

**INFORMAL ECONOMY, WAGE GOODS AND THE
CHANGING PATTERNS OF ACCUMULATION
UNDER STRUCTURAL ADJUSTMENT**

**Theoretical Reflections Based on the
Tanzanian Experience**

By Prof Marc Wuyts

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LIST OF ABBREVIATIONS

- CIS - Commodity Import Support**
- ESR - Economic and Social Research Foundation**
- GDP - Gross Domestic Product**
- ILO - International Labour Organization**
- OGL - Open General License**
- TBC - The Business Centre**
- UNDP - United Nations Development Programme**
- URT - United Republic of Tanzania**

PREFACE

This paper draws upon two sources. First, it is based upon a (selective) literature study of writings on Tanzanian development in recent decades. Second, the paper contains my reflections on a set of recent research studies carried out by the Economic and Social Research Foundation (ESRF), based in Dar es Salaam, the former of which contain novel data and provide a fertile ground for generating hypotheses on the nature of development under structural adjustment in Tanzania. I am greatly indebted to Professor Samuel Wangwe, Executive Director of ESRF, for giving me the opportunity to pay a research visit to ESRF in August 1997, providing me with its recent research publications and materials, and for reading, commenting and discussing various tentative ideas worked out in this paper. I am also indebted to Dr. Haji Hatibu Semboja on the valuable discussion on recent developments within the Tanzanian manufacturing industry. More generally, I thank ESRF staff for the hospitality I enjoyed, the assistance they rendered, and for their patience and time in assisting me during my stay. Let me add, however, that the views expressed here and the errors or inadequacies they may contain are entirely my own, and not those of ESRF. I also thank Prof. Benno Ndulu and Bridget O'Laughlin for incisive comments on earlier drafts.

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1.0 INTRODUCTION

Structural adjustment policies sought to effect a radical change in the policy regime prevalent within Tanzania with the explicit aim of changing the nature of economic development, away from a more inward-looking state-led process of import substituting industrialization, and towards export-led growth based upon private initiative propelled by market forces rather than state intervention. Much of the discussion about structural adjustment tends to concentrate on the conduct—on how much liberalization, deregulation, privatization, and restructuring actually took place (Amsden, 1997a: 477); on the pace at, or sequence in which reforms took place or should have taken place; or on the extent to which certain performance indicators (such as GDP growth, export growth, export diversification and the rate of inflation) point at the success or failure of intended outcomes. This paper instead focuses on the changing *processes* of accumulation under structural adjustment.

Most analysts of Tanzania's economic development agree that the period of economic reforms under structural adjustment heralded a radical break with the past. There is, however, much less clarity on the direction of development inherent in present-day economic policies: that is, whether it constitutes an unguided (or perhaps, misguided) missile as far as the potential for future sustained economic growth is concerned, or whether it lays sound foundations for such a growth process. It is clear, however, that outcomes are as yet far from certain and the relevant data are rather thin on the ground, particularly as far as the nature of development of the *second economy* (or informal economy) is concerned. Yet much of the debate about the nature of recent economic developments in Tanzania concerns the supposed dynamism, or lack thereof, of the second economy (which, by its nature, is not very visible as far as official statistics are concerned) on which the livelihoods of Tanzanian households, both rural and urban, came increasingly to depend on. A key question is whether the increased reliance of Tanzanian households on multiple and mutually reinforcing income generating sources, both formal and informal, is no more than a defense mechanism to alleviate poverty in a context of secular decline or whether it is a manifestation of a different growth momentum, with or without much potential for sustained development (Maliyamkono & Bagachwa, 1990; Sarris & Van Den Brink, 1993; Jamal & Weeks, 1993).

Notwithstanding this increased emphasis on the importance of understanding the second economy, surprisingly little attention has been paid, however, to the nature of the *processes* which propel the forms of production which arise within this second economy, to their interactions and tensions with the development of the formal economy, and, to the way they are shaped by public policy and by the use of public money, including foreign aid. Furthermore, the question of the nature of the labour regimes which underscore the development of this second economy is seldom addressed, often leaving the impression that this sector mainly consists of an amorphous mass of self-employed producers.

This paper seeks to develop some theoretical propositions concerning the nature of the processes of accumulation which propel the development of the informal economy under structural adjustment. The analysis concerns theoretical reflections on the Tanzanian experience, but is deemed to be of wider relevance for other similar experiences in Africa, although the precise

mechanisms at work are likely to differ depending upon concrete circumstances and historical specificity. This paper is essentially theoretical in nature and only makes reference to empirical evidence insofar as the latter served as a stepping stone to the making of theoretical inferences.

In a recent article, Amsden (1997a) argues that mainstream economic theory tends to emphasize markets at the neglect of production. Economic development, she argues, entails the social (public & private) construction of competitive assets at the micro level,¹ while periods of intense policy change, often induced by crisis, invariably entail the (partial) dismantling of "old" social constructions and, possibly but not inevitably, may give rise to the emergence of a new social construction of competitive assets necessary for the resumption of economic growth. This argument serves as a useful starting point to look at processes of change under structural adjustment in Tanzania, in general, and at the role the second economy plays in reshaping the social construction of competitive assets, in particular, and the nature of economic growth to which it gives rise. But the argument also needs both further elaboration and qualification.

First, it needs elaboration since the social construction of competitive assets is a dynamic process in nature and, hence, inevitably involves *processes of accumulation*. Amsden does not stress the importance of analysing the character of accumulation; however, her analysis points out that these processes cannot be analysed only at the level of macro aggregates, that an analysis of how macro policy and processes shape micro assets and behaviour is also required, the success or failure of which, in turn, affects the room for manoeuvre and reveals the constraints which operate at the macro level. Second, shifting the emphasis back towards production should not lead to the ignoring of markets. On the contrary, the emergence of a new social construction of competitive assets also implies the *making of markets* within economic restructuring—a point which Amsden does not sufficiently address. The character of production, therefore, is not independent from the nature of markets within which it is embedded.

These elements together make up the framework of analysis used in this paper to look at the dynamics of the second economy under structural adjustment in Tanzania. Section II takes a critical look at some key contrasting views encountered in the literature on the functioning of the second economy in Tanzania. It shows that, in general, most of the analysis of the second economy reveals a strong preoccupation with measuring its size and with assessing its importance in terms of household welfare and survival. Less attention is given to the nature of accumulation within the second economy and to its potential for growth. Two views, however, are of specific importance to the argument in this paper. First, there is the analysis put forward by Jamal and Weeks (1993) who depict the informal economy as dependent (*in Keynesian fashion*) on the demand emanating from wage employment in the formal economy, and, hence, the growth, decline and fluctuations in the latter will dictate the plight of the former. In sharp contrast, Sarris and Van Den Brink (1993) picture an export-led and (*in Keynesian fashion*) demand-constrained second economy which exists side by side and independent from the formal (official) economy which is assumed to be supply-constrained. They argue that, in fact, the second economy never witnessed a crisis similar to that experienced in the official economy and, hence, that the Tanzanian economy in general 'fared much better than has been thought' (57). This section concludes that both these views lack a clear conceptualization of the nature of capital accumulation in informal sector development.

Section III, which constitutes the core of this paper, seeks to develop a theory of accumulation in the informal sector under structural adjustment. It argues that the fact that production within the informal sector is largely labour intensive does not mean that capital accumulation in this sector is absent, or can be ignored (as both Jamal & Weeks, 1993, and Sarris and Van Den Brink, 1993, tend to do). Instead this paper argues that capital accumulation in the informal sector can best be depicted in a Ricardian fashion of *capital as a wage fund*, implying that the expansion of the wage fund brings in its wake the growth in demand for *wage goods* either produced at home (in the formal or informal sectors) or imported. It then argues that the competitiveness of (certain sectors of) informal sector production mainly depends on the nature of the labour regimes (and the flexibility of labour markets to which they give rise), on the one hand, and on the cheapening of wage goods, on the other. The former, the more flexible labour regimes, explains why households came to depend increasingly on multiple sources of income generation, both formal and informal. The latter, the cheapening of wage goods, came about by the increased reliance on the importation of cheap consumer goods, financed initially by the own-funded import scheme and subsequently also by foreign aid (in particular, balance of payment support).

In the concluding section, the paper investigates the implications of the dynamics of the informal sector for formal sector industrial production, in general, and manufacturing production of consumer goods, in particular. On the one hand, an important aspect of accumulation in the informal sector is that its competitiveness (abroad and in the home market) is enhanced by the importation of cheap wage goods which in part is financed by (and, hence, dependent upon) foreign aid. On the other hand, this switch towards imports goes at the expense of the de-industrialization of the local manufacturing industry, particularly that producing wage goods. Import liberalization, therefore, stimulated informal sector development, but prompts the domestic manufacturing industry to seek protection. The section concludes that the challenge to domestic manufacturing industry may well be to develop capabilities in the production of cheap consumer goods to overcome its tension with informal sector production and reduce the import dependence of the latter.

