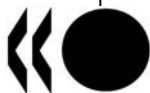


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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

## **Global Forum on Competition**

### **COMPETITION POLICY AND THE INFORMAL ECONOMY**

**Contribution from Ms. Taimoon Stewart**

-- Session II --

*This contribution is submitted by Ms. Taimoon Stewart, Associate Senior Fellow, University of the West Indies, Trinidad and Tobago, under session II of the Global Forum on Competition to be held on 19 and 20 February 2009.*

Contact: H el ene CHADZYNSKA, Project Manager of the Global Forum on Competition  
Tel: 33 1 45 24 91 05; email: helene.chadzynska@oecd.org

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## **THE INFORMAL SECTOR IN JAMAICA: EXPLORING COMPETITION, COMPETITIVENESS, AND ANTITRUST ENFORCEMENT ISSUES**

**--Ms. Taimoon Stewart--**

### **Abstract**

1. The paper provides a brief description of informality in Jamaica and the features of this sector. A conservative estimate is that 41 per cent of GDP is generated by this sector, and businesses span the subsistence sub-sector through micro, small, medium and even large firms that do not conform to regulations and evade taxes. It concludes that informality is the norm in Jamaica.

2. Competitiveness of informal firms is reduced because of their expenditure on protecting themselves from criminal activities. Productivity levels can be increased if informal firms access government assistance, both financial and technical, but this requires firms to be registered. However, this can prove to be an incentive to move into the formal sector.

3. The Jamaican government is making serious efforts to eradicate corruption in customs, to stamp out evasion of customs duties, and to enforce the law in respect of tax obligations. However, there are bureaucratic bottlenecks that still need to be addressed, and the need to introduce good governance practices within government.

4. While under the Fair Competition Act (FCA), all businesses, regardless of size, are under the jurisdiction of the Fair Trading Commission (FTC), it does not cover practices involving evasion of government business regulations. The FTC does, in the course of its investigations, encounter firms that are operating illegally, and does engage in advocacy to the relevant government agencies. The FTC also encounters problems in defining relevant market because of grey areas in terms of market segmentation. However, there are geographic locations where markets are segmented.

### **The Jamaican Informal Business Landscape**

#### ***Types of Business***

5. Fifty-two per cent of the 2.7 million population of Jamaica lives in urban areas (Statistical Institute of Jamaica 2007) and there exists in these areas large and volatile inner cities, particularly in Kingston. Poverty and unemployment rates are high, and there is a large informal economy, here defined as economic activities in the production of goods and services that are unregistered and operate outside government regulation and taxation systems<sup>1</sup>.

6. Features of this sector found in other countries also apply to Jamaica. It generally involves use of cash as the most common medium of exchange, or bartering or swapping goods or services. In both cases, it means receiving payment that is not traceable, and the income is not reported for tax purposes. Another feature of the informal sector is that labour laws, health conditions, safety standards, and location of activities according to zoning laws are all largely ignored. (Losby et al. 2002: 6-8). These strategies provide the informal business persons with a competitive advantage: paying lower wages, non-compliance with tax, and inattention to other regulations allow them to operate at cost levels that give them their edge (ibid: 37). In Jamaica, avoidance of custom duties is an important part of cost cutting strategies.

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<sup>1</sup> Between 1989 and 2003, Jamaica's poverty headcount ratio declined from 30.5 percent to 19.1 percent (World Bank Development Progress Report, October 2008). Many analysts attribute this remarkable phenomenon to the existence of the informal subsistence sub-sector in the economy.

7. Crime has a great impact on the competitiveness of both the subsistence sub-sector and established firms throughout the economy, as the criminals are organised “mafia-style” and extract “protection” money, rob, steal, and threaten physical safety. This has negative impacts on costs and productivity throughout the economy<sup>2</sup>. In the World Economic Forum, Global Competitiveness Report 2008-2009, 22.7 per cent of Jamaican business persons identified crime and theft as the most problematic factor for doing business, while 12.7 per cent identified inefficient government bureaucracy, and 9.8 per cent identified corruption as the greatest problem. Small businesses were identified as the ones most affected by criminal activity (World Bank 2004, *The Road to Sustained Growth in Jamaica*. [www.worldbank.org](http://www.worldbank.org)). These firms may not be able to pay the cost of high security and are thus rendered vulnerable to the criminals.

8. Types of businesses found in the informal sector include subsistence level operations, micro and small enterprises (MSEs), and even medium and large enterprises.

