

DONOR COMMITTEE FOR ENTERPRISE DEVELOPMENT

Technical Report

Dealing with Informality in Conflict & Fragile Settings

Business Environment Working Group



Nancy Benjamin

April 2023



The Donor Committee for Enterprise Development

Business Environment Working Group

Donor Committee for Enterprise Development: www.enterprise-development.org

Citation: Benjamin, N. (2023) *Dealing with Informality in Conflict and Fragile Settings*; Technical report. Donor Committee for Enterprise Development, Cambridge, UK.

Acknowledgements

The author wishes to extend their thanks to all the interviewees who participated in this research, as well as the DCED Business Environment Working Group for their guidance and review. Particularly: Tania Ghossein (World Bank), Anastasia de Santos (USAID), Sylvia Solf (World Bank), Moussa Traore (USAID), Siobhan Kelly (FAO) and Judith van Doorn (ILO), and to Ella Duffy (DCED Secretariat) for editorial work.

Cover image by Mahmoud Sulaiman / Unsplash

This material has been prepared for discussion purposes only. As such, the material should not be regarded as incorporating legal or investment advice, or providing any recommendation regarding its suitability for your purposes. Conclusions expressed in this report do not necessarily reflect the views of the DCED or its members.

Table of contents

EXECUTIVE SUMMARY	2
1. INTRODUCTION.....	4
METHODOLOGY	5
2. GOVERNANCE, CONFLICT AND INFORMALITY.....	5
3. THE INFORMAL ECONOMY IN CONFLICT AREAS	7
4. POLICY OPTIONS AND BARRIERS IN A FRAGILE CONTEXT	8
4.A. POLITICAL AND ECONOMIC FRAGILITY	9
4.B. INFORMALITY AND VULNERABLE WORKERS.....	11
4.C. POLICY APPROACHES.....	12
5. THE LOCAL DIMENSION	13
6. FORMAL/INFORMAL: IMPACT ON CONFLICT AND FRAGILITY	16
6.A. JOBS AND RESILIENCE.....	16
6.B. THE 'PLAYING FIELD'	18
6.C. EXTRACTING NATURAL RESOURCES.....	19
6.D. LOCAL DISPUTE SETTLEMENT	20
7. LESSONS FOR REFORMERS	21
7.A. MAIN DIRECTIONS.....	21
7.B. WHAT TO AVOID.....	22
7.C. WHAT WORKS?	22
7.D. CONCLUSION AND RECOMMENDATIONS	24
REFERENCES.....	28
ANNEX: INSTITUTIONS FROM WHICH STAFF WERE INTERVIEWED.....	33

Executive summary

Within the overall context of how to support the private sector in fragile and conflict countries (FCS), the role of the informal economy requires a specific focus. The informal sector is likely to change and grow as a share of the economy under fragile and conflict circumstances. But the lower productivity of informal firms contributes to their offering lower quality and more precarious jobs, with lower pay. Thus, there exists a strong economic and social rationale for encouraging informal firms to adopt more of the behaviour of formal firms. Any such initiative, however, becomes more difficult in the circumstances of fragile or conflict-affected developing countries. This paper examines the literature on informality in fragile and conflict countries, as well as the approach of donor and development agencies in dealing with business environment issues in such settings, in the interest of improving that approach. Given the different degrees and dimensions of informality, it should be noted that the goal is to support firms who have the capacity to transition – formalize – while helping subsistence firms to grow or become more productive.

Fragility and conflict both signal weak institutions and deep governance issues leading to a weak and unstable business environment. Among informal firms in general, but especially among those in conflict zones, business is very risky and default risk is high. Yet the development and protection of economic opportunity is the main source of resilience in fragile states. And without institutions that can enforce a formal set of business regulations and provide relevant services to enterprises in the formal economy, formalization of firms loses meaning.

Focus on the need for effective governance to support and sustain the business climate leads directly to the critical role of local governments, including the need to strengthen fiscal decentralization where local services must substitute for central-level institutions overrun by violence and fragility. In fragile and conflict states, recovering economic activity, and in particular, a constructive environment for private sector activity will require collaborative outside assistance from DFI's and NGOs over an extended period of time. This assistance must help compensate for weak or absent public institutions and steer through the local political economy in order to help establish essential institutions and services that can provide a stable environment for the private sector.

Relevant literature, front line officers with donor and development agencies, and business environment improvements sought by informal firms in fragile and conflict states do not emphasize traditional approaches such as expanding institutional credit, direct jobs creation, or refinements of business rules, but rather emphasize the following elements:

Security: Assuming there is sufficient security to begin discussions with donor agencies, a major concern of all firms is establishing confidence in institutions that can maintain that security well enough to provide reasonable protection for property and business investments.

Access to infrastructure and information technology, and thereby, connections to markets or sectors that may allow greater sales and a larger scale of operation are key elements of the business environment for the informal sector. Access to electricity is a top BER priority for those who do not have it, and such access is most associated with higher productivity among informal firms and therefore, their ability to progress toward formalizing.

Social Protection: Providing public systems of social protection based on shared payments is a major contribution to the business environment, especially for informal firms. It provides essential business services that informal firms can otherwise ill-afford and which ensure essential protection for workers against substantial risks, while also providing a step toward formalization.

Governance: Any agenda must provide for improvement in governance. Corrupt government systems and elite capture will only entrench fragile conditions for years to come. A major concern vital to formalization is the domain of public services. Research shows that informal businesses choose to adopt more of the characteristics of formality as these come to be seen as serving their business interests.

1. Introduction

Within the overall context of how to support the private sector in fragile and conflict countries (FCS), the role of the informal economy requires a specific focus. In particular, the informal sector is likely to change and grow as a share of the economy under fragile and conflict circumstances (Speakman and Rysova, 2015) While the informal sector can serve as a flexible source of otherwise unavailable income, its existence is partly a function of a weak business environment. The aims of business environment reforms must adapt to the nature of informality in fragile and conflict conditions while maintaining the objective of encouraging informal firms to take on more of the characteristics of formal firms.

The ILO defines the informal economy as referring to “all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements.” And while Informal business can involve different aspects and degrees of informal activity, informality differs from illicit activities, in particular the provision of services or the production, sale, possession or use of goods forbidden by law, including the illicit production and trafficking of drugs, the illicit manufacturing of and trafficking in firearms, trafficking in persons, and money laundering.¹

The objective to pursue the formalization and modernization² of firms in the informal economy derives from several motivations. These include the broadly observed fact that the practices of formal firms lead them to have higher productivity than informal firms (World Bank, 2019; Benjamin and Mbaye, 2012). The lower productivity of informal firms contributes to their offering lower quality and more precarious jobs, with lower pay. When enterprises are not registered, their workers are not declared and cannot access contributory social protection benefits. Further, the extensive operation of firms more or less outside the regulatory framework restricts the effectiveness of business policy to enhance economic growth. Thus, there exists a strong economic and social rationale for encouraging informal firms to adopt more of the behaviour of formal firms. Any such initiative, however, becomes more difficult in the circumstances of fragile or conflict-affected developing countries. Formal business practices are difficult to promote and sustain where institutions and governance mechanisms are weak, the political landscape uncertain. Informality often serves as the means for resilience where fragility, conflict or a protracted crisis prevails. The purpose of this paper is to examine the literature on informality in fragile and conflict countries, as well as the approach of donor and development agencies in dealing with business environment issues in such settings, and to advise on improving that approach.

¹ Transition from the Informal to the Formal Economy Recommendation (ILO, 2015).

² Modernization addresses issues deriving from economic under-development and poor quality governance. See Williams and Kedir, 2018.

It is important to note that interventions aimed at formalization do not necessarily target full legal formalization; the goal is to support firms who have the capacity to transition – formalize – while helping subsistence firms to grow or become more productive.

While a state of fragility and violent conflict are distinct, they both signal weak institutions and deep governance issues leading to a weak and unstable business environment. Business environment reforms (BER) must help to provide the enabling environment for firms to survive and progress under the difficult and unstable conditions of fragility and conflict.

The paper will not directly assess the causes of fragility and conflict, or of informality, but will touch on what is most commonly associated with each. It will begin with a section describing key governance issues, because the absence, or lack of enforcement of good governance is fundamental to both fragility and informality. The following section will discuss the nature of the informal economy in conflict areas and basic donor approaches to operating in such environments.

Section 3 will survey policy options in fragile contexts and barriers to formalization, including gender dimensions. Section 4 will take up the local dimensions of informal economy in fragile and conflict settings, including both the governance challenges and the fiscal difficulties of decentralizing central-level resources. Section 5 will look at how the formal and informal sectors respond under fragile and conflict circumstances and survey a few cases of conflict over natural resources, where the formal sector remains actively involved in conflict areas. Section 6 will look ahead to developing lessons for reformers and the donor community going forward.

Methodology

As indicated above, this report is based on a review of the relevant literature and discussions with representatives from donor and development agencies with expertise in designing and implementing business environment programs in fragile and conflict countries.