2.0 CONTRASTING VIEWS ON THE FUNCTIONING OF THE SECOND ECONOMY

2.1 *Prelude*

During the 1960s and 1970s there was relatively little explicit analysis of, or debate on the nature of the so-called second economy in Tanzania. The period from the late 1960s to the crisis of the early 1980s was characterised by a state-led aid-propelled process of import substituting industrialization and basic needs provisioning. The underlying model of development was not exceptional, but largely rooted in the literature on economic development of the 1950s, 1960s and early 1970s. More specifically, development was to take place within a Lewis-type process of industrialization (through import substitution) based upon the expansion of wage employment in industry, services and larger scale agriculture within a dual economy framework in which the peasantry, characterized by a surplus population, supplied cash and food crops as well as migrants into formal employment. The informal sector was seen to constitute a shock absorber and a temporary (or perhaps, probabilistic) abode between rural out-migration and formal employment in industry and services. The economy, therefore, was depicted as consisting of three sectors: agriculture, formal sector, and urban informal sector (Jamal & Weeks, 1993:30). In the tradition of two-gap models, aid as investment support was seen to promote the economic growth of the formal sector by augmenting the available savings and relieving the foreign exchange constraint. Finally, there was a strong belief in the capacity of the state to direct development and to compensate for market failures.

In reality, however, the key mechanisms at work during this period led to mounting tensions and subsequently to crisis, within the process of accumulation based upon this model. The process entailed a vicious circle which depended largely on the way public and private action interacted, and particularly on how public action, including the use of foreign aid (as public money), affected the dynamics of production in general, and the interaction between agriculture (and, within it between cash and food crop production) and industry in particular (Doriye and Wuyts, 1992; Wuyts, 1994). One manifestation of these tensions was the emergence of the parallel economy: the growing prevalence of production and exchange (domestic as well as exports and imports) which by-passed the official channels and operated at prices well above the official levels. This growth of the parallel economy eroded the capacity of the state to direct the economy and, consequently, was perceived as obstructing the normal development of modern economic structures and, as such, was undesirable. (Maliyamkono & Bagachwa, 1990: 30).

Hence, in the 1970s and the early 1980s, two concepts of the second economy existed side by side: the concept of the informal economy, on the one hand, and that of the parallel economy, on the other. As the economic crisis deepened and widened during the late 1970s and the early 1980s, however, and real wages in formal employment started their secular decline (a phenomena which was to continue during the period of economic reforms from the mid-1980s onwards), the notion that development was to be based upon the expansion of formal sector employment where households depended on one or more wage earners in formal employment to secure their livelihoods became increasingly more questionable in theory, and less viable in practice. Instead, households came to rely increasingly on multiple sources of income generation, both formal and informal, official or parallel (Maliyamkono & Bagachwa, 1990).

2.2 *The Informal Versus the Parallel Economy*

It is then not surprising that, from the 1980s onwards, the "second economy" came to occupy a more prominent position within economic debate and analysis. The first major contribution by Maliyamkono and Bagachwa (1990) proceeded to analyse the functioning of the second economy by contrasting two hypotheses which reflect the above mentioned dichotomy between the second economy as the informal economy and as the parallel economy. One hypothesis, they argue:

... points to its [= the second economy] dysfunctional aspects by postulating that the existence of the second economy is necessarily antipathetic to the healthy development of modern economic and social service structures. This view emanates from the belief that the second economy activities represent departures from established social norms or equilibrium. (30)

Hence, this hypothesis asserts that, rather than contributing to economic development, the second economy effectively detracts from it. The alternative hypothesis, they argue:

... regards the various institutions harbouring the second economy activities as fulfilling, at least in part, positive functions which are not adequately fulfilled by existing social and economic structures. ... According to this view the second economy is not a pathological fact but rather a kind of 'nature's revôlt', a sort of healthy reaction to the pathology of the state. (33)

While the former view was shared by the Tanzanian government up until the mid-1980s, the latter view was undoubtedly more in tune with the new spirit of the 1980s which identified government failure, rather than market failure, as a major obstacle to development. 'Nature' in this context refers to social and market forces which, although hampered by government interference, seek to work towards societal harmony or equilibrium (33).

These two hypotheses on the nature of the second economy, rather than constituting competing explanations, in fact reflect different sides of a more complex reality which came to be referred to as the second (or hidden) economy. Common to both is that these activities tend to fall outside the range of official statistics, and hence are at best only partially recorded in national income accounting. On the one hand, there is the informal sector proper which consists of a multitude of 'small-scale producers and their employees, together with the self-employed working in the production of goods, plus those engaged in commerce, transport and the provision of services' (Thomas, 1992:4). In the Tanzanian context, these activities generally do not include peasant production of food or export (cash) crops, but they do include small-scale rural off-farm production, commerce, transport and services, apart from urban small-scale activities. On the other hand, there are what Thomas (1993: 4) refers to as 'irregular' activities which all involve some illegality, such as tax evasion or the avoidance of regulations (for example, minimum wage and employment legislation). While the form of most of these goods and services is perfectly legal, their production and/or distribution involves some illegality (Thomas, 1992: 4) inasmuch as they, as Maliyamkono and Bagachwa (1990, 33) put it, represent departures from established social norms or equilibrium.

The key purpose of the book clearly consisted in convincing policy makers that, while certain elements may be socially or economically harmful, the greater part of the activities of the second economy constitute a potential asset for economic development (32). At the analytical level

therefore, the main concerns of the book were to argue first, that the second economy is sizeable and, hence, cannot be ignored, and second, that the livelihoods of a majority of the population depend on its existence. They argued, therefore, for a more 'laissez faire' policy towards the informal sector, given its importance, both in its size and as a key component in sustaining livelihoods.

Both these issues are undoubtedly important and the analysis of Maliangkou and Bagachwa (1990), has contributed greatly towards making the second economy more visible and highlighting its importance in terms of sustaining livelihoods of households. In fact, much of the subsequent analysis of the second economy followed these emphases set out by both authors. But the strengths of their arguments also points at the very weaknesses of the latter. The preoccupation with the size of the second economy made that their analysis became focused on *measurement*, and, hence, deflected attention way from process. And, similarly, the emphasis on the importance of the second economy for household survival and poverty alleviation deflected attention away from the nature of its underlying processes of accumulation and its potential for fuelling a resumption of growth. In other words, their analysis was essentially static in nature and short term in outlook.

These shortcomings are particularly prevalent in the last chapter of the book which supposedly deals with the "dynamics" of the informal economy. In fact, the chapter presents an argument about the "pervasiveness" of the second economy rather than its dynamics, the only point about dynamics being that the second economy has become more pervasive. But there is relatively little discussion of what propels (and possibly impedes?) the growth of this pervasiveness. Insofar as the authors deal with this question, however, there is a peculiar paradox in their argument. As shown above, the book warns against treating the second economy as an aberration of economic development and points towards its potential for development. But as the argument unfolds, the prime (and valid) reason given for this potential is that it secures household survival and alleviates poverty, without much reference to its longer run dynamics. In the concluding sections of the book, the authors then argue that the second economy is bound to linger on for quite some time because of the long gestation period before the intended benefits of the economic reforms are likely to emerge in the formal sector (137). But this suggests that the second economy is an aberration after all, a growing pervasiveness by default (because of the delay in formal sector development), be it for most part benign (and legal) and necessary in terms of household survival and poverty alleviation, but without much potential for propelling new patterns of growth. Indeed, in their final conclusion, the authors argue that 'sustained economic recovery is a prerequisite to the reduction in the volume of illegitimate economic activity' (138). But this still leaves the question unaddressed whether, using Amsden's (1977a) terminology, the growing pervasiveness of the second economy can in any way contribute towards a new social construction of competitive assets necessary for the resumption of economic growth.

