

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM

**Session I: Informal Economy in Latin America and the Caribbean: Implications for
Competition Policy - Call for contributions**

18-19 September 2018, Buenos Aires, Argentina

This document is circulated in preparation of the discussion under Session I of the Latin American and Caribbean Forum that will take place on 18-19 September 2018 in Buenos Aires, Argentina. Delegates are requested to submit their written contributions to the Secretariat by 20 August 2018 at the latest. Advance notice of your intention to submit contributions before or by 25 July 2018 would be useful.

Ms. Iratxe Gurpegui, Competition Expert, - Iratxe.GURPEGUI@oecd.org.

Ms. Lynn Robertson, Manager GFC, LACCF ; Competition Expert - Lynn.Robertson@oecd.org.

JT03434587

*Session I: Informal Economy in Latin America and the
Caribbean: Implications for Competition Policy
Call for contributions*

1. This request for contributions is circulated in preparation for the discussion to be held at the 2018 Latin American and Caribbean Competition Forum (LACCF) during Session I dealing with the topic “Informal Economy in Latin America and the Caribbean: Implications for Competition Policy”.
2. Session I will be divided in two parts. The first part of the session follows the traditional format of sessions in the LACCF, i.e. a substantive discussion based on an issues paper along with interventions and delegations based on their written contributions; a high level of interactive debate with delegates is encouraged. The second part of the session will consist of an informal discussion with non-governmental advisors and delegates on the topic.
3. You are invited to prepare and submit a concise and synthetic written contribution for the first part of this session. In this call for contributions, we aim to identify some of the topics that you may wish to address in your written as well as your oral contributions. Please note that this is neither prescriptive nor exhaustive. You are free to raise other relevant issues that reflect your experiences.
4. To assist the OECD Secretariat in planning this session, please inform us by **Wednesday 25 July 2018** if you intend to submit a contribution.
5. The contributions should be sent by email (as a Word document in electronic format, 5 pages maximum in Spanish or English) to Angélique Servin [Angelique.Servin@oecd.org] and copied to Iratxe Gurpegui [Iratxe.Gurpegui@oecd.org] by **Monday 20 August 2018** at the latest. Country contributions will be circulated to participants through the LACCF website www.oecd.org/competition/latinamerica/ and <http://laccf2018argentina.com>. Furthermore, if you would like to circulate other relevant material, such as relevant enforcement decisions or advocacy initiatives related to the topic, please submit a copy to the Secretariat before **20 August 2018**.
6. This session is scheduled to last 3 hours with 1.5 hours devoted to each part. An issues paper will be distributed in advance of the meeting and can be used as a starting point for discussions in the first part of the session. The Annex identifies a number of relevant topics for discussion and suggested reading material. The list can inform the preparation of contributions, but should not limit the debate nor the contributions of the issues discussed.

Annex A

1. Background

7. There is no uniform definition of the informal sector in economic literature. The informal sector was first defined in the 1970s as part of the urban labour force, which takes place outside of the formal labour market (contractual and legally regulated employment), capturing the categories of small self-employed (Hart 1973). Another element that has been used to define the informal sector is the size of firms, considering employment of less than ten persons to be part of the informal sector [S.V. Sethuraman, (1976)]. Other authors have defined informality as the activity non-compliance with government and tax regulations [S.V. Sethuraman (1976), Feige (1981) and Tanzi (1982-1989)]. However, regardless of the fact that informality means different things to different people and different countries, researchers often view informality as a serious problem, especially in developing countries where the informal sector tends to be large in terms of GDP and informal labour and an non-negligent part of the economy. Tax evasion and as a consequence budget deficits and increase in tax rates, low productivity, unfair competition by informal firms, poor working conditions and corruption are some of the concerns that the economic literature has associated to informality.

8. Statistics reveal that the size of the informal economy within many developing countries is large, often amounting to more than 50% of their GDP. The extent of informality in Latin America substantially differs among countries. Data show that the informal economy represented 28.2 % of the GDP in Mexico and 68.2% of the GDP in Paraguay (Vuletin 2006). In contrast, the average size of informal economy in the OECD members was close to 15% in 2015 [Data from Schneider, F. (2015)].

