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## **Global Forum on Competition**

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

#### **Contribution from Colombia**

-- Session II --

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## COMPETITION POLICY AND THE INFORMAL ECONOMY

### --Colombia--

#### 1. Definition of the informal economy

1. *“The term “informal sector” was first coined by a British economist, Keith Hart, in a study of economic activities in urban Ghana (Hart, 1973). Today, the concept of an “informal sector” seems to be replaced by “informal economy”, which includes all economic activities by workers and economic units that are—in law or in practice—not covered or insufficiently covered by formal arrangements, directing both enterprise and work relationships”<sup>1</sup>.*

2. Several authors have developed the study of informal economies around the world for developing countries. The usual sense given to the term is brought from the Anglo-Saxon current (United States and Occidental Europe), which describes the informal as the group of economic activities that are carried out lawfully inside a market, but the resultant transactions are not counted in the national statistics and accounts, due to the fact that such activities escape from the formal registration, with the purpose of evading the control of the State either partially or totally. This definition does not include illegal undesirable activities and productive activities destined to self consumption. In order to make our contribution, this is the meaning that we choose for the figure exposed, in application to the Colombian economy and the effects generated in the market.

#### 2. Causes, characteristics and size

3. The informal economies are generally associated with developing countries, which is the case of Latin American nations, but is not strange to developed countries either. For the first scenario, developing countries, one of the predominant factors for informality is unemployment in the formal sector, accompanied by other ones such as tax and law evasion.

4. There is a large range of causes for the increasing extension of the informal economies pointed in the study of this topic, however, we would like to aim some of them because of their significance towards this analysis in developing economies such as the Colombian one.

5. The migration of population from the country to the urban centres is one of the fundamental origins of informality. As known, the migration produced internally in a State, entails to disproportionate growth of the cities, as well as marginalised strata and unemployment because of the impossibility to absorb the increasing offer of able work force. When these factors are congregated in the major cities, the unoccupied population might decide to produce or commercialise products and services informally, as said in the definition proposed, this production or commercialisation and the resultant products and render services are legal, but the transactions generated in the process flee out of registration, which ends up in evading a serious number of requirements, such as proper accounts and books, taxes, labour law, social security law among other serious effects.

6. On the other hand, even though at the beginnings the notion of informal economy was placed in a marginal place, not linked to the formal sector, and expected to disappear when the nations achieved sufficient levels of economic growth and industrial development, now a days is clear that the informality can not be longer considered as a temporal event. From this point, the theory of the economic cycle has

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<sup>1</sup> LARSSON Allan. “Empowerment of the Poor in Informal Employment”. Commission on Legal Empowerment of the Poor. January 2006. Pg. 1.

been applied by some authors, exposing that it constitutes another visible cause for this phenomenon. In general terms, the exposed hypothesis establishes that the successive stages that develop the formal economy influence the informal economy. In this sense, when the formal sector is in crisis, the informal one experiments an increment and vice versa. As seen, the relation between the two economies would be indirectly proportional. “Furthermore, the informal economy has been observed to have more of a fixed character in countries where incomes and assets are not equitably distributed. It seems that if economic growth is not accompanied by improvements in employment levels and income distribution, the informal economy does not shrink. The situation is, therefore, that the informal economy is continuously increasing in most developing countries, even in rural areas. In all developing countries, self-employment comprises a greater share of informal employment than wage employment<sup>2</sup>.”

7. In Colombia the informal economy is subdivided depending on the activity, product or service which is developed. For instance, we can discern informality in commerce, industry or services.

8. In commerce, informality is mostly observed in street vendors, an activity which is practiced commonly along Latin American cities from which Colombian cities are not excluded. All kind of products are commercialised, perhaps the only requirement is that they are easily transportable because of the conditions of the business.

9. Informal industry, in the other hand, is mainly underground in comparison to informal commerce, which is generally visible. “*There are two kinds of informal industrialists in Latin America, one is the formal industrialist who informalises part of his production as a result of the high cost of regulation or taxes. Even though he may conceal part of his production, he belongs to the community of established industrialists. In many cases the high cost of legality in Latin America has forced him to move part of his production to the informal sector.*” For the Colombian case the informality is present on both manners mentioned above.

10. Regarding services, the usual example in developing countries is public transportation, activity that goes hand in hand with the fact that the government is unable to cover all the needs in this field. In our country, public transportation prices are regulated by the administration, so that the offer from the transporters whom escape from regulation normally consists in charging less for the same service.

11. The last official statistic analysis concerning informal economies covered the thirteen (13) principal Colombian cities during years 2001 – 2006 from April to June, and was prepared by the Administrative National Statistic Department (*Departamento Administrativo Nacional de Estadística – DANE*). This Department includes for the given study, domestic and independent workers, excluding professionals or technicians.

