

# ► **Business informality**

## International Labour Organization

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# What are the goals and definitions of formality?

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## ► ILO Recommendation 204: Transition from the Informal to the Formal Economy (2015)

### ► **Informal economy:**

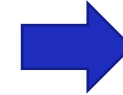
*“All economic activities by **workers** and **economic units** that are – in law or in practice – not covered or insufficiently covered by formal arrangements”*

### Enterprise formalization



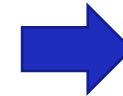
#### **Means to an end**

*(Social and economic growth, tax revenues, structural transformation, decent work)*



#### **Reduce unfair competition**

*(level playing field)*



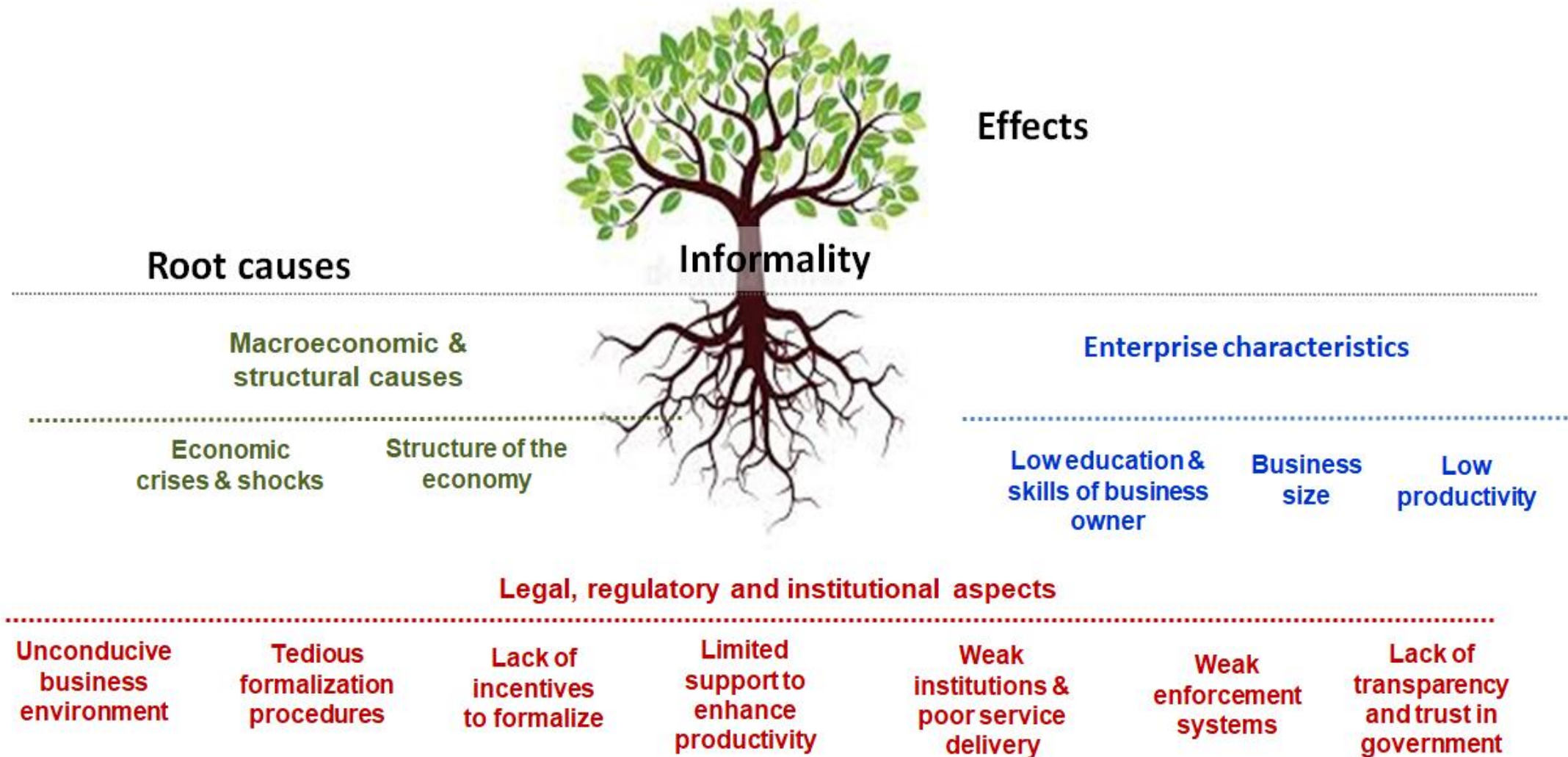
#### **Requirement to formalize employment**

