Maposa, Dalu, & Pabwaungana, 2014).

Recent researchers reveal that there informal sector is potential tax revenue in the growing informal sector in developing countries (Masairambi 2013; Kedir 2014), and thus taxing this sector will increase the national tax revenue and enhance the economic development of a country (Pfister 2009; John 2010; Ohaka & Zukbee 2015). Taxing of informal sector is a method of state-engagement and thus encouraging lawfulness, supremacy, and political accountability (Joshi, Prichards and Heady 2014). According to World Bank estimates, the informal sector accounts for 40% of GNP of low-income countries (Yadav, 2009). Despite the significant contribution of the informal sector to the economies of developing countries, they are the least taxed. This implies that there is indeed a significant amount of money that goes untaxed in the informal sector and this poses a threat to the stabilization of the economy (Zimra: 2009).

Although Botswana recognise the importance of informal sector growth but still has not establish an effective system to measure it and tax this giant sector (The Sunday Standard, 2018). Zimbabwe's tax legislation have been perceived as not adequately covering the informal sector thereby placing tax burden on few companies still functional. This will have a detrimental impact on taxpayer's willingness to comply voluntarily (Yesegat and Fjeldstad, 2016). AFRODAD (2011) concludes that in Zimbabwe, not much progress have been made to bring the informal sector into the tax net. Literature shows that there is little known about government's commitment to informal sector tax reform (Joshi et al. 2014). The remaining issue is about how to achieve meaningful improvements in as far as the taxation of the informal sector is concerned as progress in implementation has been slow. The development of effective strategies to expand the tax base in the informal sector in an efficient and equitable one is therefore both an issue of revenue and justice.

This paper aims at comparing the informal sector in Botswana and Zimbabwe with the objective of informing policies on the best strategies to strengthen and harness revenue from this giant sector

II. OVERVIEW OF INFORMAL SECTOR AND TAXATION

Several scholars elucidate on the definition of informal sector Klinglmair, (2004); Masairambi (2013); Chen, 2012; Kedir (2014); Medina & Schneider, (2017); Yesegat and Fjeldstad, (2016); Tanzania Revenue Authority (TRA) (2010); Dalu *et al* (2014); Alabede (2012); John (2010). This paper defines informal sector as economic activities (of a legal nature) that is hidden from revenue authorities.

Literature spells out the causes of the proliferation of the informal sector in the world include: monetary (taxes and social security contributions), regulatory (avoiding government bureaucracy or regulatory burden) and institutional (corruption law, quality of political institution and weak rule of law) (The Sunday Standard, 2018; CAGE, 2013; Dalu, Maposa, Dalu, & Pabwaungana, 2014). However, these institutional factors range from one country to another (Klinglmair, 2004). There is little doubt that informal sector contributes heavily to the national economy through employment creation (Mwobobia, 2012), poverty eradication (Sparks & Barnett, 2010; Mwobobia, 2012), income redistribution (CAGE, 2013), moulding skills for young people (nursery for entrepreneurs in both developing and developed countries) (Masagni, Moore and McCluckey 2014; FinMart, 2012; Yadav, 2009) and drivers of industrialisation (Mwobobia, 2012). Scores of researchers reveal that informal

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sector is visible in both developing and developed countries (Pfister, 2009; John, 2010; Ohaka & Zukbee, 2015). 10 to 20% of the global output in developed countries is estimated to be from the simmering informal sector with nearly a third of global output from developing countries (Benjamin & Beegle, 2014).

Reviewed literature shows that informal sector (commonly referred to as underground economy) in a period of 15 years 1991 through 2015 was 32.5% of official GDP, which was previously 34.82% in 1991. Medina and Schneider (2017) show that in 2015 the informal sector dropped to 30.66%. The authors reveal that the lowest record of informal sector was reported in East Asia averaged at 16.77% followed by OECD member countries 18.7%. They pointed out that the highest informal sector was found in Africa with value above 35%. (Medina & Schneider, 2017). Similar studies reveal that in Botswana, Kenya and Zimbabwe most informal sector activities consist of the entrepreneur (Haan (2006) cited in Benjamin & Beegle, 2014). They concluded that similar patterns cut across the globe.