2. Governance, Conflict and Informality

One of the main tenets in the study of conflict is the central importance of government control over the entirety of a country's territory – from border to border (World Bank, 2011). The less charming terminology often used among political scientists is that governments must have a monopoly over the use, or delegation of the use of violence in their territory. This condition may seem demanding, especially for some countries, yet we can easily see the consequences from the failures of central governments to exercise such control.

One major conflict zone in Africa is the Sahel, a huge desert area encompassing much of northern Mali, Niger, and Chad, but also impacting border zones of many neighbouring countries including Nigeria, Libya, Algeria, Mauritania, Senegal, and Burkina Faso. The general challenges posed by a

huge territory nearly impossible to patrol were exacerbated by a lengthy period in the early 2000's when Guinea Bissau, a gateway from the Atlantic Ocean to the Sahel, was unable to establish a stable central government. The lack of territorial control in Bissau, along with other gateways and the general lack of governance in the northern Sahel shaped the region into a competition for 'uncontrolled' space, useful for trafficking guns, goods-- licit and illicit-- as well as people, between Africa and Europe.

Across the upper Sahel, a toxic cocktail of armed groups—insurgent movements, ethnic militias, criminal gangs, smugglers and traffickers, and, indeed, violent extremists—compete for preeminence. The lines among these various players are not always clear: membership can be fluid and overlapping, and alliances of convenience emerge and fracture depending on interests, personalities, and the broader political context. (Cooke and Sanderson, 2016).

While a local branch of Al Qaeda has become active in the Sahel, Boko Haram has come to dominate the border between Niger and Nigeria. This dominance includes control over much informal trade across that border as well as the theft of Niger livestock and the recruitment or kidnapping of new forces from Niger villages. Again, the lack of enforcement of any legal order contributes to the illegal exploitation of the territory.

... the internal strife along the borderlands and the collapse of state control in these areas has enabled the proliferation of small arms that have drastically increased the intensity of banditry in the Nigeria's northwest. The research shows and indeed concludes that the long period of neglect of border communities have deprived them of basic necessities of life, exacerbated the situation. Thus, Nigeria's north-western states of Sokoto, Zamfara and Katsina that bordered Niger republic have become safe havens for raiders and bandits to operate freely and in some cases, established 'informal structures' of control over borderland communities. (A. Samaila, 2022).

Similarly, the lack of central government control over eastern DRC has enabled militias to control valuable resource mines in that part of the country. One point to keep in mind from these and similar cases is that violent groups do not directly attack the institution of the central government or broadly take over its role. The cases where this does occur are distinct and will be discussed later.

FCS generally exhibit poor governance and lack of institutional capacity. Government institutions may not be able to provide adequate services, and informal institutions— often non-inclusive, i.e., available to only certain segments of society—may take a large role in managing daily life and commerce. Poverty is often substantial, and people lack formal employment – leading to the preservation and growth of the informal economy. When the government lacks the capacity (and in many instances, the legitimacy) to deliver economic stability, effective public services, and

opportunities that firms and individuals need, the private sector finds it challenging to reach its full potential for growth and job creation.

As indicated above, this kind of governance environment directly affects the persistence and practices of informal firms. Research shows that weak government enforcement capabilities combined with an adverse business climate increase the costs and reduce the benefits of operating formally (Benjamin and Mbaye, 2012; Kanbur, 2012; Gelb et al. 2009). In two Latin American fragile states, Honduras and Haiti, weak governance is exploited by gangs who extort substantial payments from the private sector. Indeed, the high perception of lack of government enforcement capabilities is an important factor associated with informality. With these conditions in mind, it is easier to understand the nature of the informal economy in fragile and conflict settings.

3. The Informal Economy in Conflict Areas

Starting from the common case where conflict affects one or more regions of a country but is not centred in the capital, we find that economic activities will be determined by local conditions. Typically, the most widespread activity is agriculture which in turn includes crops, pastoral livestock, forestry, fisheries, aquaculture, and various rural services related to agribusiness. Informal businesses also include small scale mining, such as for diamonds in Central African Republic, and artisanal manufacturing. Other common sectors for informal activity are cross-border trade, commerce, and services.³

The cross-border transit of imports to landlocked countries, such as Mali or Chad, often includes important segments that are controlled by informal businesses. Since there are competing routes to these destinations, the degree of enforcement of a secure trade and border control can influence the choice of routes, even among the informal. Businesses transiting imports to Chad tend to prefer the relatively more predictable patterns of informal checkpoints and fees in Cameroon over the routes across CAR, rendered chaotic and insecure by the informal competition for diamond mining territory.

Despite their avoidance of the more dangerous traffic in illegal goods, informal businesses in conflict zones often provide peripheral services for other informal traders, legal or otherwise. These include financing and lodging, as well as service to refugee camps. For example, before the passage was suppressed by EU policy, thousands of undocumented migrants came from throughout the broader Sahel region to Agadez in Niger to join convoys across the largely uncontrolled regions of Libya, hoping to reach and cross the Mediterranean Sea (Abebe, 2019). Although few of the migrants were from Niger, many Nigeriens were informally employed supplying vans, repairs, drivers, fuel, phones, supplies, as well as food and lodging in Agadez.

³ Informal businesses in FCS are pervasive, particularly in sectors such as agriculture and services (IFC, 2021). See also Speakman and Rysova (2015).

One noteworthy feature of informal business in the Sahel is the strong bond of family connections, a significant informal institution. Evidence from surveys indicates a strong preference among African informal firms for personal sources of financial credit—savings, retained earnings, and family members – and a lack of preference for any formalized form of credit, including micro credit (Mbaye and Benjamin, 2018; Beck, 2015). While informal credit may seem expensive, it usually provides greater protection for the borrower against default risk. Among informal firms in general, but especially among those in conflict zones, business is very risky and default risk is high.

Despite progress against poverty over recent decades, what is clear is that poverty is increasingly associated with conflict countries (Burt, Hughes, Milante; 2014). One of the main ways of coping with poverty in conflict areas is employment or self-employment, and the greatest access to these is in the informal sector. Thus, the development and protection of economic opportunity is the main source of resilience in fragile states.

4. Policy Options and Barriers in a Fragile Context

The conditions described above indicate the central importance of sequencing earlier the provision of security in areas marred by conflict and fragility.

No one wants to invest or build business surpluses in an insecure environment. Whether security ends up being provided from the central or local level of government – discussed below—either is better than succumbing to control by local militias who have no interest in the business climate. One significant point for central governments is that if they are to win local confidence as security-providers, they must offer something that local governments or militias cannot provide (Catens and Raballand, 2016). Such unique contribution can include efficiency, new security jobs for local citizens, lesser degrees of corruption, higher quality services or direct connection to a system of standard central-level services such as education or health.

There is a hypothesis that business formalization can contribute to peace through various channels, such as creating higher quality job opportunities. However, evidence on this theory is mixed at best. Various programs have attempted to reduce the supply of new recruits to violent groups in the Sahel by offering better alternatives. Several programs subsidized the creation of jobs for young people in the hope that reducing youth unemployment would diminish the attraction of joining militant groups. While they succeeded in creating some jobs and generating some experience, the hoped-for impact on participation in militias was not observed.

Berman, Felter, & Shapiro, (2018) provide a useful explanation for why this approach does not work. One important factor is the somewhat internationalized market for militant labour, so that these cadres cannot be depleted by competing demands for local labour. A second factor, sadly, is the tremendous amount of damage that can be caused by a very small number of militants.

It is important to note that a difficult and unfavourable business environment coupled with an increased risk profile of countries engulfed in FCS deter both local and foreign investors, as well as traditional lenders (primarily banks) from investing.

Policy interventions for economic growth that are typically recommended in conflict-affected areas are improved financing and training. For small informal actors throughout the Sahel, and especially in conflict-affected areas, the most used sources of financing are retained earnings, family savings, family loans, support from friends, and the like. Survey results tell us that, in fact, 80 percent of informal actors in Bamako and 70 percent in Mopti use personal savings as their main sources of investment financing.⁴ Now that most sources of livelihoods are drying up due to the conflict, it is likely that opportunities for financing will become even rarer (Mbaye and Benjamin, 2022).

Policy initiatives that act through formal credit arrangements, including micro credit, have not been found to have any discernible impact on social stability in post-conflict situations. Cash grants were found to have greater impact on building assets, for example, in terms of livestock financing, developing self-employment and increasing income over the long run (Blattmann & Ralston, 2015; Blattman et al, 2018, 2019; Jayachandran, 2021).

More recent efforts have focused on the importance of improving the overall environment in the Sahel by raising the quality and extent of governance, security, and the business climate, as well as the ability to adapt to climate change. (See Benjamin, 'The Governance Frontier', in *The Broker*, 2016)

The need to improve the quality and reach of governance has been noted by many, but there was little success in early-stage programs. Governance initiatives often began with capacity-building programs, which ended up pouring skills into an empty well; there was never enough to change government operations. Much leaked out through transient staff, and to certain militias who found it advantageous to insinuate their members into the Government.

