



The State of the Informal Economy in Ethiopia: Insights from Addis Ababa City Administration

Edited by Dereje Tesema and Zerihun Mohammed

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Ethiopia: Insights from Addis Ababa
City Administration*

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Dereje Tesema
and
Zerihun Mohammed



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Good Governance Africa- Horn of Africa (GGA-HoA)

P.O. Box 46214

Addis Ababa, Ethiopia

Email: info.easternafrika@gga.org

Web: www.gga.org

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Introduction

Dereje Tesema and Zerihun Mohammed

The informal economy serves as the main source of employment and livelihoods for a significant portion of the world's population, particularly in urban areas of developing countries. It encompasses informal employment, which includes both self-employment and wage employment, as well as unregistered enterprises and employment relationships that lack legal regulation or protection (Chen, 2012). The International Labour Organization (ILO) estimates that over 61 percent of the global workforce is engaged in informal economic activities (ILO, 2018; Bonnet, Vanek, & Chen, 2019).

In sub-Saharan Africa, the informal economy comprises approximately three-quarters of the non-agricultural labour force and accounts for about one-third of gross national product (GNP), although there are regional variations (Ohnsorge & Yu, 2022). Western Africa has the highest share of informal employment, with 92.4 percent of total employment, followed by Eastern Africa at 91.6 percent and Central Africa at 91.0 percent. In contrast, Southern Africa has a relatively lower proportion of its employed population in the informal sector, at 40.2 percent (ILOM 2018:28). As Meagher (2024) aptly states, the African informal economy is rapidly becoming the "real economy" rather than gradually being supplanted by the formal economy. The growth of informality and its contribution to the overall economy—along with its connections to poverty, inequality in developing countries, and various Sustainable Development Goals (SDGs)—have garnered renewed attention from policymakers, development practitioners, and academics over recent decades (Chen, 2012).

Discussions on policy and academia regarding the informal economy began in the 1970s, following seminal studies on the characteristics of 'traditional economies' in urban Africa and potential strategies for their integration into modern economies (Chen, 2012). Despite the widespread usage of the concept

and ongoing efforts to establish an international definition, significant divergence exists regarding its meaning, measurement, and composition. A review of various strands of economic and statistical literature reveals that the term 'informal economy' is often used interchangeably with policy labels such as shadow, unofficial, hidden, unrecorded, black, or underground economy (Dell'Anno, 2022). However, these expressions only capture certain aspects of informality due to its heterogeneity across different socio-economic and political contexts. For instance, the label 'underground' is contested, as many informal activities throughout Africa operate openly and are widely known to the public (Charmes, 2016).

Despite the diversity of conceptualisations and approaches, the ILO provides a widely accepted policy definition of the informal economy as "all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements" (ILO, 2015). In this context, key defining features of the informal economy include the absence of social protection, formal registration, and compliance with labour market regulations. Other definitions and measurements often adopt a regulatory perspective, which can risk conflating informality with 'illegality', even though these two categories are conceptually distinct. The International Conference of Labour Statisticians (ICLS) acknowledges that informal activities are not necessarily undertaken with the intention of evading taxes, social security contributions, or violating labour laws or other legislative and administrative provisions. This highlights the importance of situating the informal economy and its drivers within a broader socio-economic and cultural context (Kraemer-Mbula & Wunsch-Vincent, 2016).

In addition to the lack of social protection, the ILO (2022) provides specific criteria to further define the informal sector. Informal enterprises are primarily single-person operations or family-run firms/farms, with very few being owned or operated by employers who hire workers. Informal economic units are also unincorporated enterprises that do not maintain a complete set of accounts as required by law (e.g. balance sheets) or other official records, such as a book of accounts. Typically, these units operate at a low level of organisation, on a small scale, and with little or no division between labour and capital as factors of

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production. They are characterised by ease of entry, partly due to their accessibility, minimal start-up capital requirements, and the absence of formal entry barriers. However, the criteria used to define the informal economy vary across countries, complicating international harmonisation (Bonnet, Vanek & Chen, 2019).

The traditional approach to understanding the informal economy relies on dual economy models, which suggest that labour markets are divided into formal and informal sectors. This perspective highlights the distinction between economic units that are registered with relevant administrative authorities (formal) and those that are not (informal), as well as between workers who have employment-based social protection and those who do not. In this binary view, influenced by modernization theory, the informal sector is often perceived as stagnant, and less productive than the formal sector (Dell'Anno, 2022). Furthermore, it is frequently portrayed as marginal or peripheral, with minimal connections to the formal sector or to modern capitalist development (Chalachew, 2018). However, the reality is that these two economic sectors are intrinsically linked in many parts of the world.

Building on evidence that illustrates the dynamic interplay and coexistence of formal and informal economies, policymakers and practitioners have increasingly challenged the traditional dichotomy between formality and informality in favour of a continuum approach (Gutierrez et al. 2019; Charmes, 2016). Consequently, rather than perceiving the informal economy as a separate economic sphere, the focus has shifted to understanding the complex interrelationships between formal and informal activities. Evidence from many African countries demonstrates that economic units often fall along a continuum, with 'formal' relations at one end and 'informal' relations at the other, including various categories in between that reflect differing degrees of informality (Chen, 2005). As is frequently observed, formal businesses may resort to informal practices to evade state taxation on the surplus value generated by labour. Overall, both businesses and workers consistently straddle the boundaries of the formal and informal economies, exhibiting characteristics of both.

There are competing arguments regarding the drivers of the informal economy. Proponents of the dualist model argue that the growth of the informal economy in developing countries is primarily due to the imbalance between population growth and the development of formal industrial employment. This perspective also highlights the mismatches between individuals' skills and the structure of modern economic opportunities. In contrast, experts who subscribe to the structuralist perspective attribute the proliferation of informality to the growth of capitalism. They contend that the capitalist economic structure and the associated competition force microenterprises and their workers to remain in the informal economy, where they are exploited for the benefit of modern sectors. The legalist perspective, however, posits that the informal economy emerges as a reaction to excessive regulation and government burdens, such as taxation and administrative costs. From this viewpoint, informal operators voluntarily choose to exit the formal economy due to the limited benefits associated with formal employment (Bonnet & Venkatesh, 2016). While each argument offers a partial explanation of informality, a holistic approach is often recommended, given the heterogeneous composition of the informal sector in developing countries (Chen, 2012).

In Africa, the informal economy largely arises from exclusion from the formal and modern sectors. This means that the primary drivers of informality stem more from a lack of alternatives for entering the formal sector than from a deliberate choice to evade taxation (ILO, 2018). The macroeconomic root cause of the informal economy is primarily the mismatch between the surplus of low-skilled urban labour—prompted by natural population growth and rural-to-urban migration—and the limited growth of job opportunities in the modern sector. This situation is exacerbated by significant public and private sector retrenchment, the active downsizing of formal employment due to economic restructuring, and the resulting unemployment and declining real wages. In West African countries, the instability and unpredictability of formal institutions amid economic reforms further encourage movement into informality (Meagher, 2024). Overall, the World Bank argues that the growth of the informal economy in developing countries is driven by a lack of development and poor governance (Ohnsorge & Yu, 2022).

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Several socio-economic contributions of the informal economy are discussed in development literature. In many African countries, the informal sector significantly contributes to GDP, job creation, and income generation for the majority of citizens. It serves as a primary survival strategy for many poor individuals and aids in poverty reduction efforts. Additionally, it acts as a safety net, particularly for those who may lack access to jobs in the formal sector—such as women, migrants, and persons with disabilities—due to various barriers like education, skills, or legal documentation (Oviedo et al., 2009). The informal economy is not only the main producer of goods and services for the formal economy but also functions as a market for formal sector products. Thus, it should not be viewed merely as a 'sector of last resort,' as it is often perceived and discriminated against by policymakers. Case studies in African countries also illustrate that it is a source of innovation and entrepreneurship (Kraemer-Mbula & Wunsch-Vincent, 2016).

Nonetheless, the downsides and multifaceted negative impacts of the informal economy on workers and broader socio-economic development cannot be overstated. The ILO has recognised that informal workers experience greater deficits than their formal counterparts across the four pillars of decent work: economic opportunities, rights, social protection, and voice. The informal economy is typically characterised by low productivity, relying on less-skilled labour and traditional technologies, which results in lower wages for workers (ILO, 2018). The absence of social protection exacerbates the exploitation of informal workers and increases their vulnerability to various shocks, as highlighted during the COVID-19 pandemic (Chen & Skinner, 2021). Tax avoidance within the informal economy, along with its detrimental effects on government revenues, hampers investment in the formal sector and public services, ultimately impacting overall national development (Meagher, 2013). Evidence from East Africa shows that countries with larger informal sectors tend to have limited access to finance for the private sector, lower labour productivity, slower accumulation of physical and human capital, and weaker investment growth. Consequently, widespread informality is closely linked to weaker governance and significant delays in achieving all dimensions of the SDGs (Ohnsorge & Yu, 2022).

Effectively managing the negative impacts of the informal economy while maximising its multidimensional benefits for the poor requires strong and responsive governance tailored to each country's specific circumstances and the underlying drivers of informality (Ohnsorge & Yu, 2022). However, most governments in developing countries have regarded the informal economy as problematic and unproductive, with some even labelling it as 'illegal' in extreme cases. Across Africa, macroeconomic policy objectives often favour the small modern sector, aiming to suppress, regulate, or formalise the informal economy. Labour, educational, and financial policies are typically designed to serve the modern formal sector, often neglecting the informal sector that supports the majority of citizens (Chen & Carré, 2020). This bias partly stems from the influence of the 'modernisation' development model and the subsequent structural adjustment policies in Africa, which view the informal economy as marginal, assuming it will dissipate or be absorbed into the formal economy. Consequently, the informal sector is perceived as transient rather than as a development sector in its own right. In contrast, the reality in urban areas across developing countries shows that the informal economy continues to expand alongside economic development and industrialisation (Chen & Skinner, 2021). This resilience of the informal economy has prompted policymakers to reconsider their approaches and develop a more strategic framework for the sector, including integrating it into development policies and fostering equitable linkages with the formal economy.

Over the past few decades, alternative policy perspectives in many countries have aimed to unlock the growth potential of resources within the informal economy by promoting stronger linkages with the formal economy and facilitating their gradual integration (see ILO & UNDP, 2023). Poverty reduction strategies across nations have also emphasised the provision of better public services and social safety nets to protect vulnerable groups who remain in the informal sector. These policy shifts are further supported by the introduction of ILO's Recommendation No. 204, which primarily aims to integrate the informal economy into the formal sector and ensure a just and smooth transition. The Recommendation encourages countries to adopt relevant policy frameworks that focus on empowerment, inclusion, and the protection of informal workers' rights during this meaningful transition. As the ILO (2018) aptly argues, efforts

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to transform the informal economy are context-sensitive, shaped by the specific features of the informal economy and the broader socio-economic, political, and legal contexts of each country.

As highlighted above, effective governance is crucial for transforming the informal economy. However, evidence from various African countries shows that systemic interventions are still uncommon. National-level initiatives often fail to meet local needs, leading to frequent misalignments between national and local coordination (Kraemer-Mbula & Wunsch-Vincent, 2016). This indicates a need for country-specific evidence on the state of the informal economy, its drivers, the policy environment and governance, as well as strategies to fully harness the potential of the informal economy.

In the context of the preceding discussion, Good Governance Africa-Horn of Africa (GGA-HoA) has initiated a public dialogue project aimed at examining the state of the informal economy and its governance in Ethiopia. While accurate estimates are lacking, Ethiopia is regarded as having one of the largest informal economies in Eastern Africa. The country achieved impressive economic growth averaging about 10 percent occurred from the 2000s to 2018. Despite pro-poor economic policies pursued by the government, decent employment opportunities did not increase, and the integration of its large workforce from the informal to the formal economy remained a challenge. This situation reflects limited progress in structural transformation, which is necessary for shifting labour to more productive sectors with greater potential for growth and job creation (Stollreiter et al, 2023; WB, 2021).

In addition to providing employment, the informal sector is a crucial provider of services for a significant segment of the urban poor, especially in Addis Ababa. The Central Statistical Agency of Ethiopia has consistently cited rapid urbanisation and high rates of rural-to-urban migration of unskilled labourers, along with the resulting unemployment, as major drivers of the informal economy in urban areas. Given the sector's multifaceted contributions, its transformation is strategically important for both workers and the government. This transformation necessitates a comprehensive assessment of the forms and characteristics of the informal economy, its significance for various socio-economic groups, and the governance frameworks that influence it.

In light of the above, GGA-HoA's public dialogue seeks to illuminate the overall state, characteristics, and governance practices that influence the informal economy in Ethiopia. Focusing on Addis Ababa, the dialogue contextualizes governance experiences at the subnational level. To facilitate this, three discussion papers were prepared by researchers and experts in the field and presented at a public dialogue organised in collaboration with the Addis Ababa City Trade Bureau. These papers were revised based on feedback from reviewers and inputs gathered during the dialogue convening governmental and non-governmental organisations, opposition political parties, informal trade operators, and researchers. The focus and key findings of each papers are summarised below.

Chalachew Getahun examines the nature and characteristics of the informal economy in Ethiopia. Drawing on national employment and labour force surveys, as well as reports from international organisations, the paper highlights the predominance of the informal economy within Ethiopia's labour market, particularly in urban service sectors. Ironically, recent official national reports indicate a significant decline in the proportion of the urban population working in the informal sector. This inconsistency is argued to arise primarily from two non-economic reasons. These are related to administrative and legal measures, and changes in the definition and measurement of the sector. By adopting narrower operational definitions than those recommended by the ILO, recent Ethiopian national surveys have overlooked important aspects of informality. Self-employment remains the predominant business structure in Ethiopia's urban informal economy, with most operators facing limited access to finance and infrastructure. By emphasising the interconnections between the informal and formal economies in urban Ethiopia and their substantial contributions to sustainable development, Chalachew underscores the need for an evidence-based policy framework that transforms the informal economy while safeguarding the livelihoods of the poor.

Getahun Kebede revisits the governance context of the informal economy in Ethiopia, focusing on policies, key actors, institutional arrangements, and coordination mechanisms. Despite having a large informal sector, Ethiopia lacks a coherent policy framework to effectively harness its growth potential. The

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government relies on fragmented strategies and regulatory reforms across various sectors, emphasising the formalisation of the informal sector through the expansion of Micro and Small Enterprises (MSE) and the promotion of entrepreneurship. However, formalisation initiatives often overlook the diverse nature and needs of informal businesses and operators, leading to inadequate achievement of their intended goals. In addition to ongoing regulatory burdens, a lack of consistent institutional support and economic instability have hindered efforts to meaningfully transform the informal economy into the formal economy. This suggests the need for a whole-government approach to facilitate a smooth transition to the formal economy and ensure inclusive development while recognising the persistent characteristics of the informal economy.

The case of Addis Ababa provides valuable insights into the governance practices of the informal economy in urban Ethiopia, as discussed by Tesema Chemedo from the Addis Ababa City Trade Bureau. The significant influx of low-skilled migrants from rural areas, combined with ongoing unemployment challenges, has led to the continued growth of the city's informal sector. Although this sector has historically been marginalised in urban planning and development, Addis Ababa has implemented successive regulations aimed at recognising the potential of the informal economy and integrating it into the formal sector. This represents a positive shift from previous assumptions that often characterised the sector as 'illegal' in various national development strategies. However, acknowledging the sector is merely the first step toward harnessing its contribution to overall development. Tesema highlights the necessity of establishing coordination mechanisms among government departments, informal sector operators, and development partners to improve the governance of the informal economy and promote inclusive development.

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Understanding the Nature and Features of the Informal Economy in Ethiopia

Chalachew Getahun

Introduction

The informal economy represents a significant portion of the global labour market, accounting for approximately 58% of total employment worldwide (ILO, 2023a). This prevalence is particularly pronounced in low-income countries, where informal employment can reach up to 84%, compared to about 14% in high-income nations (Women in Informal Employment: Globalizing and Organizing (WIEGO), 2023). In Africa, the informal economy is often referred to as the continent's "real economy," as it not only employs more people than the formal economy but is also expanding rather than contracting, even in times of economic growth. The informal sector is primarily concentrated in agriculture, trade, services, and construction, with women and youth disproportionately represented. In certain countries, up to 92% of employed women are engaged in informal work (ILO, 2023b; WIEGO, 2023).

Despite being marginalised in policy frameworks, the informal economy is a significant and growing component of urban economies in the Global South (World Bank, 2024). The urban informal sector includes a variety of activities such as street vending, home-based enterprises, informal transport, and casual labour. These activities are generally characterised by small-scale operations, low capital intensity, unregulated and insecure working conditions, and limited legal protections (Skinner, 2008; World Bank, 2024). Informality is also associated with precarity, which is marked by irregular income, a lack of social security, and vulnerability to market fluctuations and environmental shocks (Chen, 2012; World Bank, 2024).

The persistence of informal employment is driven by a combination of structural and institutional factors. These include rapid urbanisation that

outpaces the growth of formal employment opportunities, restrictive labour regulations, limited access to education and vocational training, as well as underdeveloped infrastructure and welfare systems (Chen, 2012). Contrary to the portrayal by policymakers, informal employment is not transitional; it represents a long-term reality for many individuals, deeply embedded in social and cultural contexts defined by trust, kinship, and reciprocity (Meagher, 2010).

The urban informal economy is vital to the livelihoods of millions in developing countries, serving both as a source of income for workers and as a provider of essential goods and services to underserved communities (Chen, 2012). Additionally, it acts as a coping mechanism in the face of ongoing economic challenges, such as unemployment, economic downturns, and limited social protection (World Bank, 2024).

Nonetheless, informal workers often face harassment or displacement due to urban policies that criminalise their activities in the name of promoting order or modernisation (Roever & Skinner, 2016). Many governments continue to view informality as a problem to be eradicated rather than as an economic sector to be integrated into an inclusive development agenda (Bénit-Gbaffou, 2016; Meagher, 2010). In contrast, the informal economy continues to expand across developing countries, highlighting the importance of understanding the dynamics of urban informality for equitable and sustainable urban planning

In Ethiopia, the informal sector accounts for a significant share of national employment, supports household consumption, and contributes to around one-third of the GDP (First Consult, 2024; Desalegn, 2023). The growth of the informal economy can be partly attributed to the country's policies shaped by the developmental state model, which have failed to generate sufficient formal employment opportunities as anticipated. The persistence of informality in Ethiopia is also linked to various drivers, such as economic barriers—unemployment, low wages, and restricted access to finance—and institutional constraints, including high taxation, bureaucratic inefficiencies,

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and weak regulatory enforcement. Furthermore, limited education and socio-cultural factors contribute to the sector's continued relevance.

The informal sector provides jobs for a large labour force resulting from rural-to-urban migration and rapid population growth. It continues to exist even during periods of accelerated GDP growth, which often does not create inclusive formal employment opportunities. In cities like Addis Ababa, the informal sector is a vital safety net for migrants and low-skilled urban residents (Cherie, 2019). Recent evidence indicates that women are disproportionately represented in informal jobs such as street vending, domestic work, and home-based production, highlighting deeper gender inequalities in access to the labour market (Ethiopian Economics Association, 2023; UN Women, 2024).

Ethiopia's informal economy is highly diverse and spans multiple sectors. While smallholder farming keeps agriculture as the dominant sector, urban areas are characterised by informal activities in construction, trade, manufacturing, and services. Informal enterprises primarily produce goods such as textiles, leather items, and handicrafts. Community-based financial institutions like *equb*¹ and *edir*² provide financial alternatives for those lacking access to formal credit and insurance services (Fransen, Kassahun & van Dijk, 2010). Informal trade activities, including street vending, are particularly prominent in urban centres, with Addis Ababa hosting a large number of street vendors due to a high rate of rural-urban migration and unemployment.

Recent years have witnessed the rise of the gig economy in Ethiopia, driven by digital platforms that provide flexible employment opportunities. These emerging jobs particularly attract urban youth who are navigating high unemployment, technological change, and expanding cityscapes (Addis Fortune, 2023).

¹ Traditional rotating savings and credit associations.

