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“Impact of the Informal Sector on Trade & Competition”

David Miller
Executive Director, Fair Trading Commission (FTC)
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Colleagues, friends, Good Morning.

Firstly, I must thank SELA, UNCTAD and the Competition Authority of Ecuador for providing us, the Jamaica Fair Trading Commission, with the opportunity to be here in Manta to share our views with the Latin American and Caribbean community¹. I also extend our gratitude to the Staff of the Superintendency for Control of Market Power of Ecuador for welcoming us into their home in such a warm manner and for sharing with us, their culture and city.

Today I will share information on Jamaica’s informal economy, specifically, the impact of the informal sector on trade and competition by giving you the context and history of our ‘underground’ economy, which as you will hear, is a significant part of our consumers’ income stream.

Jamaica’s Informal Sector

A conservative estimate is that 41 per cent of GDP is generated by Jamaica’s informal sector, and businesses span the micro, small, medium and even large firms that do not conform to regulations and in instances evade taxes. Informality in doing business is considered by many to be the norm

¹ The WGTC was organized by the Permanent Secretariat of the Latin American & Caribbean Economic System (SELA) & the United Nations Conference on Trade & Development (UNCTAD) together with the Superintendency for Control of Market Power of Ecuador (SCPM).

in Jamaica.² It has been a process of finding ways not only to identify the informal players, but also to measure their output and to regulate them where necessary. This brings about challenges. Challenges which not only we as Jamaicans face, but also several of our Caribbean colleagues face these issues as well because of a similar type of economy and history as that of Jamaica.

For this discussion the informal economy is defined as economic activities in the production and trade of goods and services that are unregistered or which are conducted by unregistered entities, and which operate outside of government regulation and taxation systems.

The most common explanation for why enterprises remain informal is the high cost of doing business as a formal establishment. The World Bank's Doing Business 2014 ranked Jamaica 94th of 189 countries, with the worst scores for paying taxes (168), getting electricity (132) and enforcing contracts (131). Negotiating the bureaucracy has long been a complaint of the investor community and one of the challenges governments have accepted in crafting growth strategies. The costs are probably most burdensome on small enterprises that do not have the margin of employee time and resources to spend in compliance, particularly tax payments. Tax avoidance is perhaps the single most common reason and avoidance of the costs of the bureaucracy is perhaps the main motivating factor for enterprises to remain informal.³

Ladies and Gentlemen, please note that the activities which are undertaken and the business in which these firms are engaged are not necessarily illegal; what it is, is that these firms are unregistered and/or choose to side step the established procedures for operating.

Features of informal operations generally include:

- a. the use of cash as the most common medium of exchange, or bartering or swapping goods or services.

² Stewart, Taimoon. 2010. "The Jamaican Informal Business Landscape." In *Roundtable on Competition Policy and the Informal Economy*, by Organisation for Economic Co-operation and Development. Accessed November 27, 2015. <http://www.oecd.org/>

³ International Labour Organization. 2014. "Informal Employment in Jamaica." Accessed November 27, 2015. <http://www.ilo.org/>

- b. receiving payment that is not traceable, and income is not reported because of tax implications.
- c. labour laws, health conditions, safety standards, and location of activities according to zoning laws are all largely ignored.
- d. Self-financed and/or under-financed. Experience difficulties accessing credit.

These features invariably provide the informal business persons with a competitive advantage arising from paying lower wages, non-compliance with tax requirements including avoidance of customs duties and statutory payments and non-compliance with established regulations and standards.

Several factors have been advanced to explain the existence and pervasiveness of informal economic activity. In 2003 a study of the “informal economy” in Jamaica, cited the demand for informal services, including illegal goods and services, by tourists as well as Jamaican households. Specific reference was made to the demand for marijuana and other illegal substances, personal services (e.g. hair braiding and prostitution) and music and entertainment.

Data on Jamaica’s Informal Economy

- In the World Economic Forum, Global Competitiveness Report 2014-2015, 16.9 per cent of Jamaican business persons identified crime and theft as the most problematic factor for doing business, while 15.0 per cent identified inefficient government bureaucracy, and 12.0 per cent identified corruption as the greatest problem.⁴
- Medium, Small and micro firms employ approximately 84.4 per cent of the working population and are therefore very important.⁵ According to data published by the Statistical Institute of Jamaica, in July 2013, there were 1,108,100 persons employed, and of that, only 173, 024 were employed in large establishments. Therefore, 935,076 persons were employed by medium, small, and micro enterprises.