12. It can be said that in Colombia an important percentage of the labour occupation is informal. In the 90’s, the informal occupation inside the major cities was ranged close to the 54 %, from the year 1996 and ahead, this proportion rose constantly until year 2001, when the percentage is pointed in 61%. From 2001 to 2003, this participation decreased in 7 points. The last statistic revealed in 2006, showed that in the thirteen principal cities in the country the informal employment achieves the 58.5 % of the labour occupation. The statistics reveal an indirectly proportional relation between the increasing of formal work

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<sup>2</sup> BECKER Flodman Kristina. “The Informal Economy”. International Finance Corporation. World Bank Group. <http://rru.worldbank.org/Documents/PapersLinks/Sida.pdf>. March 2004.

and decreasing of informal jobs, as well as frames that a 14% contributes to social security, while 76% have health insurance both paid and subsidised<sup>3</sup>.

13. The Gross Domestic Product behaviour is one of the most relevant sources of the fluctuation between formal and informal economies. Evidence points to the fact that in front of a sustainable, continued growth in the economy, a correlative reduction in the range of informality is shown.

14. However, lately a tendency has taken place in Colombian economy, constituting a paradox: meanwhile the economy is growing, unemployment increases or at least it does not decrease. This has been exposed by the Administrative National Statistic Department (Departamento Administrativo Nacional de Estadística – DANE) when comparing the increment in the Gross Domestic Product (GDP) with the raise in the unemployment rate<sup>4</sup>.

15. An hypothesis might be deducted from the exposed above; even though formal economy is the principal and direct source of the GDP, informal economy income indirectly fortifies this indicator, beginning with the increase in consumption power from those that accrue working informally. This track shows how GDP increment does not necessary reflects in the decrement of unemployment and can, as suggested, grow in an opposite way: while unemployment in the formal economy rises, translating hand work to the informal sector, the last one expands and contributes to the GDP.

16. *“Estimates have been made of the contribution of the informal sector (i.e. not the informal economy as whole, only informal enterprises) to the GDP. These estimates indicate that the contribution of informal enterprises to non-agricultural GDP is significant. The average share of the informal enterprise sector in non-agricultural official GDP varies from a low of 27% in Northern Africa to a high of 41% in Sub-Saharan Africa. The fact that such a large number of countries in Sub-Saharan Africa have such estimates reflects recognition of the importance of the informal sector in total GDP. The contribution of the informal sector to GDP is 29% for Latin America and 41% for Asia”<sup>5</sup>.*

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<sup>3</sup> DEPARTAMENTO ADMINISTRATIVO NACIONAL DE ESTADÍSTICAS. Informalidad Laboral en las Trece Principales Áreas y Ciudades Colombianas, 2001 – 2003 (abril – junio).

<sup>4</sup> SEGUIMIENTO Y EVALUACIÓN TRIMESTRAL DEL MERCADO LABORAL COLOMBIANO 2003 - 2006 Trimestre de 2007. Documentos Técnicos sobre Mercado Laboral. La paradoja del crecimiento económico sin empleo. [http://www.dane.gov.co/index.php?option=com\\_content&task=category&sectionid=19&id=77&Itemid=259](http://www.dane.gov.co/index.php?option=com_content&task=category&sectionid=19&id=77&Itemid=259)

<sup>5</sup> BECKER Flodman Kristina. “The Informal Economy”. International Finance Corporation. World Bank Group. <http://rru.worldbank.org/Documents/PapersLinks/Sida.pdf> . March 2004. Pg.19.

**Contribution of the informal sector to the GDP in selected developing countries**

<b>Country (year)</b>	<b>Informal sector GDP as percentage (%) of non-agricultural GDP</b>
Northern Africa (2002)	27
Sub-Saharan Africa (2002)	41
Benin (1993)	43
Cameroon (1995–96)	42
Kenya (1999)	25
Mozambique (1994)	39
Tanzania (1991)	43
Latin America (2002)	29
Colombia (2002)	25
Colombia (2002)	25
Mexico (1998)	13
Peru (1979)	49
Asia (2002)	31
India (1990–91)	45
Indonesia (1998)	31
Philippines (1995)	17

Source: ILO, Women and men in the informal economy – a statistical picture 2002<sup>6</sup>

17. Towards the activity, the statistics show that the informality in Colombia concentrates in commerce and services, and in a minor level in industry. The first two (2) categories represent the 70% percent of the informal economy, mean while industry corresponds to the rest. In the industry, qualified work force and a minimum of capital are required, in opposition to the first classifications.

18. There are other indicators studied, such as the level of education. The population that integrates the informal sector is mostly composed by unskilled population. This participation, added to the population with primary degree education, conforms the 83% of the informal occupation.

