

**INFORMAL SECTOR AND LOCAL GOVERNMENT REVENUE:
THE CONTRIBUTION OF STREET VENDORS ¹**Tutik Rachmawati ²**Abstract**

This paper discusses the contribution of street vendors as the majority group of informal sector to the generation of local government revenue. Based on the desk study of the available literature and research reports on informal sector, this paper analyse how local government should tax informal sector to boost its revenue. In the perspective of legalist school, taxing the informal sector will only increase the informal sector activity, hence formalising the informal sector will not be a recommended policy. Other option to tax the informal sector is by the use of informal sector unions which requiried an understanding of citizenship and awareness of their civil rights to establish them. This eventually also beneficial for informal sector as the creation of informal sector unions means the creation of networks and associations which enable them having power vis a vis local government.

Keywords: *informal sector, street vendors, local government revenue*

¹ This paper is a revised and expanded version of a paper entitled: Informal sector and local government revenue: the contribution of street vendors, presented in 8th Annual Green Economics Conference, 17-20 July 2013, Oxford University.

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Introduction

Whilst Indonesia is Asia's fifth largest economy and the fourth most populous nation the world which endowed with abundant natural resources, development gap among local governments still apparent. With the introduction of Local Autonomy Policy with the Local Government Act No. 22 & 25 year 1999, it is expected that better development result across local governments in Indonesia can be achieved. However, development will be only possible if it is supported with certain amount of financial capacity of the local government.

Decentralization requires local governments to be able to generate its own revenue. Local government is in a dire need to manage their financial capacity since the degree of independent in local revenue will have a positive impact on the degree of local government autonomy. This means the more local revenue that a local government can generate, the more autonomy will be achieved the local government. The majority of local governments in Indonesia still rely on the fiscal transfer from national government. The amount of fiscal transfer follows a certain formula that includes factors such as the number of population and the size of the area. However, in reality, a part from this formula, local governments may be able to run a lobby to the national government to increase the amount of the fiscal transfer. This has created a window of opportunity for bribery. This however disadvantaged other local governments who outperform in the lobbying and it will further worsened by the fact that it is difficult to generate local revenue.

Decentralization seems to create a high-cost economy primarily due to the euphoria of local governments to increase their local-based revenues (Pendapatan Asli Daerah) along with political and bureaucratic rent-seeking³. The new power of autonomy held by the local governments allow them to set up policies to generate money either through natural resource exploration (for local government which has many abundant natural resources) or through the taxation policies. Further, these taxation policies became reckless policies as local governments see anything as a tax object, hence the tax object and tax base has grown too wide, often overlapping with the tax policies from national government and at times one objects are being taxed with two or more tax policies. Informal sector particularly, such as street vendors is also seen as a potential tax object for its visibility by local governments.

What is informal sector?

The role of informal sector to local economic development has been discussed by many authors. Informal sector is defined as one group of economic arrangements⁴ which are not subject to government regulations⁵ and of which the nature of employment is both self

³ Fitriani, F., B. Hofman, and K. Kaiser (2005). Unity in Diversity? the Creation of new local governments in a decentralizing Indonesia". *Bulletin of Indonesian Economic Studies* 41, no. 1 (2005): 57–79.

⁴ Gallaway, Julie H and Bernasek, A (2002). Gender and informal Sector Employment in Indonesia, *Journal of Economic Issues*, Vol. XXXVI, No.2 June).

⁵ Castells, M., & Portes, A. (1989). World Underneath: the origins, dynamics, and effects of the informal economy In A. Portes, M. Castells, & L. Benton (eds) *The informal economy: studies in advanced and less developed countries* pp (11-37). Baltimore: Johns Hopkins Press.

employment such as home production and petty trading and wage employment such as casual labour, contract labour and piecework⁶, characterized by small competitive firms, petty retail and services, labour-intensive methods, free entry, and market-determined factor and product prices as Todaro⁷ argued. In a less developed world, the informal sector is most visibly appearance in the form of street vendors⁸. A further useful discussion of informal sector concept is provided by Broad (1991)⁹.