Subsequent writings on the second economy tended to follow the dual emphasis on the measurement of the size of the second economy, on the one hand, and on survival and poverty alleviation, on the other. But more attention came to be devoted to an analysis of the mechanics underlying the dynamics of the second economy. This is particularly the case in the works of Sarris & Van Den Brink (1993) and of Jamal & Weeks (1993) both of which use a *Keynesian* framework in analyzing the behaviour of the second economy, but arrive at widely divergent views on the functioning of the second economy. Table 1 summarizes the key points of each of

these approaches in terms of their respective assumptions about the functioning of the second economy

Table 1: Two Views on the Mechanics of the Second Economy

1. Basic Assumptions	
<p>While the official economy is assumed to be supply-constrained, the second (unofficial) economy is demand constrained.</p> <p><i>The methodology which we shall term the "missing income" methodology, starts by assuming that second economy GDP is not supply-constrained as total economy GDP or official GDP would be (Ndulu 1988; Lipumba et.al. 1988), but instead adjusts to satisfy demand for it, much as in the Keynesian economic model. (50)</i></p>	<p>The informal economy is demand constrained in its production of basic consumer goods in response to the demand originating from (wage) income in the formal economy.</p> <p><i>The primary impact of falling real wages is to depress consumer demand for food crops, formal sector commodities and informal goods and services. With urban wage employment down and rural monetary incomes down, the demand for urban informal activities falls. (131)</i></p> <p><i>... that manufacturing in SSA countries is to a great extent directed at an elite market and that most rural consumption items are produced in the informal sector (33).</i></p>
2. The Models*, **	
<p>Let,</p> $Y_u = C_u + E_u - M_u \quad [1]$ $C_u = C_u(Y_u) \quad [2]$ $M_u = M_u(Y_u) \quad [3]$ <p>taking the total differential yields the following multiplier,</p> <div style="border: 1px solid black; padding: 5px; display: inline-block;"> $dY_u = \frac{dE_u}{1 - \alpha + \mu}$ </div> <p style="margin-left: 20px;">where, α = marginal propensity to consume μ = marginal propensity to import (both for the second economy).</p>	<p>Let,</p> $Y_u = C_o + C_u \quad [1']$ $C_u = C_u(Y_u) \quad [2']$ <p>taking the total differential yields the following multiplier,</p> <div style="border: 1px solid black; padding: 5px; display: inline-block;"> $dY_u = \frac{\gamma \cdot dC_o}{1 - \alpha}$ </div> <p style="text-align: right;">[3']</p> <p>where, γ as defined. γ = proportion of formal sector consumption spent on informal sector goods and services. C_o = consumer expenditures in formal economy</p>
3. Key Implications	
<p>The second economy operates parallel to, and largely independent of the official economy, and, hence, there is no necessary covariance in the movements of both economies. Fluctuations in the former may compensate, or accentuate fluctuations in the latter. Whether they do so or not depends on the evolution of each component, the assessment of which is largely an empirical matter.</p>	<p>A crisis in the formal economy as revealed by declining demand for formal sector output and employment lead to a fall in consumer demand for necessities produced in the informal sector and, hence, depresses demand in this sector as well. Fluctuations in the second economy (the informal economy), therefore, will mirror the fluctuations in the formal economy.</p>
4. Empirical Conclusions	
<p>The crisis in the Tanzanian economy (before the economic reforms) was 'for most part a crisis of the formal part and not necessarily the whole economy' (57).</p>	<p>The crisis of, and secular decline in formal sector incomes made the informal sector 'a purgatory of falling incomes and poverty without prospects of improvement' (131).</p>

Notes:

- * Jamal and Weeks (1993) did not express their ideas in a set of equations. Their basic premise is put forward here in a simple Keynesian framework akin to that used by Sarris and Van Den Brink (1993) with the explicit purpose to highlights similarities and differences.
- ** Y = income, C = consumption, E = exports and M = imports. The subscript u refers to the unofficial economy.

2.3 *The Home-Demand Constrained Second Economy*

The position of Jamal and Weeks (1993), is perhaps closest to that of Maliyamkono and Bagachwa (1990), and, hence, their approach provides a useful starting point for this comparative analysis of the diverging views on the functioning of the second economy. For Jamal and Weeks (1993), the key mechanism which explains the dynamics of the informal economy lies in its near exclusive dependence on the domestic formal economy as the only *exogenous* source of demand for the goods and services it produces.

That is, the informal economy produces necessities (basic consumer goods) in response to demand originating from formal sector employment (expenditures out of wages/not paid for by wages, especially on the part of low-income earners) and to its own demand which itself depends on informal sector income (equations 1' and 2' in Table 1). Implicit in their argument is the (questionable) view that the formal manufacturing sector mainly produces luxuries and, hence, that the demand for necessities, particularly the rural demand, is mainly satisfied through informal sector production.

The implication of this view on the functioning of the second economy is that fluctuations in the official economy, particularly those affecting employment and real wages, will be directly transmitted to the informal sector through fluctuations in demand for its goods and services. That is income in the informal sector will fluctuate in accordance with the working of a Keynesian *multiplier* (see equation 3' in Table 1) which operates upon changes in consumer demand from the formal sector for informal sector goods and services as its autonomous trigger. In other words, the ups and downs in the second economy will mirror those in the formal economy and, hence, the informal economy cannot really compensate for crisis or decline in the formal economy.

Jamal and Weeks (1993), qualify this latter argument somewhat, however, inasmuch as they see subsistence production acting as a buffer which is largely insulated from fluctuations in the monetary economy at large. That is, the effect of crisis and decline in the formal sector and its effects on production in the (monetary) informal sector will be in part cushioned by a retreat into subsistence production (46-50). The latter argument introduces a certain ambivalence, if not contradiction, in the analysis of Jamal and Weeks (1993). On one hand, they argue that the informal sector mirrors the formal sector inasmuch as the demand of the former springs from incomes generated in the latter. On the other hand, the informal sector is seen as cushioning the effect of formal sector crisis through a retreat into subsistence.

The latter argument bears much resemblance to Hyden's (1980) notion of the economy of affection featuring an uncaptured peasantry. There is, however, an important difference between the production for own consumption embedded within, and dependent upon, monetary production and exchange, on the one hand, and subsistence production as a self-contained system, on the other. It is the former, and not the latter, which is largely dominant in African rural economy today. For example, the production of food for own consumption often depends on purchased inputs paid for through the sale of cash crops and a large part of the consumption items (such as garments, cloth, footwear and batteries) needed by rural producers are only obtained through purchase paid for by the sale of cash crops or wage income. Consequently, a crisis in the monetary economy does *not* leave production for own consumption unaffected. The latter can at best only provide a temporary shelter to weather the storm. It does not, however, constitute a

viable alternative way of life. The assumption, therefore, that a secular and deep crisis in the monetary economy can persist without affecting 'subsistence production' is highly questionable.

Given the assumed dependence of informal sector income on formal sector employment and real wages as depicted by this simple Keynesian multiplier, it is not surprising that the focus of analysis shifts towards the formal sector, in particular towards fluctuations in its employment and in real wages. In this respect, Jamal and Weeks (1993) note the steep secular decline in real wages in Tanzania since 1974, by as much as 85% in the period 1974 to 1991 (55-6). They then observe that the fall in real wages did not bring about a rise in urban formal sector employment, but instead employment actually fell because of falling demand for formal sector output (130). That is, the formal labour market did not clear in response to falling real wages. Consequently, the decline in the real wage bill will reflect the combined effects of the fall in real wages and that in employment. The resulting contraction in consumer demand is, therefore, bound to be considerable.

Jamal and Weeks (1993), then argue that, in the absence of the official transfer of payments such as unemployment benefits or income support, the informal sector will act as a 'source of last-resort employment' (130). The inflow of workers made redundant in the formal sector adds to the number employed in the informal sector at a time where the demand for its output contracts as a result of the decline in formal sector employment and real wages. Consequently, 'the informal sector serves to absorb the unemployed at progressively falling income levels' and, hence, they conclude, 'to view the expansion of the urban informal labour force as evidence of reallocative efficiency (shifting labour from capital- to labour-intensive activities) is to make a virtue of growing impoverishment' (131). The argument that employment is growing in the informal sector while its demand is imploding effectively implies that Jamal and Weeks (1993) assume that, in this case, the market for labour clears with increasing numbers of workers and declining levels of incomes.

But what about export production as a viable way towards recovery and as an avenue for absorbing labour? In fact, a major objective of the economic reforms under structural adjustment is to alter relative prices to stimulate export production and, hence, to shift from import-substitution towards export-led growth, particularly that involving the production of export crops. On this count, Jamal and Weeks (1993) argue that 'in a demand-constrained situation, the consequence of urban workers shifting to agriculture would be a tendency to drive down prices and reduce returns to rural work' (129). The presumption here is that cash crop production confronts an inelastic world demand and, hence, if a majority of cash crop producing countries under structural adjustment programmes all attempt to increase their output (say, by depreciating their real exchange rates), the result would be a fall in the world price contingent upon the greater supply, thereby offsetting the gains of increased output. This argument questions the validity of sustained export-led growth based on the production of cash crops facing an inelastic world demand, and may be valid in its own right.

