

Entrepreneurs also suffer from the informal economy

Many Latin American entrepreneurs suffer from competition from informal companies. These companies do not pay taxes or social security contributions and they also ignore labour laws, which means that they can work much more cheaply. Later this year, DECP will bring representatives of South American business organisations and the OECD together to come up with solutions.

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August 5, 2019 - Although many South American countries are modernising rapidly, in most countries more than half of the economy is still "informal." This means that their activities are not seen nor registered by the authorities. This informal sector includes self-sufficient farmers, street vendors, shoe polishers and maids. But there are also entire companies – e.g., print shops, textile factories, construction companies – that operate under the radar.

Self-employed and informal employment

If you Google the term "informal economy", you will find a great deal of information about self-employed workers such as farmers and street vendors, who usually have no right to social security. This is a social issue that should be addressed right away. This also applies to employees who are hired "informally" and who are thus not protected by labour legislation.

But from the perspective of entrepreneurs, the informal economy is primarily unfair competition. Formal companies must pay taxes, pay contributions, comply with working conditions and environmental rules and, when applicable, pay termination benefits. Informal companies can choose not to do any of these. As a result, the costs of doing business are considerably lower.

Narrow basis for taxation

Another problem is that Latin American countries rely heavily on corporate taxation for their income. However, because a large percentage of companies are hiding from the government, the basis for the levy is much narrower. In other words, formal companies

pay much more tax than would be necessary if all companies paid. And this in turn increases the incentive to step out of the formal economy and continue informally.

Finally, a large informal sector is also bad for the country as a whole because informal companies almost by definition have low productivity. No investments are made in employees because that is precisely the business model. No investments are made in machines because banks do not provide credit to companies that do not formally exist.

Two million football shirts

The fact that informal companies are no exception was clearly demonstrated in June 2018 in Peru. Totally unexpectedly, Peru qualified for the football world championship in Russia. Within two weeks, the informal textile factories in the Gamarra district in Lima managed to produce and market two million shirts of the national team.

In November, business organisations from Colombia, Bolivia, Ecuador and Peru will meet to discuss the informal economy at the initiative of the Dutch Employers' Cooperation Program (DECP). They will also discuss possible solutions with OECD researchers.