- In the subsistence informal sub-sector are found street vendors or itinerant traders selling out of vehicles or hand pushed carts. Others include domestic helpers and cleaners, hair dressers, gardeners, taxi-drivers, construction workers, cosmetologists, and so on. Businesses of these types can be very transient because of under-financing or unprofitability where there are too many players in the market. In the rural areas, they produce and sell food products (ground provisions, vegetables and poultry etc.), engage in agro-processing (jams, jellies, sweets, etc.) and even provide technical agricultural services, such as artificial insemination of animals (which has been learned from technicians and sold on at a lower price).
- There is also a multitude of persons operating as informal taxis in the transport sector, and competing with the registered taxis. There are no limits imposed on the number of registered taxis that can operate on a route. It is standard procedure for a car owner who needs additional income to operate illegally in this sector, or hire drivers to do so. As such, there are too many operators, too much competition, and too little regulation.
- Beyond these, there are the informal firms that deliberately remain invisible to escape meeting tax and regulatory requirements (MSEs, medium and large firms), the home-based business persons of higher education who do not register, and those who operate both in the formal and informal sectors. Medium, Small and micro firms employ approximately 84.9 per cent of the working population and are therefore very important<sup>3</sup>. According to a recent IADB study<sup>4</sup>, the size of the informal sector in Jamaica is estimated at 43 per cent of GDP as at 2001, and is estimated to have doubled over the previous decade<sup>5</sup>.

9. The IADB study revealed that many enterprises are concentrated in low-productivity, labour-intensive activities, with some 60 per cent of persons operating in the informal sector engaging in

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<sup>2</sup> Jamaica is an extremely open economy, and domestic firms compete with imports in their home market, and export competitiveness is lessened.

<sup>3</sup> According to data published by the Statistical Institute of Jamaica, in July 2008, there were 1,163,200 persons employed, and of that, only 175, 936 were employed in large establishments. Therefore, 987,264 persons were employed by medium, small, and micro enterprises.

<sup>4</sup> IADB, 2006 “The Informal Sector in Jamaica”. (December). [www.iadb.org](http://www.iadb.org).

<sup>5</sup> The target groups that were measured in this study were in three categories: pure tax evaders (operating registered businesses but not reporting earnings); the irregular economy (unregistered businesses); illegal activities (evading taxes, unregistered and criminal activities). The survey was based on a size-stratified random sampling of 1,226 out of a full listing of Jamaican [business] premises.

wholesale/retail trade. Most own-account business persons do not have a bank account, either maintaining total financial self-sufficiency or managing their affairs through other informal financial institutions.”<sup>6</sup> Banks require a business plan and lower income persons generally do not have the skills to produce it, and do not have the money to pay someone to do it.

### ***Level of non-compliance***

10. An important finding of this study is that most Micro and Small Enterprises (MSE) do comply with some regulations, but not all. The authors concluded that “... informality is a continuum...”, given that most MSEs satisfy some requirements but not others, and that informality is, to a large extent, standard operating procedure among Jamaican MSEs (IADB 2006:27). *Indeed, in the January 2009 budget speech, the Prime Minister pointed out that a mere 1 percent of firms pay 80 per cent or more of taxes, and only a handful of the employed labour force pays income tax. He also said that far too many eligible firms are not registered to pay or do not remit their General Consumption Tax (The Gleaner, Editorial, Monday January 19, 2009).*

11. The authors of the IADB study found that ignorance and high bureaucracy were among the most cited reasons for non-compliance among MSEs. Yet, the World Bank study, *Doing Business 2009* ([www.worldbank.org](http://www.worldbank.org)), which undertook to compare regulations in 181 countries, found that in Jamaica, six procedures were required which took 8 days to accomplish, at a cost of 7.9 % GNI per capita. Jamaica had a global rank of 11 out of 181 countries. The Business Registration website for Jamaica confirms this.

12. The *Doing Business 2009* ranked Jamaica a low 173 out of 181 countries in terms of ease of paying taxes. They found that 414 hours were needed to prepare and submit tax returns, and the total tax rate was 51.3 per cent of profit. In the Global Competitiveness Index, 8.2 percent of businesses felt that the tax rate was the most problematic factor for doing business. It therefore seems that the bureaucratic tangle is at the level of doing business rather than the initial registration, and procedures for paying taxes. This and the high rate of taxation are the major disincentives to compliance. These factors are exacerbated by lack of trust in government’s usage of the tax dollars, lack of enforcement on the part of government, and a culture of lawlessness in the country.

### ***Trends toward formalisation of firms***

13. Certainly there are advantages to be gained by subsistence level informal businesses if they moved to the formal sector and some businesses are taking advantage of incentives. For instance,

- registering with the Ministry of Agriculture would then give persons access to free plants, chicks and other supplies; and
- in times of natural disaster, such as hurricane damage, only those businesses that are registered would get access to government’s recovery assistance. Insurance is generally too expensive for these poorer entrepreneurs.