## **2. Level playing field and productivity**

19. As a characteristic of capitalist developing economies, the expansion in work demand does not come entailed to the same amount of work offer in the formal sector. In consequence, a huge part of the population is enforced to secure their living by producing o commercialising products or services in a small scale, with low resources, limited organisation and non entry barriers. The result of this scenery supposes insignificant productive levels, with absence of technique and accumulation, which means that both, the perspectives of real competition and the possibilities of saving, are minimum or non existent. In this frame, binding to law and all types of regulation represents enormous difficulties for this part of the population. Normally the population described dedicates to informal commerce and services rather than to informal industry.

<sup>6</sup> BECKER Flodman Kristina. “The Informal Economy”. International Finance Corporation. World Bank Group. <http://rru.worldbank.org/Documents/PapersLinks/Sida.pdf>. March 2004. Pg.20.

20. Informal economy constitutes a problem for the population that is affected in their minimum rights, as well as for the government because the tax income is reduced parallel to the highly inversion that has to be made to minimise the damage due to the evasion mainly towards the defenceless workers.

21. In diverse sceneries, the International Labour Organization (ILO) has pronounce it self about informal labour, pointing that half of the world's workers do not earn enough to lift themselves and their families, noting an overlap of informality and poverty. *“The reality is that workers all over the world face degrees of informality, the most formal of which have multiple forms of protection, the least formal none at all”*<sup>7</sup>

22. For informal industry the scenery is different; it refers to a sector of the population that might have the capital and the knowledge to participate of the formal sector, but decides to exclude it self from the regulation in order to expand their income margin or to commercialise at lower prices in the way to increase a market share or to eliminate competitors. In this panorama must been included the firms that do make part of the formal sector but leave partially informal a section of their business.

23. Even though informal industry represents a lower proportion than commerce and services in the informal economy in Colombia, it constitutes an important obstacle to the economic development of the country. From the moment the tax evasion begins, the measure employed by the government is raising the tributes to the formal firms, in such way that the inequality between the transaction costs for these firms and the informal ones is unsustainable. Competition, as a result, grounds on the basis of disparity.

24. *“The effect of the informal economy on productivity and economic growth is discussed in a recent McKinsey study. Companies around the world underreport employment, avoid certain taxes, ignore product quality and worker safety regulations, violate copyright and intellectual-property laws, or even fail to register as legal entities. The problem is particularly acute in developing countries, where companies that operate informally produce as much as 80 percent of the output in some industries. Few policy makers are concerned, but they should be. By avoiding taxes and regulatory obligations, informal companies gain a substantial cost advantage that allows them to stay in business despite their small scale and low productivity. This prevents more productive, formal companies from gaining market share. The result is slower economic growth and job creation”*<sup>8</sup>.

25. This lack of transparent competition affects the possibility of growth of the formal firms that, additionally, offer quality work conditions. The productivity of the country is also affected because generally the formal firms are more prolific than the informal ones, but the existence of the last ones reduce sells from the first ones, implying a raise in unused installed capacity and stock. However, is possible that informal firms become more productive, this as a result of the savings that constitute the serial evasion to law, regulation and taxes. Due to this situation, the margin might be invested in technology, which can promote efficiency. Even though, this outcome, as positive as can be seen, can't be promoted or encouraged; to achieve this condition many sacrifices are made along the way including, as said before, the minimum rights for the workers that belong to this class of market, as well as the common interest and the solidarity that characterises the purpose of the taxation, the public order when breaking the law and the equality between equals, when competing in profuse different conditions towards the firms that fulfil all the legal pertinent requirements.

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<sup>7</sup> INTERNATIONAL LABOUR ORGANIZATION (ILO). Report “Economic Security for a Better World”. ILO 2004b: 4

<sup>8</sup> MCKINSEY Quarterl. “The Hidden Dangers of the Informal Economy”. Commission on Legal Empowerment of the Poor. January 2006. Pg.3

#### **4. Competition law enforcement**

26. Small firms operating within informal economy are most certainly outside of the reach of the Colombian competition authority, or at least on a direct manner. A possible solution given by the competition authority would be through competition advocacy.

27. Market definition allows establishing the products that are part of a same market and between which competition appears, as well as those products that are substitutes. When a firm is part of the informal economy, it is not possible to take it into account to realise the market definition making it difficult to have a real market structure. Additionally, due to the possibility that informal firms tend to evade taxes and regulations, it is possible that they may sell products to prices under those given by formal competitors, in this way disabling formal firms to have a major market participation and preventing the competition agency to have a suitable control of the competition in a certain market.

#### **5. Advocacy**

28. The importance of analysing informal economies has been subject of our attention. The Superintendency is aware of the global tendency to implement remedies on this area.

29. What the Superintendency may do being a technical organism created to inspect, control and supervise, is to advice the government regarding the importance of attending the needs of these phenomenon, fulfilling the need and the obligation of this agency to stress the importance of turning the economies into a formal scenario. These kinds of matters are a State policy issue in our country. The government should, through institutions structured with this kind of faculty, adopt the needed measures.