

INFORMAL SECTOR AND DOMESTIC RESOURCES MOBILIZATION

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Development Finance Network (DeFiNe) Meeting,
Paris on 25 September 2009

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Introduction

- Public resources consist in large part of external resources
 - Strong dependence on volatile external financing
 - Lack of liquidity on the international market because of the financial crisis, e.g.
- Sustainability of development process?

Toward better mobilization of domestic resources

- Enlargement of tax base
- Make effective and efficient use of domestic resources

Problems : Inefficient tax system and very high informal sector

Toward better mobilization of domestic resources (contd.)



An important way to widen the tax base is to find ways to bring informal sector into formal sector

Informal sector in developing countries

- The informal sector contributes 20 per cent to 65 per cent to the total employment and produces between 20 per cent and 40 per cent of GDP.

Countries	% non agricultural employment	% non agricultural GDP	% total employment	% total GDP
Sub-Saharan Africa	77.4	39.6	19.7	25.9
Asia	67.5	37.3	33.6	27.7

Informal sector in developing countries (contd.)

- Larger informal sector is usually associated with poor economic performance and higher debt level
- The informal sector expands during downturns to absorb increased unemployment due to job destruction in the formal sector
- Evidence suggests that in times of economic distress this sector works as a type of safety net and as a buffer against greater poverty

Informal sector in developing countries (contd.)

- The informal sector is not a marginal sector and gets larger everyday
 - The informal sector has enormous revenue potential
- The informal sector should be considered as a partner in shaping the local economy

The “raisons d’être” of the informal sector

- Excessive regulatory system, inefficiency and corruption.
- Bureaucracy
- Presence of entry costs into the formal economy
- Macroeconomic instability
- Poor public services

Characteristics of informal sector

- Large and diverse
- Mobility in operations
- Domination of cash transactions
- Poor record keeping
- No culture of tax compliance
- Absence of financial education

How to formalize?



The key to bring informal sector into formal sector is to design an incentive mechanism through which informal sector participants get some legitimacy and also enjoy public services in exchange for paying tax

Problems to overcome



- Inappropriateness of existing tax mechanisms
- Lack of adequate logistics
- Bad governance

What should be done ?

- Integration of the informal sector participants into the economic and social mainstream
- Ensure the participation of informal sector participants in the development process and representation in the decision making, through trade organizations.
- More accountability and transparency, higher penalty rates, fewer restrictions to formality, clarifying legal and regulatory codes, simplifying business permit

Conclusion

- Collecting taxes from the informal sector is obviously a difficult exercise, but the potential gains justify thinking about incentive mechanisms that improve commitment to pay tax.
- Impediments to formalization should be minimized in order to limit the share of the informal sector.
- Meanwhile, a more flexible and adaptive tax system, the integration of informal sector into the development process, and a better supply of public goods could encourage the informal sector to help fund productive public services.