² Traditional mutual aid and social insurance associations.

While the informal economy contributes significantly to socio-economic development, informal enterprises encounter several challenges, including limited access to credit, inadequate infrastructure, and vulnerability to evictions. Workers often endure poor conditions, lack protections, and have few opportunities for skill development. It is essential to address these issues through targeted institutional support and to create pathways for formalisation, thereby improving livelihoods and maximising the development potential of the sector (Teshome, 2022; Assefa, 2023).

The urban informal economy in Ethiopia—characterised by low income, job insecurity, and limited legal protection—plays a crucial role for many individuals. It is sectorally diverse and socially embedded, shaped by migration, economic necessity, and structural exclusion. While it significantly contributes to national development, addressing its challenges through inclusive policy is essential for unlocking its full potential. The informal economy is dynamic and evolves alongside development processes. Therefore, understanding the sector's status and characteristics is vital for informing effective policies and practices aimed at promoting inclusive development. This paper examines the state of the urban informal economy in Ethiopia, focusing on conceptual issues, key drivers, the link between informal and formal sectors, and its impacts.

Conceptualizing the informal economy

Despite the widespread use of the concept of the informal economy, a universal definition and clear categorisation remain elusive. For analytical purposes, however, the informal economy is characterised by various criteria that distinguish it from the formal economy. According to the International Labour Organization (ILO), the criteria used to define informality broadly include the presence or absence of regulation, employment characteristics, business size and structure, income and earnings, working conditions, and social and legal status:

Lack of regulation: The informal economy operates outside the regulatory framework of the government. This means that businesses and workers in

the informal sector are not subject to formal labour laws, taxation, or social protection (ILO, 2021).

Employment characteristics: It typically includes self-employment, casual labour, and unpaid family work. Jobs often lack security, labour law protection, and social benefits such as health insurance and pensions (Chen, 2016).

Business size and structure: Informal businesses are typically small-scale and synonymous with the owner/family. These businesses may include street vendors, home-based enterprises, and small workshops/kiosks (Thulare, Moyo, & Xulu, 2021).

Income and earnings: Earnings in the informal economy are generally low and unstable compared to the formal economy. Workers in the informal sector often face income volatility and lack access to financial services (Bromley & Wilson, 2017).

Working conditions: Working conditions in the informal economy are often poor, with long hours, low wages/income, and inadequate health and safety standards. Informal workers are more vulnerable to exploitation and abuse than those working in the formal sector (Chen, 2016).

Social and legal status: Informal workers and businesses often lack legal recognition and social protection. This limits their access to public services, credit, and legal recourse (ILO, 2021).

These defining features of the informal economy are based on the ILO's continued work of revisiting the understanding of the sector in its series of International Conferences of Labour Statisticians (ICLS) over the last two decades. In general, while contextualising the understanding of the informal economy based on countries' circumstances is acknowledged, it is advisable to use the ILO's conceptualisation of the informal economy to guide countries' labour market classification and analysis.

In Ethiopia, the criteria used by the Central Statistical Service to define informality are generally limited and have been inconsistent over time. The presence of a book of accounts and a licence are consistently used as

variables to distinguish between formal and informal businesses, with those lacking either defined as informal. Nonetheless, factors such as employee size or purpose of the product/service have been included in other surveys inconsistently. This inconsistency, coupled with the use of only very few indicators across the surveys, has led to an underestimation of the informal economy. This, in turn, makes comparison over years difficult (see the subsection on the growth of informality for a more detailed discussion on this issue).

State and Trends of the Informal Economy in Ethiopia

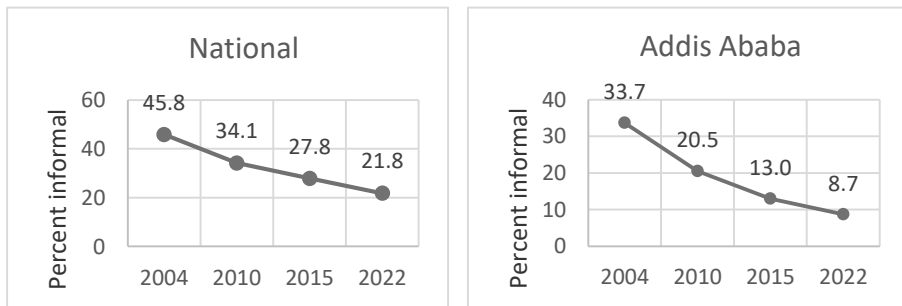
Ethiopia's pursuit of economic growth over the last two decades has largely been guided by the developmental state model, characterised by state-led reforms and centralised political control. Despite the remarkable development progress, job creation in urban centres has not kept pace with GDP growth, population growth, or the steady increase in rural-urban migration. Consequently, employment in the informal economy has become crucial for a large portion of the population unable to access the formal labour market (Clingendael Institute, 2021).

Historically, the informal economy has been a significant component of Ethiopia's urban labour market. It has evolved over time, with different sectors experiencing growth or decline depending on economic conditions and the policy environment (World Bank, 2020). Recent trends indicate a shift in the types of activities within the informal economy. While sectors such as manufacturing and trade have declined, construction activities have increased (Central Statistical Agency, 2022).

Growth in the informal sector

Ethiopia's annual rate of urbanisation is 4.8% (World Bank, 2020). However, formal employment opportunities have not kept pace with this rapid growth, resulting in an increase in informal jobs. Data compiled by the author from national surveys across various years illustrates the trend in the proportion of urban informal employment over time (Figure 1).

Figure 1. Trends in proportion of urban informal employment: National vs. Addis Ababa



Source: National urban employment unemployment surveys (2004, 2010, 2015, 2022).

The figure depicts a decline in the percentage of urban informal employment at both the national level and in Addis Ababa. It is observed that the proportion of urban informal employment at the national level declined by approximately 52.4% between 2004 and 2022. For Addis Ababa, the decline was approximately 74.2%, which is significantly more rapid than the national level.

Two observations can be made from these surveys: First, compared to the size for other sub-Saharan African countries (which is about 61% of urban employment, 78% of non-agricultural employment, and 93% of all new jobs created), Ethiopia's informal sector employment is lower in general (see also World Bank, 2018). Second, it is much lower for Addis Ababa compared to the national urban level for all the survey periods, and is declining much faster than at the national level, likely suggesting the effects of economic conditions and policy changes. Contrary to the low figures reported by national surveys, recent reports indicate a higher level of informal employment in Ethiopia. According to the International Labour Organization (ILO, 2021), about 90% of total national employment in sub-Saharan Africa, including Ethiopia, is informal (see similar reports in WIEGO, 2023). Even when excluding agriculture, informal employment continues to dominate the labour market, accounting for 76.6 percent of employment in Eastern Africa.

A World Bank (2009) report also states that the informal sector in Ethiopia is the fastest growing segment of the private sector. Nonetheless, estimates vary across different reports. For example, according to the 2005 national labour force survey (cited in the World Bank, 2009), the sector accounted for 71% of employment, in large part due to substantial flows of labour from rural to urban areas and the lack of effective mechanisms to absorb this labour in the urban labour market. Other reports indicate that approximately 69% of the working population in Addis Ababa is engaged in informal employment (self-employed individuals, domestic workers, apprentices, and unpaid family labourers), while overall urban areas have about 65% informal employment (Cherie, 2019; Fransen, Kassahun & van Dijk, 2010). The recent Ethiopian labour force and migration survey reports that 45.6% of the general urban residents are engaged in informal employment, while the figure for Addis Ababa is 52.4% (ESS, 2021a).

The question remains why the national surveys report lower figures of informal employment, despite a large portion of the population still making a livelihood in the sector. Why do the official data show a declining trend or lower figures than what one would expect given the socio-economic context of Ethiopia?

We argue that, while informality can decrease due to economic growth and transformation, the Ethiopian case is rather a result of two non-economic reasons: (1) a response to administrative and legal measures taken by the government, and (2) conceptual changes in what constitutes informality. In the case of the first, authorities appear to have compelled informal job operators to step up to the formal sector by enforcing the following administrative procedures: issuing Commercial Registration and Business Licensing Proclamation No. 980/2016 (Federal Democratic Republic of Ethiopia, 2016); providing skills training, helping with access to business premises and infrastructure; and applying stiff tax rules and enforcement measures. Additionally, if informal job operators cannot or are not willing to upgrade to the formal sector as just discussed, they are prohibited and harassed in which case they will be less likely to be enumerated during surveys.

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In the case of the second explanation, informality is often defined from a sectoral or enterprise perspective rather than being understood as a broad economic sector. Additionally, when relying on the sectoral definition of informality, authorities often consider only a limited set of indicators. Moreover, as mentioned above, consistent indicators were rarely used throughout the survey years except for questions on whether the enterprise has a licence and a book of accounts, making it difficult to make comparisons. For example, in a 2004 national survey, an additional question on employee size was asked (10 or more employees to be considered formal), whereas this was not the case in the remaining surveys considered for this analysis. Instead, only a license and a book of accounts questions were used in 2010, and an additional question on whether the product or service was meant for the market was used in the 2015 and 2022 surveys.

Furthermore, while persons engaged in subsistence farming and those who work in private households were excluded from the analysis of the informal economy per the recommendation of the 15th International Conference of Labour Statisticians (ICLS) (ILO, 1993), consecutive Ethiopian surveys indicate that persons employed in government, government parastatals, NGOs, and members of cooperatives were, by default, classified as formal sector workers. For the remaining employed persons, the formal sector was indicated by those employees who satisfied at least one of the indicators, whereas the informal sector was indicated by those who responded “no” to all of the questions considered.

By considering certain organizations as formal *prima facie*, consecutive Ethiopian national surveys have overlooked important aspects of informality beyond informal sector enterprises, as highlighted in the 17th ICLS (ILO, 2003). For instance, these surveys exclude casual, short-term, and seasonal workers within organizations classified as formal. In addition, formal enterprises frequently engage in informal employment relations, such as hiring unskilled labour informally, while formal sector employees rely on informal services, as discussed in the literature on formal-informal linkages. Though connected to formal enterprises, these workers often lack social

protection, health benefits, legal recognition, labour rights, and freedom of association—the defining features of informality.

Moreover, official statistics in Ethiopia neglect several other dimensions of informal sector employment, as outlined in the 17th ICLS. These include self-employment (which also exists in the formal sector but at a lower prevalence), the lack of legal status of enterprises (e.g., unincorporated businesses), enterprise size indicators, and limited capital investment—common in farms, small workshops, garages, shops, restaurants, and service providers. Other overlooked informal employment indicators include unpaid family labour, workers operating in informal locations such as homes, streets, and open markets.

Most importantly, possessing a business licence, bookkeeping records, or paying taxes does not necessarily define formal employment. Many workers remain informal by lacking essential protections under labour laws, including written employment contracts, income taxation, social security, and fundamental employment entitlements such as advance notice of dismissal, severance pay, paid leave, and maternity benefits.

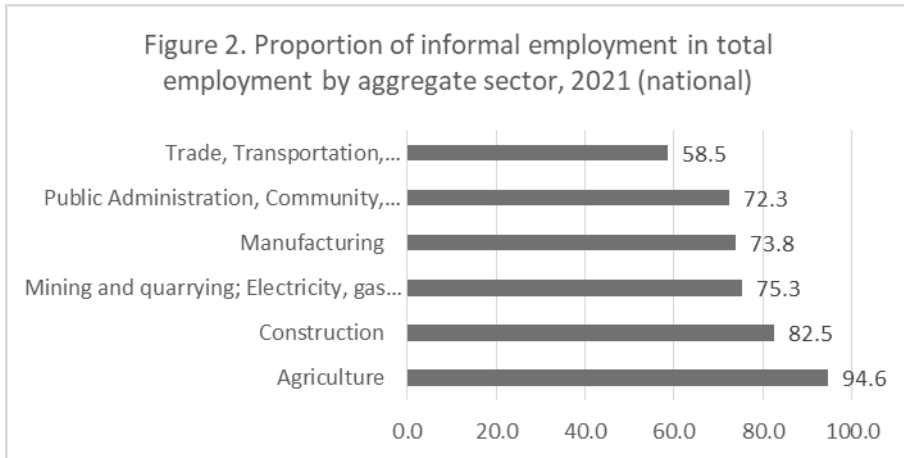
In sum, this section unpacks informality in the Ethiopian context in relation to the ILO's standard frameworks. The ILO has continued to refine the operational definitions of the informal sector, introducing more comprehensive frameworks over recent years. Nonetheless, it is evident that informality in Ethiopia is far more widespread than national surveys suggest. Indeed, informal employment in African cities is a norm rather than an exception (Rigon, Macarthy, Koroma, & Frediani, 2018), and we cannot ignore the several dimensions of informality by merely relying on the narrowly defined concepts of employment in the informal sector.

Sectoral Composition of the informal economy in Ethiopia

As is the case for formal employment, informal employment has a sectoral pattern. Figure 2 presents the proportion of informal employment in total employment by aggregate sectors. The figure shows that, as expected, informality is most prevalent in the agricultural sector, likely due to small-scale farming, family labour, and subsistence agriculture, which operate

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largely outside formal systems. The high prevalence of informality in agriculture is followed by construction, mining and quarrying; electricity, gas, and water supply; manufacturing (indicating a substantial reliance on informal labour despite its industrial nature); public administration, community, social, and other services; and finally trade, transportation, accommodation, food, and business.



Source: ILO (2021). <https://ilostat ilo.org/topics/informality/>

Other reports show shifts in the composition of informal employment over the years. For instance, between 1994 and 2004, informal sector employment saw substantial growth, with notable increases in construction and related activities, while sectors such as manufacturing, services, and trade, hotels, and restaurants experienced declines. Informal small-scale manufacturing enterprises produce goods such as textiles, leather products, metalwork, woodwork, and other handicrafts. These businesses typically operate with minimal capital and often lack formal recognition, limiting their access to markets and financing (Assefa, 2023).

On the other hand, based on its recent labour force and migration survey, the Ethiopia Statistics Service (ESS) reports that informal employment was concentrated in petty trade (36.7%), small-scale manufacturing (17.4%), construction (12.5%), transportation (10.2%), and other informal services (23.2%) (ESS, 2021a). Similarly, the informal sector sample survey report reveals that the trade, hotels, and restaurants industrial group accounts for

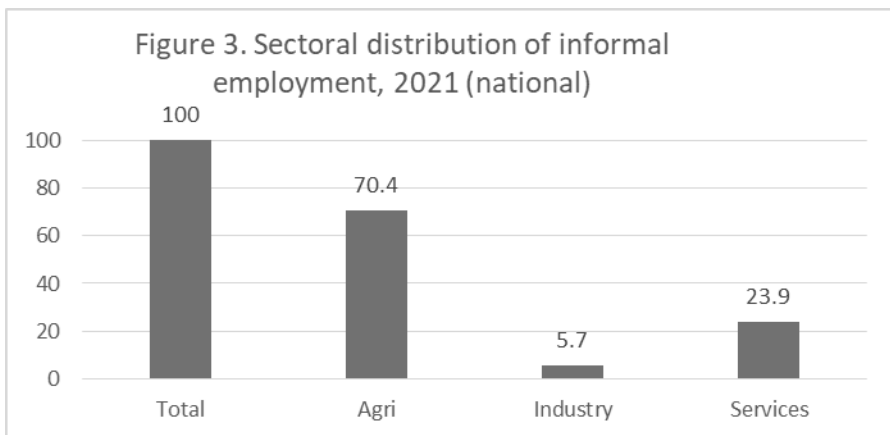
50.3% of the establishments/activities in the sector, followed by the community and personal services category, which constitutes 28.7% of the total number of the sector's establishments/activities (ESS, 2021b). This showcases the high concentration of informal activities within the service sector.

Informal trade and services include informal transport usage (57%); traditional/informal health service usage (27%); waste collection and management (about 50% of all waste is dumped in public spaces) (Fransen, Kassahun & van Dijk, 2010). They also include domestic work, shoe shining, and small repair businesses. Domestic workers, in particular, represent a large portion of informal employment, with women comprising approximately 81% of this workforce in Addis Ababa (Cherie, 2019). Informal trade and services offer over 90% of informal employment in wholesale and retail trade, hotels and restaurants, and primary production activities (Fransen, Kassahun & van Dijk, 2010)

Street vending is a prevalent form of informal employment, especially among women, involving the sale of food, clothing, electronics and other household goods in public spaces in Addis Ababa. While it is common everywhere in the city, street vending is typically widespread in areas such as Megenagna, Hayahulet, Piassa, Mercato and Mexico (Tulu, 2021). Although this sector provides vital income opportunities and livelihoods, it also leads to congestion and conflicts with authorities. Women street vendors face significant challenges, including harassment and lack of legal protection.

Informal savings and credit groups, commonly known as equb, provide financial services to members, allowing them to save and access credit outside formal banking institutions. Edirs provide members with informal insurance in cases of death of members. These associations are vital for those excluded from the formal financial sector. A study by Fransen, Kassahun & van Dijk (2010) indicates that 55% of informal workers rely on informal credit sources, pointing to limited access to formal financial systems.

Another important dimension of the composition is the broad-based sectoral distribution of informal employment at a national level. Figure 3 shows that while significantly smaller than agriculture, the service sector accounts for a significant proportion of informal employment. The low share of the industrial sector in informal employment suggests a relatively limited role, possibly due to more formalised industrial activities and the capital-intensive nature of industries compared to agriculture and services.

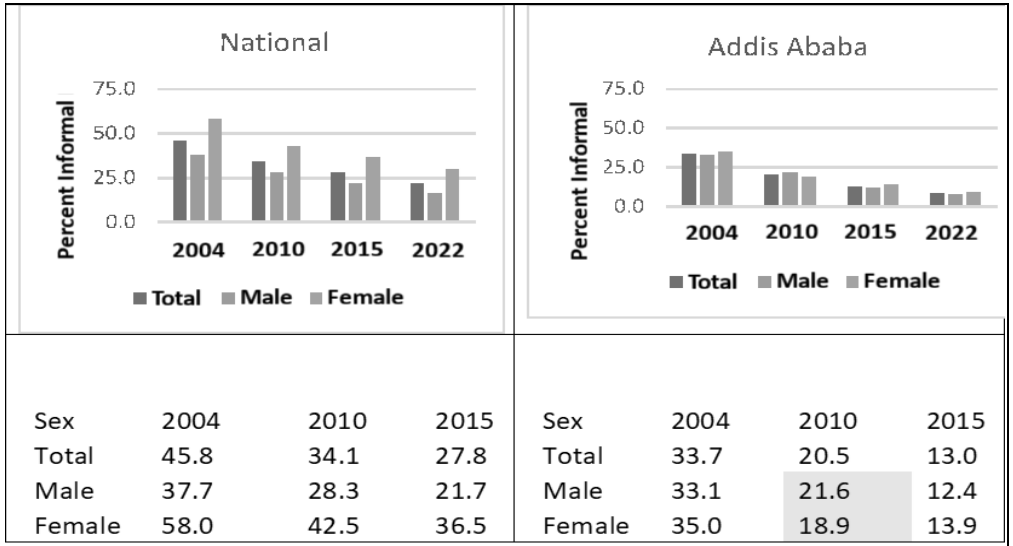


Source: ILO (2021). <https://ilostat.ilo.org/topics/informality/>

Gender dimension of the informal economy

Reports indicate that women constitute the largest share of informal workers, mainly in low-paying domestic work, street vending, and home-based enterprises. Data from national surveys generally show a substantial concentration of women in urban informal employment over the years (Figure 4). While surveys show a decline in the proportion of informal employment for both genders over the years, the gap between men and women remains significant, reflecting the structural and societal factors that drive gender disparities in access to formal employment. Although the overall decline in informal employment is steeper in Addis Ababa, women still account for a larger proportion across all years, indicating that even in urban contexts, they are more likely to rely on informal employment than men.

Figure 4. Gendered urban informal employment: National vs. Addis Ababa



Source: National urban employment unemployment surveys (2004, 2010, 2015, 2022).

