



Conference on Business Environment
Reform and the Informal Economy:
“How Business Environment Reform
Can Promote Formalisation — Learning
From Our Experiences”

12-15 April 2010

Cape Town, South Africa

REPORT ON CONFERENCE OUTCOMES

TOWARDS RECOMMENDATIONS FOR DONOR AND DEVELOPMENT AGENCIES

The purpose of the conference was to focus on practice and programme interventions that improve the business environment in order to enhance the opportunities for informal enterprises. The conference sought to better understand the kinds of reforms that allow informal economy actors to formalize, to access new markets and contribute to growth. It provided the opportunity for a wide range of donors, development practitioners and programme partners to share and reflect on practical experience and empirical evidence in business environment reforms that has led to increased transition from the informal economy to formality.

Two outputs from the conference were envisaged:

1. A reader on business environment reform and the informal economy: this will be a collection of documents presenting current debates, practices and research highlighting the links between business environment reform (BER) and the informal economy. This material is immediately available on the conference website:
<http://www.enterprise-development.org/page/informal-economy-conference-2010>
2. Advice to donor and development agencies: recommendations to donor and development agencies on how donor and development agencies can support BER that addresses the concerns of the informal economy.

In 2008, the Donor Committee for Enterprise Development (DCED) produced donor guidance on business environment reform, titled *Supporting business environment reforms: practical guidance for development agencies*. This document presents a distillation of the lessons learned by development agencies in their support of BER in the form of general principles to guide the future work of agencies. It provided a basis for the many discussions during the conference.

The second outcome of the 2010 Cape Town conference described above will complement the current donor guidance and will focus specifically on reforms that affect the informal economy. This will either be produced as a second volume to the current guidance or will be incorporated into a second edition of the revised guidance.

1 Positioning donor guidance on supporting reforms targeting informality

When formulating recommendations and guidance to donor and development agencies on how to support informality-oriented reforms, it will be useful to address the following:

1.1 *The rationale for reforms targeting the informal economy*

It will be useful to highlight the **importance of the informal economy phenomenon to the development agenda** of donor and development agencies and the host government. The informal economy phenomenon should be described using neutral, functional terms. The links between the informal economy and other development themes or goals should be clearly identified.

1.2 *Define and categorise the informal economy*

Informality is difficult to accurately define. Various degrees of informality can be found along a continuum between an enterprise operating completely informally and its workers to one that complies with law and regulation, but engages in informal or even illegal activities. There are also different kinds of informality (e.g., informal enterprises, informal workers). Thus, informality contains a **diverse range of enterprise actors**, which requires careful description and analysis. Indeed, it should be recognised that the informal economy is a significant contributor to the national accounts of many developing countries, although this contribution is often unseen or difficult to measure. Advice can be provided to donor and development agencies on ways to **categorise informality and to tailor interventions accordingly.**

1.3 *Relevance of BER to the informal economy*

Because there are different categories of informal enterprises, the linkages between BER and these enterprises will vary. It is important to identify these links and to **show how BER will affect these enterprises.** In addition, because there are **different drivers** of informality, there are **different starting points and priorities** for reform programmes. For example, reforms designed to address informality that is created by war and conflicts will differ from those used to address informality created by exclusion or inequality. While **BER is not the only intervention required** to address the concerns of informality, greater attention needs to be given to understanding the above distinctions and to **ensuring not all reforms targeting the informal economy are pursued in the same way.** In some cases, **social policy responses may be more appropriate** than business environment responses (e.g., many survivalist informal enterprises will be unable to take up the opportunities offered by a reformed business environment).

Finally, just as the donor guidance identifies “contested issues” that not all agencies agree on, the recommendations on supporting reforms targeting the informal economy should describe **key controversies** within this topic.

2 Generalised approaches to supporting reform

Throughout the Cape Town conference discussions there was broad agreement on the key messages and principles contained in the donor guidance:

- i. Focus on what the private sector needs through public-private dialogue (Principle 6) — **ensure there is continual consultation with beneficiaries;**

support efforts that strengthen the role and capacity of key stakeholders (Principle 5); and ensure domestic ownership and oversight of reforms (Principle 4).