Nevertheless, the diagnosis of poor governance as a major shortcoming hindering stability in the Sahel is certainly correct, as noted by Serge Michailof in "Crisis and Development: The Lake Chad Region and Boko Haram" (FERDI, June 2018). Without institutions that can enforce a formal set of business regulations and provide relevant services to enterprises in the formal economy, formalization of firms loses meaning.

4.A. Political and economic fragility

The study of fragility, and of policy specifically aimed at improving resilience shows that the sources of fragility are quite complex, and its nature varies greatly across countries. But in considering ways to engage with the private sector and to improve economic policy under fragile circumstances, the salient characteristics of fragility have a clear impact.

⁴ FERDI reports similar numbers for Burkina Faso.

The OECD characterizes fragility as “... the combination of exposure to risk and insufficient coping capacity of the state, systems and/or communities to manage, absorb or mitigate those risks. Fragility can lead to negative outcomes including violence, poverty, inequality, displacement, and environmental and political degradation.” (OECD, 2020)

Along with weak institutions, fragile states suffer from an inability to supply basic services to the population, including security. Typically, a state that cannot protect its people lacks the capacity to provide other services as well, including basic macroeconomic services that prevent debt and economic crises. Two recent examples include economic crises in Lebanon and Sri Lanka, neither country lacking in basic capacity, but both suffering from gridlock-causing political conflicts and corruption.

In Lebanon for example, a state of deep fragility has culminated as a result of over three decades of social, economic, financial and fiscal mismanagement. While the ramifications and impact are being felt more severely now, the shortcomings and structural deficiencies have continued to exist and grow, exacerbated by the ongoing COVID-19 pandemic and the Beirut port explosion – coming to a point where the country no longer had the fiscal space to stimulate the economy.

The economy has struggled to reduce widespread poverty and to generate inclusive growth, as job creation has been weak and poorly distributed. The long-run employment-growth elasticity is estimated at 0.2 (World Bank, 2012), much lower than an estimated MENA average of 0.5 (IMF, 2014). This has resulted in a large informal sector, with an estimated size equivalent to 30 percent of GDP, according to the IMF. Only about one in three labour force participants have a formal sector job. Meanwhile, the employment that has been generated has been concentrated in informal low productivity activities as those involving higher productivity have not grown proportionally.

Lebanon’s current economic crisis finds its roots in elite capture and regional conflict, both of which have served to block reform and development when it did not benefit all confessional leaders. Furthermore, the large size of the informal economy is also affected by rigid labour market regulations, excessive regulatory burden in product market, volatile situation, low quality of institutions and governance – including political uncertainty - and an excessive tax burden. These factors increase the costs of operating in the formal economy and provide strong incentives for workers and firms to operate informally.

Fragile situations such as these tend to be characterized by the inability or unwillingness of the state to manage or mitigate risks, including social, economic, and political risks. Fragile states are particularly vulnerable to corruption from non-government entities with enough leverage to undermine the functioning of legal or economic institutions in order to pursue activity that thrives without them. This type of corruption, as distinct from petty corruption, is often included under the title ‘state capture.’

4.B. Informality and vulnerable workers

The means to ensure order, political, institutional, and economic, is at the foundation of formalization of economic units and the workers they employ. Formalization is not a one-off activity but a multi-step process which involves various dimensions. Hence, to develop a path toward economic institutions that can support formalization, the nature of formalization should be clear. Research has established that firms in developing countries, including fragile states, exhibit varying degrees of formality and informality along a spectrum of characteristics. These can include whether the firm has a fixed place of business, if it keeps honest and formal accounts, if it is registered with the local government, the national business registry or other relevant agencies, if it uses formal credit, if it has a website or uses information technology, whether or not it pays formal taxes, declares workers, and meets sectoral or other obligations on a continuing basis.

A firm can become more formal as it takes on more of these modern characteristics, and can be informal along one or more of the dimensions listed. Inevitably, this heterogeneous nature of informal firms calls for different types of policy recommendations for different types of firms (Mbaye and Benjamin, 2015). And while research on informal firms around the world has confirmed that formal firms have higher productivity than informal firms, research on west and central Africa has shown that the *degree* of formality (as indicated by characteristics listed above) is correlated with the *degree* to which productivity of informal firms approaches that of formal firms (Benjamin and Mbaye, 2012). Nevertheless, various constraints hinder the progress toward formalization, and these limitations are even more severe in fragile and conflict countries (Benjamin and Mbaye, 2020).

For new entrepreneurs, especially those from such vulnerable groups as women and minorities, it is worth noting again the high reliance on the endowment and financing that is available from within the family. This highlights the reality that one's relative position in the family or social sphere may govern the size of the endowment available for starting a business. This endowment includes the entrepreneur's level of education, family-based financing, access to infrastructure and information technology, and connections to markets or sectors that may allow greater sales and a larger scale of operation. Data across West and Central Africa show that female entrepreneurs are relatively disfavored in all of these factors (Mbaye et al., 2015). And yet these are the factors most associated with higher productivity among informal firms (Benjamin and Mbaye, 2012).

Female entrepreneurs play an essential role in fragile economies, but their role is largely transacted in the informal sector. Given that women owned and led micro, small and medium enterprises (WMSMES) face greater operational challenges than those owned by men, due to lower access to financial and working capital, and greater barriers in terms of connectivity, accessing markets and contracts, WMSMEs have a higher propensity to be pushed into the informal sector (Torres et al. 2021). Furthermore, women are more exposed than men to the most precarious symptoms of informality, such as lack of social protection, lower participation in the more profitable sectors, limitations to engage in business due to cultural norms, and exclusion from most public infrastructure services, the type of services that would allow them to expand beyond the smallest scale of activities where most of them operate (ILO, 2018). In Cameroon, the one feature that statistically most distinguishes female-run firms is lack of access to electricity (Gueye, Mbaye, and Benjamin, 2022).

Evidence from Ethiopia, an East African county experiencing conflict, has found that youth who started businesses in rural areas faced challenges due to poor market linkages and limited complementary infrastructure developments such as electricity access and passable roads to market centres. Entrepreneurs running micro and small enterprises noted that lack of adequate working premises, lack of access to credit and shortage of electricity supply were the top three constraints impeding smooth daily operation and the growth of enterprises (Getahun and Fetene, 2020).

4.C. Policy approaches

One possible policy response would be for the government to provide working space, shelters, and shops with public services included. Having a physical space is an initial inroad into formality, a critical opportunity to be encouraged and supported. In 2019, the ILO convened a co-creation workshop to facilitate workspace design for informal traders as a means to support their transition to formality in the city of Bulawayo, Zimbabwe. Together with representatives from the national and district level government, the private sector, business development agencies and informal economy associations, plans were developed to turn existing factory shells into suitable business incubation workplaces for the informal entrepreneurs, further allowing them to access needed services (e.g., business development and access to markets).

One program launched during Arab Spring instabilities in Morocco has shown promise in improving the functioning of informal firms by supporting their activities and increasing their access to infrastructure and essential services. It also makes strategic use of public social protection plans, in particular for health, unemployment and pensions. (See Mbaye, Zogning and Gueye, 2020).

A key feature of the program is a distinct set of reforms for the larger and more sophisticated informal firms, with a separate approach for informal micro-enterprises. For the larger informal firms, the program creates a special legal category (as OHADA has also proposed) that ensures registration of participating firms, and payment of a reduced tax, while offering several public benefits in exchange. These include publicly financed health and pension benefits for all workers – who must also be registered – and amnesty on past taxes. While the Government takes on added liabilities for social protection payments, it gains information on informal workers, which will be useful as more firms join this legal category and some workers are formalized.

As a prominent example, Benin, along with 16 other OHADA countries in Africa, revised its commercial laws to introduce a new status called Entreprenant. This status was designed for micro and small businesses, and made registering with this new status easy, free of charge and possible in only one business day.

Governments can revise the legal and regulatory framework to create ‘entry-level’ mechanisms for enterprises that meet a specific set of criteria. Some policy initiatives in the domain of special legal or tax categories or social protection have shown promising success in middle income, nonfragile countries. Examples of ‘entry-level’ mechanism include the monotributo mechanisms in Argentina

and Uruguay, the auto-entrepreneur statute in France and Morocco, and Brazil's Micro-Empreendedor Individual mechanism.

While these approaches display promising features, their introduction and enforcement require good governance which by definition is absent in fragile contexts. Additionally, low income, fragile states tend to have limited and low-quality data which makes it difficult to effectively evaluate and measure the impact of 'simplified legal status plus effective incentives' and similar interventions (Kiaga and Leung, 2020; Mbaye, Zogning and Gueye, 2020).