But how realistic it is to expect people to flock into an informal sector which, given Jamal and Weeks's (1993) own analysis, confronts an even worse situation of a rapidly imploding demand? Why not produce cash crops instead even if it may provoke falling terms of trade? Or did the informal sector in fact offer better opportunities for genuine expansion and, if so, what are the mechanisms which fuelled this expansion? A qualitative field study on rural change under

structural adjustment carried out by Booth *et al.* (1993) and covering 12 villages spread across Tanzania, helps to throw some light on these questions. Three of its general findings are of specific relevance here:

- (a) 'while economic liberalization seems to have contributed new dynamism to village economies, it certainly has not done so by the route of "classic" structural adjustment - incentive-led recovery of traditional agricultural exports. Indeed, the one textbook feature of agricultural adjustment that is present—reduced use of import-intensive inputs —is largely depressive in its implications.' (67)
- (b) 'the dominant view was that, the much improved availability of goods since 1984 more than compensated for the steep rise in real prices that had, in many cases, accompanied improved supply. More significantly, those expressing these views often included poorer people, or inhabitants of poorer villages; and women were even more inclined to affirm the benefits of trade liberalization than men.' (58)
- (c) 'the evidently expanding activities ... look much more like extensions of the processes of rural commercialization and diversification ... : survival strategies from an earlier era now boosted by the availability of incentive goods and fuelled by the new income flows generated by a poorly understood mixture of factors including illegal natural-resource exports and the restoration of foreign aid.' (68)

These findings throw some doubt on Jamal and Weeks' (1993) analysis since it suggests that a certain dynamism is taking place in the rural economy. This dynamism is not based on export expansion of traditional export crops but instead relies on new avenues of income generation based on, among others, natural-resource exports, and is boosted by the increased availability of "incentive goods" since 1984. But if the informal sector is not just a venue to absorb employment of last resort, but in fact contains elements which provide alternative forms of accumulation, either in export production or in the production for the domestic market (and possibly, in direct competition with the formal sector), the question then arises as to the nature of the mechanisms which render informal production, or at least significant parts thereof, competitive at home or in export production. Jamal and Weeks (1993), fudge answering this question by dismissing any argument that the shift of labour from capital- to labour-intensive production, brought about by the growth of the informal economy, may improve 'efficiency' and possibly enhance the growth potential of the economy (131). In their opinion, as shown above, this argument boils down to making a virtue out of impoverishment. Instead, section III in this paper argues that this hypothesis should at least be seriously investigated, both theoretically and empirically.

To sum up, Jamal and Weeks' (1993) analysis of the processes at work within the functioning of the informal economy only admits the hypothesis that the decline in formal sector employment and real wages goes hand in hand with demand contraction in the informal sector since the autonomous component of the demand for informal sector goods and services is seen to depend only on formal sector incomes. A strong point in this analysis is the attention they draw to the importance of investigating the connections between the informal and the formal sectors in the economy. They do this, however, only with reference to the argument that the formal sector is an important source of demand for the informal sector. This is an important point. But they do not analyze any further connections between both sectors which may influence the dynamics of

each of them and explain the nature of possible harmony and conflict between them in the process of restructuring. The reason for this may well be that Jamal and Weeks do not give credence to any argument that, under the economic reforms of the 1980s, the informal sector developed a certain dynamism of its own, both within the home market and in export production.²

2.4 The Export-Led Demand-Constrained Second Economy

An alternative analysis of the functioning of the second economy has been put forward by Sarris and Van Den Brink (1993). The brief outline of their model, as depicted in Table 1, reveals a different view on the underlying dynamics of the functioning of the second economy. In their view, the second economy is not constrained by demand emanating from the official (formal) economy, but instead has a dynamic of its own as a self-contained system propelled by its own exports (as the autonomous component of expenditure), producing for own consumption, and relying on its own imports. Hence, the second economy is depicted as existing side by side but not interdependent with the official economy.³ Moreover, while Sarris and Van Den Brink (1993), follow Ndulu (1988) and Lipumba *et al.* (1988) in assuming that the official economy is *supply constrained*, they assume that the second economy is *demand constrained* with a Keynesian multiplier as defined in equation 4 in Table 1.

Given these assumptions, it is clear that there is no necessary *covariance* between the evolution of official GDP and that of the second economy. Whether their respective evolutions over time reinforce one another or compensate for each other is therefore a matter of empirical investigation. In fact, in line with the concerns of Maliyamkono and Bagachwa (1990), most of the book deals with issues of measurement of the size of the second economy and with assessing its importance in terms of sustaining rural and urban livelihoods. Briefly put, the authors argue that the crisis of the Tanzanian economy before the economic reforms was a crisis of the official economy, but not of the second economy. More specifically, they argue that neither during the 1970s and early 1980s (which witnessed the depth of the crisis in the official economy) nor during the years of economic reforms from the mid-1980s onwards did any serious income declines occur as far as the poor were concerned. They conclude, therefore, that when account is taken of the second economy, the Tanzanian economy (with the exception of a few crisis years) 'fared much better than has been thought' (57).

It is not the main concern of this paper to assess the empirical validity of these claims, although (as will be shown below) some of the assumptions upon which the estimates of the size and evolution of the second economy are based are highly questionable and, at times, internally inconsistent. Instead, this paper is concerned with the analysis of the mechanisms which propel production and exchange in the second economy. On this count, the assumptions implicit in the model put forward by Sarris and Van Den Brink (1993), leave considerable room for doubt.

Consider their key assumption that not only does the second economy operate independently from the official economy, but it does so in a demand-constrained fashion, unlike the official economy which is supply-constrained. This is a steep assumption which even the authors find hard to sustain in their subsequent argument. It is useful, therefore, to pinpoint the reasonable doubts which Sarris and Van Den Brink (1993), themselves subsequently throw upon their own

key proposition. There are mainly (but not only) two major instances where this occurs: one concerns their attempt to measure the size and evolution of the second economy using the model depicted in Table 1, and the second relates to their empirical analysis of rural change during the crisis years and the subsequent reform period.

Tackling the first issue requires a brief digression on the way Sarris and Van Den Brink (1993), use their model to arrive at estimates of the size and evolution of the second economy. They do this as follows. First, they try to estimate the size of the multiplier as depicted in equation 4. To do this, they utilize the estimates of the income elasticity of private consumption expenditures and the income elasticities of intermediate and consumer goods imports arrived at by Lipumba *et al.* (1988) using data for the official economy (Sarris & Van Den Brink, 1993: 51). This in itself is a questionable procedure since it is by no means clear why the second economy should have the same elasticities as the official economy, particularly in a situation where their structures of production and incomes differ and where the former is assumed to be demand-constrained and the latter supply-constrained. The authors then proceed by estimating an elasticity of aggregate second-economy imports using the elasticities for the official economy mentioned above and the estimated shares (Ndulu and Hyuha, 1986) of respectively consumer goods and intermediate goods in imports financed under the own-import scheme instituted since 1984 as a first measure of import liberalization. Finally, using estimates of the average propensities to consume and to import, the authors arrive at estimates of the marginal propensity to consume (= 0.68), and of the marginal propensity to import (= 0.13).

Now, given that the multiplier equation is given by,

$$[4]$$

[4] (from Table 1)

it follows that the estimated value of the Keynesian multiplier equals,

$$[5]$$

[5]

Furthermore, since,

$$[6]$$

[6]

and, hence,

$$[7]$$

[7]

it follows that,

$$[8]$$

[8]

and, hence, an increase in exports by Tshs1 will bring in its wake a much lesser increase in imports by Tshs0.29, given the estimates arrived at as shown. The implication is that, assuming an initial trade balance of the unofficial economy, the growth in exports will outstrip the resulting growth in imports and, hence, over time the trade balance will turn positive.

So far, so good, provided one is willing to accept the assumptions made above. The next step in the authors' argument, however, begins to reveal the difficulty they have to sustain their own initial assumptions. To arrive at an estimate of the size of the second economy, the authors first assume that unrecorded exports are approximately equal to recorded own-funded imports (instituted since mid-1984). Their argument is that this is a plausible assumption to make given the prevailing lack of data. This assumption is indeed plausible if imports are assumed to be supply constrained (by exports), but it makes little sense if imports are demand-constrained in a manner described by equation 7. That is, if, as Sarris and Van Den Brink (1993) assert, the second economy was demand constrained both before and after the economic reforms, there is no reason why imports should be equal to exports in any given year since, by assumption, the former are not constrained by the foreign exchange income obtained from the latter. Moreover, and here the argument becomes really contradictory, it makes even less sense to assume that this equality between exports and imports prevailed over a number of years (the authors use the period 1985 to 1988), since, given their earlier computation of the multiplier, their model implies that export growth exceeds import growth, although they subsequently assume that exports equal imports throughout. Their resulting estimation of the size of the second economy is derived on the basis of contradictory assumptions and, therefore, largely meaningless.³

The second issue through which Sarris and Van Den Brink (1993) throw doubt on their own specification of the functioning of the second economy relates to their analysis of processes of rural change, particularly before the period of economic reforms. This concerns their discussion of the food-versus-cash (export) crops argument which posited (Odegaard, 1985; Lundahl and Ndulu, 1987; see also Wuyts, 1994) that the upward movement of the relative price of food in relation to cash crops led to a major increase in food production as resources shifted from the latter to the former. Sarris and Van Den Brink (1993), qualify this argument somewhat by advancing the following alternative hypothesis,

For the period up to the mid-1980s, one could posit a scenario of stagnation and modest increases in per capita food production based on two related arguments: first, the profitability of off-farm, income-generating activities declined, increasing the relative profitability of farm activities and inducing an increase in the availability of farm labour. Additionally, the relative profitability of export crop production declined, causing a shift of resources from export to food crops. So far, the thesis is a basic cash-versus-food- crop argument.