- ii. **Highlight the benefits of reform** (anticipated and actual) so that all actors recognise how this will improve the circumstances of private enterprises. This is likely to involve sensitising relevant stakeholders and raising their awareness of the needs for and benefits of reform. Government needs to realize that it should not come across merely as the tax collector when it wants to maximize voluntary formalization. It is likely that this will involve the use of media and the formulation of a communications strategy (see Principle 10).
- iii. **Target reform efforts based on a clear assessment of what is needed.** This corresponds with Principle 7 in the Donor Guidance, which encourages agencies to focus on the binding constraints to business growth and scope reforms accordingly.
- iv. **Support policy makers and government officials who are reform champions and other change agents.** This is likely to require agencies to understand and respond to the political economy of reform (Principle 2) and to stimulate the demand for reform and drivers of change (Principle 3).
- v. **Sequence reforms by designing first, second and third order reforms** (Principle 8), and ensure the implementation gap is addressed (Principle 9). This may involve the building of professional competencies and organisational capacities to implement and sustain reforms especially in the mandated government institutions and local municipalities.

The above recommendations correspond to a number of principles and messages contained in the donor guidance. **These are good practices for all BER-support programmes and interventions.** They are especially important when supporting reforms that **improve the growth opportunities for informal economy actors.**

3 Specific concerns around reforms targeting the informal economy

While the term “private sector” and “private sector development” (as used in the donor guidance) encompasses all forms of privately owned enterprises, formal and informal, it is recognised that **many informal economic actors do not identify with these terms.** Informality involves a degree of exclusion and operating on the edge of the formal or official economy. Thus, even when referring to the broader business community, it is important to **use language that is inclusive and accurate.**

Reforms targeting the informal economy should consider the **ambitions and motivations of informal actors.** It should encourage reforms that respond to what is happening on the ground, rather than imposing donor-driven concepts or models. Many informal enterprise owners and managers do not believe they have a choice other than to operate informally. Thus, they should be offered with affordable choices that lead toward formality.

Donor and development agencies should not overload BER agendas. The focus should be on the **priorities defined by programme partners and beneficiaries** (i.e., informal economic actors) **using participatory and objective assessment measures.**

While it is tempting to dive into specific reforms targeting the informal economy, it is often better to consider the big picture first and to **understand the broader relationship that exists between formal rules and institutions and informal economic actors**. It is important to analyse and understand the political economy of reform in any one country. Rules and regulations that reflect social norms and values are often more effective and enforceable than those that have been imposed.

4 Objectives of reforms targeting the informal economy

The conference has seen how BER has typically sought to **encourage the formalisation of informal enterprises**. By improving the legal and regulatory framework in order to make formalisation easier and cheaper, governments and their development partners (including business membership organisations, donor and development agencies) have encouraged informal actors to become formal and participate more in the mainstream, formal economy—including the global economy. While these efforts have achieved some success, the more effective interventions have contained responses to the specific needs, expectations and fears of informal actors. **Formalising informal enterprises through BER requires a detailed understanding of the systems that create and perpetuate informality.**

Formalisation is not the only objective of BER. While informality is typically described in negative terms, it can produce positive outcomes for a developing economy. Informal economic activity can promote innovation and can act as a buffer to economic shocks that developing economies regularly face. Thus, an additional objective of BER is to **improve the conditions in which informal actors operate** — to enhance the positive effects of informality while making it safer, protecting the vulnerable and encouraging equity. A dynamic, competitive and growing economy will display movement between the formal and informal economies.

The DCED should be clear in its advice in this regard: what are the objectives of reforms targeting the informal economy? The logical framework for BER support interventions that focus on the informal economy needs to be clearly articulated. It may also be useful to graphically illustrate some of these key concepts and approaches.