5. The Local Dimension

Focus on the need for effective governance to support and sustain the business climate leads directly to the critical role of local governments. Local governments play an important 'interface' role for actors in the informal sector. They are also the fallback institutions for providing services when violent groups have overrun central-level institutions and agents. In the early 2000's during a lengthy period of political violence in Togo that shut down many central government services, towns and villages organized themselves to set up their own schools and health clinics. However, evaluation after that episode showed that these schools were less efficient and less successful in outcomes than were schools managed through the system set up by the central government. Nevertheless, these local efforts were an improvement over doing without any public services.

High tensions arise when local governments must handle the balance between local demands, difficulties in obtaining central level resources, and fighting or negotiating with militias. These tensions point to several critical needs for government—central and local-- to support the local business climate:

- The need to extend **central-level government control** to the full extent of the countries' international borders, with focus on settled regions. Under current conflict conditions, where militias thrive in under-governed areas, neglect of any occupied region in the country is not an option.
- The need to strengthen **decentralization** – from the centre to villages in conflict zones-- improving on previous initiatives by making use of recent technical and institutional innovations. 21st century communications facilitate the exchange of simple spreadsheets throughout developing countries, which in turn facilitates the programmed control of transfers out to decentralized areas as well as accountability in localities over the use of money sent. Frank, Bergman, and Vaillancourt in "Intergovernmental Fiscal Relations in Fragile and Conflict Situations," (World Bank, 2014) warn against letting deficiencies in local capacity hinder decentralization: *"Weak capacity should not be a deterrent to engaging with SNG (sub-national governments): the risks of weakening support for peace are even higher if state-society relations cannot be improved because SNG are devoid of means to deliver basic services to the populace."*

In recent years, institutional innovations have had some success by tying capacity building directly to financial transfers from the centre. This improves results over telling localities that they need to spend ten years developing literacy and numeracy skills before any money will come.

The circumstances are challenging, but it is difficult to imagine a government improving conditions in conflict zones without increasing its local presence. Surveys and focus groups report that people in the conflict zones would welcome a greater central government presence (Mbaye and Benjamin, 2022). Local authorities may cut deals with militant groups in the interest of self-protection, but these are not fundamental alliances based on common objectives. Residents would be content to have central government forces provide security and social services. The main request is that they hire some staff locally; government jobs are good jobs, and people like to see some of their own on staff, especially among security forces.

- The **central and local governments must collaborate** to support a plan to improve the business climate. In this domain, providing basic security is critical. Economic growth and the supply of credit in the Sahel depend on some entrepreneurs' succeeding in building surpluses. No one is interested in developing surpluses that cannot be protected from predatory invaders.

Local governments are also the fallback institution for many donors when they cannot or will not deal with the current central government. Donors can set up an entity that provides aid directly to local administrations as a means to support the local populations. This has been done at various times in Lebanon, Bangladesh, Iraq, Afghanistan, and the West Bank and Gaza. The West Bank has some of the oldest, continuously inhabited cities in the world, with lengthy experience in municipal government. They have been called on to carry many burdens given the large political barriers blocking the operation the central government.

Local Struggles: Diffa and Mopti

Diffa, in eastern Niger, and Mopti, in northern Mali, are both substantial towns near the borders of conflict zones in the Sahel. Firms in both towns were surveyed in 2018-2019 using the same survey approach as was used in their respective capital cities, as well as focus groups. The firms in Diffa are virtually all informal whereas Mopti has hosted a number of formal and large informal firms serving the local crossroads for domestic and trans-Sahel trade as well as the Sahel tourism business.

As the table below indicates, Mopti firm-owners reported substantial damage to business from the conflict crisis that began in 2013 and continued into the survey period. And the reported decline in business volume and investments was far greater in Mopti than it was in the capital, Bamako. Hotels and restaurants suffered substantial losses in business volume, as did banks, including credit flows and repayments. Unemployment rose, as did the risk of being able to obtain essential inputs.

Table 1: Impact of the security crisis on investments (%)

<i>City</i>	<i>Informality</i>	<i>Risen</i>	<i>Constant</i>	<i>Decreased</i>	<i>Total</i>
<i>Bamako</i>	Formel	4,35	43,48	52,17	100
	Gros informel	0,00	100,00	0,00	100
	Petit informel	0,00	88,89	11,11	100
	Total	3,03	57,58	39,39	100
<i>Mopti</i>	Formel	1,06	8,51	90,43	100
	Gros informel	0,00	4,35	95,65	100
	Petit informel	1,09	16,39	82,51	100
	Total	1,00	13,00	86,00	100

Source : Mbaye, 2018

One major local challenge in Mopti has been maintaining security for public schools funded through the central government. Militias have attacked the more outlying schools and set up their own religious schools, as a way of undermining the local influence of public institutions.

In Diffa, for the informal businesses, security is critical in order to maintain access to their land, livestock, water and other inputs essential to production. They are open to central government support for local security, though not necessarily to dispute settlement. Their main requests for improvements in the business environment do not relate to regulations but rather to infrastructure, including roads, electricity and water for irrigation (Mbaye and Benjamin, 2022).

6. Formal/Informal: Impact on conflict and fragility

This section examines the different roles of the formal and informal sectors in responding to conflict and fragile conditions.

6.A. Jobs and resilience

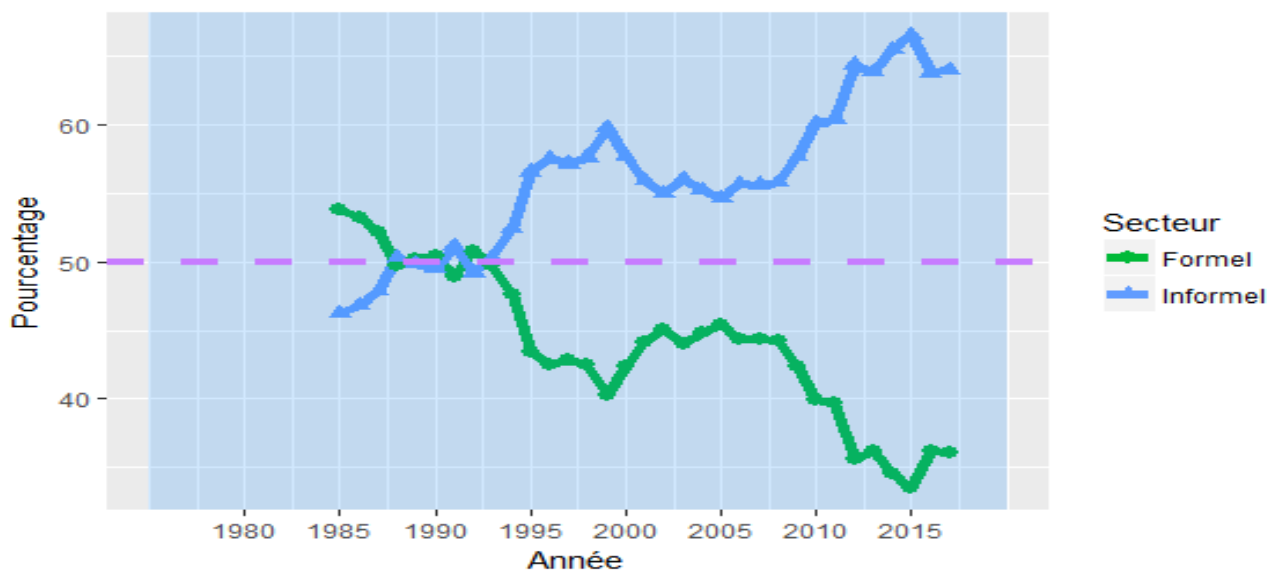
The seminal World Bank study on conflict and fragility (World Bank, 2011) identified the existence of economic opportunities as a principal factor in generating resilience in fragile and conflict states. Research shows that in these countries most jobs and economic opportunities, particularly for the disadvantaged, are in the informal sector (World Bank, 2016; Speakman and Rysova, 2015). Jobs in the informal sector also show a definite countercyclical nature in that their share increases during episodes of economic instability (World Bank, January 2019). Similarly, World Bank (2016) documents that conflict and macroeconomic instability lead to increases in informality.

In Ethiopia, one of the few fragile and conflict-affected countries with capacity for large scale manufacturing, many female textile workers lost their formal jobs at the onset of the Covid-19 crisis. Evidence from Innovation for Poverty Action (2020) and from World Bank household surveys (2021) shows that they were not able to find other formal sector jobs. Almost all ended up in informal jobs or returned to family farms and the agriculture sector. In the wake of a crisis, such as Covid-19, informality presents the newly unemployed with the occasion or the necessity for pursuing alternative livelihoods – providing flexible ways for people with very little capital to earn a living. This signals the need (as well as the challenge) for policymakers to acknowledge the presence of informality and find means to provide support to the informal sector. Policies should support informal firms' productivity and human capital formation for the informal sector, rather than hoping that informal activities will gradually be absorbed by the formal sector.