Towards the gig economy

The expansion of digital platforms in Ethiopia over recent years has integrated informal workers into the gig economy—characterised by flexible, temporary, or freelance work, facilitating job opportunities for thousands of youth. This shift is driven by factors, such as technological advancements, increased internet penetration, urbanisation, and high youth unemployment rates. For example, ride-hailing services, such as RIDE, have allowed drivers to offer transport services at users’ discretion. Building on the success of ride-hailing platforms, e-commerce and delivery services have also emerged, utilising fleets of motorcycle drivers working on an ad-hoc basis. In addition to these services, the gig economy in Ethiopia includes a wide range of freelance work, from web development and graphic design to domestic help and tutoring. The gig economy provides several benefits, including flexibility and additional income.

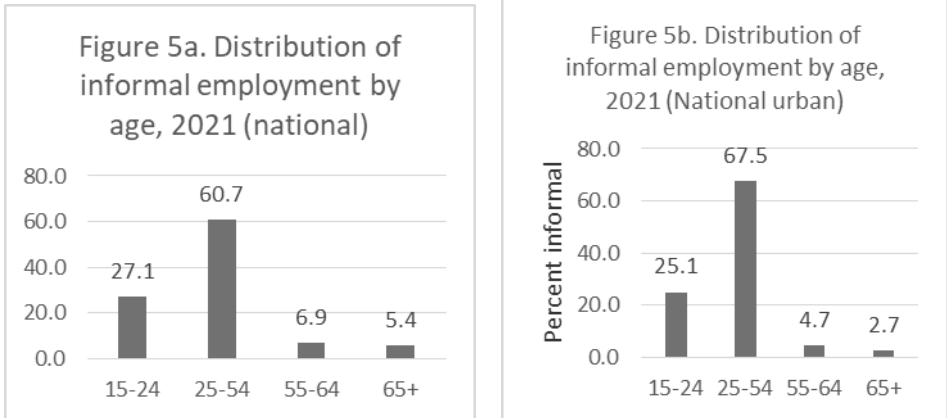
Features of the Informal Economy

Based on the conceptualisation discussed above, the following characteristics of the informal economy can be identified across Ethiopian national surveys.

Demographic characteristics: Demographic features are linked to the Human Capital Theory (Becker, 1964; Schultz, 1961) which posits that individuals' economic productivity and labour market outcomes are significantly influenced by their accumulated knowledge, skills, and experiences—collectively known as human capital. These attributes are shaped by socio-demographic factors such as education level, age, gender, and marital status.

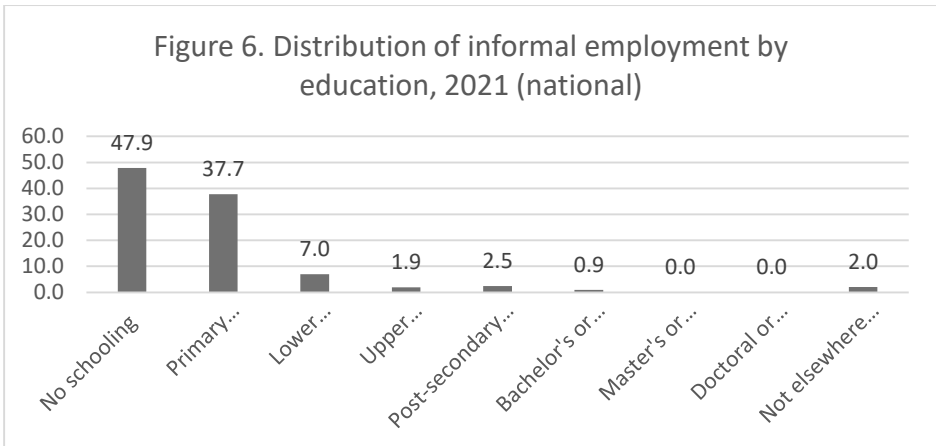
Reports show that a significant portion of informal sector workers in Addis Ababa are youth and rural-to-urban migrants (Elias, 2021). Many have limited education, primarily being school dropouts from primary and secondary levels, which limits their formal employment options (Mesele, 2019). A recent assessment indicates that around 42.6% of informal workers have no formal education, while 30.9% have completed only grades 1-6. Self-employment is common, with many businesses relying on unpaid family labour (Cherie, 2019).

Figures 5a and 5b present the age distribution of informal operators. The figures show that youth employment at ages 15-24 is slightly higher at the total national level compared to urban areas, potentially reflecting the relatively high prevalence of informal agricultural jobs in rural areas. This tendency changes for the prime working age group (25-54), likely reflecting their economic structure and sectoral focus on trade, services, and small enterprises. There is a noticeable drop in the proportion of older informal workers in urban settings compared to the national average.



Source: ILO (2021). <https://ilostat ilo.org/topics/informality/>

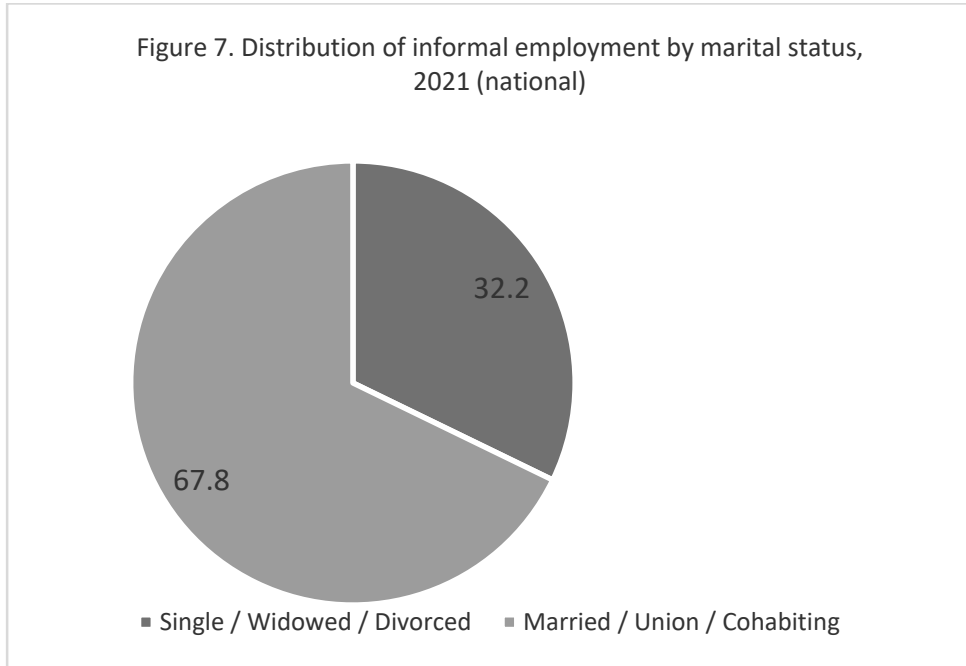
Figure 6 presents the educational characteristics of informal work operators. The figure indicates that the majority of informal work operators possess low levels of education with the largest share of operators having no formal education, and a significant portion having only completed primary school. It shows that a smaller group reached lower secondary education with a negligible proportion having advanced educational qualifications.



Source: ILO (2021). <https://ilostat ilo.org/topics/informality/>

Marital status is one of the key demographic features characterising informality. Figure 7, presenting the distribution of informal employment by

marital status, reveals that a substantial majority of informal workers are married, in a union or cohabiting, with a smaller proportion being single, widowed or divorced.



Source: ILO (2021).

Poor work environment and limited access to resources and finance:

Informal operators often work in vulnerable conditions, with many operating from home or open spaces. For example, over half (54%) of the informal operators in Ethiopia work from home, reflecting a common trend in informal setups, and 26% operate in open spaces, illustrating their vulnerability to external conditions limiting their productivity (Fransen, Kassahun & van Dijk, 2010). Poor infrastructure and inadequate working premises further hinder the growth and sustainability of informal enterprises (First Consult, 2024).

Informal businesses also operate with limited access to formal financial services. As highlighted earlier, many rely on informal financial systems for savings and loans. Limited access to formal credit, discriminatory lending practices, and the absence of collateral constrain growth opportunities for

informal enterprises. Further, a significant 40.8% of informal businesses lack access to business development services (BDS), underscoring a gap in support for business growth and development (Fransen, Kassahun & van Dijk, 2010).

These problems can partly be understood as emanating from institutional failures. Institutional theory highlights how formal institutional failures, such as inadequate enforcement of regulations and legal frameworks, contribute to the persistence of informality (Gaiger, 2017). The theory describes the informal economy as a hybrid institution where regulations are partial and restricted, leading to self-regulated social and economic dynamics.

Business size and ownership

Sole proprietorship remains the dominant business structure in Ethiopia's urban informal economy. It represents an unincorporated business owned and managed by one individual with no separation between the business and the owner. The 2002 urban informal sector survey by the Central Statistical Agency (CSA) shows that nearly 99% of informal businesses were sole proprietorships (CSA, 2003). In 2021, this figure stood almost unchanged at 98% as documented in the 2021 urban informal sector sample survey (ESS, 2021b, p. 38). This ownership pattern is particularly evident among street vendors, small-scale retailers, artisans, service providers, and home-based workers in Addis Ababa and other urban areas (Getahun, 2021).

Own-account informal enterprises are preferred for several reasons. They offer low entry barriers, requiring minimal capital, paperwork, or legal procedures. These features make them especially appealing to individuals with limited formal education or access to employment opportunities, including youth, women, and rural-to-urban migrants (First Consult, 2024). In contexts where regulatory complexity and enforcement are weak, operating alone allows entrepreneurs to maintain autonomy and reduce exposure to administrative burdens (World Bank, 2016).

However, the dominance of sole proprietorship also reflects underlying structural constraints within Ethiopia's informal economy. One key challenge is limited access to finance. Sole proprietors rarely have the

collateral, documentation, or credit history needed to obtain loans from banks or microfinance institutions. According to a recent study, over 80% of informal businesses in Addis Ababa identify lack of finance as a major constraint to their growth and stability (Hassen, Benjamin & Abegaz, 2022). Additionally, sole proprietorship limits collaborative potential and resource sharing. Unlike partnerships or cooperatives, sole-owned businesses often lack access to networks that can facilitate knowledge transfer, bulk purchasing, or market entry. This isolation contributes to stagnation and inefficiency, hindering growth and competitiveness.

Scalability is another pressing issue. Sole proprietors frequently operate at a subsistence level, with limited ability to reinvest profits or hire labour. The informal nature of their operations further excludes them from state support programmes, skills training, or digital technologies that could improve productivity (First Consult, 2024).

Moreover, sole proprietors are highly vulnerable to economic, health, and environmental shocks. Without social protection, savings, or diversified income streams, they face heightened precarity during crises such as inflation, illness, or displacement from public trading spaces (Getahun, 2021). This vulnerability was particularly evident during the COVID-19 pandemic, where many informal sole proprietors experienced a dramatic loss of income due to lockdowns and reduced consumer demand (ILO, 2020).

In sum, while sole proprietorship offers a practical entry point into the urban informal economy, it also reflects broader structural constraints. Addressing these challenges requires targeted interventions, such as improving financial inclusion, simplifying business registration, and encouraging collective enterprises or cooperatives that enhance bargaining power and resilience

Ease of entry

The informal economy is marked by low entry barriers, enabling individuals with limited education or financial resources to establish businesses. This flexibility plays a vital role in absorbing excess labour resulting from rural-to-urban migration. For many, informal employment is driven by necessity rather than choice, as individuals pursue survival strategies in the absence

of formal job opportunities (Chalachew, 2018). As discussed above, limited human capital, coupled with structural barriers, prevents marginalised groups from accessing the formal sector, making the informal economy their primary option. This aligns with the Dual Labour Market Theory (Doeringer & Piore, 1971), which posits that the labour market is divided into two segments: the primary labour market, which offers stable, well-paying, formal jobs with good working conditions, benefits, and career advancement opportunities; and the secondary labour market, characterised by low wages, job insecurity, limited mobility, and poor working conditions—a category in which much of the informal economy resides.

Social networks

In Ethiopia's urban informal economy, social networks play a vital role in shaping how individuals enter, sustain, and navigate informal livelihoods. These networks serve not only as channels for economic opportunity but also as crucial mechanisms for coping with institutional and structural deficiencies. Social networks are shaped by concepts such as embeddedness, social capital, and solidarity, and their usefulness in Ethiopia is influenced by the country's unique social fabric and developmental context.

One of the remarkable functions of social networks in the informal economy is their role in compensating for institutional gaps. In the absence of adequate formal employment opportunities and limited access to formal financial services, informal workers depend heavily on community-based financial systems such as *equb* and *iddir*. These traditional institutions not only provide access to emergency funds and start-up capital but also reinforce solidarity and mutual support among members. This embraces the concept of resilience through social capital, where actors rely on trust, reciprocity, and social norms to manage risk and insecurity (Getahun & Odella, 2014).

Social networks also facilitate entry into the informal sector, particularly for new rural-to-urban migrants. Migrants often rely on family members or

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acquaintances already settled in the city for housing, job referrals, or access to vending spaces (Sosina & Holden, 2014). These embedded relationships act as informal labour market intermediaries, shaping employment pathways that operate outside formal labour market mechanisms (Getahun, 2015).

Other forms of social networks shaping the operation of informal enterprises are ethnic networks. Ethnic solidarity is particularly important across Ethiopia's ethnically diverse urban centres, such as Addis Ababa. Informal business activities often cluster along ethnolinguistic lines, where shared identity fosters trust and cooperation (Clingendael Institute, 2021). These networks can enhance collective resilience and economic opportunity for marginalised groups. Nonetheless, ethnic-based networks may also reinforce social segmentation and limit broader inclusivity within the urban informal economy.

In the absence of formal dispute mechanisms over vending spaces, pricing, or ethics in business transactions, informal actors turn to community representatives and social norms for conflict resolution and governance (Getahun & Odella, 2014). Women also rely on gendered support networks to access credit and share caregiving responsibilities, helping overcome barriers to their economic participation. Overall, social networks act as informal institutions that help urban informal workers cope with poverty, exclusion, and institutional weakness in Ethiopia's cities.

Drivers of the informal economy

Several factors contribute to the persistence and expansion of Ethiopia's informal economy. These factors can broadly be categorised as follows: policy, regulatory and institutional; sociocultural and demographic; economic and infrastructural; rapid urbanisation, housing shortage and poor land management; and technological factors

Policy, regulatory and institutional factors

Policy, regulatory, and institutional environments play a critical role in shaping the informal economy in urban areas such as Addis Ababa. In

contexts where the formal business environment is marked by bureaucratic barriers, weak institutional support, and high tax burdens, many individuals and enterprises are compelled to operate outside formal regulatory systems. These challenges not only discourage formalisation but also foster a business climate where informality becomes the most viable or even the only available option, particularly for low-income and small-scale operators.

Despite government efforts to streamline procedures and improve the business environment, Ethiopia's regulatory framework remains complex, time-consuming, and costly for small-scale entrepreneurs. Lengthy registration processes, rigid licensing rules, and inconsistent enforcement often discourage formalisation, especially among low-income groups with limited literacy and capital (Gebrehiwot & Wolday, 2006). These bureaucratic hurdles disproportionately affect micro and small enterprises (MSEs) that lack the resources to navigate formal procedures. Consequently, informal operations remain a practical option.

Institutional support systems in Ethiopia often fall short of providing the necessary infrastructure and services to promote formal business development. Key challenges include the absence of training in entrepreneurship, limited access to market information, weak institutional coordination, and minimal outreach by regulatory agencies (Gebrehiwot & Wolday, 2006; First Consult, 2024). These constraints prevent informal entrepreneurs from accessing credit, business services, and regulatory guidance. Moreover, social protection mechanisms are largely inaccessible to informal workers. The Ethiopian labour force and migration survey (ESS, 2021a) shows that only 10.4% of informal workers have access to insurance or pension schemes. This lack of institutional support perpetuates informality by failing to offer a safety net or incentives for formalisation (Wondimu & Birru, 2020). High taxation, administrative burdens of tax compliance, and competition from informal businesses are commonly cited deterrents to formalisation. Many small businesses prefer to remain informal to avoid high tax costs, particularly when they perceive no tangible benefits from operating formally. Similarly, formal firms that perceive

intense competition from informal enterprises tend to exhibit lower levels of tax compliance.

Sociocultural and demographic factors

Sociocultural and demographic factors play a critical role in shaping the growth and persistence of urban informality in Ethiopia. These factors influence who participates in the informal economy, the types of activities they engage in, and how they navigate economic opportunities and constraints. In Addis Ababa, informality is deeply embedded in patterns of migration, education, cultural norms, and community networks, all of which shape labour market outcomes outside the formal sector (Getahun, 2021).

Rural-urban migration significantly shapes urban labour markets. The influx of young migrants from rural areas to urban centres like Addis Ababa increases the labour supply, significantly contributing to the growth of the informal economy. Many migrants are pushed out of rural areas by declining agricultural opportunities and limited access to infrastructure and services (Getahun, 2021). The formal sector often lacks sufficient job opportunities to absorb the growing urban labour force, pushing many migrants into informal work as a means of survival.

In addition to labour migration, environmental shocks—including droughts, floods, erratic rainfall patterns, natural disasters, and resource depletion—also disrupt the livelihoods of rural people, leading to displacement and compelling many to seek informal livelihoods in urban areas. Climate-induced migration from rural Ethiopia has contributed to the swelling of urban informal sectors like construction and petty trade. According to Thornton et al. (2024), migration patterns in Ethiopia—especially those driven by environmental stressors—affect urban economies and labour markets.

Lower levels of education, vocational training, and skills are common among urban informal workers in Ethiopia, limiting their eligibility for formal sector employment and pushing them towards informal employment. As discussed earlier, social networks and community support systems are also crucial in sustaining the informal economy. Informal workers in Addis Ababa often rely

on family, kinship, and community ties to find jobs, gain information, and access informal credit or housing.

Cultural factors, including traditional practices, norms, and values, influence the growth of the informal economy. Cultural acceptance of informal economic activities can support their growth, while resistance to formalisation can hinder integration into the formal economy. In many cases, operating outside the formal system is seen not as deviant, but as legitimate and necessary for economic survival. In some communities, informality aligns with long-standing economic practices, and resistance to formalisation stems from mistrust of government or fear of taxation and bureaucratic oversight.

Economic factors and poor infrastructure

Economic pressures are significant drivers of the urban informal economy, particularly in low-income urban settings such as Addis Ababa. Structural unemployment, underemployment, and insufficient formal job creation mechanisms leave large segments of the population without stable income sources. Moreover, high living costs, limited access to finance, and poor infrastructure further push individuals into informal work. These factors often intersect with demographic and sociocultural pressures, discussed above, reinforcing the informality trap for urban residents, particularly youth and women.

According to the 2021 Ethiopian labour force and migration survey (ESS, 2021a), the rate of total urban unemployment for 2021 was 17.9%, with the corresponding figure for females being 25.4%. While urban unemployment is slightly declining over time (only 0.8 percentage points from 2020 to 2021), rural unemployment is rising sharply. The survey also shows that the total youth unemployment rate in urban areas for 2021 was 23.1%, with a corresponding female unemployment rate of 28.8%. This compels many young people to resort to informal jobs for survival. Thus, the informal sector serves as a critical outlet for surplus labour unable to penetrate the formal economy.

Even those employed formally often face a significant mismatch between wages and the cost of living. This huge disparity in the formal sector drives many to supplement their income through informal activities. For instance, public sector workers may engage in weekend vending, taxi driving, or home-based services to make ends meet (Wondimu & Birru, 2020). This trend underscores how informal work is not always a result of exclusion but sometimes a coping strategy for inadequate wages within the formal economy.

Lack of start-up capital and limited access to affordable credit hinder many from establishing formal enterprises. Financial institutions often impose stringent requirements—such as collateral or guarantors—that low-income individuals cannot meet (Serawitu, 2015). When credit is available, it is often expensive and discriminatory, especially against women and youth (First Consult, 2024). The informal economy becomes a default option, as many informal activities require little capital and minimal skills, making them accessible to the urban poor. Moreover, inadequate infrastructure and lack of secure business premises force many entrepreneurs to operate informally on streets or in residential areas with poor access to utilities and public services.