There are two contrasted perspective to understand informal sector in relation to formal sector. On one end, informal sector is viewed negatively as it is seen as marginalising the poorest and the most vulnerable people in the society and the only way to deal with this is through the expansion of the formal sector, hence the informal sectors will disappear (Moser, 1984). On the other end of perspective, informal sector is seen as a contribution to the economy by providing the poorest and the most marginalised people who do not have access to the formal sector with opportunities to earn an income. Even though it is claimed that this perspective is a not ideological but pragmatic one¹⁰ (Gallaway, Julie H and Bernasek, A, 2002), it is evident from the experience of Indonesia that what seems to be pragmatic turned out to be the most useful survival way in the hardest economic hit has ever happened. This pragmatic thinking is in line with the approach of the populist critique¹¹ (Overton J, 2000). Populist critique suggests us to look up to the informal economy to provide a degree of security for people in a future of diminished state support.

Contribution of informal sector to the economy

Even though there is a general conception that informal sector is an inferior alternative to the formal sector for employment in terms of the earnings, security and protection from exploitation regarding such things as labour standards, lending terms, and other contractual arrangements. Informal sector also contributes to the national output. In country like Africa, the role of the informal sector in the domestic economy is demonstrated in the wide variety of goods and services produced by the sector¹². JASPA (1989) survey concluded that informal sector

⁶ Gallaway, Julie H and Bernasek, A (2002). Gender and informal Sector Employment in Indonesia, *Journal of Economic Issues*, Vol. XXXVI, No.2 June, p.314

⁷ Todaro, Michael P., (2000), *Economic development*, 7th ed. Reading, Mass: Adisson Wesley Longman, Inc. p. 749.

⁸ Rachmawati, T. (2013). A survival mechanism for the poor and equity in a mutual symbiosis: a case study of street food vendors in urban Indonesia in Gale de Oliveira, M.S., Blacket-Ord, R. And Kennet, M (eds), *Green Economics & Food, Farming and Agriculture*, pp (181- 185). Green Economics Institute.

⁹ Broad, Dave (1991), Global Economic restructuring and the (Re)Casualization of Work in the Centre: With Canadian Illustrations, *Review* Vol.14, No.4, pp.555-94.

¹⁰ Gallaway, Julie H and Bernasek, A (2002). Gender and informal Sector Employment in Indonesia, *Journal of Economic Issues*, Vol. XXXVI, No.2 June).

¹¹ Populist critique is one of critique to capitalism. Populist do not focus on transforming the production relation in big capitalism but to winning a space for small producers. They look on the problem of urban bias and ineffectiveness of state policies, to reform the state and change the policy in order to protect and further the interests of the 'community' (Overton j, 2000., p.11).

¹² ISSER (2003) *The State of the Ghanaian Economy in 2002*. Accra: The Institute of Statistical, Social and Economic Research, University of Ghana.

accounts for about 22 percent of real GDP, with the contribution trade and commerce as the largest accounting for 52 percent¹³.

Recent calculations for developing countries suggest that the informal sector varies from between about 20 per cent of GDP in Indonesia to around 67 per cent in Bolivia; and that it accounts for over 40 per cent of GDP in twenty-four of the fifty-five countries.¹⁴ In addition to the contribution to the GDP, informal sector may help to create markets, increase financial resources, enhance entrepreneurship, and transform the legal, social, and economic institutions necessary for accumulation.¹⁵

At times of economic crisis, when the number of poor people falls deeper under the poverty line seems to be increasing, in Asia (particularly in Indonesia) and in Africa continent for example the fee from business license imposed to informal sector traders which were increased dramatically in 1998, can be passed on, at least to consumers, many of whom will be poor.¹⁶ This is one aspect that makes informal sector survives through the crisis.

According to dualist school of thought on the informal economy, informal economy persists due to a slow rate of economic growth and/or to a faster rate of population growth.¹⁷ Since population control in Indonesia was rather successful, then the possible cause to the growth of informal sector is the economic contraction that has emerged since the Asian crisis in 1997–98. A quick survey conducted by the World Bank, the Ford Foundation and Statistic Indonesia (Badan Pusat Statistik) found that urban areas and Java have been the hardest hit by the crisis.¹⁸ Following the dualist school, the informal sector was the primary cushion for labour force in Java and the urban areas during the economic crisis. Low economic growth inhibits the labour force from finding employment opportunities in the formal sector, and then forces them to enter the informal sector such as small and cottage industries.