However, second, farmers did not continuously expand food crop production significantly above subsistence levels due to the increasing uncertainty of the economic environment in the period 1971 to 1984. That period saw decreasing availability of incentive goods, an inability of the official marketing system to assure producers of a consistently profitable market, and often high risks associated with using the parallel markets. In other words, the increase of the relative profitability of food crop production did not result in a continued expansion of food crop production over and above subsistence levels. (124/5).

This argument provides some real insights, while at the same time throwing some doubt on their own model (see Table 1). Indeed, in the quotation above they argue (i) that the profitability of off-farm income generating activities declined, thereby freeing labour for farm work, and (ii) that the decreasing availability of incentive goods discouraged a strong production response in food production, given also the often high risks associated with using the parallel markets. This suggests that the second economy was less insulated from what happened in the official economy than their model asserts, and particularly that production and consumption in the second economy was not left unaffected by the decreasing availability of goods on offer in the official economy. Some of the supply constraints of the official economy, therefore, cannot fail to exert their impact on the dynamics of the second economy.

In sum, the emphasis that Sarris and Van Den Brink (1993), place upon the independent development of the second economy draws attention to the role of hidden exports in terms of propelling new avenues of growth and the need for imports to fuel its production and consumption. It is, however, questionable that the second economy can simply evolve in an export-led demand-constrained fashion in the midst of an official economy which operates in a supply-constrained fashion. It is reasonable to assume that the second economy is at least in part dependent on demand and supply emanating from the formal economy, without denying the importance of the second economy's avenues for export earnings which, in turn, provide added finance for imports, hidden or recorded.

2.5 The Absence of Capital Accumulation in Both Models

Neither the work of Jamal and Weeks (1993), nor that of Sarris and Van Den Brink (1993) and nor, for that matter, that of Maliyamkono and Bagachwa (1990) pay much attention to investment and its financing. For example, the model as formulated by Sarris and Van Den Brink (1993: 50; also see Table 1) does not feature investment as a component of unofficial GDP. Similarly, investment is absent in the home-demand constrained model depicted in Table 1 which gives a fair representation of the key argument put forward by Jamal and Weeks (1993). Capital accumulation is simply left out of the picture.

Perhaps one reason why this is the case concerns the assumption that production in the second economy is largely dependent on labour as the only factor of production. Sarris and Van Den Brink (1993), for example, write the production function of the informal sector as follows,



[9]

where K_u summarizes the contribution to informal sector production of other primary factors', and L_u denotes the labour employed in this sector (1993: 161). But, as will be argued in the next section, the fact that production is labour intensive by no means imply that capital accumulation does not take place. What is needed, therefore, is a more comprehensive theory of informal sector accumulation which recognizes not only its own internal dynamics, but also its interconnections with the formal sector.

3.0 TOWARDS A THEORY OF INFORMAL SECTOR ACCUMULATION

3.1 *The Complexity and Changing Boundaries of the Second Economy*

To come to grips with the nature of accumulation in the second economy it is perhaps useful to start with a word of warning that the concept of the second economy itself refers to a complex set of economic activities, the boundaries of which changed over time. Broadly speaking, the second economy refers to 'economic activities that are unregistered and exist outside state regulations' (Engberg-Petersen *et al.*, 1996: 43). Three aspects are important in the context of the Tanzanian economy after the economic reforms. First, since the economic reforms alter the context of regulation, the boundaries of what exists outside formal state regulations will change after the reforms. Second, as the economy moved from *quantity rationing* towards *price rationing*, the scope of activities in the second economy were bound to change. That is, the character of activities changed as the economy shifted from a regime in which the lack of availability of goods was what prompted most of the activities within the second economy, to one in which cost considerations became more important. Third, while most of the activities in the second economy concern small-scale production, commerce, transport or service provisioning, an important part nevertheless also involves the '*informalization*' of formal sector activities. (Engberg-Petersen *et al.*, 1996: 42-45; Raikes & Gibbon, 1996: 275-281).

Notwithstanding considerable variety, most of the activities in the second economy tend to be largely labour-intensive, involving mainly (but not exclusively) smaller-scale activities based upon an often bewildering variety of labour regimes which escape formal regulation and, therefore, tend to be more flexible and insecure as forms of employment (that is, work is only paid for if orders come in), and differentiated by gender as men and women often engage in different activities or different types of work. In rural areas, in particular, the spread of (off-farm) small scale enterprises (along with migration) led to the increasing feminization of agriculture (Mbilinyi, 1988), and proceeded to "an extent that some commentators are now referring to 'de-peasantization'" (Engberg-Petersen *et al.*, 1996: 44).

It is well beyond the scope of this paper to deal in detail with these different currents within the development of the second economy. In fact, this paper argues that, to make sense of this bewildering variety of activities, it is first necessary to come to grips with the basic underlying dynamics which propel these activities in the era of reforms. What matters in particular is to explain how the shift from quantity rationing to price rationing conditioned the nature of capital accumulation in the second economy. This paper argues, therefore, that the problem of analyzing the second economy is not just the lack of data (which invariably leads to a fair amount of doubtful claims being made about the nature of its development), but also the lack of a conceptual framework capable to inform the analysis of the major social forces at work behind the development and change of the second economy. It is with the construction of elements of such a framework that this section is concerned.

3.2 *Capital Accumulation and the Wage Fund*

Given the reasonable assumption that informal sector production is largely labour intensive, Ricardo's theory of *capital as a wage fund* is perhaps the most appropriate framework to analyze capital accumulation in the informal sector. In a recent book on development economics,

Hayami (1997) explains the Ricardian concept of the wage fund as follows:

Capital' in his [= Ricardo] view was the 'wage fund', defined as the sum of payments to labour in advance of the sale of commodities produced by the labour applied, as well as payments for the purchase of tools and structures complementary to the use of labour. Therefore, the demand for labour increases proportionally with the increase in the wage fund (1997: 67-8).

Capital accumulation, therefore, implies that savings (obtained either within the informal sector or as an inflow from the formal sector) are ploughed back into the expansion of the wage fund to allow for increased production. This has two important implications.

First, even if production is largely labour-intensive and can be started without too much of a gestation period, capital as a wage fund needs nevertheless to be advanced in production. In practice, this requires access to finance to bridge expenditures (acquisition of tools, if applicable, intermediate inputs, and the consumption of producers) during the period of production. Although the funds required may be relatively modest (depending on the activities in question), it cannot be readily assumed that most producers in the informal sector have sufficient access to finance, either their own or through credit. In fact, in the Tanzanian context, the various avenues of access to credit for informal economy operators are fairly limited and often boil down to borrowing from relatives or friends (Ndanshau, 1995).

It is misleading, therefore, to depict the informal sector as the site of an amorphous mass of small independent producers who mainly rely on their own labour to obtain a living. On the contrary, it is more appropriate to assume that a bewildering variety of *labour regimes* will be prevalent within informal sector production, the extent and variation of which will depend on the activities in question and the prevailing structure of ownership of resources and control over finance. In the mining sector, for example, claim owners may be either actively involved in mining themselves, or derive a rent from subletting their titles to pitowners or financiers, while pit owners, in turn, employ labour, but often do so within arrangements akin to share cropping where workers get the assurance of their daily food but await the outcome of production to get a share (Wangwe *et al.*, 1997: 21, 24). Financiers may fund activities without directly being involved in production, but they can also be the actual owners of key assets used by seemingly self-employed operators. In the discussions in a workshop of the Equity And Growth through Economic Research (EAGER) conference held in Dar es Salaam in August 1997, J. Semboja succinctly remarked that 'many of the owners of the informal sector were located in the formal sector' which suggests that the formal sector, including the public sector, is undoubtedly a major source for channeling resources and finance to the informal sector, often (but not always) within the confines of household or kinship relations (Tripp, 1997).