Rapid urbanisation rate, housing shortage and poor land management

Rapid urbanisation and inefficient urban land management significantly contribute to a critical shortage of affordable housing and the growth and persistence of the informal economy. These structural urban challenges often create environments in which informal settlements and economic activities flourish, as formal urban systems struggle to accommodate the needs of growing populations.

Ethiopia's urban population has been growing rapidly, with Addis Ababa experiencing one of the highest urbanisation rates in the country. However, this urban expansion has not been matched by adequate housing provision from the formal sector. The resulting housing deficit has forced large portion of the urban population to settle in informal or substandard housing

conditions. These informal settlements often emerge on the urban periphery or in unplanned inner-city pockets and become centres of informal economic activities such as petty trade, food vending, and home-based manufacturing (Adam, 2014). Informal housing thus provides not only shelter but also an operational base for urban informal livelihoods, reinforcing the symbiotic relationship between informal settlements and informal economic activities.

In addition to housing condition, weak urban land governance further exacerbates informality. Land administration in Ethiopia is often characterised by bureaucratic inefficiencies, lack of transparency, and slow land registration processes, making it difficult for the poor to access legal land tenure or develop property through formal channels. High land lease prices and speculative land markets place formal land ownership out of reach for many urban residents and small entrepreneurs. Consequently, informal land markets thrive, and residents resort to informal construction and land use. These spatial dynamics not only entrench residential informality but also sustain informal economic systems that rely on non-compliant land use.

Technological drivers

In Addis Ababa, the rise of digital technologies has opened up new avenues for informal employment. Mobile phones and internet access have allowed informal workers to advertise services, coordinate transactions, and reach broader markets. Informal vendors and service providers use messaging apps and social media platforms to promote their products, organise deliveries, and communicate with customers. For example, informal food vendors, artisans, tailors, retailers, and so on are increasingly leveraging platforms like Facebook, Telegram, and WhatsApp to expand their reach beyond their immediate neighbourhoods. The gig economy, driven by app-based platforms such as ride-hailing services and delivery networks, has emerged as a prominent segment of technology-enabled informality. These platforms absorb large numbers of unemployed or underemployed youth who lack access to formal employment, allowing them to earn income with

flexible work arrangements. Moreover, digital financial services lower entry barriers, reduce transaction costs, and enable informal workers to manage and expand their businesses more effectively.

However, the growth of digital informality also raises concerns about new forms of precarity, including algorithmic control, lack of labour rights, and increased surveillance. Algorithmic control refers to the way digital platforms, such as ride-hailing or food delivery apps, use automated systems to manage workers. Instead of a human supervisor assigning tasks, monitoring performance, or setting wages, the platform's software makes these decisions based on data and coded rules. This form of management can lead to opaque decision-making processes, where workers may not understand how tasks are allocated or why certain actions are taken, contributing to job insecurity and stress (Li et al., 2023). In urban informal economies where platform-based work is growing, gig workers often operate without contracts, benefits, or legal protections. Algorithmic control deepens this precarity by replacing even the minimal protections that informal workers might have negotiated through personal networks or informal norms. For instance, in Addis Ababa, ride-hailing platforms like Ride and Feres use algorithms to assign trips and calculate earnings. Drivers typically lease vehicles, cover their own fuel and maintenance costs, and can be locked out of the system without explanation, highlighting the vulnerabilities introduced by algorithmic management (Rest of World, 2021). Despite these risks, technology continues to serve as a powerful enabler of informal economic participation, offering new avenues for income generation and access to market.

Linkages and Mobility between Formal and Informal Sectors

Informal and formal economies are not completely separate or binary but exist along a spectrum or continuum with various degrees of formality. This concept challenges the traditional view that separates the informal and formal sectors as distinct and mutually exclusive. Growing evidence highlights the multi-faceted linkages between the two sectors. This linkage is manifested through the supply of resources (such as raw materials),

production processes, market/consumption interactions, employment relationships, and other economic activities.

Informal enterprises often play a pivotal role in supplying raw materials, intermediate goods, and services to formal businesses that the latter may not adequately produce. This symbiotic relationship enables formal enterprises to access cost-effective inputs and services. Informal producers in Addis Ababa contribute significantly to the supply chains of formal manufacturing and service industries, offering flexibility and adaptability in meeting market demands (Fransen, Kassahun & van Dijk, 2010).

The informal sector also serves as a crucial channel for distributing goods and services produced by formal enterprises, especially in reaching underserved or remote areas. Informal vendors and retailers bridge the gap between formal producers and consumers, facilitating market penetration and expanding the customer base for formal businesses. This distribution network is particularly vital in Addis Ababa, where informal channels often provide access to essential goods and services for both low-income and affluent households (Lorato et al., 2023). For example, a study on micro and small enterprises in Addis Ababa reported that micro and small enterprises are involved in value chains such as cloth production, although weak linkages, low demand, and lack of support hinder their full integration into formal supply chains (Kussia & Gebre-Egeziabeher, 2015). Another study found that informal-sector producers such as traditional weavers and footwear makers often contribute to formal-sector production chains through subcontracting arrangements. Similarly, many traditional weavers in the informal sector produce fabrics for fashion designers operating in the formal sector, who then market the final products under their own trademarks (Kifle, 2018). Unfortunately, the absence of reliable data hinders a clear understanding of the scale of these interlinkages.

The labour market in Addis Ababa exhibits significant mobility between the formal and informal sectors, influenced by various economic, policy, and individual factors. This mobility is characterized by transitions not only from informal to formal employment but also vice versa, reflecting the dynamic

nature of the urban labour market. A study analysing panel data from urban Ethiopia between 1994 and 2004 shows that the probability of transitioning from informal to formal employment increased over time (Bigsten, Mengistae, & Shimeles, 2007). Specifically, the transition rate rose from 1% during 1994–1997 to 12% in 1997–2000, and further to 15% in 2000–2004. Notably, workers in the informal sector showed higher mobility into the formal private sector compared to the public sector. By 2000, approximately 15% of those in informal employment had transitioned to jobs in the formal private sector. Further analysis supports these findings, indicating that mobility from informal employment to formal private sector positions was more feasible than transitions into public sector roles (Fransen, Kassahun & van Dijk, 2010). Their study highlighted that 3.7% of informal employees transitioned to formal private sector employment annually, whereas transitions to public employment remained significantly lower. The rate of absorption of unemployed individuals into the formal sector increased from 2% (1994–1997) to 18% (1997–2000), but much absorption was into the informal sector, rising from 5% to 19% over the same period (Bigsten, Mengistae, & Shimeles, 2007). The same report highlights a decline in labour market segmentation, as evidenced by increased mobility between the informal and formal sectors.

Contributions of the Informal Economy

As indicated above, the informal economy plays a pivotal role in Ethiopia's socio-economic development. The informal economy significantly contributes to employment creation, livelihood security, poverty alleviation, domestic gross product, and environmental sustainability, particularly in urban centres like Addis Ababa.

Employment, livelihoods and poverty alleviation

The informal economy accounts for over 80%-90% of national employment, serving as a primary source of livelihood (Etefa, 2023; ILO, 2021; World Bank, 2025). This is very significant compared to 61.2% of the global workforce and 85.8% of the workforce in Africa (Etefa, 2023). It is a major source of employment, particularly for marginalised groups such as women and

migrants who cannot access formal employment opportunities. In addition, the informal economy ensures the availability of affordable goods and services for the urban poor (First Consul, 2024; Tulu, 2021).

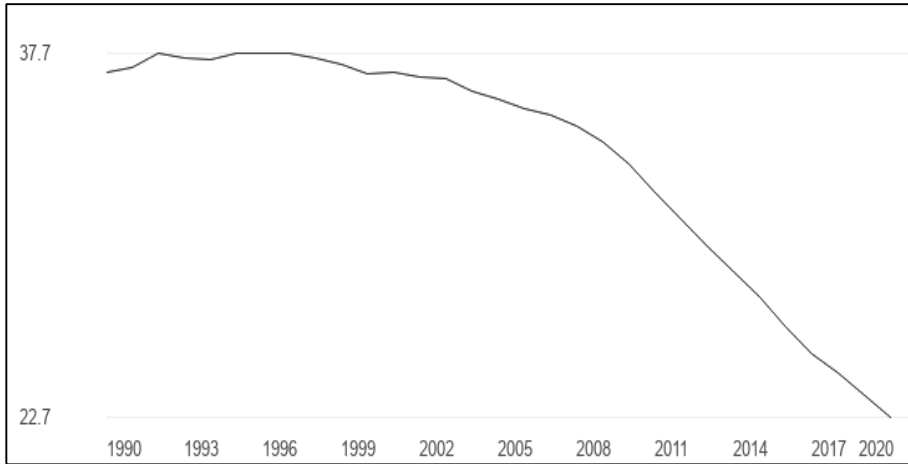
The informal sector also plays a crucial role in sustaining the livelihoods of urban residents across Ethiopia. A study in Hawassa city revealed that 67% of participants perceived that engaging in informal sector activities significantly improved their livelihoods. Factors contributing to better livelihood outcomes included higher monthly income, savings, longer business tenure, access to credit, and training opportunities (Lorato et al., 2023). In the context of rapid urbanisation and limited formal employment opportunities, the informal sector contributes to poverty reduction by providing income-generating opportunities for marginalised groups (World Bank, 2020, September 30). In view of this, the World Bank's Urban Productive Safety Nets and Jobs Project aims to improve the incomes of the urban poor and promote the inclusion of disadvantaged urban youth in the labour market.

Gross Domestic Product - GDP

The informal economy is a significant contributor to Ethiopia's GDP. According to the Global Economy.com (2020)³, the average value of GDP from the informal sector from 1992 to 2020 was 33.45%. The average value in 1992 was 37.7% and dropped to 22.7% in 2020.

³ https://www.theglobaleconomy.com/Ethiopia/informal_economy_dge/

Figure 8. Trend of GDP contribution of the informal economy



Source: Global Economy.com.

Other reports indicate that the informal economy is still estimated to account for about a third of Ethiopia's GDP, highlighting its significance in economic activities and employment generation (First Consult, 2024; Stock Market Ethiopia, 2023; World Bank, 2020).

Environmental sustainability

The informal economy contributes to environmental sustainability through activities such as waste recycling and sustainable resource use. Informal waste pickers, for example, play a vital role in managing urban waste (UNDP, 2020). A study on municipal solid waste management in Ethiopia highlights that approximately 5% of municipal waste in Ethiopia is recycled through informal means (Teshome, 2021). In Addis Ababa, informal waste collectors and recyclers play a crucial role in supporting the formal waste management system, recovering materials that would otherwise end up in landfills (UNDP, 2020). Locally referred to as *Koraliyo* (*hawker traders buying used materials/scrap metals*) they move through neighbourhoods buying items such as old shoes, clothes, broken appliances, plastics, large jerrycans, used metals, or even old pots and pans, that they can fix up or remould to make other things they can sell. These activities have existed for a long time,

servicing not only as a means to dispose of unwanted items but also as a way to earn income through the resale of used goods. Additionally, retail shops buy used papers to create bags for packing items for sale. According to the UNDP (2020), after collecting waste from institutions, households, waste collection points, and landfills, the *korales* sell it to wholesalers, who in turn sell it to recycling industries and local artisans. Addis Ababa's *Min Alesh Tera* in Merkato is a well-known hub for local artisanship using various recyclable and reusable materials, including metal, plastic, paper, rubber, wood, and more.

Thus, the labour-intensive technique of recovering recyclable materials helps reduce municipal spending on extensive formal waste management infrastructure (Tilaye, 2014). However, the sector is marked by inefficiencies due to technical constraints, inadequate infrastructure, and limited access to markets. This suggests the need for integrating informal waste collectors and recyclers into the formal waste management framework (UNDP, 2020, July 30; Teshome, 2021). Nonetheless, the negative impact of informal activities on the urban environment cannot be overstated.

Challenges Facing Informal Enterprises

This section highlights key challenges affecting the development of the informal sector. These challenges can be broadly categorised as capital shortages, bureaucratic constraints, lack of skills, limited government support, and social-economic vulnerability.

Capital shortages and limited access to finance

Studies highlight that informal sector entrepreneurs face significant capital shortages. The majority of entrepreneurs in this sector often start their businesses with minimal capital, sourced from personal savings or small loans from family and friends (Chalachew, 2018). The persistence of this pattern (low start-up capital and its source) has remained unchanged, as documented in the recent national urban informal sector sample survey (CSS, 2021). A recent labour force and migration survey (ESS, 2021a) indicates that 71.5% of informal workers lack access to financial services.

Informal businesses often lack the necessary collateral and documentation to secure loans from financial institutions, including banks and microfinance institutions. When loans are available, they sometimes face discriminatory practices based on their sector, size, or ownership structure (First Consult, 2024). Micro finance institutions also charge high interest rates, partly because they borrow from banks at high interest rates themselves, and partly due to their perception of informal businesses as high-risk clients (Getahun, 2021). Additionally, studies show that many informal business owners lack awareness of financial services or the capacity to utilise them effectively. For instance, they lack access to information about available financial services, such as loans, or are unable to meet complex application requirements (First Consult, 2024).

Inadequate infrastructure, services and working premises

Informal businesses often operate in temporary or substandard locations such as roadside setups or rented spaces, limiting their potential for growth (Chalachew, 2018; Getahun, 2021). A survey found that 71% of operators often start their businesses in rented premises and frequently face evictions, tenure insecurity, and high rental costs (Gebrehiwot & Wolday, 2006). The lack of basic infrastructure and services—such as reliable electricity, water, and roads—poses significant operational challenges. A recent labour force and migration survey by the Ethiopian Statistics Service (ESS, 2021a) highlights that the lack of occupational safety measures affects 71.3% of informal workers. Further, limited access to technology and adequate facilities hampers productivity, reduces competitiveness, and constrains long-term growth (First Consult, 2024).

Regulatory and bureaucratic constraints

Informal enterprises in Ethiopia face significant challenges related to complex regulatory frameworks and bureaucratic obstacles that discourage formalisation. The Ethiopian labour force and migration survey (ESS, 2021a) reveals that 68.3% face regulatory challenges in registering or formalising their businesses. These regulatory hurdles include the involvement of multiple institutions, rigid and lengthy approval procedures, and frequent

institutional restructuring (Getahun, 2021). In Addis Ababa, street vendors and home-based businesses avoid registration out of fear of eviction or penalties.

The lack of government support further undermines informal enterprises' transition to the formal sector. As they operate without business licences, informal enterprises rarely receive government support or access to formal markets. Furthermore, complex procedures for obtaining licences, low awareness of registration processes, and discriminatory enforcement practices make formalisation seem costly and confusing to micro and small enterprises (Getahun, 2015). Municipal governments, lacking capacity for inclusive planning and necessary infrastructure, further marginalise informal operators (Fransen, Kassahun & van Dijk, 2010).

These interacting regulatory and administrative challenges are structural outcomes of misaligned formal rules that fail to meet the needs of informal enterprises. This shows that informality is not merely a matter of individual choice, but a rational response to institutional exclusion and inefficiency (Helmke & Levitsky, 2004).

Lack of skills and business development support

The lack of legal recognition also limits informal enterprises' access to government subsidies and business development. A survey showed that approximately 87% of informal business owners do not receive vocational or technical training, either before or after starting their business. This is reported to significantly hamper productivity and the ability to adapt to changing market conditions (Chalachew, 2018; Gebrehiwot & Wolday, 2006). Most informal businesses operate without proper documentation, making them vulnerable to eviction, crackdowns, and penalties from local authorities and the police, particularly in high-traffic commercial areas (Teshome, 2022; Tulu, 2021).

Social and economic vulnerability

Informal businesses often provide low-quality jobs with minimal productivity. According to the Ethiopian Labour Force and Migration Survey

(ESS, 2021a), on average, persons engaged in the informal sector work more hours per week compared to their formal sector counterparts (49.2 vs. 43.8 hours), yet they earn only 38% of what their formal sector workers earn (ETB 1650 vs. 4300). As mentioned above, women are disproportionately represented in the informal labour market, yet they face additional challenges, including restrictive societal norms and the absence of institutional frameworks.

Conclusion

The informal economy remains a major sector influencing the socio-economic development of developing countries such as Ethiopia. It consists of small-scale unregulated economic activities that typically operate without legal recognition, labour protections, and social benefits. Informal enterprises encompass a wide array of activities, including street vending, home-based production, small-scale services, and a growing array of gig-based businesses. These businesses are marked by ease of entry, small or single ownership, limited access to capital, and strong reliance on informal networks for resources and support.

Despite Ethiopia's economic growth, the creation of formal employment opportunities has not kept pace with rapid urbanisation and population growth. Though official data suggest a decline in urban informality, estimates from international organisations and researchers indicate that over half of urban jobs remain informal. While the ILO offers a comprehensive framework for defining informality, Ethiopia's statistical agency often employs inconsistent and narrow criteria, resulting in underreporting and limited comparability over time. This also hampers evidence-based policy-making related to the sector.

An estimated 80–90% of the urban workforce in Ethiopia is engaged in informal activities. The sector provides crucial employment and income-generating opportunities, especially for marginalised groups such as women, youth, and rural-urban migrants. The informal economy also plays a key role in poverty alleviation by absorbing labour excluded from the formal sector, particularly in urban areas such as Addis Ababa. It also makes a significant

contribution to the national economy, accounting for nearly one-third of GDP. Despite operating under precarious conditions, these businesses also provide essential goods and services and support environmental sustainability. This underscores the sector's importance not only as an economic safety net but also as a hub of entrepreneurship and social resilience.

While Ethiopia has made strides in acknowledging the sector's relevance and in data collection—most notably through the Ethiopian Statistical Service's 2021 Urban Informal Sector Sample Survey—the country still lacks consistent and regular documentation on informality. The lack of periodic assessments has limited policymakers' ability to track trends, understand the evolving nature of informal employment, and design effective interventions.

The informal and formal economies in Ethiopia are closely interlinked, highlighting the need to challenge the dichotomy between formality and informality in favour of a continuum approach. Informal businesses are the main suppliers of goods and services to the formal sector. In addition, informal enterprises often serve as key distributors of products from the formal sector. Moreover, workers frequently move between the informal and formal sectors, particularly into the private formal sector. These connections suggest that the informal sector is not merely a fallback but a dynamic and adaptive component of the broader urban economy. As such, policy approaches that treat the informal sector as separate or temporary are likely to fall short. This suggests that effective strategies should leverage these complementarities to promote inclusive growth and foster synergies across sectors.

Multiple interrelated factors hinder the growth of the informal economy and limit its diverse contributions to Ethiopia's development. These include burdensome and often opaque regulations, complex licensing procedures, unreliable infrastructure, and limited access to finance. Informal entrepreneurs often start with minimal capital and lack collateral or documentation to engage with formal financial institutions. These

challenges are compounded by the sector's socio-economic vulnerability, further undermining its sustainability.

While Ethiopia has made strides in acknowledging the sector's relevance and in data collection—most notably through the Ethiopian Statistical Service's 2021 Urban Informal Sector Sample Survey—the country still lacks consistent and regular documentation on informality. The lack of periodic assessments has limited policymakers' ability to track trends, understand the evolving nature of informal employment, and design effective interventions. As Ethiopia continues to urbanise and struggle with unemployment challenges, it is imperative to institutionalise regular data collection, broaden labour market indicators, and align national statistical practices with international standards to ensure sustained evidence-based policymaking and tailored interventions.

Policy Recommendations and Practical Strategies

Adopt a Comprehensive and Standardised Framework for Defining and Measuring the Informal Economy.

- **Recommendation:** The Government of Ethiopia should implement a comprehensive and standardised framework for defining and measuring the informal economy, in alignment with the International Labour Organization's (ILO) guidelines. This approach will enhance the accuracy, comparability, and policy relevance of data on the informal economy, facilitating the development of tailored interventions that reflect the sector's scale and diversity.
- Strategies:
 - Institutionalise the ILO's multidimensional approach to informality.
 - Harmonise and standardise the dimensions and indicators of the informal economy across surveys.
 - Provide capacity building and technical support to statisticians and enumerators through collaboration with the ILO, UNECA, or UNDP.

