



HOW TO FORMALIZE THE INFORMAL SECTOR: MAKE FORMALIZATION EASY AND DESIRABLE

A majority of the world's active population works in the informal economy

1.8 billion people work in informal jobs compared to 1.2 billion who benefit from formal contracts and social security protection. That number is projected to grow to two thirds of the workforce by 2020

Informality manifests itself in many ways, but especially in land and housing ownership, business operations and labor

There is a widespread misconception that the informal economy is somehow illegal, or even criminal. A clear distinction should be made: illegal activities go against the law; *informal activities are "extralegal"*, in the sense that they are not officially declared and do not take place in the realm of the laws which should govern them. "The recent re-convergence of interest in the informal economy stems from the recognition that the informal economy is growing; that it is a permanent, not a short-term, phenomenon; and that it should be viewed not as a marginal or peripheral sector, but as a basic component of the total economy".

How to formalize the informal economy: make formalization simple and desirable

1. Explain what formalization means

What minimum conditions should a small business satisfy to have legal existence and to operate legitimately? A majority of informal entrepreneurs don't have a reply to this question and don't know where to find an answer. Apart from creating a company – which is usually costly - what are the other available business regimes; is registration in the national tax registry sufficient, or should one register also with municipal tax authorities; which activities require a special license; what health and retirement protection scheme are available; should account books be held, do they need to be legalized; can an entrepreneur undertake formalities personally? Lack of awareness of the rules and procedures, and fear that they will be too complicated, inhibits microentrepreneurs and is a major deterrent to the formalization of small businesses.

Adapted information. Clear and easily understandable information on existing legal regimes, for registration and operation, and on the related procedures, should be widely made available to microentrepreneurs. Options for legalizations – available legal regimes - should be clearly explained, with their respective advantages and downsides. The procedures should be explained steps by step, with all the necessary details.

Targeted dissemination. Information should be brought to microentrepreneurs. Microcredit officers go find their customers where they live: on the markets, in small shops and in the streets, in working-class business districts, shanty towns and villages. This is also where the information on formalization procedures should arrive. Microfinance institutions, NGOs, small trader associations, churches and all other institutions working with the poor are good



channels to reach them. Schools and colleges are other good channels to pass the message, through the children. Cybercafés are good spots to disseminate information to microentrepreneurs. Postings on municipalities' public boards may have same impact. Newspapers, TV and radio are very effective media, if messages are broadcasted through programmes with large audience in the targeted segment. Massive, multi-channel, formalizations campaigns could be launched, on the model of literacy or vaccination campaigns.

2. Make formalization easy

Procedures should be made as simple as possible, within the framework of existing laws or by amending them. Creating a one-stop-shop dedicated to microentrepreneurs is a good way to cut time and moves for the entrepreneurs. eGovernment tools are a clear plus, but not a must. Physical one-stop-shops, with manual information processing, can greatly facilitate the formalization of small businesses, the more so if they are strategically located and easily accessible. A single form should suffice to register with all concerned administrations and, ideally, the right to operate legally should be delivered immediately. This is the case in the United Kingdom, where the only obligation for self-employed or sole traders is a notification to the tax authority, by post, phone or through a simple, online form. However, it might be difficult to reduce the number of supporting documents required for registration, when they are listed in the law. For example, the OHADA Uniform Act Relating to General Commercial Law, applied in 16 African State and which governs part of the trader's registration procedures, requires to produce five documents: birth certificate, wedding certificate, certificate of nationality, lease contract and police record. Obtaining each of these documents gives rise to at least one, and sometimes two steps, with their corresponding requirements, costs and delays. This greatly limits the possibility for those 16 African countries to radically simplify the process.

New legal schemes for self-employed. In cases when it is too difficult to change the laws, it might be simpler to create new regimes with a new law. An increasing number of countries now create special schemes for individual entrepreneurs. This is what France did in 2009 with the new "autoentrepreneur" a scheme that allows any individual operator to register at the same time, in a few minutes, with the trade registry, the tax administration and social security. In one year, more than 300'000 new enterprises have been registered. In Rwanda, since the introduction in 2009 of a new company law, a trader can register in three steps and 24 hours, through a one-stop shop implemented at the Rwanda Development Board. Panama introduced in 2007 a new law abolishing all previous procedures with multiple administrations and establishing that traders – nationals or foreigners – just need to register and pay online \$15 to start operating legally. The whole process is very simple and takes no more than 10 minutes.

Simplified tax regime. New small business schemes usually include a single tax system - combining the income tax, the VAT and social contributions - and a "forfait" payment, as a way to facilitate registration and compliance; small tax payers units are created in business areas, just as big tax payers centres have been created in the 1980s and 1990s. The Rwanda Revenue Authority introduced in 2009 a new "Block Management System", installing tax offices in districts where small businesses operate.



3. Make formalization desirable

Establishing good regulations and simple processes, however, is not enough. Besides being known of their intended targets, they also have to be perceived as beneficial. Most Latin-American countries have introduced simplified tax regimes for microbusinesses in the past ten years. Only a small minority of microentrepreneurs took advantage of them. In 2004, Argentina implemented a new simplified tax system for small businesses. After two years, only 44'000 new tax payers had enrolled.

Communicate on benefits. Peace of mind and protection against unscrupulous officials are very attractive benefits. They are sometimes not very well understood, since microentrepreneurs already make payments and satisfy a number of obligations they consider legal. They are abused by local officials, lawyers or intermediaries and, henceforth, often operate extra legally in total good faith. It is important to clearly explain which norms are legitimate, what authorizations and documents are officially delivered, and what the corresponding payments are. Being legal opens the possibility to expand, by legitimately selling to, and making contracts with, other formal businesses and public entities, importing and exporting, employing workers, renting, buying and selling premises and properties, getting access to credit and investment. Social protection - health care, retirement and unemployment protection schemes - are key additional benefits usually linked to formalization. It is essential to publicize that these benefits are part of the legalization package.

Reinforce benefits. In case social protection is not a part of the package, or when it is not applicable to non-wage operators and their family, such schemes should be developed, even if on a modest scale. Microfinance institutions have started to build for their clients private microinsurance schemes that could be offered to small entrepreneurs at the time of registration. Easier access to credit, training, business advisory and development services, could be triggered by legalization. Microfinance institutions would certainly encourage microentrepreneurs to legalize their activity and would willingly propose slightly better credit conditions to formal entrepreneurs.

Enforce compliance. The creation of simplified regimes must be accompanied by enforcement measures, to ensure that the few obligations remaining are well respected, in particular as regards the declaration and payment of taxes, but also in terms of hygiene, health and labour relations.

Partnering with other empowering services. Improving access to the law, just as opening the access to finance, or offering training and business support, are necessary and effective approaches to empower the poor. Strong operational synergies should be developed between the institutions offering those services, which are complementary and mutually reinforcing.



UNCTAD's easy business formalization (microlegalization) programme

UNCTAD has designed a programme to help governments implement regulations adapted to the needs of micro and small enterprises and facilitate the legalization of informal businesses, based on international best practices. Advisory and capacity building services will be offered for:

- Inventory and diagnosis of existing regulations applicable to the creation and operation of microbusinesses (initial registrations, licenses of activity, tax and social declaration and payment)
- Simplification of existing schemes and/or proposal of new, adapted regulations with a view to minimizing the number of steps and requirements for the users, and to maximizing legal and social benefits
- Organization of internal processing – within and among the administrations involved, with emphasis on the use of eGovernment tools
- Negotiation of partnerships for combined delivery or services with microfinance institutions and other providers of basic services to the poor
- Drawing and execution of external communication
- Measure results