5 Supporting reforms that target the informal economy

There is no blueprint for reforms that encourage formalisation or address the problems faced by informal actors. This requires a **comprehensive and clear understanding of the forces that produce and sustain informality**. A large informal economy is often a **symptom of a number of broader social and economic conditions** (e.g., land ownership, migration, unemployment, poverty, inequality). Reforms that do not identify and address these issues will not succeed. Thus, BER should not address the informality per se, but rather address the causes that force enterprises to operate informally.

BER that addresses informality contains the following elements:

- 5.1 **Ensure informal actors have a stake in reform processes:** While stakeholder engagement is a fundamental element of effective BER, informal actors are often excluded from these processes. Reform processes need to contain measures that deliberately involve informal actors and their legitimate representatives. This will often require support to better organise informal actors and ensure they are effectively represented in public-private dialogue processes, e.g., through capacity-building support to business member organisations that represent informal enterprises. In addition to general public-

private dialogue measures, informal enterprises should be supported to engage in discussions and initiatives between formal and informal firms.

- 5.2 Differentiate reform processes to address specific target groups and informality drivers:** The contexts and needs of informal actors vary greatly and need to be carefully assessed. Reform processes should respond to the specific concerns of these actors.
- 5.3 Reduce the legal and regulatory barriers to enter the formal economy, while ensuring that the legal and regulatory framework is equitable, transparent and enforceable:** Reforms should distinguish between those that reduce the overall levels of informality (i.e., reforms that lead to broad-based economic growth) from those that increase the rate of graduation into the formal economy. While the barriers to enter the formal economy vary, labour and taxation laws and regulations are two of the most common. **High quality laws and regulations are essential** if formalisation is to be nurtured. The rule of law is weak in many developing economies. Thus, promoting formalisation and strengthening the rule of law involves a stepped process that encourages informal actors to move toward greater degrees of compliance and formality. Finally, it is important to remember that good business environments promote openness and transparency—these are critically important to informal economic actors.
- 5.4 Create structure for greater accountability between the state and informal actors:** BER is a process that leads to a better relationship between the state and informal actors. While governments, at all levels, should become more accountable to the business community (especially with regard to the provision of public services), informal actors should also be able to seek justice through the courts and other mechanisms that enshrine rights and remedy complaints. **Access to information is critical for informal actors.** This includes access to government information and access to market information. Informal actors require opportunities to participate in government planning and decision-making processes, and mechanisms to provide feedback on government services.
- 5.5 Look, learn and build on what works best and monitor changes in the informal economy:** Donor and development agencies should support reforms and interventions that appear to be working—identify good practices, apply lessons learnt, scale-up local successes, and support domestic ownership. Design indicators that can be used to regularly monitor changes in the informal economy and to assess the impact of reforms.
- 5.6 Economic policy and informality:** In developing countries some economic policies may lead to greater levels of informality. In an open economy, domestic production has to deal with more competitive products from industrialized countries, so in order to compete, local industry needs to reduce costs and increase productivity. One response to this—although a wrong response—is to operate informally to reduce costs. Thus, **informality may be a consequence of the external economic environment** and, hence, to reduce the informality, business environment reform must consider the current economic policies, both internal and external.

Governments and their partners (i.e., donor agencies, business membership organisation, including associations of informal enterprises) need a systematic way of learning about the effectiveness of reforms targeting the informal economy. We need to

know what is working in reforms targeting the informal economy and what is not. This requires continued investment into research, knowledge management, training and support for communities of practice. In addition to general guidance on how to support reforms that target the informal economy, donor agencies and their partners require “how to” manuals and case studies.

On its own, BER is an inadequate response to the challenges faced by informal actors. Many of the drivers of informality are beyond the reach of business environment interventions. Thus, **consideration should be given to programme interventions that complement BER.** These may include access to resources that boost enterprise productivity and growth, the provision of education and health services, housing and infrastructure, and the creation of social safety nets. This requires policy coherence and coordination. It should not be forgotten that **economic growth that creates a greater demand for formal employment** is a powerful force that pulls informal businesspeople and workers into the formal economy and into more productive and decent employment.