Even where the informal sector activity involves a longer gestation period to construct the assets to enable subsequent production to take place, this Ricardian framework of capital as a wage fund remains quite relevant provided the construction of infrastructural assets is equally labour intensive in nature. In mining in Merelani, for example, 'initially, before the pit starts to supply mineral, about 50 workers can be operating but as soon as it starts producing, the number of workers in one pit can even reach 150' (Wangwe *et al.*, 1997: 21). Here, the start of production involves an initial wage fund to prepare the pit for operation (the outlay on infrastructural

investment), before production can start which, in turn, implies the advance of a further wage fund. The initial labour required for infrastructural investment shows that capital is assumed to be produced mainly by past labour (Hayami, 1997: 16-19).

Second, the expansion of the wage fund brings in its wake the growth in the demand for *wage goods*, the goods and services consumed by workers in the informal sector. The growth in consumer demand is, therefore, a reflection of the growth in employment in the informal sector propelled by capital accumulation in the form of the wage fund. This explains why the growth in the *availability* of wage goods is an important aspect of informal sector development. It is, therefore, unlikely that in a period of goods famine within the official economy, the informal economy would have much capacity to expand (apart from the increasing pressure to reroute official supplies into parallel circuits). Indeed, as Sender and Smith (1986) argued, what matters to producers (and wage earners) within agricultural or informal production is 'the possibility of exchanging their output with such manufactured goods as soap, kerosene, cooking oil, sugar, batteries, pots and pans, corrugated iron roofing material, radios, bicycles, cloth, etc.' As argued above, Sarris and Van Den Brink (1993) hinted at this point, but they did not investigate the implications of this point in terms of their own model.

Wage Rate, Cost of Living, Productivity and Unit Labour Cost

What then are the principal mechanisms through which a labour intensive informal sector can develop greater competitiveness?. This requires looking at the relation between the real wage, the cost of wage goods, productivity, and the unit cost of labour in production. This can be done by adapting a framework used by Amsden (1997b:124) which assumes that labour is the only (or, more realistically, major) factor of production.


Let, W = nominal wage bill
 L = labour
 P_c = composite price of wage goods
 W_r = real wage bill :
 W_r = real [10]

Y = value of output of commodity Y (say, an export product)
 P_y = price of Y
 Y_r = real output: [11]

and, hence,

W = nominal wage rate [12]

W_r = real wage rate [13]


 labour input per unit of output (the inverse of labour productivity) [14]

 unit labour costs [15]


Note that

 [16]

or, alternatively,

 [17]

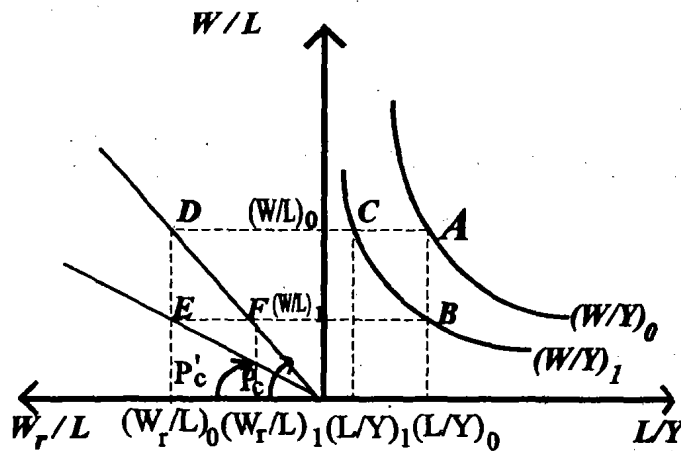
which shows that the unit cost of labour not only depends on the real wage and on real output per head, but also on the price of wage goods relatively to the price of output of the commodity in question. Taking logarithms of both sides of equation 17, and differentiating, yields an expressing in rates of change, as follows:

 [18]

In fact, Amsden (1997b:124) ignores the last term on the right hand side in equation 15 and, hence, also in equation 16. She overlooks, therefore, the effect of changes in relative prices on unit wage costs. Equation 18 implies that, *other things being equal* (in particular, the real wage), a rise (fall) in the price of wage goods relatively to the price of output will lead to a rise (fall) in unit wage costs.

The relation between unit wage cost, labour productivity, the nominal wage rate, the price of wage goods, and the real wage can be depicted graphically by using equations 16 and 10. This is done in figure 1. The curves in the quadrant on the right hand side are rectangular hyperbolas (given equation 16) which feature the unit labour costs loci. That is, movements along a curve keep unit labour costs constant, while curves located closer to the origin represent lower unit labour costs and, hence, other things being equal, higher competitiveness of the industry. The rays through the origin in the quadrant in the left hand side (which depicts equation 10) have a slope equal the composite price of wage goods, P_c , and, hence, translate changes in real wages (the horizontal axis) into changes in nominal wages (the vertical axis).

Fig 1: Productivity, Real Wages, Costs of Living and Wage Costs



(Adapted from Amsden, 1997b: 125) ^{4, 5}

Assume that point A in figure 1 depicts the initial position of the industry producing good Y. Amsden (1997b) argues that an industry can lower its unit labour costs either by moving in the direction of C (increasing productivity), or downwards toward point B (reducing the wage rate), or some combination of both. The former, greater productivity, does not necessarily imply investment in an improved vintage of equipment, but also improvements in production and operations management—including labour relations (Amsden, 1997b: 125). As to the latter, the reduction in the wage rate, Amsden only considers the case of falling real wages. This case implies that the move from A to B goes hand in hand with a move from D to F in the left quadrant. That is, unit labour costs are lowered due to a fall in real wages.

But the move from A to B can also be brought about as a result of cheapening the price of wage goods (from P_c to P'_c), a move from D to E in the left quadrant, leaving real wages unchanged. Amsden did not consider this possibility. Such a situation can arise, however, if productivity in the domestic wage goods sectors increases or if cheap imports of these goods substitute for local production.

3.3 Productivity, Flexible Labour, Labour Regime and Wage Costs

Table 2 compares value added per person per urban industrial sector between the informal sector and the parastatal sector in Tanzania for 1991. The data show that it cannot be readily assumed

that informal sector production always has a lower productivity than formal sector enterprises in the same industrial category. More specifically, sectors such as urban agriculture, mining and quarrying, construction and community and personal services show a higher value added per person than the comparative parastatal sectors. Obviously, care should be taken with this type of comparisons since the quality of data collection may differ significantly and the use of averages based upon sectoral aggregates can hide a lot of variation within each sector. More specifically, it is not clear from the table how output per person is actually measured since, in the informal sector at least, employment can vary considerably depending on demand and availability of inputs.

Table 2: Value-Added per Person: Informal versus Parastatal Sector (Tshs, 1991)

URBAN INDUSTRY	INFORMAL SECTOR	PARASTATAL SECTOR
Agriculture & Fishing	76,200	55,800
Mining & Quarry	1,300	
Manufacturing	12,300	24,670
Construction	700	3,800
Trade/Rest/Hotels	13,900	69,500
Transport	300	12,000
C & P Services	400	10,250
TOTAL	10,700	63,380

(Source: Planning Commission/Ministry of Labour & UNDP/ILO, 1991: 1-17, Table 3.2.2)

As shown in figure 1, wage costs can be reduced as a result of a rise in productivity. This corresponds to a move from point A to C in figure 1. How relevant is this mechanism for the analysis of competitiveness in the informal sector in Tanzania? To answer this question, it is useful to reflect on how labour, L , should be measured? The best way to do this is to consider *labour time*, and not number of workers, since labour time per worker can vary depending on the specific prevailing institutional arrangements which structure employment, labour markets and the organization of production.

Take, for example, the hypothetical situation of a labour intensive firm (say, in brick making) in the formal sector. The firm employs a number of workers and the prevailing labour regulations are such that wage costs are essentially *fixed costs* in the short run. That is, fluctuations of capacity utilization due to demand or supply constraints are not immediately reflected in the day to day recruitment of labour. Consequently, while the existing labour force is paid for the whole period, it may remain idle for part of the time due to a lack of orders or shortage of materials and, as a result, L/Y will vary with capacity utilization in the short run, while W/L remains constant. Consider next the case of a brickmaker in the informal sector who regularly employs several workers. In this case, however, the firm operates on a *stop/go* basis, meaning that workers are only employed when orders come in and, hence, the labour time paid for contains no slack periods in terms of employed labour remaining idle. Other things being equal, these two cases correspond to a move from point A in figure 1 (depicting the formal sector firm) to point C (depicting the informal sector firm). Obviously, in reality, other things are not equal: both technology and wage levels may differ. The point here, however, is that this *stop/go* pattern which makes labour utilization depend on available orders or on the availability of inputs is often

very characteristic for the nature of labour regimes in the informal sector, and can be an important factor in reducing their unit wage costs in competition with formal sector firms, even if the latter are technologically more advanced.