In the case of Indonesia, the author had come across to a case study where the contribution of the informal sector is particularly fascinating. The contribution of street vendors in Surakarta Indonesia has shown an increase.

¹³ *ibid*

¹⁴ J. Alm and J. Martinez-Vazquez (eds.) (2003) *Public Finance in Developing and Transition Countries: Essays in Honor of Richard Bird*. Papers presented at a conference at Andrew Young School of Policy Studies, Georgia State University. Cheltenham, UK: Edward Elgar: 146–78

¹⁵ Schneider, F. and R. Klinglmair (2004), *Shadow Economies Around the World: What Do We Know?*, Discussion Paper Series IZA DP No. 1043 <http://ftp.iza.org/dp1043.pdf>

¹⁶ Devas, Nick and Korboe, David., (2000), City governance and poverty: the case of kumasi, *Environment and Urbanization*, 12: 123

¹⁷ Chen, M. A. (2007). Rethinking the Informal Economy: Linkages with the Formal Economy and the Formal Regulatory Environment, DESA Working paper No. 46, United Nations. http://www.un.org/esa/desa/papers/2007/wp46_2007.pdf

¹⁸ Watterberg, A., S. Sumarto, and L. Pritchett. (1999). A National Snapshot of the Social Impact of Indonesia's Crisis, *Bulletin of Indonesian Economic Studies* 35, no. 3: 145–52.

Table 1. The contribution of street vendors in Surakarta Indonesia

Year	Amount
2002	IDR 120.120.900
2003	IDR 150.306.400
2004	IDR 150.449.200
2005	IDR 153. 000.000
2006	IDR 155.000.000
2007	IDR 155.000.000
2008	IDR 208.250.000
2009	IDR 98.474.800
2010	IDR 239.175.000

Source: KOMPIP 2011 in Rachmawati (2013)

Although the data in the table above had been used as a justification on how local government policy on street vendors e.g. street vendors re-location,¹⁹ it showed the possibility of potential revenue that local government can generate if the street vendors as part of informal sector are taxed.

Report on the realisation of Surakarta city regional budget on 2008 showed that with the amount of money generated from the informal sector tax was IDR 208.250.000. Further, there was an amount of around IDR 2.4 billion dedicated to the development of informal sector (street vendors). There is an indication that the amount of money to manage the informal sector has taken up a significant amount of the regional budget and yet the contribution of the informal sector is only about 8.6%.

The budget for the informal sector development is thought as an investment that it is expected in the future the taxation from informal sector will balance with the money spent for the development and further expected to increase when the informal sector is graduated to a more formal sector. Yet, it is important to note that high taxes in countries with large informal economy will only induce non compliance (informal sector) that reduces the government revenue and thus in return also reduce the amounts of funds available to provide and maintain market-supporting, public goods and services such as the court system, government administration, agencies.²⁰

¹⁹ Rachmawati (2013), Re-location for a better livelihood: a case study of street vendors in local authorities in Indonesia, *International Journal of Green Economics*, Forthcoming 2013.

²⁰ Johnson, S., Kaufmann, D. and Zoido-Lobaton, P. (1998), Regulatory Discretion and the Unofficial Economy, *American Economic Review* 88(2): 387–432

To Tax or Not To Tax

Further fieldwork by the author has suggested that the perspective to approach the issue of informal sector is from the perspective of local government revenue generation. The local government of Surakarta recognised the importance of informal sector contribution to the local government revenue (based on interview with the Mayor and Vice Mayor of Surakarta on 9 April 2011 and 10 April 2011).

An illustration on the potentials of informal sector is a food street vendor who runs his business almost twice a day. Adek, being his name a middle aged seller who sells a chicken porridge in the morning and meatball soup in the afternoon with his mobile cart. A street vendor like Adek can be found throughout the area in Indonesia and if each of street vendors does their business twice, hence the local government is able to tax them twice as well. This means double the money.