Literature points out that informal sector in Africa play a pivotal role in employment creation and poverty eradication (Munjezi, 2017; Njaya, 2015). Klinglmair (2004) observed that ordinarily the shadow economy was 13.2% in 21 OECD countries investigated for the period 1989/90 and it rose to 16.4% in the year 2002/2003. However, a significant change was marked in 2003 in which Belgium recorded a -1% (22.5% to 21.5%), Denmark -0.8%, Italy -1.1% and Finland -1.3% between period 1997/98 and 2002/2003 or for from 27.3% (1997/98) to 26.2% (2002/2003) (Klinglmair, 2004). Austria and Germany also show a significant increase between 1997 and 2003 with +1.8% and +1.9% respectively (Ibid). Recent study conducted in Africa reveals that the largest informal was found in Zimbabwe (69.1%), with Nigeria (56.7%) sits on second place (Medina & Schneider, 2017). Botswana and Namibia show a lowest informal sector in Africa, 30 and 28 respectively in Africa (Medina & Schneider, 2017; The Sunday Standard, 2018). Medina & Schneider (2017) indicate that Zimbabwe (60.6%) is the world second largest informal sector with highest being reported in Bolivia 62.3 percent of GDP.

In both countries, Zimbabwe and Botswana, informal sector activities are hindered by lack of finances, inadequate infrastructure (premises), high finance costs, which exacerbate the cost of imported raw material inputs; longer liability terms and unhealthy financial status; banks that are risk-averse and prefer to lend at favourable rates only to firms that appear to be more financially viable; high collateral requirements for most commercial banks; lack of credit history. poor access to credit, lack of training, primitive skills, lack of security, managerial incompetence and competition (Sparks & Barnett, 2010, Mwobobia, 2012; Murimoga & Musingafi, 2014).

These problems facing the informal sector are universal. Addressing these challenges and others will make this sector more visible and vibrant (FinMart, (2012). Literature suggests that policymakers in developing countries need to recognise the importance of informal sector and hence support it (Sparks & Barnett, 2010). Several recommendations have been made to strengthen this simmering sector and include: establish an enabling environment and supportive regulatory framework provide access to appropriate training, improve basic facilities and amenities and infrastructure, increase ability to obtain property right and access to credit, improve national data base and establish uniform standards (Sparks & Barnett, 2010, Mwobobia, 2012).

Literature points out that formal employment creation is a challenge in most developing countries, Botswana (unemployment rate 17.6% (Mwobobia, 2012) and Zimbabwe (90% (BBC News, 2017, eNCA News, 2017) inclusive. The government of Botswana has accepted the reality that informal sector is real and is steadily growing due to the fact that the government is failing to provide much needed employment (The Sunday Standard, 2018). The issue of the informal sector is also highlighted in NDP10 (2009/2010-2015/2016). Here the government of Botswana recognizes the informal sector as one of the sectors that provides the much-needed self-employment though the conditions of work are unsatisfactory (NDP 10 2010: 156). Since the collapse of the formal economy in the mid- to late 2000s, Zimbabwe's informal sector has become the lifeblood of the economy, providing livelihoods to many unemployed Zimbabweans who lost jobs in the formal sector.

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Zimbabwe has the fastest growing informal sector in the Southern African Development Community (SADC) (Zimstat Survey: 2012).

Botswana government viewed informal sector as an additional avenue to create jobs for Batswana (The Sunday Standard, 2018). According to Mwobobia (2012), Botswana government empowered its citizen who participated in the informal sector by availing the following schemes; Citizen Entrepreneurial Development Agency (CEDA), Local Enterprise Authority (LEA), Youth Grant Fund (YGF), e-innovation Youth Empowerment Programme (e-YEP) and Young farmers ceda fund. Botswana government stride hard to strengthen this young promising sector by offering training, mentoring and advisory services, identifying business opportunities for existing and future SMMEs, promoting domestic and international linkages, facilitating access to markets, facilitating access to finance, facilitating technology adoption and diffusion and promoting general entrepreneurship and SMME awareness (Mwobobia, 2012: 98).