Figure 1, below, shows that in Mali, the share of the economy generated in the informal sector rises as conflict increases over time. Indeed, the informal sector is the main source of subsistence when formal institutions break down.

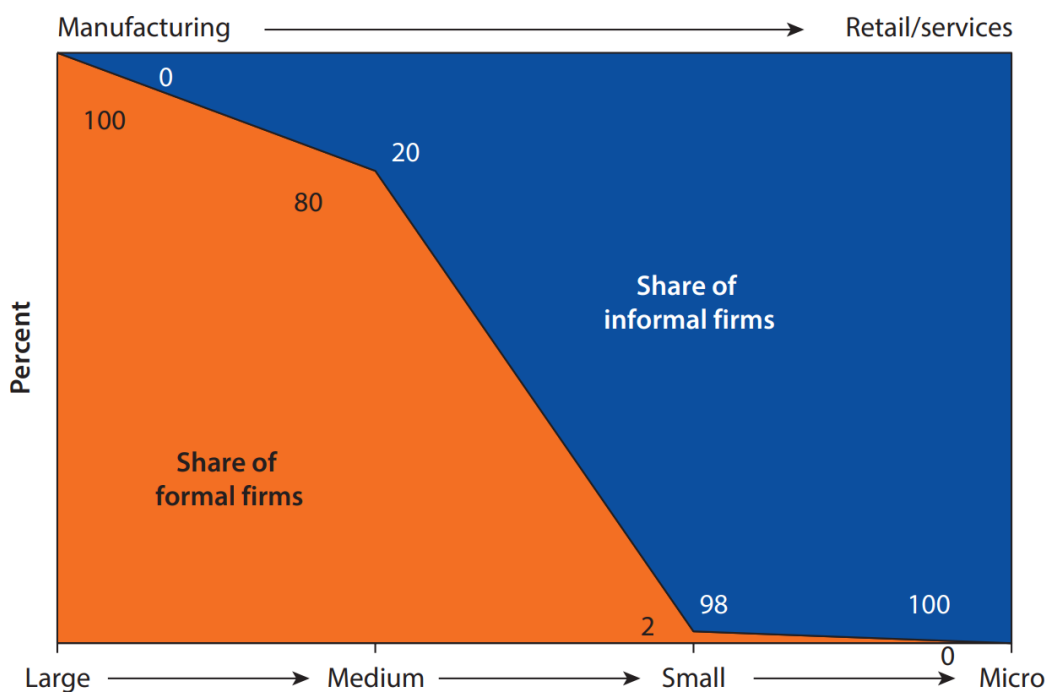
Fragility and conflict not only affect the distribution of jobs between the formal and informal sectors, but they also affect which productive sectors are best able to survive in such difficult circumstances. Generally, these favour productive activities dominated by informal firms, including commerce, trade and services (Speakman and Rysova, 2015). This would be indicated by an expansion toward the right in Figure 2, below. In addition, remittances from diaspora populations abroad, which often increase under fragility and conflict shocks, will generally be allocated by recipients to informal activities.

Figure 1: Decomposition and evolution of value added 1985 - 2017 in Mali.



Source: Mbaye and Benjamin, 2022

Figure 2: Universe of private enterprises in FCS countries in which size of shadow economy reaches 50% of GDP.



Source: Data from Schneider 2007.

Note: FCS = fragile and conflict-affected situations; GDP = gross domestic product.

Source: Schneider, 2007

While the informal economy creates informal jobs, it is not safe to assume that formal firms create only formal jobs. The ILO definition of informality allows for informal jobs created by formal firms.⁵ In a study of North Africa it was found that most informal jobs are created by the formal sector, and that most people working informally were working for formal firms (Gatti, 2011). In sub-Saharan Africa, and especially in fragile and conflict states, sub-contracting from formal to informal firms is prolific, so that firms maintain the appearance of formality, and pay taxes on their formal workers and value added, but the overwhelming share of the work is accomplished by, often temporary, informal workers. In addition to informal workers brought on board for a particular project, formal firms seem to have no difficulty creating regular jobs off the books, as the practice is widespread and keeps costs low.

6.B. The ‘playing field’

In addition to this confusion about the data on jobs, there is also confusion in the discussion of ‘level playing fields’ and ‘unfair competition’. Some are quick to assert that informal firms represent unfair competition because they do not pay taxes as formal firms do. This notion neglects, first, that informal firms pay a variety of taxes and fees to various authorities, but, more importantly, neglects the substantial advantages granted to formal firms through official policy. These advantages can include government arrangements that grant to certain firms’ monopolies or quasi-monopolies over the imports of major consumer goods like grains, food oil, and pharmaceuticals, but also of major inputs such as fertilizer and fuel. As Mbaye, Golub and English (2018) document, such public favours extensively protect the profits of formal firms, but also of large informal firms. The favours also extend to preferred treatment in the allocation of government contracts. Rijkers, Freund and Nucifora (2017) and Schiffbauer et al (2016) find similar types of protection for formal firms, particularly well-connected ones, in Tunisia and Egypt. And this does not count the advantages gained from state capture, discussed below. In sum, the ‘playing field’ is not levelled in many respects, and these dimensions need to be examined in order to assess the best policy directions.

As Mbaye and Benjamin (2017, 2020) point out, formal and informal firms in the same sector have a variety of relationships, not all of them competitive. Sometimes they operate in such different segments of the market that they cannot be seen as competitors. Sometimes the formal firms rely heavily on work from, or sales to informal firms, and informal firms in turn rely on inputs bought from formal firms, so that they are collaborators much more than competitors. And while they do sometimes compete, Mbaye and Benjamin show that the details of production and markets need to be examined, sector by sector, in order to understand the relationship formal and informal firms might have in the sector in any given country.

Care must be taken to check results from business opinion surveys against objective data. For example, evidence across countries shows little correlation between expressed opinions about lack

⁵ Employees holding informal jobs in or for formal enterprises, or in or for economic units in the informal economy, including but not limited to those in subcontracting and in supply chains, or as paid domestic workers employed by households (ILO, 2015).

of credit and actual credit constraints. Through extensive examination of credit and micro-credit programs, Beck (2015) and Jayachandran (2021) both came to the conclusion that access to credit is not the binding constraint to business growth, despite what firms say.

Similarly with competition from informal firms, data on whether or not formal firms actually suffer from such competition simply cannot be established by opinions expressed on business surveys. One reason for taking note of this is a small literature claiming to demonstrate that informal competition causes a drop in formal sector productivity or a drop in formal sector jobs (World Bank, January 2019.) In this literature, data on the degree of this competition comes exclusively from business opinion surveys. Whereas evidence on this competition needs to come from independent, objective data, carefully assessed by sector and country, as indicated above, and cannot be established simply by asking the opinions of business rivals, especially when these opinions are shown to be at odds with reality on other points, such as credit.

Until data on formal/informal competition in fragile and conflict states can be better established, it will be more constructive to look at how the various segments of the private sector survive under fragile and conflict conditions and contribute to economic resilience. One important factor is the degree to which a business is committed to its location and community. Formal firms financed by footloose capital and answering to shareholders may be more willing to pull out of investments in fragile or conflict countries and find safer, more stable locations. Other formal firms with stronger local attachments may make great efforts to preserve jobs and economic activity that will help the community to survive and to maintain their relationship to it.

6.C. Extracting natural resources

Where formal firms remain active in conflict zones, a common sector of activity is the extraction of natural resources that have well-established international markets. Research has shown that where the contribution to the economy of such exportable natural resources reaches above 30 percent, they will be controlled by the central government. It is in these cases that insurrectionist violence often aims to take over the central government (Guardado and Pennings, 2020; Dube and Vargas, 2012; Collier and Hoeffler, 2002). This is the case with oil production in Libya, South Sudan, and Chad. In these circumstances, formal firms needed for resource extraction tend to focus on securing their own operations, building their own infrastructure, and providing their own security, including for the import of all inputs and most workers, turning production facilities into virtual enclaves. They continue to make whatever payments are contractually obligated to the accounts of record and leave others to settle who controls those accounts.

However, near neighbours in the informal sector, though still in the conflict zone, have found ways to benefit from the infrastructure, including roads built by the extractive formal sector, such as the mining sectors in Kenya and Guinea. A similar contribution from the formal sector arose in Mopti in central Mali which was a centre of Sahel trade and tourism before the escalation of conflict over the last decade. The formal sector provided jobs in hotels and as tour guides before tourism dropped in view of the violence.

6.D. Local dispute settlement

In the more common case of small informal businesses based in agriculture, services and artisanal mining, security was, by longstanding tradition, managed within small villages governed largely autonomously by local authorities. However, these local institutions have had to adjust in places such as the Sahel as it was, in the last decade, overrun by international traders in illegal drugs and arms, leading to greater violence. In the sixth chapter of *My Brother, My Enemy*, Smucker provides a detailed portrait of the Sahel before the increase in violence. As he relates it in 2010, the inevitable conflicts among localities and business owners were rarely settled by violence, and the presence of weapons was limited. Since then, new militant groups with international connections have brought violence with new force and ambition.