Establish a National Informal Economy Data System

- **Recommendation:** Develop a national framework for the regular and comprehensive collection, analysis, and dissemination of data related to the informal sector.
- Strategies:
 - Institutionalise nationwide surveys on a periodic basis.
 - Utilise digital tools, mobile platforms, and participatory methods to gather real-time data on informal activities.
 - Create a central database or observatory to serve policymakers, researchers, and development practitioners.

Integrate the Informal Economy into National Development Frameworks

- **Recommendation:** Acknowledge the informal economy as a permanent and integral component of Ethiopia's urban economy in national economic planning.
- Strategies:
 - Incorporate informal enterprises into urban development plans, employment strategies, and industrial policy frameworks, ensuring that data collection systems sufficiently capture their contributions.

Improve the Regulatory and Tax Environment

- **Recommendation:** Simplify regulatory procedures and adopt a progressive and inclusive tax regime that is straightforward, realistic, fair, and easy to comply with, encouraging informal operators to participate without penalising them or pushing them further underground.
- Strategies:
 - Develop simplified registration and licensing processes tailored for micro and small informal businesses.

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- Introduce presumptive or turnover-based tax models with low compliance costs.
- Establish one-stop service centres to reduce bureaucratic burdens.

Improve Access to Finance

- **Recommendation:** Expand financial inclusion initiatives tailored to the needs of informal entrepreneurs.
- Strategies:
 - Promote collateral-free microloans and guarantee schemes.
 - Strengthen mobile banking and digital payment systems.
 - Provide financial literacy programmes and enhance capacities to utilise available financial services.

Improve Infrastructure and Workspaces

- **Recommendation:** Develop inclusive infrastructure that supports informal businesses.
- Strategies:
 - Create accessible, affordable, and secure workspaces, such as designated market zones and vendor stalls.
 - Enhance access to essential services like electricity, water, and sanitation in high-density informal business areas.

Strengthen Skills Development and Capacity Building

- **Recommendation:** Invest in demand-driven technical and vocational education for informal workers.
- Strategies:
 - Collaborate with NGOs, local governments, and private providers to deliver short-term, practical training on business skills, digital literacy, and production techniques.
 - Facilitate peer learning and mentorship programmes within informal networks.

Leverage Formal–Informal Linkages

- **Recommendation:** Promote synergies between formal and informal enterprises to foster inclusive value chains.
- Strategy:
 - Support the gradual transition of the informal sector into the formal economy by incentivising formalisation.

Protect and Empower Vulnerable Groups

- **Recommendation:** Design targeted support for women, youth, and migrants within the informal economy.
- Strategies:
 - Provide gender-sensitive training and financial services.
 - Establish childcare services and flexible workspaces for women entrepreneurs.
 - Support migrant entrepreneurs with local integration programmes and language assistance.

Enhance Institutional Coordination and Accountability

- **Recommendation:** Foster inter-agency collaboration for informal economy support.
- Strategies:
 - Create a national coordination body to harmonise informal sector interventions across ministries and municipalities.
 - Monitor and evaluate the impact of formalisation programmes with stakeholder participation.

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Governance of the Informal Economy in Ethiopia

Getahun Fenta

Introduction

In the mid-1950s, W. Arthur Lewis developed a seminal framework for economic development that posits the widespread availability of a surplus labour supply across developing countries. He asserted that this surplus workforce would be absorbed as the modern industrial sector grew (Lewis, 1954; Hosseini, 2012). The successful reconstruction of Europe and Japan, coupled with the post-WWII expansion of mass manufacturing in Europe and North America, led to the widespread acceptance of Lewis's theory of economic development during the 1950s and 1960s. Development policymakers and practitioners were largely convinced that, with the appropriate combination of resources and policies, traditional subsistence economies could evolve into modern formal economies (Harrison, 2000; Kesternich, 2014).

However, the anticipated economic growth in many developing countries failed to create sufficient formal employment opportunities to reduce unemployment. By the mid to late 1960s, growing concerns about rampant unemployment eclipsed the initial optimism regarding growth prospects (Bhagwat, 1973; Turnham & Eröcal, 1990). In response, the International Labour Organization (ILO) embarked on comprehensive, interdisciplinary employment missions across various countries. In 1972, the ILO deployed its first mission to Kenya (ILO, 1972). This mission recognised that the traditional sector, referred to as the informal economy, had not only endured but had also expanded. Moreover, it discovered that the informal sector encompassed successful and efficient businesses rather than merely traditional subsistence activities. The report further highlighted that the

informal economy is often overlooked, rarely supported, frequently unregulated, and generally discouraged by policymakers (Chen et al., 2002).

The 1980s saw a surge in the informal economy, especially in countries undergoing economic transitions. With the closure or downsizing of public enterprises, workers who were laid off turned to the informal economy (Chen et al., 2002). This shift occurred as households needed to supplement their income from formal employment in response to inflation or reduction in public services. The informal economy grew in countries with established industrial sectors for several reasons (Carr & Chen, 2002; Chen et al., 2002). Firstly, increased capital investment in industrial sectors led to a reduced workforce. Those unable to secure formal employment either remained jobless or entered the informal sector. Secondly, production decentralisation resulted in smaller, specialised, and more flexible production units, with some subcontracting to informal or unregistered entities (Chen et al., 2002). Thirdly, cost-cutting measures aimed at improving efficiency led to a decrease in formal employment relationships and an increase in service outsourcing (ILO, 2007).

The increasing international integration and competition in the 1990s further accelerated the expansion of the informal economy. To enhance global competitiveness, investors often adopted informal employment practices or relocated production to countries with lower labour costs (ILO, 2009). Many industries underwent significant restructuring, involving subcontracting or outsourcing through international commodity chains. According to Theron and Godfrey (2000), these chains involve large retail or manufacturing companies subcontracting their production to foreign suppliers, who then engage small, sometimes informal, production units. These economic shifts, among other factors, have contributed to the expansion of the informal economy in many developing countries.

Ethiopia's informal sector has a long history. Informal financial systems, such as *equb*, have played a crucial role in providing credit to informal traders, including those working with government licences but are unable to access bank loans (Getahun, 2015). Due to limited formal job opportunities, many

people who migrated to urban areas historically turned to informal employment (Getahun, 2015; Schwettmann, 2023). Economic reforms in the 1990s, including the liberalisation of trade, significantly increased informal activities. Despite these substantial changes, the informal sector remains a vital part of Ethiopia's economy, providing jobs and income to a large portion of the population (Lorato et al., 2023).

In fast-growing Ethiopian cities like Addis Ababa, the informal economy is a crucial source of employment for the large urban workforce. With 58% of Addis Ababa's population growth resulting from rural-urban migration, the majority of urban informal workers are migrants from rural areas (World Bank, 2015). According to the Central Statistics Agency (2003), 90% of rural migrants enter the informal economy, a trend that is even more rapid in secondary cities.

Workers in the informal sector engage in economic activities that are not regulated by the government and typically lack formal employment contracts. This sector encompasses a diverse array of jobs, including street vendors, small traders, daily labourers, artisans, domestic employees, and transport operators. While not all individuals in the informal economy are poor, poverty and social exclusion are key drivers and consequences of informality (ILO, 2007).

Informal employment in urban Ethiopia is largely driven by exclusionary practices, such as structural and economic barriers. However, a smaller segment of informality is voluntary, as businesses weigh the advantages and disadvantages of becoming formalised. A study conducted by Getahun (2015) on informal street vendors in Addis Ababa found that 76% entered the trade due to a lack of alternative livelihood options, highlighting the prevalence of necessity-driven informality. The remaining 24% chose to engage in street vending voluntarily, either to supplement low incomes from other sources or because they deemed it profitable.

The extent to which the informal economy contributes to or hampers overall development largely depends on governance practices. This chapter focuses on the governance of the urban informal economy in Ethiopia. It begins by

presenting the core policy debates on the importance and sustainability of the informal economy. This is followed by a section that examines the policy environment shaping the informal economy in Ethiopia. The remaining section discusses the key governance challenges affecting the growth of the informal economy and offers policy recommendations to maximise the sector's multidimensional contributions.

Debates on the Informal Economy

The informal economy has been a subject of debate among scholars and policymakers (Chen, 2023; ILO, 2007), especially concerning its economic and social contributions and sustainability. Critics often portray the informal economy sector as an obstacle to economic growth, characterising it negatively as a last resort employment option (ILO, 2001). From this standpoint, the informal economy undermines governmental revenue, limits public investment in development and strains public services, ultimately obstructing economic growth (Loayza, 1996). In addition, critics argue that the informal economy undermines market efficiency, as informal workers engaged in the sector derive limited benefits from their participation. Moreover, opponents advocate for formalising the informal sector to ensure businesses comply with labour laws and tax obligations, while addressing unfair competition and poor working conditions. Informal workers often experience low wages, limited social protection, and job insecurity, all of which worsen inequality and impede inclusive growth (Mugisa, 2021; Chen et al., 2002).

Conversely, protagonists emphasise the positive impact of the informal economy on overall development (Bhattacharyya, 1993; Asea, 1996; Schneider & Enste, 2000). They argue that informal enterprises stimulate growth by creating demand for formal sector products and indirectly boosting government tax revenues. The sector is viewed as a flexible and resilient component of overall economy, capable of absorbing a large labour force even during economic downturns. Challenging the portrayal of the sector as merely a last resort for the poor, proponents underscore that many entrepreneurs in developing countries choose informality voluntarily rather

than being forced into it. In addition, they view the informal sector as a safety net that nurtures entrepreneurship, provides vital employment and income opportunities, and reduces poverty and inequality, particularly in developing countries (Chen, 2023). Moreover, the informal sector is the main provider of affordable goods and services to low-income populations. By operating with flexible hours and informal transactions, informal enterprises foster community engagement and social interaction (Chen, 2012).

Urban design and planning are also topics of policy discussions concerning the governance of the informal economy (Mugisa, 2021). This is due to the prevalence of informal activities, particularly in urban areas struggling with demographic pressure and economic challenges, prompting discussions on how urban policy can accommodate and support informal workers and businesses (Chen, 2023). A central debate is whether to regulate, integrate, and formalise informal businesses or to preserve the informal economy as a distinct economic sector (Chen et al., 2002).

This idea relates to the essence of government intervention in regulating the sector. Advocates of government involvement emphasise the importance of protecting workers' rights, ensuring equitable benefits, and improving working conditions. Many informal workers, especially women, experience discrimination, lack skills and market awareness, and have limited protection—factors that exacerbate existing socio-economic disparities (Chen et al., 2002). There have been strong calls for government to enhance the productivity of the informal sector, protect informal workers, and gradually transition the sector into the formal economy (Bacchetta & Bustamante, 2009).

Perspectives on Formalization of the Informal Economy

Similar to the debates on the relevance of the informal economy, there are ongoing arguments regarding the importance of its formalisation. Advocates of formalisation contend that regulating the informal sector improves working conditions, facilitates access to social protection, and increases government tax revenue. It also enables informal businesses access to

necessary infrastructure, training, and funding, thereby enhancing productivity and growth. In addition, formalisation helps informal workers gain improved labour rights and access to protections, such as health insurance, pensions, and legal safeguards (Mugisa, 2021). Formalisation also addresses problems like child labour and environmental harm while boosting tax revenues (ILO, 2007; Moyo, 2022). Proponents further recommend that governments gradually incorporate informal businesses into the formal economy by creating a supportive and organised environment to promote sustainable growth and development (Chen et al., 2002).

Opponents of formalisation argue that markets can function effectively without government intervention, which they believe often leads to inefficiencies and distortions. This line of argument emphasises that formalisation could impose stringent regulations that hinder small businesses or drive them further into informality. Excessive regulations, taxation, and bureaucratic obstacles can stifle innovation and entrepreneurial initiatives, ultimately reducing economic activity and resulting in job losses (ILO, 2007; Williams & Nadin, 2010). Moreover, government actions often benefit large corporations through trade, industry, and fiscal policies, and hence interventions tend to affect the informal sector differently from the formal sector. Government intervention could push informal businesses underground, making them more difficult to monitor and support. Instead, opponents of formalisation advocate for creating an environment that encourages voluntary formalisation through incentives, such as reducing costs and complexities associated with formalisation, rather than relying on coercive measures (Bacchetta & Bustamante, 2009).

In summary, there is no one-size-fits-all answer to the question regarding the appropriate level of government involvement in the informal economy. Strategies may vary according to each country's priorities and situations. Nonetheless, there is an increasing consensus on the need for a balanced approach.

The Ethiopian government generally portrays informal sector activities as a threat to formal businesses and tax revenue. This often leads to restrictive regulations and crackdowns, including the confiscation of goods from street vendors (Lewis et al., 2019). Discouraging informality and promoting the formal sector have been key policy priorities (Yonathan, 2019). Before 1991, the informal sector largely operated without oversight, with small enterprises functioning without licences. However, following the fall of the Derg regime, the government began recognising the significance of this sector and introduced laws to legalise and support it through initiatives such as cooperatives and microfinance (Garoma, 2012). Since the 1990s, a range of policies, strategies, legislation, fiscal and financial incentives, and regulatory reforms have been implemented to support Micro and Small Enterprises (MSEs) and to promote the transition of informal workers and businesses into the formal sector. The primary goals are to bolster economic stability, enhance tax revenue, and improve social protections for informal workers (World Bank, 2015).

Policies and Institutional Frameworks relevant to the informal economy in Ethiopia

Since the 1990s, Ethiopia's approach to development has prioritised microenterprise development as a strategy to address informality, unemployment, and poverty while also fostering economic growth (Mammo & Eshetu, 2009). The government has implemented a microenterprise development strategy that underscores the significance of micro and small enterprises (MSEs) through improved access to working capital, training, and business development services. These strategies generally emphasise the formalisation of the informal sector (UNDP, 2012). However, Ethiopia lacks a comprehensive policy framework specifically dedicated to the governance of the informal economy. Instead, a range of general economic and social policies, plans, laws, and programmes targeting entrepreneurship and small business growth are employed to address the challenges related to the informal economy (FDRE Ministry of Industry, 2019). The policies, strategies, and regulatory frameworks that directly or indirectly influence entrepreneurship and the informal sector are outlined below.

National Entrepreneurship Strategy of Ethiopia (2020-2025)

The National Entrepreneurship Strategy (NES) of Ethiopia (2020–2025), introduced in 2019, aims to promote inclusive and sustainable economic growth by creating a supportive environment for entrepreneurship. It outlines five primary goals: refining the regulatory framework to reduce barriers and simplify procedures, improving entrepreneurship education and skill development, facilitating technology transfer and innovation to boost productivity, increasing access to financing, and fostering awareness and networking opportunities. The strategy also emphasises cross-cutting themes such as supporting women and youth entrepreneurs, strengthening rural-urban connections, and initiatives focused on a green economy. It targets innovators, agropreneurs, green entrepreneurs, young entrepreneurs, women entrepreneurs, and social entrepreneurs (Ministry of Industry, 2019).

While the informal sector is not the main focus, NES takes into account the needs of micro, small, and medium enterprises (MSMEs), many of which operate informally. By improving the financial and regulatory environment, it supports the transition of informal businesses into the formal sector, promoting inclusivity and sustainability. The Ministry of Industry is responsible for overseeing the strategy's implementation, ensuring alignment with national development objectives, and providing tailored support for entrepreneurs through various initiatives and services. Ultimately, NES aims to empower individuals, foster innovation, and drive Ethiopia's economic progress (Ministry of Industry, 2019).

Similarly, the Plan of Action for Job Creation (PAJC) (2020-2025) aims to generate 14 million jobs, promote a dynamic private sector, and address unemployment through innovation, policy changes, and inclusivity. It prioritises creating a job-rich ecosystem by supporting micro, small, and medium enterprises (MSMEs) and enhancing human capital to meet labour market demands. The initiative focuses on sectors with high potential, such as agriculture, manufacturing, tourism, ICT, and creative arts. The Job Creation Commission (JCC) is responsible for overseeing the implementation

of the plan, collaborating with federal and regional governments, private sector stakeholders, and development partners.

Micro and Small Enterprises (MSE) Development Policy and Strategy

The Micro and Small Enterprises (MSE) Development Policy and Strategy—originally adopted in 1997, updated in 2012, and revised in 2016—is crucial for advancing socioeconomic development by empowering small business owners. Its objectives include creating extensive employment opportunities, alleviating poverty, and ensuring fair income distribution, while also promoting sustainable economic advancement, industrial growth, rural-urban connections, and urban investment (MoUDH, 2016). The policy focuses on improving infrastructure, capacity building, offering financial assistance to MSEs, encouraging market growth, and establishing a favourable business climate. Key initiatives include ensuring access to affordable credit and financial services, and supporting connections to domestic and international markets. In addition, the strategy emphasizes the importance of adopting modern technologies and fostering innovation to improve the competitiveness and efficiency of MSEs. Furthermore, it aims to integrate informal enterprises into the formal economy to increase productivity, enhance labour rights, and extend social protections such as health insurance and pensions (MoUDH, 2016).

The Ministry of Urban Development and Housing (MoUDH) leads the implementation of this policy in collaboration with partners, including the Federal Micro and Small Enterprises Development Agency (FeMSEDA) and regional bureaus. In addition to capacity building and market development, these entities are mandated to promote job creation and poverty alleviation. They are also responsible for facilitating the integration of informal businesses into formal markets and promoting entrepreneurship across different regions (MoUDH, 2016).

Ethiopian Youth Revolving Fund Establishment Proclamation

Proclamation No. 995/2017, which established the Youth Revolving Fund aims at empowering young people (aged 18 to 34) by providing financial and technical support for organized income-generating ventures. It focuses on

enabling youth to create jobs, actively participate in the economy, and address economic and social challenges through sustainable solutions. The fund targets youth engaged in micro-enterprises and income-generating activities, such as informal workers, assisting them in transitioning to structured and sustainable business models to integrate them into the broader economic system.

The implementation of the Ethiopian Youth Revolving Fund was initially overseen by the Commercial Bank of Ethiopia (CBE) in coordination with regional authorities and microfinance institutions (MFIs). These organisations are responsible for recruiting eligible youth, providing technical assistance, and facilitating access to loans. The Ministry of Finance manages financial matters, while the Ministry of Youth and Sports is tasked with identifying and supporting youth. The proclamation outlines the role of local and regional authorities in collaborating to ensure initiatives align with national development goals. Through this coordination, the fund promotes youth empowerment, sustainable livelihoods, and increased economic participation.

The National TVET Policy and Strategy (2008 & 2020)

The 2008 National Technical and Vocational Education and Training (TVET) Strategy of Ethiopia was designed to establish a cohesive, decentralized, and outcomes-focused system aimed at alleviating poverty and enhancing livelihoods. It focused on reorganizing the system into centres for technology advancement and dissemination, emphasizing decentralization and collaboration between public and private sectors. Key components included modular training, cooperative training approaches, and the integration of information and communication technology (ICT) to improve flexibility and efficacy. The Federal TVET Agency was responsible for implementing the strategy, focusing on TVET students and graduates to develop a competent and self-reliant workforce (MoE, 2008).

The former Ministry of Science and Higher Education (MoSHE) was responsible for overseeing the development, implementation, and evaluation of the policy. In 2020, it revised the TVET Policy and Strategy to

align with Ethiopia's educational and training framework and development plan. The updated policy focused on Science, Technology, Engineering, and Mathematics (STEM) education, encouraged private sector participation, and addressed sustainable development objectives, aiming to cultivate skilled and innovative citizens. The policy targeted youth, women, and marginalized groups, equipping them with skills for job readiness and entrepreneurship (MoSHE, 2020).

While the National TVET Policy does not explicitly address the informal sector, it seeks to cultivate a skilled workforce to support the broader economy. By emphasising capacity building and responding to labour market demands, the policy aims to assist workers in transitioning from informal to formal employment, thereby contributing to sustainable economic development.