14. In addition to these carrots, government is also wielding the big stick. It is becoming increasingly difficult to evade custom duties and tax obligations, government increased enforcement in the last year. A six month tax amnesty was offered to non-compliant businesses, ending 31 October 2008; recalcitrant tax payers were invited to pay fully or in tranches, without incurring the interest and penalties involved. Since then, the Tax Administration has taken legal action against 200 self employed persons and companies, for

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<sup>6</sup> The “pardner” system, which involves pooling of resources by depositing each week a small amount of money, and taking turns accessing the accumulated capital (getting a draw).

failing to make arrangements to pay outstanding taxes. They may have to pay over half a billion Jamaican dollars in outstanding tax and fines (4.8 million Euros). There is also a crackdown on firms that have not been submitting funds collected from the General Consumer Tax to the relevant government authority. Moreover, systems are being put in place, requiring a tax registration number (TRN). This is similar to the social security number in the US, the intention being that the TNR will have to be provided for every transaction with a government agency. In addition, a tax compliance certificate (TCC), has recently been introduced and this must be provided by importers before goods are cleared from the wharf or airport. Tax evasion will therefore become much more difficult.

15. The transport sector poses a serious challenge because of the size of informal operators, the difficulty of enforcing regulations due to the chaotic and brutal nature of the fierce competition in the sector. There is a concern that removing illegal taxis and bringing efficiencies to the sector may incur a high social cost and lead to increased crime as such operators lose income<sup>7</sup>.

### *The Interface between the Formal and Informal Sectors and Competition Issues*

16. There is trade taking place between the formal and informal sectors. Larger businesses supply informal businesses with goods:

- Street vendors buy final goods or intermediate products from the formal sector (wholesale stores, supermarkets), and then sell these goods on the streets.
- Manufacturers and distributors supply goods to MSEs and corner shops in inner cities. For instance, Grace Kennedy Ltd., one of the conglomerates in the economy, stocks informal businesses in inner-cities and rural areas with agro-processed products and give a time line to pay. Vendors are provided with biscuits and sweets.
- Supermarkets provide vendors with expired or soon to be expired goods to sell on the streets. Retailers use vendors to sell their goods on the pavements outside their stores and the GCT is not charged (a practice called “fronting”). By doing so, the established businesses can compete with the informal businesses at their level, and also gain advantages over their rivals in the formal sector.

17. Large formal businesses purchase goods from the informal sector. For instance, Courts Ltd. and Singer Ltd. purchase furniture from small informal operators. Grace Kennedy Ltd. purchases raw materials from the informal producers in the agricultural sector. These large conglomerates do not face competition from the subsistence level operators. Rather, they draw consumers away from the informal sector by offering hire purchase arrangements with guarantees, and a monthly payment that is manageable for lower income groups.

18. Some persons employed in the formal sector also work in the informal sector in order to supplement their income: tradesmen such as electricians, plumbers; or civil servants may operate as private taxi drivers in their non office hours, or higher skilled workers such as computer technicians may lure customers away from their employers by offering to do jobs privately at a lesser cost. In doing so, they are competing directly with their employers, taking jobs that would have gone to the company.

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<sup>7</sup> Stewart, Taimoon. “Competition Issues in Selected Caricom Countries: An Empirical Examination.” The University of the West Indies, 2004: 149.

**What action can the Jamaican Fair Trading Commission (JFTC) take to deal with anti-competitive practices in the informal sector?**

19. According to the JFTC, in its interpretation of the application of the law, it has jurisdiction to investigate and sanction all business persons operating in the Jamaican market, including vendors, and irrespective of legality of the business operations. The Jamaican Fair Competition Act (FCA) addresses the conduct of 'enterprises, suppliers and persons'. There are standard exemptions, but these do not include the categories of businesses dealt with in this paper. The FCA does not provide a definition for 'person' or supplier, but Jamaica's Interpretation Act defines "person" as including any corporation either aggregate or sole, any club, society, association or other body, of one or more persons. Businesses in the informal sector fall within this definition.

20. A decision was made by the Commissioners of the JFTC on this issue. A legal firm came under surveillance for offering an illegal DSS satellite service, and the question was raised as to whether the FTC has jurisdiction. The Commissioners directed that, as a matter of policy, a legitimate business offering an illegal service falls under the ambit of the FCA and should therefore be investigated (communication from the JFTC).

21. However, the FTC is limited to investigating conduct of firms as defined in the FCA, and while the process of compliance with regulations and paying of taxes increases considerably costs of operations of firms, thereby giving an unfair competitive advantage to those firms that do not comply, this does not fall within the scope of the FCA. In this regard, therefore, the FTC is limited to engaging in advocacy with other government agencies to encourage enforcement of the law.

