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DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

Global Forum on Competition

COMPETITION POLICY AND THE INFORMAL ECONOMY

-- Session II --

Call for Country Contributions

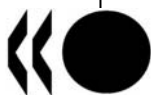
This document is a call for country contributions for Session II of the Global Forum on Competition to be held on 19-20 February 2009. GFC participants are invited to submit their contributions i) by 8 December 2008 (non-members); and ii) by 5 January 2009 (members and observers to the Competition Committee).

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TO ALL GLOBAL FORUM PARTICIPANTS

Re: Competition Policy and The Informal Economy

Global Forum on Competition (February 19 – 20, 2009)

Session II

1. The OECD Global Forum on Competition will hold a roundtable discussion on competition policy and the informal economy on February 19, 2009. The roundtable will follow the traditional format of roundtables in the Competition Committee. It is scheduled to last for 3 hours. A background paper and country contributions will be circulated. On the basis of the latter, a scenario will be prepared for the discussion, allowing contributing countries to share their views and experiences according to several themes. Presentations by several panellists will precede the general discussion.

1. Background

2. Within the economics literature the concept of the informal firm is loosely defined. At times an informal firm is defined to be an unregistered firm with 5 or fewer employees. In other situations it refers to a firm that fully or partially evades taxes or other forms of regulation such as product, labour or land regulations. In short, no common definition of an informal firm exists and consequently there is no common definition of the informal economy, either. However, regardless of the fact that informality means different things to different people, researchers and developing countries often view informality is a serious problem.

3. Recent statistics reveal that the size of the informal economy within many developing countries is large, often amounting to more than 50% of their GDP. Within industrial countries, in contrast, it is estimated to be 15% of GDP. Research findings indicate that excessively costly and stringent regulations, overly burdensome taxes, and ineffective governance help explain some of this difference, though other factors surely contribute. Excessively high taxes and costly regulations incentivize firms to operate informally because firms lower their cost structure when taxes and regulations are evaded successfully. Weak governance structures also contribute to the extent of informality as firms may rationally forecast low expected penalties from failing to comply with various regulations due to a low detection rate. In essence, firms choose to operate informally (either partially or fully) because they see profit in it.

4. Because informal firms often evade costly taxes and other regulations, many observers are concerned that the informal sector significantly affects 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. That, in turn, may prevent the entry or expansion of formal firms in the market.

5. Beyond the fact that informal firms evade the rule of law and potentially cause law abiding formal firms to exit the market, 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 large, formal firms in some markets 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 larger, more productive 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 impede productivity enhancing investments.

6. Competition law enforcement agencies are familiar with some of these concerns. For example, some competition authorities routinely examine laws with a view towards assessing their impact on competition. But World Bank economists point out that more must be done even on fundamental regulations. For example, the Doing Business Indicators published by the World Bank reveal significant differences across countries in the speed with which companies can open a business. Such observations point out the need for advocacy by competition authorities.

7. Although moving informal firms to the formal economy is an issue in which some competition authorities may want to get involved, a more immediate one revolves around competition law enforcement actions and cases that involve firms in the informal economy. Several examples come to mind. A merger enforcement action involving formal firms might be rebuffed by the defendant's assertions that informal producers discipline formal ones. Moreover, assigning market shares when the market definition includes informal firms could be especially difficult due to data limitations. Alternatively, laws mandating minimum prices might be enacted to help support formal firms survive competition from informal firms. Furthermore, anticompetitive action by small, informal firms may present special challenges to competition authorities.

8. The quality and utility of the roundtable will be strengthened by written contributions from participants. It will be especially helpful if you include a discussion of relevant cases from your jurisdictions. Your written contributions will complement a background paper prepared by the Secretariat.

9. To help you to 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. Administrative Issues

10. Please advise the Secretariat **by 1 December at the latest** if you will be making a written contribution. Written submissions are due **i) by 8 December (non-members); and ii) by 5 January 2009 (members and observers to the Competition Committee)**. Failure to meet that deadline could result in a contribution not being distributed in a timely fashion in advance of the meeting.

11. All communications regarding documentation for this roundtable should be sent to Jennah Huxley, Telephone – 33 (0)1 45 24 85 55; Fax – 33 (0)1 45 24 96 95; E-mail – Jennah.huxley@oecd.org. Ken Danger would be pleased to answer any substantive questions you may have about the roundtable. His phone number and e-mail address are: 33 (0)1 45 24 82 50, ken.danger@oecd.org.

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

1. *Definition of informal economy.* What is an appropriate definition of the informal economy? Are some measures better than others?
2. *Causes, characteristics and size.* What factors contribute to the formation of informal firms? Do some factors appear to be more important than others? 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?
3. *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? Do informal and formal firms collaborate? Does a large informal economy impede the entry or expansion of foreign firms? Are informal firms less productive than formal firms *per se*? Alternatively, are they ever more productive? Why or why not? Does regulation and taxation evasion by informal firms keep larger, more productive formal firms from entering the market or expanding in some instances? Does informal production appear to hamper economic growth – or does it enhance it?
4. *Competition law enforcement.* Are small firms operating within the informal economy outside the reach of competition authorities? If so, what alternative strategies could be used to deal with competition problems in the informal sector? What competition cases in your jurisdiction have involved aspects of the informal economy? How can the informal economy affect market definition and the calculation of market shares? What methods should be used to estimate the possible effect on competition from a merger in the formal economy when there is a concern about substitution by consumers to informal firms?
5. *Advocacy.* In what ways can competition authorities contribute to solving the informality problem? What methods have been used in your jurisdiction to move informal firms to the formal economy? What methods seem to be especially pro competitive?

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