The mining of gemstones in Tanzania, for example, typically goes through booms and busts, often in quick succession. As new mine areas are discovered and opened up for production, employment and production expands rapidly, thereby quickly altering the volumes of supplies in the markets, which, in turn, provokes volatile price conditions to which employment conditions quickly respond (Wangwe *et al.*, 1997). Hence, miners (whether self-employed or in wage labour) stop work and move to other activities when prices fall dramatically, and take up work again when the price recovers.⁶

Another mechanism, pointed out already above, through which informal production can reduce its unit labour costs is when wage labourers (for example, in mining) are only paid part of their income as an advance on production, while the other part consists of a share in output and, hence, varies with the value of the output actually produced. That is, in terms of the variables in figure 1, W/L depends on L/Y , not unlike in the case of a sharecropper.

Both these mechanisms, however, imply that the burden of adjustment when the value of output is lower than expected, or demand is slack, or prices fell dramatically, falls upon the direct producers. Given the insecurity inherent in these types of flexible labour use, it is then not surprising that producers and workers seek to develop household strategies which diversify sources of income generation (formal and informal, food production for own consumption and monetary production) so as to secure more stable livelihoods. Sender and Smith (1986) make a similar point in the context of rural production as follows:

Labour shortages or bottlenecks at peak periods are often the critical constraint on raising the marketed output of particular crops (Richards, 1983); it is, therefore, vital to appreciate the determinants of labour supply, which will include the relative returns to labour in a range of non-agricultural activities as well as those in agricultural activities (including processing) that are competing for labour in the same season (1986: 125).

The Wangwe *et al.*, (1997) study on gemstone and gold mining, for example, hints that, in some instances, mine labour is seasonal, with labour withdrawing in harvest time to aid in the production of food crops. The analysis of labour regimes, therefore, needs to take account of this structure of interdependence between differentiated activities, including its organic link with family agriculture, which reflects individual and household strategies aimed at minimizing the covariance of risks in securing livelihoods.

3.4 The Cheapening of the Supply of Wage Goods

As shown in Figure 1, other things being equal, a (relative) decrease in the price of wage goods and in nominal wages (such that real wages remain constant) leads to a fall in unit wage costs.

This is an important mechanism through which competitiveness of labour-intensive production can be enhanced. But how important is this mechanism likely to have been in the development of the second economy in Tanzania? In answering this question, it is useful to distinguish between food, on the one hand, and manufactured consumer goods, on the other, as the two major components of wage goods.⁷ Engels' law suggests that, given the relatively low levels of income, the expenditures of food are likely to account for the larger share of total expenditures.

In the pre-reform period, from the mid-1970s to the mid-1980s, it was the sharp reduction in the availability of manufactured wage goods which is likely to have acted as the major constraint on the expansion and profitability of informal sector activities. Bevan *et al.* (1989) computed an availability index for the supply of consumer goods (also called incentive goods), quoted in Dercon (1993: 180), which shows that shortages started to become more serious from 1978 onwards and hit particularly hard during the 1979-84 period, after which the situation improved considerably. Not only did the sharp decline in the availability of these goods lead to the steep rise in their prices within parallel markets, but as Sarris and Van Den Brink (1993: 124-5), as quoted earlier pointed out, this may also have adversely affected the production of food crops, whether in official or in parallel markets, thereby fuelling the inflation of food prices in parallel markets even further.

With the economic reforms, however, the availability of consumer goods increased significantly and, hence, particularly in the wake of massive depreciations in the real exchange rate, it is the aspect of the *cheapening* of wage goods which is likely to have become a key factor in determining the profitability and competitiveness of the informal sector. As to the availability of food and its price, Sarris and Van Den Brink (1993: 129-30) show that parallel market prices declined from the mid-1980s onwards as food production increased, in part due to improved weather conditions and the greater availability of incentive goods.

The inherent volatility of food production in Tanzania would lead one to postulate that most producers within the informal (and formal) sectors would seek to maintain a foothold in the direct production of food for own consumption. Take, once more, the example of mining. This sector witnessed a rapid increase in informal sector employment such that the latter was 'somewhere upwards of 300, 000 persons [a million including all those living in villages whose main activity is mining, according to Chachage (1995)] on hundreds of sites all over the country' (Gibbon & Raikes 1996).⁸ Some of these mining towns are often located in remote and not easily accessible areas of the country such that transport costs tend to be high, and, hence, in many of these areas the price of foodstuff (and other commodities as well) is well above the national average (Wangwe *et al.*, 1997). It is then not surprising that mine labour will often be seasonal in nature, with workers withdrawing from the mines during⁹ the harvest season (Wangwe *et al.*, 1997). Indeed, the growth in many of these informal sector activities implies that the rural economy in particular is subjected to different forces pulling in different directions. The peasantry produces cash (export) crops, food crops for sale and for own consumption, but also

supplies labour to agricultural plantations and farms and engages in off-farms activities, often as wage labourers. If off-farm activities prove to be more lucrative, labour is withdrawn from other uses, but this may affect agriculture, particularly at peak harvest time. At the same time, however, the growth in off-farm labour-intensive production increases the demand for marketed surpluses of food, which, in turn, affects the production of export crops. This may in part explain the apparent stagnation in the production of traditional cash crops witnessed in recent years (Gibbon & Raikes, 1996).

The other aspect concerns the relative cheapening of the prices of manufactured wage goods under structural adjustment. On one hand, the 1980s witnessed pronounced inflation and significant changes in the official relative prices in the wake of the massive depreciation of the official real exchange rate. On the other hand, however, the premium on the parallel market foreign exchange rate declined during this period, thus in part offsetting the effect of the depreciation of the official real exchange rate.¹⁰ The growth in informal sector activities and the pressures operating upon it to enhance its competitiveness brought about a more pronounced bifurcation of the market for consumer goods with the emergence of the demand for quality products emanating from higher income earners (and the growing expatriate community), on the one hand, and of the demand for cheap consumer goods at the lower end of the market, on the other. With reference to the demand for textiles and garments, for example, De Valk and Mbelle (1990) remarked that, with liberalization, the high income segment of the market has shifted its demand towards high quality and new imported garments, while the low income segment turned to low quality goods, including cheap "mitumba" (second hand clothes). This process was not just confined, however, to the importation and direct sale of cheap wage goods (such as, for example, cheap cloth imported from India). Often, the imported goods were also used as intermediate goods in informal sector production. For example, the increased importation of mitumba also created a market for refitting (and repair) which itself provided new opportunities for informal sector growth (Semboja and Kweka, 1997).

The implications of this analysis are twofold. First, the relative cheapening of wage goods enhanced the competitiveness of the informal sector by cheapening its wage costs without affecting real wages adversely. But, second, this cheapening of wage goods was not achieved by increasing productivity in the domestic manufacturing industries producing wage goods, but instead through their importation. Its consequence is that a significant part of informal sector production and of the consumption of those employed in it, came to depend on imported goods.

4.0 CONCLUSION: INFORMAL SECTOR ACCUMULATION AND FORMAL SECTOR MANUFACTURING

4.1 *Aid and Import Liberalization*

In section II, this paper argued that accumulation in the informal sector can best be depicted as a process involving the expansion of the wage fund. The growth in the wage fund brings in its wake growth in the demand for wage goods, which in turn requires growth in their availability. Competitive pressures operating on the informal sector, particularly after the economic reforms, propel the need for the cheapening of wage goods so as to reduce unit wage costs. This explains why, under the impulse of economic reforms, the domestic market for consumer goods bifurcated with the lower tier catering for the demand for wage goods, in part propelled by informal sector accumulation.

This switch towards the increased importation of cheap consumer goods was initially made possible by the introduction of the own-funded import scheme which allowed people with foreign exchange to import commodities, with no questions asked about the origin of the foreign exchange (which, as Sarris and Van Den Brink (1993) argued, effectively boiled down to a partial legalization of hidden exports). In the early stages of economic reforms, however, this process of cheapening wage goods was partly offset by aid policy. Indeed, the period of reforms was accompanied by a significant shift in the allocation of foreign aid from the earlier emphasis on "aid as investment support" to "aid as commodity import support". The system of commodity import support (CIS) involved the administrative allocation of imported goods financed through foreign grants and loans to selected sectors or firms in the public and formal private sectors. The main concern of CIS was not to foster industrial restructuring, but to increase capacity utilization in the existing, as yet heavily protected, domestic manufacturing sector. At a later stage, however, as donors grew increasingly disenchanted with CIS, aid funds as balance of payment support came to be increasingly allocated through the market-based Open General License (OGL) system. As a result, formal domestic manufacturing lost its preferential access to aid funds. Consequently, aid funds came to be increasingly available to finance, among other things, the importation of cheap consumer goods (Doriye, White & Wuyts, 1993).