In 2019 surveys undertaken in Mopti, on the border of the conflict zone in Mali, most respondents believed that modern institutions (whose main symbols are central and local administrations, the police, and the courts) are incapable of ending the spiralling violence in the country (Mbaye and Benjamin, 2022). They almost unanimously have more trust in traditional local institutions than in modern ones to deal with issues that so often are major drivers of conflict, such as those related to land, resources management, and jihadist infiltration. Local institutions use alternative instruments such as social capital, mainly kinship and religious networks, and a rather diverse set of actors, including marabouts, kadis, chiefdoms, and community leaders. Their main point of reference are communities' particular ethical and moral values, as well as long-standing intercommunity social conventions and agreements to a peaceful neighbourhood.⁶ Both in Bamako and Mopti surveys, formal and informal business managers showed more trust in informal than formal institutions. Close to 70 percent of interviewed firm managers in Bamako, regardless of their formal/informal status, think informal institutions are better fit to address the different types of conflict in Mali. In Mopti, this share increases to 90 percent.

In contrast, surveys in Diffa, Niger, while also indicating trust in local authorities to handle local disputes, show residents are content to have greater central government presence to maintain security against outside militias and protect international borders. U.N. surveys of Senegalese villages on the border with Mali show similar preference for central government forces to maintain security at village and international borders (UNDP, 2020). Even residents of Mopti lament the attacks by jihadists on government-run local schools. A recent U.N. security council agreement providing armed forces to address the conflict in Mali encourages the government to increase its control in the central and northern regions of the country (G5 Sahel, 2020).

⁶ The relations of violent groups with traditional local authorities in small villages tend to be driven by force and are predatory, rather than in the interest of competing with the national government in providing services, although in some towns, religious militants have sponsored Koranic schools. They may take over some localities and regions, but do not specifically aim at replacing national governments in the capitals.

7. Lessons for reformers

This project has conducted interviews among staff from donors and development agencies with frontline experience in business environment reforms in fragile and conflict-affected countries. In addition to first-hand experience managing projects and programs in fragile and conflict-affected countries, they bring in a comparative perspective across a number of such countries, mostly in Africa and the Middle East. Agencies with staff interviewed include World Bank Group, ILO, IDRC, AfDB, IGC, FERDI, FAO, and UCAD (see Annex).

Concluding lessons for reformers and program designers are distilled both from literature as was discussed above and from these interviews. One clear lesson, already absorbed by the donor community is:

- ➔ **Supporting fragile states in pursuing a BER agenda will require collaborative action among major donors.**

Such coordination has been observed among coalitions such as the Sahel Watch and the Sahel Alliance, as well as the DCED Business Environment Working Group. In addition, the adoption of the ILO Recommendation on Employment and Decent Work for Peace and Resilience, 2017 (No. 205)⁷ by ILO member States in 2017 provided a normative framework guiding the world-of-work responses to crisis situations arising from conflicts and disasters. However, this lesson will require ongoing follow-through on the part of donors and development agencies. Other main messages are indicated below:

7.A. Main directions

- ➔ In fragile and conflict states, recovering economic activity, and in particular, a constructive environment for private sector activity will require outside assistance from DFI's and NGOs, both in terms of financing and technical assistance. As always, careful advice, reflecting conflict-sensitivity, will be needed in distributing the use of these resources, such as pursuing equal access to support measures (ILO 2021). It is important to note that the design and effective implementation of business environment reforms – in fragile and conflict-affected situations – take much longer to realize. Given the complexity of interventions aimed at formalization (or addressing informality) persistent effort in terms of time, resources, and coordination is necessary.
- ➔ Any agenda must involve private sector actors – including formal and informal businesses, cooperatives, and associations – in the design of business environment reforms and implementation of new public investments. Local businesses and workers both should have a strong role.
- ➔ Any agenda must provide for improvement in governance. In most cases, better functioning government, economic institutions and public services are more important to the business

⁷ ILO Recommendation on Employment and Decent Work for Peace and Resilience, 2017 (No. 205)

environment than the refinement of business rules or investment codes. A conducive environment which offers and enables provisions, such as greater access to finance and markets, contract enforcement, effective dispute resolutions, etc. is likely to encourage and incentivize greater firms to formalize.

- Great advantages can be gained from restoring and enhancing basic public services. In many cases, security is the *sine qua non* required for any new investments, public or private. Macroeconomic stability, maintained by government, is an essential component of resilience to fragility, and basic social safety net services can provide vital assistance to the private sector.

It quickly becomes apparent that improving the business climate in fragile and conflict states requires a balance of both public sector reforms, and initiatives to strengthen private sector development. Approaches to striking an effective balance are discussed below.

7.B. What to avoid

Operational staff from the above-named institutions suggest avoiding the following pitfalls:

- Do not design project components as closely directed by standard diagnostic indicators. Diagnostic indicators are often aggregates based on a variety of measures, only some of which may be relevant to the case at hand, and that may only weakly reflect the most important factors in a fragile or conflict country. An in-depth assessment of business environment constraints should be employed – going beyond tools and diagnostics that may work well in non-FCS settings – leveraging innovative techniques and approaches of collecting data, such as mobile phone survey, geospatial imaging, etc.
- Do not ignore the political economy of fragile and conflict countries. In particular, avoid working closely with firms known for engaging in aggressive state capture as these firms are often at the source of conflict, fragility, and the undermining of public institutions. Some may have no interest in establishing public order or level playing fields and may in fact profit from their absence.
- Do not allocate to inexperienced entrepreneurs large sums in credit or grants for business start-ups. Investing in poor business ideas and poor managers wastes time and resources. Extensive surveys of firms, both formal and informal provide much information on the types of business managers with the best track records (including age, education and experience), as well as the essential inputs needed for any business to succeed.

7.C. What works?

What emerges from almost all quarters is the prime role of infrastructure and its renewal and expansion. Investing in new infrastructure serves a number of objectives. Access to infrastructure is a major constraint facing informal businesses, especially those run by disadvantaged segments of the population. Thus, increasing access can help level some playing fields while also enabling informal

firms to better replicate formal business practices that will enhance their productivity and ability to formalize.

And while almost all developing countries need infrastructure, these new investments serve a particular role in conflict and fragile states. It provides a vital avenue for engaging with the private sector, both firms and workers, after possibly disruptive crises. Even unskilled workers are capable of participating in a variety of public works. Such projects set up a framework for providing cash transfers or food-for-work for needy citizens. Among youth, evidence shows there is a greater need for jobs than there is for skills, which jobs can be provided under public works.⁸ Local firms and local country systems should be used to the maximum extent possible, subject to the caveats noted above. Corrupt government systems will only reinforce fragility, and firms that have captured public systems, public utilities in particular (electricity, telecoms, water), will only entrench fragile conditions for years to come. (Tunisia, a middle-income country, suffered from these circumstances, but Somalia, a low-income conflict country truly shows the limits of any business climate agenda when essential public utilities have been captured by a small number of formal firms exploiting their leverage and evading compliance with national laws or policy).

The role of DFI's and regional institutions in supporting and helping the public sector re-establish social protection and other social services is instrumental. Public institutions can be effectively supported by emphasizing accountability, good use of public resources, and other components to help build a new and better social contract. Indeed, the restoration of public institutions and enforcement of business codes can easily be more important to the private sector than new refinements to that code. However, the public sector is no match for the private sector when it comes to creating jobs, and there is seldom any reason to centralize the economy into public hands. Instead, the public sector can finance public investments that will employ the private sector. Morocco is often cited as a good example of using efficient public works projects to improve infrastructure while also creating jobs, building capacity and enhancing technical skills among the workforce.

More than one DFI has backed impact investing, an approach that supports the launching of enterprises with a combination of business and public service objectives. These enterprises provide a channel for DFIs to connect with smaller entities while they, in turn, provide commercial connections that serve other small entities which would otherwise go unserved. Studies of trial cases in Somalia, Mozambique, and Sierra Leone show that while these firms clearly serve their public purposes, they may not reach financial self-sufficiency in the short term and may continue to need DFI support beyond the first several years, before they break even.

Given the need in most fragile and conflict countries to repair and strengthen both public and private institutions, and the need for participation of both the public and private sectors, the importance becomes clear for improving the public/private sector dialogue. A well-organized dialogue can help all participants find the right balance between public and private actions and provide an opportunity

⁸ See Gertler et al. 2022, for how road maintenance aids in the transition to more formal jobs.

for all components of civil society to engage with policymakers on improvements in the business environment.

By putting in place a business enabling environment which is conducive for private sector-led growth, governments can lay the groundwork for encouraging formalization and supporting subsistence firms to build greater competitiveness in the economy. However, it is imperative to realize the limitation of traditional approaches to BER, given the heterogeneity between FCS and non-FCS countries (Ghossein and Rana, 2022). In some cases, ending the fundamental conflict takes priority over developing new business rules. Until then, public/private dialogue becomes a struggle not for balance, but for control.