However, it is argued that the informal sector employment and incomes are notoriously difficult to tax, particularly street vendors.²¹ Joshi and Ayee in Brautigam, Fjeldstad and Moore (eds.) (2008)²² gave a very interesting chapter on how informal sector in three developing countries and how the difficulties to tax the informal sector.

Most professional tax specialists tend to be sceptical on pragmatic grounds. Why chase after a sector where the direct costs of collection will be high in relation to the revenue raised, and where the costs of compliance might weigh heavily on the taxpayers themselves.²³ It is suggested that losses from not taxing the informal sector could amount to 35–55 per cent of total tax revenues in some countries.^{24 25} The conventional package of tax reforms does not directly address the issue and has largely failed to make significant inroads into the informal sector.^{26 27} The obvious challenge for governments then is to tap into this potentially large revenue source, while simultaneously keeping the costs of collection low.

A study of informal sector by two Christian Aid's partner in Ghana²⁸ has established that current tax system is not fair and inclusive for women in informal sector. They pay the taxes but often denied services provision by local government.

Conclusion: how best to tax?

²¹ Livingstone, I. and Charlton, R. 2001. 'Financing Decentralized Development in a Low-Income Country: Raising Revenue for Local Government in Uganda', *Development and Change* 32: 77–100.

²² Joshi, A. and Ayee, J., Associational taxation: a pathway into the informal sector in Brautigam, Fjeldstad and Moore eds. (2008), *Taxation and state-Building in developing countries*, Cambridge, University Press.

²³ *ibid*

²⁴ J. Alm and J. Martinez-Vazquez (eds.) (2003) *Public Finance in Developing and Transition Countries: Essays in Honor of Richard Bird*. Papers presented at a conference at Andrew Young School of Policy Studies, Georgia State University. Cheltenham, UK: Edward Elgar: 146–78.

²⁵ Terkper, S. 2003. 'Managing Small and Medium-sized Taxpayers in Developing Countries', *Tax Notes International* 29(2): 211–29.

²⁶ Smith, L. 2003. 'The Power of Politics: The Performance of the South African Revenue Service and Some of its Implications', Johannesburg: Centre for Policy Studies Policy: *Issues and Actors* 16(2): 1–19.

²⁷ Stiglitz, J. 2003. 'Populists are Sometimes Right.' Project Syndicate. www.project-syndicate.org.

²⁸ Caroll (2011), Taxing Ghana's informal sector: the experience of women, Christian Aid Occasional Paper Number 7, Christian Aid.

Pimhidzai and Fox (2010)²⁹ Recognising the characteristics of informal sector is important as a way to avoid the wrong policy recommendations that forcefully push the formalising of informal sector. This is done with reasoning that the formalising informal sector can affect the increase of productivity and their contribution to the local government revenue generation. Further, their research concluded that if the tax structure is progressive, then the formalisation of the informal sector could threaten the viability of the smallest enterprises and push poor people who can only find informal sector as the main source of livelihood fall back into poverty.

According to the legalist school, micro-entrepreneurs will continue to produce informally even though they are stifled by unreasonable government rules and regulations. In the extreme situation, informal entrepreneurs do business informally as a response to high taxation and regulation enforced by the government. In other words, high cost of formality tends to increase the informal sector activity. Other factors that explain informal sector activity include the quality of public sector services.³⁰

One of suggested method of collecting tax on informal sector is using the unions of informal sectors as collection agents. Considering the fact that the unions of informal sector such as union of street vendors had detailed knowledge of the activities of their members and could collect taxes without much effort, collecting tax through unions will probably be most effective.

The scheme was relatively easy to administer. Taking the example of taxing the informal sector in Ghana³¹, tax was collected at the lorry parks, which were under the control of the unions. Operators were liable for taxes only on the days they actually worked. This will maximise the tax collection to food street vendors like Adek (in the example above) who run his business with his mobile chart twice a day. It could also be one of the considerations to implement fairer tax to street vendors as it is collected to the street vendors who actually run the business on the day. Taxes were initially collected daily and then, to save on the costs of printing receipts, weekly. The union was offered a 2.5 per cent share of the total collection.