4.2 *The Plight of the Formal Manufacturing Sector and Its Growing Informalization*

It is beyond the scope of this paper to enter into a comprehensive analysis of the mechanisms and pressures at work in formal sector manufacturing. But the analysis in section II suggests that the drive towards accumulation in the informal sector has serious consequences for the development of formal manufacturing which cannot be ignored. The problem is akin to the opposition which arose in Ricardo's times between the interests of the landlord, on one hand, and of the manufacturing industry, on the other, with respect to the abolition of the corn laws. Ricardo argued that the free importation of corn would lower the cost of wage goods and, consequently, assuming a constant (subsistence) real wage, increase profitability in industry. It was in the interest of the manufacturing industry, therefore, to seek to obtain the free importation of corn. In the present-day Tanzanian context, a similar process is at work. The growth in informal sector activities brings with it a growing demand for the importation of cheap wage goods, while formal manufacturing industry seeks protection against import liberalization.

In fact, as argued above, initially, the manufacturing sector received mixed signals from the

economic policies of reform. On the one hand, there was the move towards increased import liberalization, starting with the own funded import scheme. On the other hand, however, the shift in foreign aid towards commodity import support sought to increase capacity utilization in industry, without, however, doing much to restructure industrial production. Later on, however, from the early 1990s onwards, direct support to the manufacturing industry was progressively withdrawn, leaving it more exposed to external competition. Traders could now directly compete with manufacturers over the available foreign exchange resources. Available data supports the view that 'manufacturing initially benefited in a limited way from adjustment, but with these benefits tailing off after 1991 (Raikes and Gibbon, 1996: 271).

Adjustment of formal sector manufacturing to changing circumstances takes a variety of forms, one of which, of course, is the demise of formal sector enterprises through exit or bankruptcy (Semboja and Kweka, 1997; ESRF and TBC, 1997). But part of the adjustment takes place through a process which involves the '*informalization*' of formal sector activities, for example, through mechanisms such as increased tax evasion, etc. (Raikes & Gibbon, 1996: 277-281). An important aspect of this process of informalization of formal manufacturing production is the shift towards a greater reliance on flexible labour regimes. The Semboja and Kweka (1997) study on the garment industry for example, points out that many firms shifted towards keeping only a skeleton of staff permanently operative, while recruiting from a fixed pool of workers on stop/go basis depending on orders flowing in, thereby reducing the cost of labour and shifting the burden of adjustment to its workers who have to find alternative ways to make ends meet. Furthermore, some of these enterprises abandoned the production of garments that they had previously undertaken and shifted towards taking on orders to refit imported second hand clothes.

One possible explanation for the stagnation or decline in manufacturing output has been put forward by Bhaduri and Skarstein (1996). In Keynesian fashion, they argue that 'the *level* of aggregate demand may also be influenced by the inflow of foreign aid through quantity adjustment rather than adjustment of relative prices' (196). That is, if the inflow of foreign aid (in particular, of balance of payments support) fails to stimulate domestic investment sufficiently, savings may adjust downwards as a result of demand contraction induced by the Keynesian multiplier operating in reverse. More specifically, they argue that,

Such downward adjustment of income to a higher inflow of foreign aid is most easy to visualize in situations where aid substitutes strictly for domestic 'savings' in the form of wage goods, which could otherwise have been produced at home. ... Thus, the multiplier operates in reverse, as aid takes the form of imports tied to wage goods, substituting domestic 'savings' of wage goods (Bhaduri & Skarstein, 1996: 198).

This argument is powerful, but remains rooted, as the authors themselves admit, in a short period context, assuming an invariant economic structure. The problem is, however, that the argument then also abstracts from any *transformations* in the economic structure induced by the reforms. More specifically, the argument ignores the dynamics of the informal economy and the nature of accumulation therein. More specifically, it ignores the growth in the demand for wage goods emanating from the expansion of informal sector activities which, in turn, depends on the process of cheapening wage goods brought about through the shift towards importation rather than local production as the main source of its supply. An important point, however, is that aid plays a key role in financing this shift which renders the expansion of informal sector activities increasingly dependent on imports.

One conclusion which might be drawn from this analysis is that it is not sufficient to argue for the selective protection of key sectors (in particular, those producing wage goods) of manufacturing industry without further analysis (Semboja and Kweka, 1997), if, at the same time, one also welcomes the development of informal sector activities (ESRF and TBC 1996; Wangwe *et al.*, 1997). To resolve the tension between both sectors requires the development of capabilities within the manufacturing industry to compete successfully with cheap manufactured imports. The failure to do so, in contrast, may render informal sector development dependent on the continued financing of imports, in part, by foreign aid. Whether or not this requires an explicit industrial strategy is a question beyond the scope of this paper. What this paper suggests, however, is that the content of such a strategy cannot just concern the protection of industry, but also needs to come to terms with the bifurcation of the market of consumer goods characterized, in its lower tier, by an expansion in demand for cheap wage goods.

ENDNOTES

- 1 The social construction of competitive assets, as a process, invariably involves both *public and private action*. In particular, public action and the use of public money which it entails, (whether by design or by default), will shape the way production in general and private action in particular, evolve. Public money in this context does not only refer to the budget resources directly controlled through taxation by the government, but also to the various forms of *fiscalization of finance* (Amsden, 1997a: 474) through which the state or other agents of public action (especially, aid donors) can influence the allocation of other non-taxation sources of finance (the disposal of private or institutional savings, money creation, the ownership of financial institutions, and importantly, foreign aid) within the economy.
- 2 Sender and Smith (1986) argue that many (left) critics of the Berg report tend to dismiss the argument that economic development in Africa failed to enhance competitiveness within international markets. Instead, they argue, any viable strategy which envisages the resumption of economic growth must come to terms with this question, given the existing international economic reality. To do so, however, requires an analysis of the nature of the changing processes of accumulation at work under economic reforms so as to gain insight whether, as Amsden (1997a) put it, it leads towards a new social construction of competitive assets capable of fueling a renewed growth momentum. The problem with the analysis of Jamal and Weeks (1993) is that they do not really address this question at all. Their conclusion, therefore, which warns against the continued adherence to the paradigm of urban bias has in fact little or nothing to say about either urban or rural dynamics as far as the changing patterns of accumulation are concerned.
- 3 Indeed, not only do Sarris and Van Den Brink (1993) assume that exports equal imports over time (and, hence, that the export to income ratio equals the average propensity to import), but in order to arrive at estimates for the size of the second economy they also assume that these average propensities are constant over time (implying that the marginal propensity to import equals the average propensity to import). That is, to arrive at their estimates of the size of the second economy, not only do they assume that,

$$E = M$$

but also that,



a result which contradicts their earlier estimates of the multiplier and its coefficients. Indeed, if dE/dY equals μ , it follows from equation 4 that the marginal propensity to consume equals 1 (contrary to the assumption that $\alpha = 0.68$), while the marginal propensity to import (earlier estimated to be equal to 0.13) should be equal to its average propensity (earlier estimated to be equal to 0.20). On top of this, their resulting estimates of the size and evolution of the second economy is then based on the assumption that the ratio of unofficial exports to unofficial GDP equals the multiplier computed on the basis

of marginal coefficients times the value of own-funded imports for each successive year, thus arriving at totally meaningless estimates of the size and evolution of the second economy.

⁴ Amsden's 1997b does not feature the left side quadrant depicted here since analysis is not concerned with the effect of cheapening wage goods on unit labour costs. In Amsden's analysis, therefore, a fall in nominal wages goes hand in hand with a fall in real wages since changes in the relative prices of wage goods are left out of the picture.

⁵ It is also possible to depict equation 11 in the fourth (lower-right) quadrant and, hence, to bring both price variables together into the graph. This addition, however, is not necessary for the argument in the paper.

⁶ In a verbal discussion, Wangwe, pointed out that this stop/go system may be an important factor which limits investment in fixed equipment or infrastructure in some sectors of the informal economy, particularly those subject to large variations in demand or to highly volatile prices, since the unit cost of fixed investment will vary with capacity utilization.

⁷ Other important components, particularly in urban areas, are transport costs and house rents which will not be considered here further.

⁸ The study by Wangwe *et al.* (1997) puts the estimate at more than half a million people directly employed in small scale mining.

⁹ As Uma Lele (1993) pointed out 'transport costs from regional headquarters to villages are often as high as those to regional headquarters from Dar es Salaam' (25).

¹⁰ I am grateful to Benno Ndulu for pointing out to me that the downward movement in the parallel market premium offset, in part, the effect of the depreciation in the real exchange rate. Since most wage earners survived on consumption at parallel market prices, the decline in real incomes as a result of the reforms was less than Jamal and Weeks (1993) argued it to be based on the movement of official prices only.

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