Business resilience and enterprise formalization in Cote d'Ivoire

The ILO supported constituents in Cote d'Ivoire to operationalize its newly created simplified legal status for entrepreneurs, in particular by supporting the identification of a range of relevant incentives (e.g., social access to protection, markets finance and training) that may be linked to the status to increase business registration. The aim is to promote the formalization of enterprises in order to facilitate transitions to the formal economy and improve their business resilience. This support was extended in the face of the economic crisis following the outbreak of the COVID-19 pandemic. A specific response to contribute to formalization and to incentivize registration of informal economic units was a special COVID-19 support fund (Fonds d'Appui au Secteur Informel - FASI) developed by the government. FASI aimed to support enterprises and workers in the informal economy who were negatively impacted during the pandemic. Business owners and their employees could apply to the fund through an online registration platform or in person, and only needed to provide proof of their occupation, economic activity and suffered financial loss, along with their bank or mobile money details. The ILO further supported the COVID-19 resilience response in Côte d'Ivoire by developing the training course "Formalize Your Business" targeted at informal entrepreneurs to enhance their resilience by supporting the formalization of their businesses and, hence, legal coverage and protection of business owners and workers. The training was developed in collaboration with a national SME Agency and other national partners. These examples demonstrate how governments can promote enterprise formalization in conditions of imminent crises and contribute to increasing resilience, in spite of a high incidence of informality.

Results so far show that registrations by economic units have increased and so has the extension of social protection coverage to business owners and employees. Results on progress toward other measures of formalization are harder to measure.

7.D. Conclusion and Recommendations

Much of what informal firms in fragile and conflict states need in order to progress toward formalization is similar to the needs of informal firms anywhere, but the conditions required to provide for these needs are lacking and will be more difficult to construct. In particular, where government structures and institutional frameworks are weak or non-existent, a greater amount of donor assistance in support of informal firms will be required and for a longer period of time. Such a landscape calls for the need to develop institutional frameworks (such as those that improve cross-

institutional coordination, remove bureaucratic redundancies, and ensure greater accountability and transparency) and focus on strengthening institutions (improving governance and service delivery).

Both formal and informal firms can play important roles in periods of recovery or reconstruction after crisis. Formal firms may have more capacity to substitute for public services – if given financial support, but informal firms are important sources of resilience - they are characterized by a flexible job market for informal workers as well as migration patterns. Family ties explain the credit market for informal businesses. They also explain why more vulnerable citizens, such as women, start with lower endowments and therefore operate at lower scale than others.

Both formal and informal firms will be beneficiaries of the kind of encouragement and incentives that provide a better business environment, but they can also aid, and benefit from, the *process* of establishing that better environment. This can start with public/private dialogue, which must be inclusive, provide a better understanding of informal firms and their needs, and not overly favour incumbent financial interests. It will also require some flexibility on rules regarding participation of unregistered firms in public works and public programs.

While circumstances will vary from country to country, the discussion below lists elements that are known to top the list of business environment improvements sought by informal firms in fragile and conflict states, and considers the conditions required to implement these.

Security: Assuming there is sufficient security to begin discussions with donor agencies, a major concern of all firms is establishing confidence in institutions that can maintain that security well enough to provide reasonable protection for property and business investments. A significant consideration is whether security should be based largely with the central government or with local or regional authorities. Where central-level institutions are weak, non-existent or untrustworthy, localities will probably prefer to organize their own security, but will also probably welcome any financial or technical (if available) help from the centre.

Infrastructure: Access to infrastructure and information technology, and connections to markets or sectors that may allow greater sales and a larger scale of operation are key elements of the business environment for the informal sector. Desire for access to electricity is usually a top BER priority for those who do not have it, and such access is most associated with higher productivity among informal firms and therefore their ability to progress toward formalizing. And while investment in infrastructure that improves access for informal firms is at the core of the agenda for improving the business environment for informal firms, it also underscores the importance of projects focused on providing fixed places of business, because in addition to other advantages, fixed workplaces for informal firms provide places to receive electricity and internet.

If the government can signal a ‘rebuilding phase’ in the wake of conflict or political crisis, it should also work to include local businesses and local suppliers in these projects. To best improve business circumstances for informal firms, procurement rules may need to be simplified. Insisting on formal registration is not likely to have meaningful impact on the performance of informal firms. Most important, donors must coordinate in order to avoid duplication of programs or conflicting and overlapping rules.

This takes the point that public investment in infrastructure is key to improving the business environment for formal and informal firms in fragile states and adds the point that jobs and market demand are key instruments for resilience in these settings. Investment in infrastructure not only provides what is most needed, but also provides an effective means to engage with the private sector in fragile settings. To take full advantage of any new public investments, informal firms will need some form of accompanying support including, possibly, training, subsidies for inputs, or aiding access to land or workspaces. All of these will require public assistance as opposed to credit.

Social Protection: Providing public systems of social protection based on shared payments is a major contribution to the business environment, especially for informal firms. It provides essential business services that informal firms can otherwise ill-afford and which ensure essential protection for workers against substantial risks. In fragile or conflict countries, these systems may not have existed or may have broken down under pressures of conflict or poor governance. Subsidizing social protection were important components of formalization programs in Morocco and Cote d'Ivoire and are considered essential inputs to informal businesses by WIEGO (Women in Informal Employment: Globalizing and Organizing).

Governance: Weak or poor governance is a common symptom affecting all businesses in fragile states. And while business environment reforms cannot independently solve bad governance, they can help inform the priorities in any program intended to strengthen public institutions. A fundamental public service important for all businesses is macroeconomic stability. Failures in this domain, including failures to manage international and domestic public debt, contributed to debilitating and costly economic crises in Sri Lanka, Lebanon, and Venezuela. Governance initiatives seeking transparency and accountability should include this most basic public service, essential to the private sector.

In addition to fundamental economic stability, firms are looking for a stable set of business rules that they can count on to prevail over the medium term. These rules should reflect the concerns of an inclusive public/private dialogue and be supportive of the modernization and formalization of informal firms. They should also support adaptation to climate change, as this is an ongoing challenge to stability. And they should avoid tipping the playing field in favour of special interests which may provoke further instability in the future.

A major concern vital to formalization is the domain of public services. Research shows that informal businesses choose to adopt more of the characteristics of formality as these come to be seen as serving their business interests. Thus, as their business becomes more complex, they find a need for more regulation or public services, despite not being able to register as formal (Benjamin and Mbaye, 2020). For example, focus groups of informal proprietors in Egypt revealed that those in the informal construction business needed more regulation to help them establish a list of workers reliably certified with certain specialized construction skills, and they were willing to work with Government to establish one.

In Dakar, Senegal, a willingness-to-pay study in an informal business neighbourhood revealed that residents were willing to pay amounts well above cost for public trash collection services.⁹ In Lebanon, however, a collective agreement among formal and informal businesses to arrange for trash collection in Beirut led to a dispute over which company had the rights to this profitable business, and the agreement broke down.

In sum, countries suffering from fragility and conflict will require much donor assistance and guidance over an extended period of time. This assistance must help compensate for weak or absent public institutions and steer through the local political economy in order to help establish essential institutions and services that can provide a stable environment for the private sector. Small informal firms may display much resilience, but they also need much support in fragile states, access to infrastructure in particular. Access to infrastructure means access to markets, and the opportunity to expand the scale, complexity and sophistication of informal businesses. These comprise an environment conducive to raising productivity and adopting more of the characteristics associated with formality.

⁹See Mbaye, 2008.

References

- Abebe, T.T. (2019) *Securitisation of migration in Africa - The case of Agadez in Niger*. Institute for Security Studies
- Anderson, C. (2015) *The Power of Drug money in Mali: Confidential research carried out by International Alert in Kidai, Gao and Timbuktu*. Christian Aid
- Beck, T. (2015) *Microfinance—A Critical Literature Survey*. IEG Working Paper 4, World Bank Group
- Benjamin, N. & Mbaye, A.A. (2012). *The Informal Sector in Francophone Africa: Firm Size, Productivity and Institutions*. World Bank.
- Benjamin, N. and Mbaye, A.A. (2012) *Informality, productivity, and enforcement in West Africa: A firm-level analysis*. Review of Development Economics.
- Benjamin, N. and Mbaye, A.A. (2020) *The Failure of Structural Transformation in Francophone Africa and the Rise of the Informal Sector* in Mbaye, A.A., Golub, S. & Gueye, F. eds., *Formal and Informal Enterprise in Francophone Africa: Moving Toward a Vibrant Private Sector*, IDRC.
- Benjamin, N. and Mbaye, A.A. (2020) *The informal sector in francophone Africa: The other side of weak structural transformation*. Brookings Institution.
- Benjamin, N. (2016) *The Governance Frontier*. The Broker.
- Berman, E., Felter, J.H. & Shapiro, J.N. (2018) *Small Wars, Big Data*. Princeton University Press.
- Blattman, C & Ralston, L. (2015) *Generating employment in poor and fragile states: Evidence from labor market and entrepreneurship programs*. Development Impact Evaluation (DIME), Social Protection and Labor (SPL), and Fragility, Conflict & Violence (FCV) groups, World Bank.
- Blattman, C., Fiala, N. & Martinez, S. (2018) *The Long-Term Impacts of Grants on Poverty: 9-Year Evidence from Uganda's Youth Opportunities Program*. American Economic Review: Insights.
- Blattman, C., Dercon, S. & Franklin, S. (2019) *Impacts of industrial and entrepreneurial jobs on youth: 5-year experimental evidence on factory job offers and cash grants in Ethiopia*, CEPR & FCDO.
- Catens, T. & Raballand, G. (2016) *Fragile Borders: Rethinking borders and insecurity in Northern Mali*. The Global Initiative against Transnational Organized Crime.