⁴ World Economic Forum. 2014. Global Competitiveness Report 2014-2015. Geneva: World Economic Forum. Accessed November 27, 2015. <http://www.weforum.org/>

⁵ Statistical Institute of Jamaica. 2015. Labour Market and Earnings. Accessed November 27, 2015. <http://statinja.gov.jm/>

- The World Bank study, Doing Business 2015, which undertook to compare regulations in 189 countries, found that in Jamaica, 2 procedures were required which took 15 days to accomplish, at a cost of 6.0 % GNI per capita. Jamaica had a global rank of 20 out of 189 countries.⁶
- The Doing Business 2015 ranked Jamaica a low 147 out of 189 countries in terms of ease of paying taxes.⁷ They found that 368 hours were needed to prepare and submit tax returns, and the total tax rate was 39.3 per cent of profit. In the Global Competitiveness Index, 11.5 percent of businesses felt that the tax rate was the most problematic factor for doing business.¹

Types of Firms in Informal Sector

A 2006 IADB study revealed that many 'informal' enterprises are concentrated in low-productivity, labour-intensive activities, with some 60 per cent of persons operating in the informal sector engaging in wholesale/retail trade; and another 15 per cent engaging in agricultural activities. Most of these enterprises or persons do not have a bank account, either maintaining total financial self-sufficiency or managing their affairs through other informal financial institutions.⁸

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. If the cost of starting a business is high, entrepreneurs delay registering and formalizing their operations.

In several instances informal firms deliberately remain invisible to escape meeting tax and regulatory requirements. They are therefore less likely to secure large contracts or overseas contracts.

The types of activities include:

1. Micro, small and medium size enterprises (MSMEs) as well as medium and large enterprises that operate in several markets and sub-markets.

⁶ The World Bank. 2014. Doing Business 2015. Accessed November 27, 2015. <http://www.worldbank.org/>

⁷ The World Bank. 2014. Doing Business 2015. Accessed November 27, 2015. <http://www.worldbank.org/>

⁸ Stewart, Taimoon. 2010. "The Jamaican Informal Business Landscape." In *Roundtable on Competition Policy and the Informal Economy*, by Organisation for Economic Co-operation and Development. Accessed November 27, 2015. <http://www.oecd.org/>

2. Street vendors or itinerant traders selling from vehicles, hand pushed carts or stalls.
3. Domestic helpers and cleaners.
4. Production and selling of food products, eg. ground provisions, vegetables and poultry, etc.
5. Agro-processing, eg. jams, jellies, sweets, etc.
6. Provision of technical agricultural services, such as farm preparation, artificial insemination of animals.
7. Crafts primarily for tourists e.g. figurines
8. Provision of technical construction services such as land preparation, masonry, carpentry, electrical, roofing.
9. Production and distribution of music.
10. Tailoring, dressmaking, barbering, hairdressers, cosmetologists.
11. Unregistered taxis in the transport sector, who compete with registered taxis and bus operators. It is standard practice for a car owner who needs additional income to operate illegally in this sector, or hire drivers to do so. As such, there are many operators, intense

Interface between Formal & Informal Sectors

There is trade between the formal and informal sectors wherein for the most part larger firms who are in the formal sector supply informal businesses with goods. In several markets the formal firms are facing more and more competition from informal ones. For example, street vendors purchase final goods or intermediate products from the formal sector (wholesale stores, supermarkets), and re-sell these goods on the streets. Supermarkets often times provide vendors with expired or soon to be expired goods to sell on the streets. Similarly, manufacturers and distributors supply goods to MSMEs and corner shops in inner cities. 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.

Large formal businesses purchase goods from the informal sector for resale Eg. Furniture is purchased from small informal operators who make the furniture. These large formal firms 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.

Also, food products are purchased from informal producers in the agricultural sector and are packaged for the local market and for export. Notably, the food packaging firms must conform with established local and international standards for packaged products and therefore demand that the informal producers produce in accordance with these standards.

There also exist established firms in the groceries and apparel sectors which are medium-sized and which operate without regard to established standards, regulations or tax laws, who undersell similar establishments in other geographical regions where consumers are of a higher income group. These firms come together and purchase 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.⁹

With regard the labour market, there are persons who are employed in the formal sector who also work in the informal sector in order to supplement their income: tradesmen such as electricians and plumbers; or employed persons operate as private taxi drivers or traders of goods in their non-office hours; or higher skilled workers such as computer technicians may lure customers away from their employers by doing jobs privately at a lower cost. In doing so, they are competing directly with their employers, taking jobs that would have gone to the company.¹⁰

Integration into the Usual Control of Authorities

Experiences in recent times has indicated that economic growth is essential for the generation of more and better jobs. There is also a general view that informality comes at a cost to competition and economic development; and that Government policy efforts to simplify entry into markets can and do make a difference. Further, Governments should and do recognize the contribution to economic stability of informal sectors; the need to facilitate the informal economy; the social

⁹ Stewart, Taimoon. 2010. "The Jamaican Informal Business Landscape." In *Roundtable on Competition Policy and the Informal Economy*, by Organisation for Economic Co-operation and Development. Accessed November 27, 2015. <http://www.oecd.org/>

¹⁰ International Labour Organization. 2014. "Informal Employment in Jamaica." Accessed November 27, 2015. <http://www.ilo.org/>

benefits that comes; capturing and harnessing the gains/benefits which arise from it; and improving the relationship and interaction between formal and informal sectors.

To reduce informality, it is necessary to implement deliberate and integrated economic, social and labour policies and reforms that complement economic growth within the framework of sustainable development.

Education, Information Dissemination and Hand-holding - Several MSMEs remain informal because they do not know the legal and other requirements for starting and operating their businesses. Further, they do not think it is necessary to abide by these requirements and thrive without conformation to the requisite laws. Hosting workshops and seminars that explain the benefits of formalization and which dispel the notion or perception that remaining informal is better.