The Ethiopian Industrial Development Strategic Plan (2013–2025)

The Ethiopian Industrial Development Strategic Plan (2013–2025), introduced in 2013, aims to transform Ethiopia into a middle-income nation by 2025 through sustainable industrial development. Its goals include fostering industrial growth, increasing manufacturing competitiveness, promoting technology transfer and innovation, and generating employment opportunities to enhance living standards. The plan emphasises sectors such as agro-processing, textiles, leather, and pharmaceuticals to improve productivity, exports, and jobs while also supporting small and medium enterprises (SMEs) (Ministry of Industry, 2013).

While the strategic plan does not explicitly discuss the informal sector, it aims to support SMEs, many of which operate in the informal sector. By providing capacity building, better access to financing, and a supportive environment, the plan aims to facilitate the transition of informal businesses into the formal sector. The Ministry of Industry is responsible for overseeing the implementation of the plan, in collaboration with regional governments and private sector partners (Ministry of Industry, 2013).

The Entrepreneurship Development Programme (2013-2022)

The Entrepreneurship Development Programme (EDP), launched in 2013 by the UNDP and the Government of Ethiopia, aims to cultivate a vibrant entrepreneurial ecosystem and support the growth of micro, small, and medium enterprises (MSMEs). The programme offers training, business development services (BDS), access to finance, and mentorship to assist entrepreneurs in establishing, growing, and formalising their businesses, thereby contributing to job creation and economic growth. It has been particularly effective in empowering women and disadvantaged groups (UNDP, 2012).

The EDP was implemented in three phases between 2013 and 2022. Phase 1 (2013–2017) focused on establishing Entrepreneurship Development Centres, training over 55,000 entrepreneurs, and providing advisory services, with special initiatives for women and startups. Phase 2 (2017–2020) expanded efforts to foster innovation, generating 147,000 jobs and improving access to finance. Phase 3 (2020–2022) consolidated these achievements, emphasising the integration of informal businesses into the formal economy and promoting inclusive growth (UNDP, 2019).

The programme is implemented by the Entrepreneurship Development Institute (EDI), which integrates the UNDP-supported Entrepreneurship Development Centre (EDC) and the World Bank-financed Women Entrepreneurship Development Project (WEDP). EDI operates under the Ministry of Labour and Skills, aiming to foster a competitive and innovative private sector by strengthening the ecosystem, building capacity, providing business development services, and facilitating access to finance. The EDP targets the informal sector by supporting informal businesses in their transition to the formal economy through targeted training and improved market opportunities (UNDP, 2019).

National Employment Policy and Strategy

The National Employment Policy and Strategy (NEPS) of Ethiopia, introduced in 2016, aims to create decent and sustainable job opportunities to alleviate poverty and support economic development. Its objectives include aligning

labour supply with demand, enhancing labour market information systems, boosting productivity and competitiveness, and promoting favourable working conditions. The policy also addresses unemployment among youth and women, supports vulnerable groups, encourages entrepreneurship, and incorporates key issues such as gender equality, environmental sustainability, and social protection.

The NEPS features components that facilitate the transition of informal businesses and workers into the formal sector by fostering a supportive environment. While it acknowledges the significance of the informal sector, it places emphasis on indirect support instead of providing a comprehensive framework tailored to the specific needs of the informal economy. The Ministry of Labour and Skills (previously known as MoLSA) is responsible for overseeing the implementation of the policy.

The National Financial Inclusion Strategy (NFIS)

Launched in 2021, Ethiopia's National Financial Inclusion Strategy (NFIS) aims to enhance access to affordable and quality financial services for all citizens. The strategy focuses on reducing financial exclusion, promoting financial literacy, and increasing the utilisation of formal financial products and services. These efforts are intended to contribute to poverty reduction and foster sustainable economic development. The NFIS specifically targets underserved populations, including low-income individuals, women, youth, rural communities, and small and medium enterprises (SMEs) (NBE, 2017).

While initiatives such as microloans, digital banking, and financial literacy programmes are relevant to informal workers and businesses, they are not explicitly designed to support the informal economy. The National Bank of Ethiopia (NBE) oversees the implementation of the strategy, collaborating with financial institutions, development partners, and other stakeholders. By emphasising digital financial services like mobile banking and digital wallets, the NFIS aims to reach remote and underserved areas, bridging the gap between formal financial institutions and marginalised communities (NBE, 2017).

Additionally, the Ethiopian government has introduced various fiscal and financial incentives to promote the formalisation of the informal economy and encourage entrepreneurship. These initiatives include tax breaks, exemptions on customs duties for imported business equipment, regional incentives to boost investments in less developed areas, and grants or subsidies to assist small and medium-sized enterprises (SMEs) in acquiring essential resources. These incentives create a supportive environment for informal businesses, driving sustainable economic growth and progress (Hassen et al., 2023).

The National Social Protection Policy (NSPP)

The National Social Protection Policy (NSPP) of Ethiopia aims to protect impoverished and vulnerable populations from adverse events and poverty. It also seeks to enhance access to healthcare, education, and social welfare services, while promoting the rights of marginalized communities. The policy advocates for social insurance, ensures minimum employment opportunities for the long-term unemployed, and addresses disparities in access to essential services (MoLSA, 2016).

The policy primarily focuses on vulnerable groups, including children, women, individuals with disabilities, the elderly, and the unemployed, particularly those facing challenging circumstances. Strategies such as social insurance, livelihood programmes, and job opportunities aim to strengthen economic resilience in both formal and informal sectors. However, like the other policy frameworks mentioned, the NSPP does not specifically target informal workers. The Ministry of Women and Social Affairs (formerly the Ministry of Labour and Social Affairs) is responsible for overseeing the implementation of the policy (MoLSA, 2016).

National Rural Job Opportunity Creation Strategy

The National Rural Job Opportunity Creation Strategy of Ethiopia aims to increase employment opportunities for rural communities, enhance productivity through improved work culture and technology, strengthen connections between rural and urban areas, and promote rural entrepreneurship. The strategy, developed in 2017, also seeks to reduce

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unemployment and underemployment in rural areas, facilitate safe and productive migration, and ensure equitable benefits, especially for marginalised groups (MoANR, 2017).

The strategy targets individuals in rural areas who are unemployed or underemployed, such as women, youth, landless individuals, school dropouts, technical and vocational trainees, university graduates, displaced farmers, and people with disabilities. It promotes rural entrepreneurship and seeks to create better opportunities for informal workers. The Ministry of Agriculture and Natural Resources is responsible for overseeing the implementation of the strategy (MoANR, 2017).

Alongside these policy frameworks, Ethiopia has implemented regulatory reforms to promote entrepreneurship and facilitate the transition of the informal economy into the formal sector. These changes involve simplifying business registration processes, offering tax incentives and exemptions to new businesses, and improving access to financing through microfinance institutions and subsidised loans.

The oversight of regulatory reforms for Micro and Small Enterprises (MSEs) is coordinated by various key offices. The Ministry of Trade and Regional Integration works to simplify trade regulations and assists MSEs in accessing markets. The Federal Small and Medium Manufacturing Industry Development Agency creates a conducive environment for MSEs through policy and institutional support. Meanwhile, the National Bank of Ethiopia (NBE) facilitates access to finance by regulating and overseeing microfinance institutions. Table 1 provides a summary of policies and strategies related to entrepreneurship (Ministry of Industry, 2019).

Table 1: Summary of policies and strategies relevant to entrepreneurship development

Policy/Strategy	Year	Major Objectives	Responsible Bodies
National Financial Inclusion Strategy (NFIS)	2021	Increase access to financial services, reduce financial exclusion, and promote financial literacy.	National Bank of Ethiopia (NBE), financial institutions, development partners, and other stakeholders

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Policy/Strategy	Year	Major Objectives	Responsible Bodies
Plan of Action for Job Creation (PAJC)	2019	Create 14 million jobs, foster the private sector, address unemployment, develop human capital, and promote entrepreneurship and innovation.	Jobs Creation Commission (JCC), federal and regional governments, private sector, development partners
National Entrepreneurship Strategy of Ethiopia (NES)	2019	Foster inclusive economic growth, reduce barriers, enhance skills, boost productivity through innovation, improve access to finance, and promote awareness and networking.	Ministry of Trade and Industry; Ministry of Labour and Skills; UNDP; EDI
Ethiopian Youth Revolving Fund Establishment Proclamation	2017	Empower youth, create jobs, and integrate informal workers into sustainable enterprises.	Commercial Bank of Ethiopia, Ministry of Finance and Economic Cooperation, Ministry of Youth and Sports, regional and local authorities
Rural Job Opportunity Creation Strategy	2017	Expand rural job opportunities, enhance productivity, strengthen rural-urban linkages, and support entrepreneurship.	Ministry of Agriculture and Natural Resources, various stakeholders
National Employment Policy and Strategy (NEPS)	2016	Promote sustainable employment, align labour supply and demand, reduce poverty, and enhance decent work conditions.	Ministry of Labour and Skills (formerly MoLSA), Ministry of Trade and Industry, International Labour Organization (ILO)
Fiscal and Financial Policies/Incentives	Various years	Encourage formalization of informal economy, support entrepreneurship, provide tax holidays, microloans, capacity-building	Ministry of Finance, National Bank of Ethiopia (NBE), Ethiopian Revenue and Customs Authority, and regional and local governments
Regulatory Reforms	Various years	Simplify business registration, improve access to finance, enhance productivity, strengthen market linkages, and ensure social protections.	Ministry of Trade and Regional Integration, Federal Small and Medium Manufacturing Industry Development Agency, National Bank of Ethiopia (NBE), regional and local governments

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Policy/Strategy	Year	Major Objectives	Responsible Bodies
Ethiopian Industrial Development Strategic Plan	2013	Promote industrial development, enhance competitiveness, foster technology transfer, and create job opportunities.	Ministry of Industry, Regional Governments, Private Sector Stakeholders
Entrepreneurship Development Programme (EDP)	2013	Foster entrepreneurship, support MSMEs, provide training, mentorship, and access to finance, and empower women and disadvantaged groups.	Ministry of Labour and Skills, Entrepreneurship Development Institute (EDI), UNDP, World Bank
Micro and Small Enterprises (MSE) Development Policy	2016 (revision), 2012	Create employment, reduce poverty, foster industrial development, and integrate informal businesses into the formal economy.	Ministry of Urban Development and Housing (MoUDH), Federal Micro and Small Enterprises Development Agency (FeMSEDA), regional agencies
National Social Protection Policy (NSPP)	2012	Protect vulnerable groups, promote social insurance, and ensure access to health, education, and welfare.	Ministry of Women and Social Affairs (formerly Ministry of Labour and Social Affairs), various stakeholders
National TVET Policy & Strategy	2020 (revision), 2008	Develop demand-driven TVET, align training with labour market needs, promote innovation, and support transitions from informal to formal economy.	Ministry of Science & Higher Education (MoSHE), Federal TVET Agency

Overall, Ethiopia lacks a distinct policy explicitly focused on governing the informal economy. This makes it challenging to address the specific needs of small businesses and informal workers, who constitute a significant portion of labour force in the economy. A more focused policy and strategy could enhance social protection, promote formalisation, and improve financial inclusion. In addition, a well-crafted policy would outline coordination mechanisms and provide legal safeguards. Without targeted interventions, informal workers will continue to face economic marginalisation, regulatory ambiguity, and limited access to resources. By drawing inspiration from countries with successful informal economy regulations, Ethiopia has the

potential to establish a more sustainable and inclusive framework for its informal sector.

Surprisingly, Ethiopia currently lacks a clear trade strategy, despite the central importance of trade for socioeconomic development. Trade-related issues are presently governed by a patchwork of laws and regulations rather than a cohesive framework. To fully harness its economic potential, Ethiopia needs a comprehensive trade strategy that integrates both formal and informal economies.

Regulating Informal Street Trade in Addis Ababa

Despite the absence of targeted policies for governing the informal sector at the national level, the Addis Ababa City Administration has recently introduced regulations to manage informal street trade. This represents a significant step towards integrating informal businesses into the formal economy. The city enacted Regulation No. 184/2017 as an amendment to Regulation No. 88/2009. The amended regulation aims to improve urban space management, restore order, and enhance cleanliness. Additionally, it has redefined the scope of informal businesses, stating that traders with capital below ETB 200,000 will now be classified as informal.

By amending the regulation, the Addis Ababa City Administration acknowledges the socio-economic contributions of the informal sector while providing a pathway for informal traders to transition into the formal economy. While the directive creates opportunities for small businesses to grow, it requires traders to move into the formal economy once their earnings exceed the defined capital threshold. Thus, the regulation seeks to balance regulation with support, fostering a more structured and sustainable trading environment in Addis Ababa. To oversee street vendors and enforce the new regulation, the city government has established a task force.

Under the new regulation, informal street businesses across the city must register and operate within a structured framework, which includes obtaining renewable permits, wearing identification badges, and trading in designated areas. To register, applicants must submit two passport-sized

photographs taken within the last six months, along with a renewed ID card issued by their *woreda* of residence. Furthermore, applicants must provide a Taxpayer Identification Number (TIN) issued by the tax office and must be at least 18 years old. These criteria must be supported by a written testimony from the *woreda* administration confirming that the applicant is not currently engaged in formal trade, employed, or involved in any other form of work. Additionally, the applicant must explicitly state their willingness to operate in accordance with this regulation and the directives issued for its enforcement.

However, these requirements have faced criticism for several reasons. Firstly, the regulation's requirement for individuals to possess a residency identity card (ID) for Addis Ababa will prevent the vast majority of informal operators, who are predominantly migrants from various rural areas of the country, from operating legally. This requirement will compel these workers to remain in the informal sector, which the city authorities may consider illegal.

Secondly, the age requirement of 18 and above does not consider that children often engage in informal trade out of economic necessity. Thirdly, the requirement for proof of unemployment may discourage individuals engaged in small-scale informal trade from participating in this scheme, forcing them to remain in the informal sector, which the city authorities aim to reduce. Lastly, strict documentation requirements may push workers into unregistered informal activities, hindering their integration and perpetuating economic insecurity and the absence of legal protections.

A more effective regulation would emphasise flexibility and inclusivity by simplifying the registration process, creating structured opportunities for younger workers, and offering alternative identification options for migrant traders to reduce financial and administrative burdens. The successful integration of informal merchants into the formal economy would be better achieved through a progressive formalisation approach, along with support systems such as financial assistance and training. Ensuring consumer well-being is also necessary through quality control measures, such as voluntary

certification programmes or periodic inspections, to guarantee product safety.

Promoting electronic payment methods and transparent pricing could enhance traders' financial security and protect consumers from fraud. Consumer education campaigns can raise awareness of rights, empowering individuals to report unethical practices and make informed choices. Safety for both traders and consumers can be improved by establishing designated trading areas with access to waste management, sanitation, and security services. To promote accountability while maintaining the autonomy of small businesses, governments and municipal authorities could collaborate with informal trade associations.

Transition from Informal to Formal Economy

The transition from the informal to the formal economy involves integrating individuals, businesses, and activities that operate outside official regulations into the formal economic structure (Kiaga & Leung, 2020). While Ethiopia does not have specific policies or strategies aimed at transforming the informal economy, the issue has been indirectly addressed through various entrepreneurship initiatives, development programmes, strategic frameworks, and regulatory reforms.

Ethiopian policies and strategies aimed at promoting entrepreneurship focus on transitioning informal businesses into the formal sector, rather than merely supporting the informal economy as a standalone entity. The primary goal is often to reduce the prevalence of the informal economy. For instance, the National Entrepreneurship Strategy seeks to enhance the regulatory framework, improve access to financing, and bolster entrepreneurship education (Ministry of Industry, 2019). These initiatives are designed to combat youth unemployment while facilitating the transition of informal enterprises into more sustainable jobs.

A key strategy for promoting the formalisation of informal businesses is the establishment of one-stop centres. The Federal Job Creation and Food Security Agency, in partnership with the Job Creation and Enterprises Development Agency, has developed guidelines to provide comprehensive

services within its entrepreneurship programmes at a single location. This initiative aims to minimise bureaucratic obstacles and encourage job creation and formalisation by offering centralised and easily accessible support. The one-stop centres provide two main categories of services: compliance with regulations and facilitation of government support. The compliance component focuses on legal services that assist businesses in meeting regulatory requirements, including Tax Identification Number (TIN) registration, obtaining trade licences, providing training, and delivering enterprise development services to enable legal operation. Conversely, the government support services empower businesses by granting access to workspaces, such as rental land and work sheds, linking them to training opportunities at TVET centres, and offering mentorship and market access. These integrated services aim to foster sustainable business growth and stimulate economic development (Federal Urban Job Creation & Food Security Agency, n.d).

While many services are offered directly at these centres, they also act as facilitators for activities requiring coordination with sectoral offices. Advisory support and initial paperwork can be completed at the one-stop centres, enhancing efficiency and user convenience. For more specialised needs—such as obtaining permits, registering a business, securing financial assistance, or resolving legal issues—the centres assist by preparing and coordinating the necessary documents before directing clients to the appropriate sectoral offices.

Although the one-stop centres do not provide training directly, they facilitate access by partnering with Technical and Vocational Education and Training (TVET) centres to guide job seekers and aspiring entrepreneurs toward suitable training programmes. Their support includes identifying relevant TVET programmes based on industry needs, assisting with the registration process, and helping individuals' access opportunities that align with their skills and career aspirations. The Revenue and Customs Authority (RCA) is responsible for issuing Tax Identification Numbers (TIN), while the regional trade bureaus are tasked with granting licences based on the type

and scale of the business (Federal Urban Job Creation & Food Security Agency, n.d).

The formalisation processes have had mixed impacts on the development of the informal sector. While some informal businesses have gained access to credit, created employment, and transitioned into the formal economy, these benefits have not been uniformly experienced across the sector. Initiatives such as MSE development programmes have particularly supported informal entrepreneurs in expanding their operations (Fransen et al., 2010). However, complex regulations, limited infrastructure, and rapid urbanisation continue to impede the development potential of the informal economy. These challenges are further exacerbated by governance inefficiencies, corruption, and a lack of meaningful representation for informal workers, all of which hinder the effective implementation of policies. Achieving a balance between maintaining the flexibility of informality and promoting formalisation remains a key focus in Ethiopia's economic discussions.

Challenges of formalizing the informal sector in Ethiopia

Despite various policies and strategies aimed at promoting entrepreneurship, the transition from the informal to the formal economy is hindered by the regulatory environment. Business registration processes are often complex, time-consuming, and costly. Additionally, limited access to resources and a lack of awareness about the benefits of formalisation and available support systems impede the growth and transition of informal enterprises. The major bottlenecks hindering this formalisation process are discussed below.

Regulatory Burdens

a) Complicated Business Registration Procedures

Establishing a business in Ethiopia is a time-consuming endeavour that involves numerous steps and requirements from various government agencies. Entrepreneurs must first select a business type—such as sole proprietorship, partnership, or limited liability Company—and secure a unique trade name. Key steps in the process include registering with the

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Commercial Registration and Business Licensing Office (CRBLO), obtaining a Taxpayer Identification Number (TIN), and acquiring a business licence by submitting essential documents like a business plan, proof of capital, authenticated lease agreements, and a memorandum of association. In some cases, sector-specific or municipal licences may also be required. The time needed for business registration varies based on the type of business and the completeness of the submitted documentation. While the launch of the online "e-trade" portal has streamlined the registration process, many procedures still necessitate in-person attendance, adding to the overall inconvenience. Table 2 below outlines the business registration procedure in Ethiopia.

Moreover, variations in regional requirements complicate the ability of businesses to operate across multiple areas. These bureaucratic obstacles, combined with the time and expenses involved, discourage many small and informal operators from formalising their businesses. Streamlining these processes and strengthening coordination among government offices could significantly encourage formalisation and foster business growth in Ethiopia.