9. Research findings indicate that economic development alone does not lead to a reduction of the informal economy. Improvement in institutions is also key to the phasing out of informality. Excessively costly and rigid regulations, overly burdensome taxes, ineffective enforcement and poor public services help explain why firms decide to operate in the informal sector, though other factors surely contribute. High taxes and costly regulations incentivise firms to operate informally because firms lower their cost structure when taxes and regulations are evaded successfully. In addition, poor public services to formal firms make it less attractive for informal firms to formalise their situation. Weak enforcement also contributes to informality as low detection rate makes it less likely to face penalties from failing to comply with regulations. In essence, informality is facilitated when the benefits of belonging to the informal economy exceeds those of operating formally (either partially or fully).

10. Researchers have shown that this is also the case for Latin America, where the primary cause of informality is poor public services and burdensome regulatory framework. Other structural factors more specific to developing economies may also have an impact on the level of informality in this region. For example, informality is more common in countries where the production structure is largely based on agriculture and where the workforce is very young. However, low levels of education do not seem to be relevant in this respect.

11. Recent economic literature has shown that at least half of formal sector firms report competing with informal firms. Because informal firms often evade costly taxes and other regulations, many observers are concerned that the informal sector distorts competition in the formal sector. The reason is that the intensity of competition between informal and formal firms is related to the costs that informal firms avoid as a result of not complying with all or some of their legal obligations. If the cumulative cost of complying with a variety of regulations is high, then informal firms will have a substantial competitive advantage over formal firms, which would increase demand for products from the informal economy. That, in turn, may prevent the entry or expansion of formal firms in the market. However, this may be less the case for higher productivity firms, which, according to recent economic literature, face less intense competition from informal firms.

12. Serious concerns have also been raised about the productivity of informal firms. In many industries informal firms are small, unregistered and often have no access to credit. Such firms may, nevertheless, be able to undercut low productivity formal firms in industries with low fixed costs due to the costs that they save as a result of evading taxes and regulations. When small, informal firms prevent the entry or expansion of formal firms, resources are wasted. Resources are also wasted to the extent that informal firms reduce the incentives of formal firms to innovate and adopt new technologies. On the other hand, the possibility certainly exists that informal firms might be more productive than formal firms if they successively evade regulations which limit productivity enhancing investments.

13. Competition law enforcement agencies may tackle some of these concerns through advocacy. For example, some competition authorities routinely examine laws with a view towards assessing regulations that impose barriers to entry and restrict competition: stringent and costly regulation to open a business can prevent entrepreneurs from entering the formal economy. The Doing Business Indicators published by the World Bank reveal significant differences across countries in the speed with which companies can open a business. However, Latin America and the Caribbean rank among the regions with the smallest shares of economies implementing regulatory reforms to make it easier to start a business. Such observations point out the need for advocacy by competition authorities.

14. Although competition authorities may contribute to the formalisation of firms operating in the informal economy through advocacy initiatives, a more direct concern is how to deal with informal firms in competition law enforcement actions and cases. Several examples come to mind. A merger control action involving formal firms might be rebuffed by the defendant's assertions that informal producers discipline formal ones or a case of an abuse of dominant position of a formal firm may be contested on the same grounds. Similarly, assigning market shares when the market definition includes informal firms could be especially difficult due to data limitations. Furthermore, detecting and sanctioning anticompetitive action by small, informal firms may present special challenges to competition authorities. Also, when sanctioning informal firms competition agencies may face difficulties regarding the calculation and collection of fines.

15. The quality and utility of this session will be strengthened by written contributions from participants. It will be especially helpful if you include a discussion of relevant enforcement and advocacy cases from your jurisdictions. Your written contributions will complement an issues paper prepared by the Secretariat.

16. To help you prepare your contribution, a number of issues and questions are raised below that you should feel free to respond to and discuss in your submission. This is not intended to be a restrictive or comprehensive list. Participants are encouraged to raise and address other issues, as well, based on their own experience. A suggested bibliography is attached, as well.

2. Some Suggested Issues and Questions for Consideration in Country Contributions

17. *Definition of informal economy.* What is an appropriate definition of the informal economy in your country? Are some measures better than others?

18. *Causes, characteristics and size.* What factors contribute to the formation of informal firms? Do some factors appear to be more important than others in your country? What types of products or services are frequently produced within the informal economy? How large is the informal economy in your jurisdiction? Is the informal economy stable, growing or reducing in size?

19. *Level playing field and productivity.* Does the informal economy impact competition in the formal economy? If so, is the formal sector affected generally or only in specific industries or by firm size and why is it the case? Do informal and formal firms collaborate? Does a large informal economy impede the entry or expansion of foreign firms? Does the quality of public services (which are only accessible by complying with regulations, such as police protection, recourse to judicial system, access to legal financial institutions for credit, public health and pension systems) incentivise enough informal firms to become formal? Does informal production appear to hamper economic growth – or does it enhance it?