*(declare workers, make social contributions)*

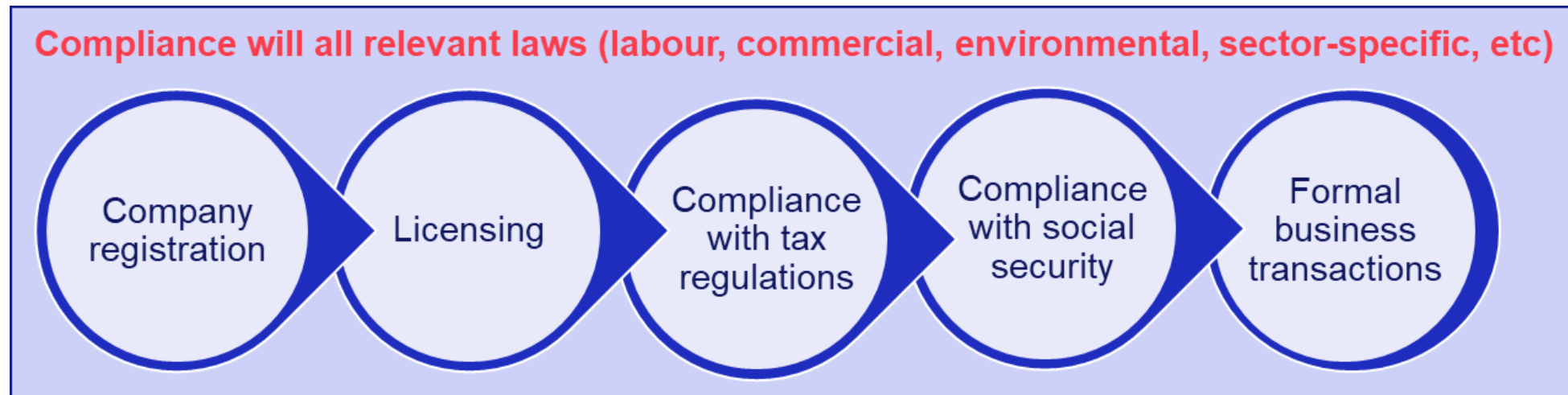
## ► Statistics on informality

- The informal economy absorbs close to six out of ten workers and eight out of ten enterprises in the world (ILO).
- It contributes from 15 per cent to 35 per cent of total gross domestic product (GDP), depending on the region (World Bank).

# What are the root causes of informality?

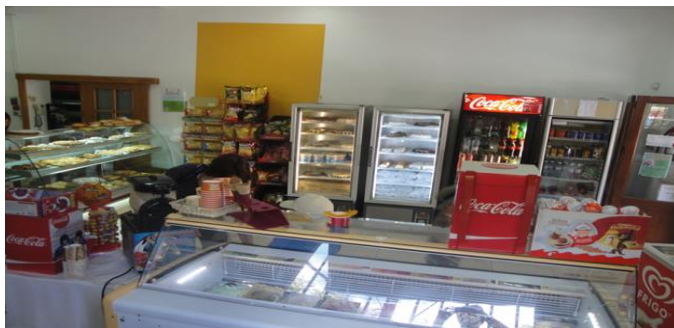


# Is formality 'binary' or is it a gradual process?





# What does informality look like?



# What does informality look like?



# How can legislative frameworks be structured to support rather than hinder this transition?

- ▶ Integrate formalization in **policy frameworks** (e.g. SME policies, National Employment Policies, Industrial Policies, Tax policies, etc..)
- ▶ **Preferential tax regimes** for smaller enterprises encourage formalization
  - Yet this is mainly the case for businesses whose practices are not too distant from the formal economy.
  - This tax incentive alone is not enough to formalize a much larger number of less productive companies.
  - Few MSEs mature from the presumptive regimes into the national mainstream tax regimes.
  - Therefore, deliberate policy measures are needed to facilitate such graduation
  - Support in access to finance and business development services, when combined with preferential taxation, can further enhance the attractiveness of the formal sector

(See [here](#) for more information)
- ▶ **Market-enhancing policies** which create and expand markets through measures such as market linkages, incentives, government procurement, trade, etc., assessing conditions that enable structural transformation while bringing small firms into the mainstream economy.



# How can legislative frameworks be structured to support rather than hinder this transition (cont'd)?

- ▶ **National formalization strategies:** e.g. National Strategy and Action Plan on Formalization in [Senegal](#)
  - Priorities: Access to finance; Productivity and market access; Business development services; Social protection; Registration, taxes and compliance (including the operationalization of the '*entreprenant*' legal status); Social dialogue; Gender; Prevention and enforcement measures; Coordination, monitoring and evaluation, communication.
- ▶ **Simplifying registration and strengthening benefits of running a formal business**
  - Simplified legal status with formalization benefits for micro and small enterprises: (i) Simplified registration, (ii) tailoring taxation and social security payments to the capacities and needs of MSEs.  
See also this DCED [Paper](#) and [policy brief](#).
- ▶ **Facilitating access to formal financial services**
- ▶ **Social dialogue and other measures to enhance compliance in supply chains**  
Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (MNE Declaration)
- ▶ **Measures to facilitate formalization through social and solidarity economy entities**

## 1) No one –size fits all approach

Segmentation and targeted approaches for different groups is important

## 2) Entrepreneurs make a rational choice on whether or not to formalize;

It is therefore essential to put in place incentives and to make it easier and more attractive to formalize.

## 3) Interventions should include both ‘carrots’ and ‘sticks’

Incentives and enforcement measures.

## 4) It is also important that entrepreneurs increase productivity

## 5) It is important to find the right policy mix.

Formalization of enterprises has many facets. Combining several reform measures may work better than piecemeal approaches.

## 6) It seems to be easier to formalize firms while they are being set up than to formalize firms that already exist. Therefore, it might make more sense to target start-ups. target start ups.



# Thank you

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