22. In the process of investigations conducted by the FTC, in defining the relevant market, the illegal status of some firms has surfaced, and advocacy measures were taken with the relevant government departments. In addition, in investigations related to predatory pricing or any investigation that requires calculation of the cost price of a product, the FTC has, in the case of illegal firms, determined cost price by including the cost of paying all relevant government obligations, thereby increasing cost and more than likely rendering selling price as below cost.

23. Moreover, the FTC would only investigate a case if the conduct has substantial effect in the market. For that reason, price fixing and barriers to entry that are practiced in the subsistence sector, imposed by Dons, are unlikely to be investigated, even though the FTC has jurisdiction. Moreover, it is physically dangerous to challenge the Dons.

24. There are businesses established in the Kingston downtown area by recent migrants (from China and India in particular), which are medium-sized establishments that operate without regard to any regulations or tax laws, and that undersell similar establishments in the 'uptown' areas. They buy in bulk to achieve economies of scale, and the goods are split and shared. They compete with medium sized supermarkets and general department stores, offering similar goods at much lower prices. Vendors frequent these businesses to get supplies at much cheaper costs. This is unfair competition, but the FTC has not undertaken any investigations because conducts involving non-compliance with regulations are not covered by the FCA.

*Market segmentation issues*

25. This is a hazy area, because while there are some clearly segmented markets, some areas are greyer.

- In most respects, the subsistence sub-sector operating in the inner cities does not compete in the same market as medium and large businesses, because the market is segmented. Those selling within inner-cities target the inhabitants of those areas, catering specifically to their income level and needs<sup>8</sup>. Persons from “uptown”, that is, the middle and higher income consumers, would not shop for goods or services (e.g., beauty services) in the inner city communities for several reasons:
  - such locations may not be considered safe;
  - because most vendors are itinerant, selling products that are of questionable quality, and offer no guarantees, those who can afford it would choose to shop at establishments that are stable and offer guarantees on goods so that they could have recourse if a product is defective;
  - the point above is even more pronounced when food items and pharmaceuticals products are involved because of health issues associated with poor standards and expired products; persons of means would choose to go to the established businesses where there is greater assurance of good quality.
- However, in some specific lines of businesses, such as apparel and shoes sold by the Informal Commercial Importers (ICIs)<sup>9</sup>, there is direct competition with the small apparel businesses. In response, many of these businesses exit the “formal” market by not registering and paying taxes in order to cut cost and compete, or give up their premises and become itinerant traders, serving their customers by taking products to them or selling from home. Small businesses within the established sector are the ones most affected by the activities in the subsistence sub-sector of the informal sector, by being placed at a competitive disadvantage by similar businesses in the informal sector.
- Market segmentation is not so clear-cut in sectors such as supermarkets, whereby the shops operated by the Chinese and Indians in downtown Kingston draw a customer base from employees of the financial and legal industries, whose businesses have remained in that area, and who feel safer because of familiarity with the area (Other businesses moved out of downtown Kingston decades ago). Such consumers may frequent both uptown and downtown businesses. The FTC takes this into account in defining the market share of a firm under investigation.

26. The JFTC has not conducted any investigation specific to the informal sector. Nor has it conducted any studies in the area. It does plan, however, to do so in the near future.

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<sup>8</sup> As such, persons from these communities may not be able to afford buying a five pound bag of flour from the supermarket, but could buy one or half a pound from the corner shop, or through credit from the shop.

<sup>9</sup> Women who travel to the US and other destinations to buy supplies, evade customs duties and sell at lower cost, sometimes plying their trade in their cars.

## **Conclusions**

27. There are already efforts undertaken by government to track down tax evaders and to clamp down on lax and corrupt practices in customs. This will accelerate the movement away from the informal sector into the formal sector. However, it is necessary for government to complement this crackdown on businesses with rigorous application of good governance practices. They must make greater effort at enforcing the law so as to reduce crime and protect businesses, freeing the monies that are currently paid to Dons for “protection” and/or are invested in security systems (guards, electronic systems, security cameras etc.). This money could then be used to pay government taxes.

28. The government now needs to simplify and streamline procedures for preparing and submitting tax returns, consider reducing the tax rate, so as to encourage compliance and spread the burden over a greater number of firms, and reform the bureaucracy to remove the bottlenecks encountered in the course of doing business.

29. The government should also embark on a programme of information dissemination and education targeting the lower income groups to highlight the benefits to be gained from government projects that can only be accessed by registered businesses. Productivity levels would rise, given the technical assistance that government agencies provide, but which is now not accessed by many informal businesses.

30. The FTC has the jurisdiction to investigate all businesses in Jamaica, however small, but can only intervene on the issue of non-compliance at the level of advocacy, and this they are doing. The FCA does not allow them to investigate “unfair” competition when cost advantages are gained through non-compliance with government regulations. They do, however, take this into account when calculating costs in predatory pricing cases.