20. *Competition law enforcement.* Are small firms operating within the informal economy outside the reach of competition authorities? What competition cases in your jurisdiction have involved aspects of the informal economy? Have you dealt with competition cases involving informal firms? If so, please explain the issues that you have encountered when dealing with the case and that are specific to the informal nature of the firms. How can the informal economy affect market definition and the assessment of market power? What methods should be used to estimate the possible effect on competition from a merger or abuse of dominant position case in the formal economy when there is a concern about substitution by consumers to informal firms? How can pecuniary sanctions be calculated when informal firms are condemned?

21. *Advocacy.* In what ways can competition authorities contribute to solving the informality problem? What tools have been used in your jurisdiction to move informal firms to the formal economy? What tools seem to be effective?

3. Suggested Bibliography

Jeffrey Allen, Shanti Nataraj, Tyler Schipper, "Strict Duality and Overlapping Productivity Distributions between Formal and Informal Firms", April 2018.

Jeffrey Allen and Tyler C. Schipper, "Understanding the Informal Sector: Do Informal And Formal Firms Compete?", August 2016.

- Shanthi Nataraj, “The impact of trade liberalization on productivity: Evidence from India’s formal and informal manufacturing sector”, July 2011
- Norman V. Loayza, Luis Servén and Naotaka Sugawara, “Informality in Latin America and the Caribbean”, March 2009.
- Joe Capp, Heinz-Peter Elstrodt, and William Jones Jr., “Reining in Brazil’s Informal Economy,” McKinsey Quarterly, January, 2005.
- Hernando De Soto, “The Other Path: The Invisible Revolution in the Third World,” Harper Row, New York.
- Klarita Gerxhani, “The Informal Sector in Developed and less Developed Countries: A Literature Survey,” 120 Public Choice 267 (2004).
- Alvaro Gonzalez and Francesca Lamanna, “Who Fears Competition from Informal Firms? Evidence from Latin America”, The World Bank, Policy Research Working Paper 4316.
- Andrew Henley, G. Rez Arabsheibani, and Francisco G. Carneiro, “On Defining and Measuring the Informal Sector,” World Bank, Policy Research Working Paper 3866.
- Thomas Kenyon and Emerson Kapaz, “The Informality Trap: Tax Evasion, Finance and Productivity in Brazil,” World Bank, Public Policy for the Private Sector, Note 301, December 2005.
- William W. Lewis, “The Power of Productivity: Wealth, Power, and the Threat to Global Stability,” University of Chicago Press, 2004.
- OECD, “Informal Employment and Promoting the Transition to a Salaried Economy,” In OECD Employment Outlook, 2004.
- Vincent Palmade and Andrea Anayiotos, “Rising Informality: Reversing the Tide,” World Bank, Public Policy for the Private Sector, Note 298, 2005.
- Guillermo Perry et al., “Informality: Exit and Exclusion,” World Bank, 2007.
- Taimoon Stewart, Good Governance, “The Informal Sector and Protection of Competition in the Market: Lessons from CARICOM,” available at www.idrc.org.
- Turkey, “The Impacts of the Informal Sector on the Effective Enforcement of Competition Law and Policy: Extracts from the Turkish Competition Authority,” Fifth United Nations Conference on Trade and Development, November 2005.
- World Bank, “Doing Business: Measuring Business Regulations,” available at www.doingbusiness.org.
- World Bank, “Worldwide Governance Indicators,” available at <http://www.govindicators.org>.
- Americas Society / Council of the Americas, Weekly Chart: Latin America's Informal Economy available at: www.as-coa.org/articles/weekly-chart-latin-americas-informal-economy.
- International Monetary Fund, “Measuring the Informal Economy in Latin America and the Caribbean”, April 2008. Available at www.imf.org/en/Publications/WP/Issues/2016/12/31/Measuring-the-Informal-Economy-in-Latin-America-and-the-Caribbean-21898.
- European Parliament, “Latin America’s Informal Economy, Some Formalisation Strategies”, September 2016. Available at: [www.europarl.europa.eu/RegData/etudes/BRIE/2016/589783/EPRS_BRI\(2016\)589783_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/589783/EPRS_BRI(2016)589783_EN.pdf).