Table 2: Business registration processes in Ethiopia

Step	Procedure	Where to Go
1. Choose a Business Name	Select and verify a unique trade name	Bureau of Trade and Regional Integration
2. Authenticate Documents	Authenticating the firm's documents and lease agreement	Document Authentication and Registration Agency
3. Obtain a TIN	Apply for a TIN	Revenue and Customs Authority
4. Register the Business	Apply for commercial registration	Ministry of Trade and Regional Integration or Ethiopian Investment Commission
5. Publicize the Business	Publish the registration in a newspaper	Nationwide circulation of newspaper
6. Register for VAT	Register for VAT	Revenue and Customs Authority

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7. Obtain a Competency Certificate	Obtain the necessary competency certificate	Relevant authority (depending on business type)
8. Create a Business Seal	Create an official business seal	Local seal-making service

As highlighted above, one-stop centres have been introduced in several cities, including Addis Ababa. However, they face interrelated challenges that hinder their ability to provide integrated services effectively. A critical lack of resources—such as insufficient funding, a shortage of trained personnel, and inadequate infrastructure—remains a major bottleneck limiting their capacity to offer comprehensive support. Despite efforts to streamline operations, coordination among different sector offices and stakeholders is often inconsistent, resulting in delays and inefficiencies (Gebreselassie, 2020). Additionally, many job seekers and entrepreneurs are unaware of the services provided by these centres, which reduces their utilisation. Moreover, most one-stop centres are located in urban areas, making it difficult for individuals in rural or remote regions to access their services. Furthermore, despite attempts to reduce bureaucratic barriers, some centres still encounter red tape, which can discourage individuals from engaging with the system. Finally, there are limited mechanisms in place to monitor the progress of job seekers and businesses after they receive initial assistance. Addressing these challenges could significantly enhance the efficiency and effectiveness of Ethiopia's one-stop centres (Gebreselassie, 2020).

b) High Cost of Compliance and Taxation Issues

Establishing a business in Ethiopia incurs significant compliance costs, including permits, licenses, and ongoing regulatory obligations. These arise from complex regulations, such as tax and labour laws, which demand substantial legal and administrative resources. Limitations in updated procedures and digital systems further exacerbate the time and financial burdens, as businesses must obtain permits, licenses, and approvals from multiple government agencies (Dadimos et al., 2025). Frequent regulatory changes and inconsistent enforcement create uncertainty, requiring

businesses to continuously monitor and adapt to ensure compliance. Non-compliance can lead to penalties, fines, or legal repercussions, adding to the burden on businesses. For micro and small enterprises (MSEs) and informal businesses, these challenges can be particularly daunting, discouraging formalisation and hindering growth. The heavy tax burden, combined with a lack of knowledge about tax benefits and inadequate education on compliance, disproportionately affects smaller businesses.

Simplifying procedures, implementing fair tax policies, and raising awareness through educational programmes are crucial steps towards fostering a more inclusive economy (Yesegat et al., 2015).

Inconsistent Policies and lack of institutional support

Ethiopia faces significant challenges in aligning its entrepreneurship and informal economy policies with broader national development objectives. A major constraint on the sector is the absence of a comprehensive policy framework specifically designed for the development of the informal economy. This lack of a coherent policy not only obscures the government's vision for the informal economy but also contributes to poor coordination among government agencies, which often operate in isolation. Inconsistent enforcement across regions and government offices results in conflicting regulations and inefficiencies that hinder the growth of informal businesses (ICTD, 2023). Furthermore, the lack of robust monitoring and evaluation systems impedes the assessment of fragmented strategies, making it difficult to identify shortcomings and implement necessary adjustments, thereby perpetuating ineffective approaches.

The absence of a coherent policy also leads to a lack of an institutional framework dedicated to governing and developing the informal economy. This deficiency limits institutional support, which hampers the formalisation of informal businesses in Ethiopia by restricting access to essential resources, including financial, human, and infrastructural support. This challenge is further compounded by the limited representation of informal workers, business associations, and civil society organisations in the decision-making processes (Schwettmann, 2023).

Frequent Restructuring of Government Offices

Frequent restructuring of ministries and agencies in Ethiopia poses a significant institutional challenge to the governance of the informal economy. For example, the constant restructuring of the Ministry of Labour and Social Affairs, the Ministry of Labour and Skills, and the Micro and Small Enterprise Development Agencies disrupts the continuity of entrepreneurship programmes and efforts to formalise the informal sector. Each restructuring entails changes in leadership, mandates, and priorities, leading to interruptions in ongoing initiatives. For entrepreneurs and informal businesses, this institutional instability results in delayed support that is critical for fostering entrepreneurship and aiding the development of informal enterprises (Haftay, 2012). Such instability makes it more difficult for informal businesses to access essential resources like training, financing, and market linkages. Additionally, these frequent changes create inefficiencies in resource allocation and result in a loss of institutional knowledge. For instance, shifts in responsibilities between agencies can lead to budgetary mismanagement, leaving some entrepreneurship programmes underfunded or neglected during transitional periods. Furthermore, personnel turnover often weakens the ability of ministries and agencies to implement programmes effectively (Gebrehiwot & Wolday, 2006).

Constant restructuring also generates confusion among informal sector operators, leaving them uncertain about which agency to approach for support. This lack of clarity undermines trust and further marginalises informal businesses, which already face barriers such as limited information and regulatory burdens. To address these challenges, Ethiopia would benefit from a stable and well-coordinated governance approach that ensures continuity, preserves institutional knowledge, and minimises disruptions to critical programmes supporting entrepreneurship and formalisation efforts. Stability and coordination are crucial for creating an enabling environment where informal enterprises can thrive and successfully transition into the formal economy (Haftay, 2012).

Financial Constraints

Financial limitations create significant obstacles to formalisation, as many informal enterprises cannot afford registration fees and taxes. The cost of licences and permits discourages informal workers from transitioning to the formal sector, especially given their narrow profit margins (Fransen et al., 2010).

Limited access to formal credit further complicates the transition to formalisation. High collateral requirements—often twice the loan amount—make it difficult for informal enterprises to access credit. Financial institutions typically favour larger, established businesses, leaving smaller companies underserved (Zeru, 2010). In addition, limited awareness of available financial services and the lack of tailored options like microloans or flexible repayment plans further perpetuate the cycle of financial exclusion (Kebede, 2023).

Informal businesses are especially vulnerable to economic uncertainties and market fluctuations, which makes the transition to formal systems even riskier. Furthermore, the absence of specialised support services, such as business training, financial guidance, and market access, deprives informal enterprises of the resources and knowledge needed for a successful transition. Combined with financial constraints, this creates a complex web of barriers that hinder their entry into the formal economy (Schwettmann, 2023).

Lack of Awareness and Resistance to Change

A significant lack of awareness is frequently identified as a major obstacle to formalising the informal economy and realising its multifaceted contributions. Informal workers often do not fully understand the opportunities available within the formal economy, such as access to financial services, legal protections, social security benefits, and potential for business growth (Yonathan, 2019). For example, research conducted in Addis Ababa indicates that street vendors are unaware that formalising their businesses could allow them to access loans for expansion or obtain health

insurance for their employees, thereby enhancing both their livelihoods and business prospects (Kebede, 2015; Kebede, 2023).

Moreover, informal operators often have limited information regarding the steps for formalization, including necessary documentation and requirements, making the process seem overwhelming (Fransen et al., 2010). Misconceptions related to excessive taxation and complex paperwork contribute to the reluctance of informal workers, reinforcing mistrust and discouraging them from considering formalization (Schwettmann, 2023). This is partly due to insufficient targeted outreach and educational campaigns about the advantages and procedures associated with formalization, highlighting the importance of accessible awareness initiatives (Hasssen et al., 2023). Studies also indicate that language barriers and literacy challenges significantly contribute to the lack of awareness. Information relating to formalization is often available only in official languages or formats that may not be understandable for informal workers with limited literacy (Hasssen et al., 2023; PSI, n.d.).

Distrust of authorities, fuelled by past negative experiences such as harassment or perceived corruption, causes informal workers to be suspicious of formal institutions. For instance, a street vendor who has been harassed by local authorities may fear similar treatment during the formalisation process, discouraging them from engaging with government agencies (Schwettmann, 2023).

Resistance to formalisation also presents a barrier, arising from factors that pose significant obstacles to transitioning to the formal economy. In addition to concerns about increased taxes that could reduce their already limited income, informal workers' fear of losing autonomy also dampens their interest in formalising their business. Informal workers often appreciate the flexibility and autonomy of operating outside regulatory frameworks and worry that formalisation could impose restrictive rules or increased oversight (Abab et al., 2022). This is especially true for operators with relatively high earnings who prefer to operate informally to maximise the benefits.

Cultural and social factors

In Ethiopia, cultural and social factors significantly influence the growth of the informal economy and its transition to the formal economy. Informal enterprises are largely embedded in traditional practices and cultural heritage, including artisanal crafts, traditional weaving, and local marketplaces that hold significant cultural value (Moyo, 2022). Initiatives to formalise these practices may disrupt long-established customs when the focus shifts from preserving cultural heritage to enforcing formal regulations. For instance, traditional weavers prefer to maintain their informal status, transferring their skills down through generations without being constrained by formal business frameworks. Moreover, informal enterprises rely heavily on strong community networks and trust-based relationships. These networks offer essential social and economic support, including informal credit and customer loyalty, which may not easily transition into a formalised environment. Hence, the potential loss of community support can render formalisation less attractive to those engaged in informal work (Chernet & Ba, 2019).

Gender roles and social norms also influence the growth and transition of the informal economy. As indicated above, the informal economy serves as a safety net for poor and vulnerable populations. Many women engage in informal home-based occupations, including food preparation or crafting, which are deeply rooted in societal social norms and enable them to balance income generation with household duties (Jenberu, 2021). The formalisation of these businesses may not align with their roles or provide adequate incentives. Furthermore, the perceived negative consequences of formalisation influence decision-making.

Informal workers also cultivate social capital through informal institutions such as savings groups and rotating credit associations. In addition to providing reliable access to finance, these informal financial institutions strengthen social cohesion among the members. These institutions are also closer to people and more trustworthy than formal financial institutions. As a result, efforts to formalise these social networks, deeply rooted in the

socio-cultural makeup of communities, are often perceived as threats to the social fabric. Together, these cultural and social factors underscore the intricacies involved in transitioning Ethiopia's informal workers into the formal economy and highlight the importance of context-sensitive strategies for formalisation (Workye, 2019).

Economic Vulnerability and Instability

Economic instability presents significant challenges to practices aimed at integrating the informal economy into the formal sector, as it exposes informal businesses to uncertainties they are unable to manage. Economic trends, including market fluctuations, inflation, currency devaluation, and unpredictability, can disrupt the operation of informal businesses by reducing consumer purchasing power (Workye, 2019; Schwettmann, 2023). For instance, a sudden increase in the inflation rate has significantly affected the financial sustainability of informal enterprises in Ethiopia. High rates of unemployment also contribute to the growth of the informal economy, as more people turn to informal work for their livelihoods. This creates a cycle of informality that challenges efforts to formalise the informal economy (UNFPA, 2023).

As discussed earlier, limited access to formal credit contributes to the persistence of the informal economy, especially during economic downturns when banks and microfinance institutions tighten their lending criteria. This makes it difficult for informal businesses to secure the funds needed for investment and expansion. Economic instability also leads to unpredictable changes in trade policies and regulations, disrupting cross-border trade and supply chains (Aga & Reilly, 2011). Moreover, economic crises often prompt governments to reduce support programmes, which in turn affects infrastructure development crucial for facilitating the transition of informal businesses. Addressing these challenges requires stabilising the economic environment, improving access to credit, and implementing reliable support programmes to assist informal workers in their transition.

Conclusion and Recommendations

Conclusion

The informal economy remains a resilient and vital economic sector, particularly in developing countries. Its growth has been shaped by historical, structural, and economic factors, including shifts in economic systems, crises, and the effects of globalisation. In Ethiopia, the informal sector continues to be a primary source of employment and income for a large portion of the population, especially in urban centres like Addis Ababa. While many individuals engage in the informal economy out of necessity, a considerable number do so to pursue entrepreneurial opportunities.

Debates surrounding the informal economy focus on its dual role as an essential economic sector and a potential barrier to sustainable development. On one hand, its adaptability and resilience are crucial for generating employment and income, fostering entrepreneurship, and meeting community needs by providing accessible goods and services, particularly for low-income and vulnerable groups, especially during economic downturns. Conversely, the informal economy functions without regulation, resulting in poor working conditions, financial instability, and limited productivity. Additionally, it creates challenges for governments in terms of tax collection and places a strain on public services.

The transition from the informal to the formal economy has been a central theme in economic development discussions. Proponents of formalisation highlight the advantages of incorporating the informal economy into the formal sector for workers and enterprises, such as improved social protections, better working conditions, and increased tax revenues. However, critics caution against excessive regulation, which could inadvertently drive informal activities further underground and stifle flexibility and innovation within the informal economy. These scholars and practitioners advocate for tailored support for informal workers and businesses, facilitating a gradual transition to formalisation.

Ethiopia's approach to the informal economy is generally integrated into broader development strategies with a focus on formalisation. While there

is no specific policy targeting the informal sector, various strategies have been developed to assist informal businesses and workers in transitioning to the formal economy by enhancing access to financing, training, infrastructure, and markets. Policies and strategies for the development of micro and small enterprises (MSE) and entrepreneurship play a crucial, albeit indirect, role in formalising informal enterprises, while also contributing to poverty reduction and job creation. Additionally, policies on social protection and rural job creation focus on the economic resilience and livelihoods of marginalised groups, including those working in the informal sector.

This emphasis on empowering vulnerable groups, fostering entrepreneurship, and promoting inclusive economic growth reflects Ethiopia's recognition of the importance of the informal economy. As in many developing countries, the informal economy continues to be a dominant feature of the overall economy, influenced by factors such as rural-urban migration, unemployment, and the limited capacity of the formal sector to absorb workers.

The combination of the aforementioned policies and strategic initiatives in Ethiopia illustrates the government's aspiration to bridge the gap between informal and formal economies, fostering sustainable growth opportunities and promoting formalisation. Nonetheless, several interconnected challenges—regulatory, financial, institutional, cultural, social, and economic—continue to impede the formalisation process and the growth of the informal economy. Regulatory challenges, such as complicated business registration procedures, high compliance costs, and frequent policy changes, deter informal enterprises from transitioning to the formal sector. These issues are further complicated by financial barriers, including restricted access to credit and inadequate financial literacy.

Resistance to formalisation stems from concerns over increased taxation, loss of autonomy, and distrust in government offices, often rooted in negative past experiences such as harassment and corruption. A lack of awareness about the benefits of formalisation contributes to the persistence

of informality. Furthermore, the informal economy is deeply embedded in the cultural and social fabric of society, complicating the formalisation process. In other words, there are informal practices that cannot be formalised, as doing so may adversely affect the values and norms of communities. Additionally, the ongoing existence of the informal economy is often justified by its relevance to the livelihoods of underserved community members. Many informal workers, such as women and artisans, value the flexibility and relative security that informality provides, often viewing formalisation as a disruption to their livelihoods and social networks. Moreover, economic instability, rising unemployment, and fluctuating trade policies contribute to the expansion of the informal economy.

Recommendations

The challenges of formalising the informal economy highlight the need for comprehensive and context-sensitive approaches. Efficient and transparent regulatory frameworks, equitable financial policies, targeted educational campaigns, and enhanced institutional support are essential for creating an enabling environment that fosters trust and encourages informal businesses to secure government licenses. Balancing regulation and support for the informal sector is crucial to maximizing its benefits while minimizing its drawbacks. Strategies that respect cultural and social dynamics while addressing economic uncertainties can create a more inclusive and sustainable pathway for transitioning from the informal sector to the formal sector. The following approaches could assist in this process.

A whole-of-government approach is crucial for addressing the informal economy in Ethiopia. This approach involves collaboration across ministries and agencies to create a supportive business environment. It encompasses aligning policies to promote gradual and voluntary formalisation, simplifying registration and licensing processes, and ensuring accessible financial support through mechanisms such as microfinance institutions (MFIs) and subsidised loans regulated by the National Bank of Ethiopia. Capacity-building initiatives, including financial literacy and vocational training, are

integrated to enhance entrepreneurial productivity, while centralised monitoring systems evaluate progress and refine strategies. This cohesive effort, aligned with frameworks like the National Entrepreneurship Strategy, fosters innovation, sustainable economic growth, and the formalisation of the informal sector.

A cross-government coordinated strategy is another critical intervention for governing the informal sector. This strategy involves unifying the efforts of various government bodies to address different aspects of the informal economy. It includes aligning policies for tax compliance, labour law enforcement, and social security access while establishing shared goals and targets across authorities. Creating a dedicated coordinating body can facilitate communication and collaboration between agencies, ensuring comprehensive rather than fragmented strategies. This approach fosters a cohesive framework to formalise the informal sector, enhance workers' protections, and support economic growth. Other countries can provide lessons from other countries can offer valuable insights to aid in the design and implementation of strategies. By reducing bureaucratic hurdles, lowering registration fees, and introducing digital platforms for business licensing, governments can make formalisation more accessible and less time-consuming for informal workers and enterprises. For example, establishing centralised "one-stop shops" or online portals can streamline the steps required for business registration, tax registration, and obtaining permits, thereby addressing inefficiencies that often deter formalisation. Such reforms encourage informal businesses to transition into the formal sector, enabling them to access legal protections, financial support, and market opportunities while contributing to tax revenue and overall economic growth. This approach also fosters trust and collaboration between informal enterprises and government institutions, paving the way for inclusive development. The following specific recommendations are proposed:

- **Simplify Regulatory Processes:** Streamline business registration procedures by utilising digital platforms, reducing bureaucracy, and aligning regional requirements. Ensuring uniformity in policy

enforcement across different areas can enhance accessibility for informal entrepreneurs and small businesses.

- **Enhance Financial Access:** Improve access to low-cost credit by promoting microfinance, lowering collateral demands, and providing customised financial products such as microloans and flexible repayment plans. Offering financial literacy programmes can empower informal workers to effectively navigate formal financial systems.
- **Introduce Fair Tax Policies:** Establish equitable and streamlined tax systems for micro and small enterprises to alleviate the financial burden and encourage formalisation. Raising awareness of tax advantages and providing compliance education can further motivate voluntary formalisation.
- **Strengthen Institutional Support:** Enhance the capabilities of institutions to implement policies effectively. Allocate adequate resources and improve coordination among government agencies to ensure a cohesive effort in supporting informal businesses.
- **Increase Awareness and Build Trust:** Launch targeted educational campaigns to inform informal workers about the benefits of formalisation, addressing misconceptions and concerns. Build trust in government institutions by tackling corruption, ensuring transparent processes, and improving engagement with informal workers.
- **Tackle Cultural and Social Dynamics:** Develop strategies that respect traditional practices and community networks. Tailor formalisation efforts to align with cultural values that informal businesses depend upon.
- **Stabilise the Economic Environment:** Address economic instability by tackling inflation, unemployment, and currency fluctuations to create a more reliable environment for informal businesses.

Enhance consumer confidence and promote market stability to encourage a shift to formal systems.

- **Continue and Expand Support Programmes:** Ensure consistent government support through training, mentorship, and infrastructure development to assist the transition of informal businesses to the formal sectors. Integrate social protection measures such as health insurance, pensions, and labour rights to increase security for informal workers.
- **Encourage Gradual and Voluntary Formalisation:** Minimise excessive regulatory interference and instead offer incentives, such as subsidies and market connections, to encourage informal workers and businesses to transition smoothly to the formal economy. A step-by-step approach helps minimise disruptions to the livelihoods of informal businesses while allowing them time to adapt to new regulations.
- **Assess and Evaluate Policy Effectiveness:** Establish robust mechanisms to evaluate the impact of policies on the informal sector, identify shortcomings, and make adjustments to ensure their ongoing effectiveness and relevance.
- **Promote Public-Private Partnerships (PPPs):** Private companies provide technology, investment, and market access to assist informal businesses in transitioning to formal entities, while governments supply policy frameworks, financial incentives, and regulatory support.

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The Governance of Informal Trade in Addis Ababa: Insights from the Addis Ababa City Administration Trade Bureau

Tesema Chemed

Introduction

Informal trade refers to small-scale and simple business activities that are not governed by the regular commercial laws or proclamations. It represents businesses that are conducted with minimal capital, without registration under the commercial proclamation, a business license or a permanent premise. According to the Addis Ababa City Trade Bureau, these businesses typically operate from portable stands, roadside displays, or through street hawking. Due to the lack of formal business registration and a fixed address, informal trade largely falls outside the government's tax framework.