Mwobobia (2012: 95) summarises some of the hiccups faced by the government of Botswana pursuing its mandate to strengthen informal sector (SMEs):

- (a) High default rate;
- (b) Failure to put in place materials and equipment for start-up SMEs;
- (c) Challenges in Monitoring and Evaluating business performance;
- (d) Weak linkages among major stakeholders;
- (e) The global recession affects business operation which eventually;
- (f) Abuse of programme funds by individuals (people buy cars and houses for their own benefits)
- (g) Poor coordination by different stakeholders;
- (h) Lack of experienced trainers in the fields from LEA, CEDA
- (i) The clientele database for LEA is so wide so much that LEA has no capacity to serve them
- (j) Lack of entrepreneurship spirit, the business dies once the owner got sponsorship or scholarship

The growth of the informal sector holds the potential for employment, greater local manufacturing, quality service delivery and eventually more tax revenue collection leading to more national tax revenue (Tanzania Revenue Authority (TRA), 2010; Colins&Brou, 2001). In Zimbabwe, the reality is that the growing informal sector has not yet significantly contributed to tax revenues. Thus taxing the ballooning informal sector presents the opportunity of revenue generation to fill the gap in the tax revenue. This will also increase the visibility of the informal sector in national programmes and in the economy (Africa Tax Spotlight, 2012; CAGE, 2013). Taxing the informal sector will improve revenue collection, growth and governance, enhance productivity, the provision of infrastructure, public education and health care, tax morale, redistribution of income and wealth and (political) representation as well as provide an interface between the government and the stakeholders (Aranjo-Bonjean *et al*, 2003; Gobham, 2005; Myles, 2007; Africa Tax Spotlight, 2012). Pfister (2009: 4) notes:

African governments aim to use taxation to:

- Finance their social and physical infrastructure needs;
- Provide a stable and predictable fiscal environment to promote economic growth and investment;
- Promote good governance and accountability by strengthening the relationship between government and citizens; and
- Ensure that the costs and benefits of development are fairly shared

Bairagya (2011) argues that the government should tax the informal sector to increase the tax yield of government, hence improved service delivery and governance. In his remarks, Bairagya (2011) asserts that the over-protection of this sector as a special category and in particular, the so-called inability to pay taxes and conform to other regulations, has an adverse effect on the economy at large. In this regard, policy makers must view the informal sector as the hub of development that will stimulate economic growth and improve the gross domestic product of a country.

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Although there are challenges in taxing this informal sector, ranging from underreporting of taxable income, the lack of authority and mechanisms to monitor the activities of the informal sector, the informal sector not being registered and taxation ethics, which lead to the budget deficit (Dalu et al., 2014; Alabede, 2012; Zimra, 2010) the exercise has to be carried out. The fact that informal sector players are unregistered and unrecognized and are engaged in illicit activities makes it difficult to tax them (Martinez-Vazquez, Parupong&Timofeer, 2009).

Compliance by informal sector players is a function of the perceived quality of tax services (Alabede, 2010). Tax payers in the informal sector will judge the quality of services they will receive in terms of their expectations (Oliver, 1980). In this regard, if taxpayers perceive that their expectation is met by the quality of service, their compliance rate is high and if not, their compliance rate is low. Generally, service delivery in Zimbabwe is poor (Murimoga&Musungafi, 2014) and taxpayers are unwilling to comply. In this light, for informal sector operators, the choice of whether or not to pay taxes is a function of cost-benefit analysis of the practice (Pfister 2009).