However, setting up unions of informal sector is not an easy job. To be able to form a union, there must be certain level of understanding of citizenship and the awareness of the right to articulate their interest and voice their needs. The establishment of union is not only beneficial for the local government in terms of taxation but it also valuable for the informal sector such as street vendors as it can be used as a channel for articulating the informal sector interest. Being in a union may also be useful for the informal sector to have stronger bargain power over local government service. Despite their informality, these small entrepreneurs pay their local

²⁹ Pimhidzai and Fox (2010), *Taking from the poor or local economic development: the dilemma of taxation of small informal enterprises in Uganda*, the World Bank Africa Regional Project on Improving the Productivity and Reducing Risk of Household Enterprises.

https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=CSAE2012&paper_id=500

³⁰ Schneider, F. and R. Klinglmaier (2004), *Shadow Economies Around the World: What Do We Know?*, Discussion Paper Series IZA DP No. 1043 <http://ftp.iza.org/dp1043.pdf>

³¹ Joshi, A. and Ayee, J., Associational taxation: a pathway into the informal sector in Bräutigam, Fjeldstad and Moore eds. (2008), *Taxation and state-Building in developing countries*, Cambridge, University Press.

government taxes and even some state-level taxes, but they continue to receive little in the way of basic services in return.

Research on building political voice within the informal economy argues that the way forward lies not only in creating networks and associations in order to facilitate participation in local governance structures, but in actually empowering those associations to make effective claims on government.

The establishment of informal sector unions does not necessarily mean that it will provide a representation of institutional channels. Dickovick (in press)³² studied collective action by informal enterprises in the transport and street-vending sectors in three localities in Lima and in the city of Chicalayo. This study showed that in a circumstance where the local government are under pressure to raise revenue, they will try to employ whatever capacity they have to enforce tax collection in a confrontational way rather than negotiate with the informal sector. If the unions have not shown strong representation, it will probably then loses its opportunity for collective action. Without strong collective action, the union will be hardly able to do anything when there are no tangible services provided by the local governments even though the informal sectors are paying the tax.

On the contrary, when the local government have not been under pressure to generate revenue, they will be more open to negotiation with the informal sector. In one of Dickovick case study, in Centro locality of Lima, the municipality has been able to negotiate with street vendors associations with mutually satisfactory outcomes: an agreement not to tax them in light of the 'extraordinary economic crisis' in exchange for their agreement to move from the valuable land they have invaded in the city centre to a less expensive area (ibid. 19). This is the kind of bargaining that has also happened in Surakarta city in Indonesia (Rachmawati, 2013).

Conclusion

Learning from the discussion above, street vendors as the most majority of the informal sector and the most visible form of informal sector, do contribute significantly to the economy within a locality. It contributes to the growth of local economy because street vendors' reliance on locally available resources. It has all the potential to contribute to the local government revenue and this potential will be greatly improved with better tax collection and tax management. It will result on better public service provision to the community at the end. On a larger scale, this will impact on the increasing financial capacity of local governments. Good management of local (natural) economic resources, add with higher local revenue will create a more stabilised local economic development.

In national scale, a country is in better position when it exports more and import less. This also applies to informal sector. Informal sector plays a significant role in the green economy for its financial limitations to import particularly import an advance technology. Even though it

³² Dickovick, J. T. (in press). 'The "Colectivo" Action Problem: The Local Politics of Small Business in Peru', in K. Burgess (ed.) *Between Cooperation and Suspicion: Civil Society and the State in Peru*. Syracuse: Global Affairs Institute.

can be disadvantage but it also encourages the creation of low and better suited technology for informal sectors. Informal sector also rely on low cost and locally available scrap construction materials. This has been regarded a disadvantage for it has seen as an infringement to safety and hygiene, yet it can also be a good way to conserve the environment in the form of recycling program.

A fairer tax collection will only happen when local governments are able to ensure that upon the tax collection, a better service provision to informal sector in infrastructure and other services will be established. Hence, the habitat characteristic of informal sector to create environmental hazardous and depletion is reduced to a minimum level. Also, with the better infrastructure service provision, it will stop the informal sector to unauthorised use of vacant public or private and to unauthorised construction of structure and buildings.

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