Informal trade is predominantly operated by individuals with limited economic means, who often lack the capital, space, and/or skills required to engage in formal business activities. Though informal trade is observed in both developed and developing countries, studies indicate that it is particularly widespread in developing countries, owing to their limited economic capacity and underdeveloped trade system.

While informal trade is common in all parts of Ethiopia, it is more prevalent in large and densely populated cities. In Addis Ababa— Ethiopia's political and economic hub - informal trade is not only widespread but it has also expanded in recent years, largely due to the city's expansion and rapid population growth.

Informal trade is a source of livelihood of many citizens who cannot afford to engage in formal trade. It also plays a significant role as a bridge facilitating the transition to formal trade. However, if this sector is not properly regulated, it may negatively affect the formal business sector. In addition to reducing tax revenue, weakening the national economy, informal

trade can lead to social, economic, and environmental problems. This suggests the need for comprehensive research on issues related to when, by whom, how, and under what circumstances informal trade should take place and policy recommendations to improve the governance of the sector.

This paper examines the state of informal trade and its governance in Addis Ababa city. It focuses on key policy frameworks and actions undertaken by the city administration to regulate the informal trade, mitigate its impact on formal trade and national economy, and leverage its role as a pathway for citizens to transition into the formal sector.

Informal trade in Addis Ababa

As indicated above, Addis Ababa serves not only as the capital city but also as the economic hub of Ethiopia. The city is home to numerous markets and commercial activities, including *Merkato*, the largest open-air market in Africa. In these markets, informal trade occurs extensively alongside the regular commercial activities.

While informal trade has a long history in Addis Ababa, it has expanded in both forms and scale in recent years due to city's sustained growth and increasing population. Hence, regardless of the scale or types, informal trade is currently practiced across all sub-cities and *woredas* (districts) in the city. Informal businesses are particularly widespread in Bole, Arada, Addis Ketema, and Gullele sub-cities. Nonetheless, with the city's expansion, it can be observed that informal trade is expanding into Kolfe-Keranyo, Nifas Silk, Akaki and Lami Kura sub-cities.

Informal trade is commonly known in Addis Ababa as street vending, and it mostly takes place in densely populated areas, around religious and educational institutions, in large neighborhoods, and under the verandas of various buildings. The main hours of market activity coincide with the peak times when the public is widely commuting to and from work.

Mobile trading or street vending is the most common form of informal trade. It encompasses the sale of goods from mobile containers, carts, or by hand, as well as trade conducted from vehicles. This form of business allows

vendors to operate flexibly across different locations. Fixed or non-movable trade activities, on the other hand, take place in designated locations, such as permanent shops and temporary stalls (shades).

In addition, informal trade also includes business activities conducted at home. This type of informal trade involves the preparation and sale of traditional beverages and foods from home. Additionally, it includes various unregulated businesses, such as hosting *Khat* chewing and Shisha smoking sessions providing decoration services for vehicles, houses, and halls, as well as rentals. According to the Addis Ababa City Trade Bureau, the growing seasonal and holiday-related businesses, along with night markets, are also included in informal trade.

Positive and negative impacts of informal trade

Informal trade has various positive and negative impacts. Studies indicate that over 100,000 individuals are estimated to engage in the informal trade sector in Addis Ababa, especially in street vending. The majority of individuals engaged in this sector are young people and women, many of whom are unable to meet requirements—such as the 20 percent savings threshold—needed to access formal credit and government-facilitated employment schemes. By serving as an accessible alternative for those with limited capacity to enter the formal trade system, the sector contributes to reducing unemployment in the city and thus plays a significant role in the local economy.

As it operates outside a formal system, informal trade does not require extensive skills or specialized knowledge, enabling individuals with low-income to easily start and run their businesses without the need for high capital, and designated work space. As a result, a substantial portion of residents sustain themselves and their families through income generated by engaging in diverse activities and selling goods in multiple location. In this sense, the sector serves as a safety net for the urban poor who have limited alternative to generate a livelihood. These people sell goods near residential areas at reasonable prices, thereby dominating the market. Beyond creating employment opportunities for a significant segment of the urban

population, it reduces dependency among the poor while fostering a culture of self-reliance and job creation. Furthermore, informal trade activities often serve as a stepping-stone that facilitates entry into the formal trade system. As observed in many parts of the city, informal businesses serve as primary markets, providing the poor with opportunities to shop at reasonable prices within their neighborhoods.

Alongside these positive impacts, informal trade is also associated with a range of negative economic, social, and environmental effects, which are discussed below.

Deepening trade injustice: According to the Trade Bureau, informal trade is negatively affecting the city's economic activities, as a significant portion of the urban population engages in this sector for their livelihood. Since they operate outside the formal system, informal operators are not subjected to tax, licensing and registration requirements; nor do they pay business or rental fees.

Reports show that most of the goods sold in the informal trade originally come from formal traders. Some formal or licensed traders sell their goods on the streets or supply them to street vendors on commission, with the intention of selling them without paying taxes or value-added tax (VAT), which significantly undermines the formal trade system and the implementation of tax reforms. This creates unhealthy competition for formal traders, forcing many to work illegally on the streets in different locations. This further undermines formal business activities of the city and the country at large.

In addition to supplying goods which are supposed to be sold in licensed shops to informal traders, a significant number of formal traders have also been observed closing their stores and selling directly on the streets at various times. Moreover, contraband goods of unknown origin are frequently sold through informal channels in various locations.

Overall, if not effectively managed, informal trade facilitates the expansion of unregulated businesses undermining the growth of businesses operating under formal arrangements. By promoting rent-seeking behaviors and

facilitating the growth of contraband activities, it undermines a healthy trading system and disrupts the balanced interests of the government, consumers, and traders.

Disrupting traffic: As informal traders lack permanent and convenient business locations, they conduct most of their businesses on the streets, strategically choosing times when they can easily reach customers, such as during commuting hours and holidays. Such unregulated trading on streets and squares with heavy traffic flow not only causes traffic congestion but also exposes people to accidents.

Increasing public health risks: The city administration also highlights the health risks posed by unregulated informal businesses. Products and services sold in the informal trade sector are often of poor quality and standards, expired, or counterfeit. As a result, they cause serious harm to the safety and health of consumers. Since the sector lacks a system of accountability, most goods purchased from the street cannot be verified for their quality or safety. In addition, a large portion of the items sold are often defective and fail to provide the intended service. Moreover, since informal traders do not have a permanent address, buyers have no means to return or claim against the seller. This exposes consumers to serious safety and health risks.

As informal trade can be easily conducted without specialized skills or significant capital, the influx of rural-to-urban migration increases the city's population, thereby exacerbating existing urban socio-economic challenges.

Undermining city's aesthetics and cleanness: Addis Ababa, as the political center of Africa and home to diverse ethnic groups, has recorded remarkable transformation overtime. Beyond serving as a role model for many African countries, the city's consistent growth also plays a central role in attracting and facilitating investment. In recent times, the city's rapid development and modernizing initiatives have made it a major tourist destination.

While the trade sector is considered a key driver of city's growth and Ethiopia's transition toward middle-income status, the unchecked expansion of informal trade has been observed to impede development,

outweighing its potential benefits. As informal businesses are conducted on the streets and public spaces with high population density, waste generated by these markets are reported to significantly affect the aesthetic appeal of the city. These problems have been spreading and intensifying, with the resulting foul odors and other related issues in each area negatively impacting on the community. Trees planted to increase the green coverage and enhance the city's aesthetics are often damaged, significantly undermining the city's beautification initiatives.

Policies and practices related to informal trade in Addis Ababa

As highlighted earlier, informal trade is a longstanding and widespread business activity in Addis Ababa. Policy makers have long perceived the informal trade to either dissipate or being gradually absorbed into the formal economy. As a result, it had not garnered adequate policy attention until recently. In reality, evidence shows that the informal economy continues to expand alongside economic development, with the number of citizens earning their livelihoods from the sector steadily rising. Hence, it has increasingly become clear that informal trade also deserves attention for its social and economic contributions.

Cognizant of this reality, the Addis Ababa City Administration has given attention to the sector by incorporating it into the city's sustainable development targets in recent years. The city administration is working to regulate the sector and maximize its potential by issuing regulations and directives and, establishing various relevant departments. Beyond recognizing the sector, the development of legal frameworks is crucial for enhancing the sector's positive contributions while mitigating its negative impacts on workers, as well as on social and economic development.

Regulating the informal trade is part of the broader trade reforms undertaken by the city administration. Other key trade reform measures undertaken so far include ensuring that trade licenses, previously issued arbitrary, are now granted based on clear criteria and creating and establishing an institutional framework that enables effective management of the sector. In addition, the city's trade reform includes strengthening

consumer cooperatives, ensuring that all transactions are properly documented with receipt, modernizing existing markets, and constructing additional ones. According to the Trade Bureau, these reform measures and complementary efforts are bringing tangible results. Additionally, initiatives made to strengthen the regulatory system, along with the trade and tax reform framework, have brought about significant changes in the trade system.

Similarly, efforts are underway to reduce the negative impacts of the informal sector on formal trade by implementing trade reform initiatives. These aim to fully address the challenges observed in the trade sector and to establish a fair and modern regulatory system.

Despite these efforts, informal trade continues to expand without a clear structure, organized framework, or a robust accountability system. As a result, the sector has long operated in a way that allows a small number of illegal actors to engage in practices that harm public interests and diminish national economic and social benefits. For instance, street trading—one of the widely known informal businesses in city—is expanding over time. Beyond its adverse impact on trade and tax reforms, it is also significantly affecting the city's traffic situation.

Moreover, it can be seen that the market places in the city are not organized and accessible in line with the city's growth. Existing markets lack the necessary infrastructure, forcing the residents to travel long distances and incur additional expenses to access products and services. Furthermore, the absence of well-developed local markets, along with insufficient wholesale and retail market centers, has led to the widespread proliferation of street trading in various industrial and agricultural products, including crops, vegetables, fruits, and livestock.

Various efforts have been made to regulate the informal trade system in the city. One of these initiatives is the establishment of Sunday markets at selected locations (streets) across the city, which has been in place since 2003. Additionally, in 2011, a task force jointly formed with the Addis Ababa Roads Authority and other sector departments selected ten sub-streets and

open spaces to serve as temporary business sites for street trade, some of which are still functional.

A city-wide campaign was launched to further regulate the informal trade sector by coordinating with relevant stakeholders, forming a general committee and a technical committee, and developing a joint plan. However, the sector faces deeply entrenched and complex problems, compounded by the absence of both a legal framework and a continuous coordination mechanism, leaving these issues unresolved.

Among the policy measures taken in recent years to regulate informal trade, Regulation No. 88/2017, can be cited as the most important one. The regulation had two complementary objectives: to recognize the informal trade and to establish a system for regulating the sector, thereby enabling it to contribute to economic and social development. The regulation was also intended to address the various challenges observed in the sector and provide support to facilitate its gradual integration into the formal trade system.

This regulation defines informal trade as “a simple business activity not governed by the regular commercial law or proclamation, conducted with a small capital of up to Birr 10,000, without being registered in accordance with the proclamation and without obtaining a business license or having a permanent business house or place, and typically carried out on streets, public squares, or roadsides in accordance with this regulation.” Recognizing that informal business activities in the city have been expanding from time to time and have created employment opportunities for many people, particularly youth and women, the regulation was introduced to govern the sector in a way that prevents unfair competition with formal traders and facilitates its gradual integration into the formal economy. Accordingly, the 2017 regulation marks the first recognition of informal trade at the policy level.

Efforts have been underway to regulate the sector since the enforcement of the regulation. Between the 2017 and 2024, available data indicates that over 29,000 traders engaged in informal business across all sub-cities were

granted (informal trade) licenses according to the regulation and legally allocated working spaces.

However, initiatives to effectively regulate the informal trade under this regulation have largely fallen short of achieving the expected results. Ironically, informal street trade continued to expand, further negatively affecting the formal sector. Recognizing the necessity of addressing this, the city administration has undertaken regulatory reforms. As a result, the regulation 2017 regulation was amended and replaced by Regulation No. 184/2025.

According to the city's Trade Bureau, Regulation No. 88/2017 had several shortcomings, including its inability to address the evolving challenges arising from the rapid growth and transformation of the city. In addition, it lacks guidance on when, how, and under what conditions informal trade operators will be integrated into the formal trade system. Another major limitation of the regulation is the absence of clear categorization and description of informal trade activities. Overall, Regulation No. 88/2017 has been amended for the following reasons:

- To include different forms of informal trade activities practiced in the city;
- The need to determine how long an operator can engage in informal trade and the amount of capital required;
- The need to involve stakeholders directly connected to informal trade;
- The importance of the city administration in providing high-level leadership, organizing a taskforce, and effectively overseeing the informal trade;
- The need to clearly define the roles and responsibilities of stakeholders involved in the taskforce;
- The need to ensure that materials used for constructing market places are standardized across the city, that fixed market locations

are organized in a way that preserves and maintains the city's aesthetics and urban plan, and

- To ensure that trade is conducted in a sustainable and orderly manner, while maintaining peace and security.

Under Regulation No. 184/2025, the capital ceiling for informal trade has been revised. Accordingly, focusing on street vending, the regulation defines informal trade as follows:

Informal street trade is a type of business that is not regulated by the commercial law or proclamation. It is carried out without the individual being registered, without a business license, or without a permanent business premises or location. According to this regulation, these activities may take place on the street at authorized locations and on designated days, with a capital of up to 200,000 Birr, and do not require extensive knowledge or specialized skills.

The focus areas and expected outcomes of the new regulation are the following: recognizing the informal trade sector, providing a legal framework to guide the sector, gradually transitioning informal trade into the formal, and establishing a coordination, monitoring, and support system.

In addition to addressing the shortcomings of the previous regulation, Regulation No. 184/2025 is expected to ensure that citizens engaged in street trade are formally recognized and permitted to operate upon fulfilling certain requirements, including obtaining a taxpayer identification number. The enactment of the regulation is also expected to curb contraband, reduce traffic-related accidents caused by congestion, and mitigate the negative impacts of informal trade on the formal sector. It also creates an opportunity for informal business operators to carry out their activities within the designated locations, times, and conditions facilitated for them.

The regulation also clearly outlines the procedures for transitioning informal business into the formal economy. According to the regulation, an individual may engage in informal businesses in the capital only if they hold an Addis Ababa city residential ID and reside in the city. This decision is

argued to prioritize job opportunities for the city's youth and curb migration to the city. In addition, the regulation states that a registered informal trader may work in the assigned location for only two years. The time limits established by the regulation are expected to create employment opportunities for other unemployed urban residents.

The regulation specifies the key stakeholders responsible for regulating the sector, mitigating its negative impacts, and enhancing its contributions to economic and social development. A task force has been established under the regulation to coordinate and oversee various enforcement departments working to achieve the goal of effectively regulating informal street trade in the city.

Accordingly, the Addis Ababa City Administration Trade Bureau has issued a directive to enforce the regulation. One of the fundamental principles of the directive is to provide appropriate support to those engaged in informal trade, enabling their gradual transition into the formal business system. The directive provides that —building on the city level task force—a task forces have been established at the sub-city and *woreda* levels to further coordinate and oversee informal businesses.

Moreover, the directive outlines the major types of informal businesses, the locations where they will be carried out, the dates and times of operation, and other related matters. Among the types of businesses permitted in the city, under the coordination of the district administration offices, are the following: clothing (for men, women, and children, as well as shoes), simple electronics and electrical items, dry foods (including biscuits, sambusa, sandwiches, and similar items), vegetables and fruits, packaged soft drinks, juices, agricultural products, industrial products, livestock, and livestock by-products.

Overall, the new regulation and its accompanying directive are expected to bring significant benefits by addressing the challenges observed in informal trade, establishing a strong regulatory framework, and strengthening the sector's contribution to the country and society—particularly by facilitating its gradual transition into the formal economy.

Conclusions

While the informal trade sector has a long history in the country's economy, it has remained underdeveloped due to a distorted trading system. The sector is marked by widespread unregulated practices, contradictions with free market principles, and a lack of well-developed organizational and operational structures. Consequently, it has failed to achieve the expected growth. Moreover, by its very nature, informal trade operates through unregulated means, with the primary focus on attracting customers. In addition to undermining environmental cleanliness and urban aesthetics, it also significantly disrupts traffic flow and poses risks to public safety.

Although the government has long been making various efforts to regulate the distorted trading system observed in the country—particularly by supporting traders in the informal sector—the sector has not been able to reach the desired level of development. Similarly, recognizing the sector's large labour force and its vital role in generating extensive employment opportunities, efforts are underway to regulate and organise the fragmented trading system through sustained support. This involves strategies through which informal operators develop their capacity and gradually transition into the formal system. Moreover, ongoing efforts include strengthening enforcement capacity, engaging stakeholders, facilitating access to credit services, providing training and support, and fostering an enabling business environment. By expanding technology-supported performance systems, ensuring that the products and services purchased by consumers meet required standards and quality, and developing transparent and accessible mechanisms that guarantee transparency and fairness in negotiation and legal recourse, the aim is to promote fair and competitive business activities.

Overall, efforts are underway to modernise the country's trade system, making it efficient, accessible, and fair, while safeguarding the balanced interests of consumers. The aim is to enable the informal trade sector to contribute its expected share to the country's economic growth. To achieve this, all stakeholders are required to play their role in fostering a competent

business community and developing the human resources required for effective policy implementation.

For the effective implementation of the new regulation, it is necessary to issue the requisite legal frameworks and to operationalize the established directions and strategies. Continuous monitoring and support are imperative to ensure that the regulation achieves its intended objectives at the desired level. This should be accompanied by corrective measures at every stage to address emerging challenges.

Contributors

Dereje Tesema: Dereje is an Associate Program Officer at Good Governance Africa–Horn of Africa. He previously served as an Assistant Professor of Sociology at Jimma University. Dereje’s research focuses on migration governance, internal displacement and refugees, the politics of ethnicity, and climate change.

Getahun Fenta: Getahun is an Assistant Professor at the Center for African and Asian Studies, College of Social Sciences, Addis Ababa University. His research interests include informal economies, migration, forced displacement, urban poverty, entrepreneurship, social protection, social capital, and inclusive development. Through numerous publications and extensive consultancy engagements, he has contributed significantly to both scholarly knowledge and practical approaches in the field of inclusive development.

Chalachew Getahun: Chalachew is an Associate Professor of Population Studies, Geography, and Socioeconomic Development Planning at the College of Development Studies, Addis Ababa University. He has an extensive publication record in the areas of population, urbanization, migration, employment and well-being, the informal sector, and the environment. Chalachew has also led numerous research projects focused on population studies and socioeconomic analysis.

Tesema Chemed: Tesema is a Team Leader for Informal Trade Licensing Facilitation at the Addis Ababa City Administration Trade Bureau, where he has served for more than a decade. He holds a BA degree in Economics from Mekelle University. Tesema has led major initiatives aimed at transforming informal businesses under the Directorate of Informal Trade Regulation at the Trade Bureau.

Zerihun Mohammed: holds a PhD in Human Geography from the University of Cambridge (UK). He has served in various academic and civil society institutions—including Hawassa University, Wondo Genet College of Forestry and Natural Resources, and the Forum for Social Studies (FSS)-in multiple capacities. He currently serves as the Executive Director of Good Governance Africa – Horn of Africa Regional Office.

This monograph offers a compelling exploration of Ethiopia's informal economy, with a particular focus on informal trade in Addis Ababa. It unpacks the evolving definitions, characteristics, and perceptions of informality—tracing the policy shift from treating informal trade as “illegal” to recognizing it as a legitimate and vital part of the urban economy. By examining the sector's contributions to livelihoods, employment, and national growth, the volume highlights both the opportunities it presents and the structural challenges it faces. Grounded in empirical insights and policy dialogue, it concludes with actionable recommendations for integrating the informal economy into Ethiopia's broader development agenda—balancing regulation, inclusion, and innovation in urban governance.