Many countries in Africa attempted to create some institutional space to harness this sector; Tanzania has introduced a *Block Management System* aimed at identifying potentially taxable firms and creating a culture of paying tax. The governments of Rwanda and Cameroon have focused on improving the quality of service delivery and Ghana initiated negotiations with the informal sector to facilitate positive compliance (Africa Tax Spotlight, 2012). Ghana adopted a number of strategies and methods in trying to rope in the informal sector and include standard assessment on individuals or businesses, occupational grouping taxation (which failed due to massive corruption and political factors) and tax stamp (Ofori, 2009). Phiri (2013) concludes that revenue from the informal sector, as a proportion of total tax revenue income has relatively been low and poor.

Zimbabwe has introduced presumptive tax legislation to broaden the tax revenue base in view of the ever-growing informal sector (ZIMRA 2009) but the revenue collected from this sector is insignificant and contributes 3% of the total revenue (John, 2010). Non-registered operators for tax purposes are required to pay presumptive taxes. Presumptive taxation is the indirect means of ascertaining an individual's tax liability and it differs from general rules based on the taxpayer's account records (Deloitte 2011, Tax Bulletin Zimbabwe, 2014, Masarirambi, 2014) and is usually used when the desired income cannot be reasonably determined (Zivanai, Manyani, Hove, Chiriseri, & Mudzura, 2014). The term presumptive implies that there is a legal assumption that the taxpayer's income is no less than the amount resulting from application of indirect methods (Masarirambi, 2014; Samuel, 2011). The objective of imposing presumptive tax is to simplify administration process, collect some revenue from the hard-to-tax sector, improves tax assessment, reduces tax evasion and avoidance and educating the informal sector players on tax issues with the aim of integrating them into a formal tax system (Samuel, 2011). The introduction of presumptive tax by ZIMRA was to tax the informal sector operators that remain outside the tax net (Zivanai et al., 2014). According to Zivanai et al. (2014), the major weakness of presumptive tax is that it lacks a clear plan to facilitate taxpayers to shift to a more formal system and taxpayers would still dodge presumptive tax. This means that taxpayers will remain informal and small to avoid normal tax.

Extant literature shows that the implementation of presumptive tax is not effective as it leaves out a number of informal sector activities and many are still outside the tax net due to one of the following reasons: ignorance of tax head, lack of follow ups by Zimra and non-participation by informal sector players in setting of tax rates (Utamire, Mashiri&Mazhindu, 2013). The presumptive tax has not achieved the desired results as statistics show that presumptive tax head is contributing only 3% to total tax revenue against its 60% contribution to gross domestic product, despite various attempts (Ofori, 2009, Utamire et al., 2013). In this light, the presumptive tax should contribute more compared to other forms of tax.

III. METHODOLOGY

We reviewed journal articles, publications and other public media to gather data about informal sector.

1. Findings, Conclusion and Recommendations

We compared some topical issues that culminate informal sector growth and development. We therefore presented our findings as follows:

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Issue	Botswana	Zimbabwe
Taxes	In Botswana no tax framework to collect tax from the informal sector.	Collect presumptive taxes from informal sector
Local Government Authority,	No interference of Local Authority in the day to day activities of informal sector	Harassment, confiscation of wares by council police,
Tax Authority Interference	Observe the growth	Advocates for the formalisation (registration) of informal sector
Political Will	Policymakers support the growth of informal sector as it is seen as the additional avenue for the creation of the employment	Politicians are capitalising on the huge informal sector to pursue their political agenda (VoteBank)(Munjeyi, 2017)
Institutional support	Informal sector in Botswana receive various forms of institutional support from government and non-state actors, ranging from the provision of entrepreneurial development support, an enabling business environment, financial institutional support and export promotion, all the way to targeted sectoral development (BIDPA, 2007) e.g. from such schemes to strengthen and finance the informal sector, LED and CEDA, YGF, e-YEP etc.	Government of Zimbabwe rolled out Small a Development Cooperation (SEDCO), and establish a Ministry for SMEs, in order to assist small business and upcoming entrepreneurs financially and intellectually (Masarirambi 2013).
Education Level	A handful of educated people are participating in the informal and exit once they obtain scholarships, however the majority receive only lower levels of education	The informal sector in Zimbabwe comprise; (i) highly educated (Master degree holders) running FleaMarket, Selling Second hand clothes, consultancy; offering extra lessons conducted in a professional way (ii) Average educated (Bachelor degree; diploma, and certificates holders) (iii)The less educated but literate (with good understanding of maths and English language)(Munjeyi, 2017)
Law enforcement Agent (Police)	Informal sector is at peace with Law enforcement with	Always at war with Informal Sector (vendors, Kombis