- Cooke, J.G. & Sanderson, J.C. (2016) *Militancy and the Arc of Instability*. Centre for Strategic and International Studies.
- Collier, P. & Hoeffler, A. (2002) *Greed and Grievance in African Civil Wars*, CSAE Working Paper No WPS/2002-01. Centre for African Economies, Oxford.
- Dube, O. Vargas, J. (2012) *Commodity Price Shocks and Civil Conflict: Evidence from Colombia*, Review of Economic Studies.
- Frank, J., Elin, B. & Vaillancourt, F. (2014) *Intergovernmental Fiscal Relations in Fragile and Conflict Situations*. World Bank.
- Gatti, R. et al., (2011) *Striving for Better Jobs: The Challenge of Informality in the Middle East and North Africa*. World Bank.
- Gelb, A., Mengistae, T., Ramachandran, V. & Shah, M. K. (2009) *To Formalize or not to Formalize? Comparisons of microenterprise data from Southern and East Africa*. Center for Global Development.
- Gertler, P., Gonzalez-Navarro, M., Gracner, T. & Rothenberg, A.D. (2022) *Road Maintenance and Local Economic Development: Evidence from Indonesia's Highways*. Working Paper 30454, National Bureau of Economic Research.
- Getahun, T. D. & Fetene, G.M. (2020) *Enhancement of Employment and Income Opportunities for Rural Youth in Ethiopia: A Review of Four Large Youth Employment Initiatives*, Forum for Agricultural Research in Africa.
- Ghossein, T. & Rana, A.N. (2022) *Business Environment Reforms in Fragile and Conflict-Affected Situations: What Works and Why?*. Equitable Growth, Finance and Institutions Insight, World Bank.
- Guardado, J. & Pennings, S. (2020) *The Seasonality of Conflict*. Policy Research Paper 9373, World Bank.
- Gueye, F, Mbaye, A.A. & Benjamin, N. (2022) *Female Entrepreneurship in Africa: Characteristics and determinants in Cameroon* in The Oxford Handbook of the Economy of Cameroon, Monga, C. ed., Oxford University Press.
- ILO (2021) *Peace and Conflict Analysis, Guidance for ILO's Programming in Fragile and Conflict-affected contexts*.

- ILO (2019) *Co-creating better workplaces for micro-enterprises*.
- ILO (2018) *Women and men in the informal economy. A statistical picture*.
- Innovation for Poverty Action (2020) *The Impact of COVID-19 on the Lives of Women in the Garment Industry: Evidence from Ethiopia*.
- Institut National de la Statistique (INSTAT) (2015) *Les comptes économiques du Mali*.
- Institut National de la Statistique (INSTAT) (2017) *Les comptes économiques du Mali*.
- Jayachandran, S. (2021) *Microentrepreneurship in Developing Countries* in Zimmermann, K.F. eds., *The Handbook of Labor, Human Resources and Population Economics*. Springer Nature.
- Kanbur, R. (2009) *Conceptualizing Informality: Regulation and Enforcement*. Working Paper 09- 11, Department of Applied Economics and Management, Cornell University.
- Kiaga, A. and Leung, V. (2020) *The Transition from the Informal to the Formal Economy in Africa*. International Labour Organisation (ILO).
- Mbaye, A.A. (2018) *The Informal Sector and Conflict in Mali*. Agence Française de Développement.
- Mbaye, A.A. (2008) *Collecting Household Waste in Dakar: Does it Cost That Much? An Application of Contingent Valuation*. *Case Studies in Business, Industry and Government Statistics* 2(1).
- Mbaye, A.A. & Benjamin, N. (2015) *Informality, Growth and Development in Africa* in Lin, J. & Monga, C. ed., *Oxford Handbook of Africa and Economics*, Oxford University Press.
- Mbaye, A.A. & Benjamin, N. (2017) *How the Interplay between Large and Small Informal Firms Affects Jobs in West Africa* in Polese, A., Williams, C.C., Horodnic, I.A. & Bejakovic, P. eds., *The Informal Economy in Global Perspective*, Palgrave.
- Mbaye, A.A. & Benjamin, N. (2018) *Improving the Contribution of the Informal Economy to GDP Growth* in Mansoor, A., Issoufou, S. & Sembene, D. eds., *Race to the Next Income Frontier: How Senegal and Other Low-Income Countries Can Reach the Finish Line*, International Monetary Fund.
- Mbaye, A.A., Golub, S. & English, P. (2018) *Policies, Prices, and Poverty: The Sugar, Vegetable Oil, and Flour Industries in Senegal* in Mansoor, A., Issoufou, S. & Sembene, D. eds., *Race to the*

Next Income Frontier: How Senegal and Other Low-Income Countries Can Reach the Finish Line, International Monetary Fund.

Mbaye, A.A. & Gueye, F. (2018) *The Competitiveness Challenge of the Formal Sector in Francophone Africa: Understanding the Role of the Informal Sector and the Business Environment* in Adeleye, I., Esposito, M. eds., *Africa's Competitiveness in the Global Economy*. AIB Sub-Saharan Africa (SSA) Series, Palgrave Macmillan.

Mbaye, A.A., Benjamin, N., Golub, S. & Ekomié, J.T. (2014) *The Urban Informal Sector in Francophone Africa: Large Versus Small Enterprises in Benin, Burkina Faso and Senegal*. Working Paper 201405, DPRU.

Mbaye, A.A. & Benjamin, N. (2022) *Institutions, informality, and conflict in the Sahel: The case of Mali*. Brookings Institution.

Michailof, S. (2018) *Crise et développement: La région du lac Tchad et le Boko Haram*. Fondation pour les études et recherches sur le développement international (Ferdj).

Milante, G. et al (2014) *Eradicating Poverty in Fragile States: Prospects of Reaching the "High-Hanging" Fruit by 2030*. Stability: International Journal of Security & Development, 5(1).

OECD (2020) *States of Fragility 2020*.

Rijkers, B., Freund, C. & Nucifora, A. (2017) *All in the family: State capture in Tunisia*. Journal of Development Economics 124.

Schiffbauer, M., et al (2015) *Jobs or Privileges Unleashing the Employment Potential of the Middle East and North Africa*. World Bank.

Schneider, F. (2007) *Shadow Economies and Corruption All over the World: New Estimates for 145 Countries*. Economics E-journal 9.

Smucker, P. (2010) *My Brother, My Enemy: America and the Battle of Ideas Across the Islamic World*. Prometheus.

Speakman, J. & Rysova, A. (2015) *The Small Entrepreneur in Fragile and Conflict-Affected Situations*. World Bank.

Williams, C. & Kedir, A. (2018) *Evaluating competing theories of informal sector entrepreneurship: A study of the determinants of cross-country variations in enterprises starting-up unregistered*. The International Journal of Entrepreneurship and Innovation, 19(3).

World Bank (2011) *Conflict, Security, and Development*.

World Bank (2016) *Creating Jobs in Fragile Situations*.

World Bank (2019) *Growing in the shadow: Challenges of Informality*.

World Bank (2019) *Promoting Business Registration with Entrepreneur Status in Benin*.

World Bank (2021) *How COVID-19 is affecting households in Ethiopia: Results from the High-Frequency Phone Surveys of Households from April 2020 through January 2021*.

Annex: Institutions from which staff were interviewed

All interviewees were interviewed regarding experience and prospects for programs in business climate reforms in fragile states.

Institution	Headquarters
World Bank (FCV, Governance, IEG units)	Washington
African Development Bank	Abidjan
International Development Research Center (IDRC)	Ottawa
International Growth Center (IGC)	London
Cheikh Anta Diop University (Sahel Project)	Dakar
Fondation pour les Études et Recherches Sur le Développement Internationale (FERDI)	Clermont Ferrand
Food and Agriculture Organization (FAO)	Rome

admin@Enterprise-Development.org

www.Enterprise-Development.org

www.twitter.com/TheDCED



Donor Committee for Enterprise Development