Registration - In the 1980s and 1990s registration was used to regulate informal commercial importers or higglers for tax purposes, for managing the demand for foreign exchange by these traders, and instilling some order in their trading activities. Having 'softer' registration requirements and social protection programmes are likely to encourage formalization.

Similar tax incentives/exemptions/subsidies for all size enterprises - The World Bank has argued that: "Some studies of Jamaica's incentives suggest a substantial bias in favour of capital intensive projects, particularly larger projects. Such tax exemptions encourage informality in the business sector and penalize firms with small amounts of capital, a characteristic of the large majority of native firms."

Training - informal employment is likely to be reduced by providing structured training programmes geared at enhancing productivity, and ultimately competitiveness of the economy. This is one of two recommendations by the World Bank for reducing informal employment. It proposed that the government should increase the demand for formal labour by ensuring "a solid business climate that gives stability for potential investors", and increase the supply of formal labour by providing "technical and vocational education that trains workers in job-relevant skills" so as to improve their chances of being employed in the formal sector.

Specialised Services to all size enterprises - The Ministry of Industry Investment & Commerce (MIIC) implements its policies through a range of specialized agencies. These agencies extend their services to both formal and informal enterprises, and in some cases use the leverage of their services to encourage formalization.

Formalizing productive activities – Implementing policies which guide and ensure compliance with labour standards, raising the skills and abilities of the labour force and those which contribute to the creation of a solid and stable business environment.

Simplified Taxation system & Stronger Tax collections – Encourages compliance by improving the administration of tax collections. Jamaica’s taxation structure has for long been considered cumbersome and difficult to navigate through. This serves as a disincentive as it requires additional time, effort and resources from these informal ‘small’ players who are unlikely to have the resources to properly handle their tax obligations. Further the same tax collection mechanisms should be employed to all persons or categories of firms.

Collaboration between Government Agencies – Concerted effort by several Agencies and various levels with the objective of encouraging formalization without prejudicing the objectives of players in the informal sector and which address their needs and goals directly. For example, Companies Office of Jamaica, Bureau of Standards Jamaica, Tax Administration Authority of Jamaica, Jamaica Customs, Ministry of Agriculture. Tax amnesties, bulk purchase of raw materials through cooperatives which are overseen by Government Agencies, direct technical assistance and capacity building projects.

Collaboration with Financial Institutions - Government facilitating cheaper loans and offering incentives to banks, credit unions and short-term lending agencies geared at stimulating the operations of MSMEs.

Employment Protection Legislation – includes flexible labour related arrangements such as flex time and a tiered system for rates of pay.

Regulating Trade & Competition in the Informal Trade

The informal sector is an important part of the economy which has always been active and which will always be present. Their contribution to the economy is significant and Government has to continue to stimulate their activities. Accordingly, it is necessary to recognize it at all times and to keep track of it through conducting surveys and questionnaires regularly, which look specifically at the operations of players in the informal trade; as well as collecting data through different Agencies such as the Jamaica Customs, Companies Office of Jamaica and extracting data from financial records of 'formal' companies.

Conducting Investigations and Market Studies

Under the Fair Competition Act (FCA), all businesses, regardless of size, are under the jurisdiction of the Fair Trading Commission (FTC), which in the course of its investigations, encounter firms that are not registered and/or which do not pay taxes consistently or file tax returns. The FTC often times encounter problems in identifying market players and in defining relevant markets because of grey areas in terms of market segmentation and obtaining relevant data that is required.

The FTC therefore engages in advocacy with other government ministries, departments and agencies on an ongoing basis to encourage conformation with government regulations and reporting requirements.

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 that requires calculation of the cost price of a product, the FTC has, in the case of informal firms, determined cost price by including the cost of paying all relevant government obligations, thereby increasing cost and more than likely resulting in selling price being below cost.

In most respects, firms operating in the groceries and apparel markets in the inner cities or low income areas do not compete in the same market as medium and large firms, because the market is segmented. Those selling within inner-cities target the inhabitants of those areas, catering specifically to their income level and needs.

Persons of a higher income level, that is, the middle and higher income consumers, do not shop in the inner city communities primarily because such locations may not be considered safe; and most vendors are itinerant, selling products that are of questionable quality, and offer no guarantees. This is even more pronounced when food items and pharmaceuticals products are involved because of health issues associated with poor standards and expired products.

For some products such as apparel and shoes sold by 'informal' firms or persons, there exists direct competition with the small 'formal' firms in that line of business. In response, many of these 'formal' firms become 'informal' by not registering and paying taxes or give up their premises and become itinerant traders in order to cut cost and to compete. Small 'formal' firms are therefore the ones that are most affected by the activities in these markets as they are placed at a competitive disadvantage by similar businesses in the informal sector. Accordingly, persons in several of these markets begin operating informally and remain informal, thereby resulting in challenges of the FTC and other government agencies in identifying the players, the true size of these markets and in effect the real contribution to consumer welfare and to the economy.

I thank you for listening and am available for further discussion.