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	exceptional cases of money changer raids reported at Bus Rank in 2017 and or when illegality trading is suspected	drivers, Carpenters, FleaMarket)
Participation in the informal sector	Both Men and Women participate in all sectors.	Both Men and women. However petty trading (cooking <i>sadza</i> / <i>parichi</i> / <i>poridge</i> is associated with female informal traders, men dominated in carpentry, building, welding, money changers, pirating etc.
Causes	Institutional factors. Botswana is not doing badly in terms of its burden of government regulations compared to other countries in the SADC and is ranked 26 out of 117 - In Botswana the government is encourage people to create employment through entrepreneurship	Taxes and regulatory burden (AFRODAD, 2012, Munjeji, 2017). Zimbabwe is ranked 100 in terms of its burden of government regulations. - The majority of people have been pushed into this sector for survival in respond to failure of government to provide/ create employment and high cost of living
Competition	Informal sector in Botswana are subject to both domestic and foreign competition, in particular competition from imports from South Africa, China (BIPDA, 2007)	Stiff competition from imports from South Africa, Zambia, Mozambique, Dubai as well as the globe at large (through internet) (FinMart, 2012).
Access to Finance	Market interests rates charged bank rates and the subsidised interest rates charged by CEDA are seen as the most deterrent factor for informal firms access funding (BIPDA, 2007)	Need of collateral security is the most deterrent factor. The proliferation of microfinance eased this problem however they charge high interest rates (Dube , 2014)
Major constraints	High finance costs, which exacerbate the cost of imported raw material inputs; Longer liability terms and unhealthy financial status; Banks that are risk-averse and prefer to lend at favourable rates only to firms that appear to be more financially viable; High collateral requirements for most commercial banks; and lack of credit history.	High finance costs, which exacerbate the cost of imported raw material inputs; Longer liability terms and unhealthy financial status; Banks that are risk-averse and prefer to lend at favourable rates only to firms that appear to be more financially viable; High collateral requirements for most commercial banks; and lack of credit history.
Contribution to Employment	Data on SMEs in Botswana is not available. However, the IMF indicated that in Botswana (1998) SMMEs employed	Data on SMEs in Zimbabwe is not available. However, recent data from IMF indicated that informal sector

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	125,000 people including business owners, (BIPDA, 2007) and contributed 30.3 % to GDP (Medina and Schneider, 2017)	employed up to 90% of the 6.6 Million people including business owners, (about 5.7 million (Fin Mart, 2012) and contributed 69 % to GDP (Medina and Schneider, 2017)
Interest Spread	Botswana 16.21(lending rate%) 9.95(Deposit rate %) and 6.26 (Interest rate spread %) (BIPDA, 2007)	Zimbabwe 278.92 (lending rate%) 103.21 (Deposit rate %) and 175.71 (Interest rate spread %), BIPDA, 2007)
Starting a Business	Botswana is among the highest, in terms of the number of days and costs incurred, to start a business e.g. 11(Number of Procedures), 108 (Time in days), 475 (cost US\$)	10 (Number of Procedures), 96 (Time in days), 97 (cost US\$)

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From the above we conclude that the challenges faced by Botswana and Zimbabwe's informal sector are the same and that these two countries must fully rally behind informal sector as they represent a potential contributor to the economy through employment creation.

We strongly recommend that the two countries must develop pro-poor policies to enhance vibrancy and visibility of this promising sector. They (Botswana and Zimbabwe) must draw lessons from Japan, Britain in terms of SMEs support and development who are doing better.

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