

**Policy support for harnessing informal sector entrepreneurs: a comparative analysis**

Dr Anjula Gurtoo  
Assistant Professor  
Indian Institute of Science  
Bangalore, 560 012 India  
Phone: 91-80-22932471  
Email: [anjula@mgmt.iisc.ernet.in](mailto:anjula@mgmt.iisc.ernet.in)

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### **Abstract**

This article profiles the various regulatory interventions taken by national governments for the informal sector entrepreneurs and explores how culture relates to levels of entrepreneurial activity and its institutional context. This exploration is motivated by the observations of economists and sociologists like Joseph Schumpeter, Max Weber and David McClelland on country differences in levels of entrepreneurial activity. Analysis of research and theory suggests influence of economic and institutional contexts on entrepreneurship and their economic development, moderated by cultural and societal factors. The article argues for a more agent and culture embedded regulatory focus in understanding the informal sector entrepreneurs. A three-dimensional approach that includes the regulatory (laws), cognitive (individual characteristics) and normative (societal characteristics/culture) aspects will expectedly illustrate a more comprehensive understanding of factors influencing and impacting entrepreneurship. This approach involves recognition of country differences including normative aspect of cultures and reduction of any mono-method bias in study of the informal sector entrepreneur.

**Key words** Informal Economy; Entrepreneurs; Growth; National Perspectives; Asia Policy

## INTRODUCTION

Economic policy reforms, characterized by trade liberalization and privatization policy regime, are being adopted as a strategy by several economies to promote economic growth. Recent evidence suggests liberalization has an illusive and troubled relationship with growth and income distribution (Ramamurti, 1999; Burton et al., 1993; McCourt, 2001). The consequent dynamism created by liberalization has increased economic vulnerability for the working population who are part of the informal economy (Kapoor, 2007; Dreze and Sen, 1995; ILO, 2002, 2006). Informal economy consists of economic activities not subject to official scrutiny and regulation (laws regulating taxes, environmental protection, safety in the workplace, and labour contracts). The participants include vendors, hawkers, petty traders, neighborhood retail stores and their assistants, shoe shine and cobblers, pedal rickshaw drivers, housemaids, and other self employed in daily waging activities. Such unregistered activities have increased considerably in the industrialized nations as well as in the less developed ones (Williams and Windebank, 2006). According to recent estimates the average size of the informal economy for the OECD countries was 16.4 per cent of GDP, Latin America Caribbean and Soviet Union were 45 per cent, Asia was 75-80 per cent and Africa was 75 per cent of GDP (ILO, 2002, 2006).

Despite the significance of these numbers, national governments had initially refused to look at them as an 'economic resource' and often reflected ambivalent attitudes. Review of literature and government documents reflects the struggle to balance pragmatic humanitarianism and regulatory control of this economic activity. However, several nations are now making attempts to officially recognize informal employment as a 'resource' and not a 'problem' and study its causes and also look for solutions. Policy makers and scholars alike are considering self employment as an alternative to unemployment and a route for economic growth for the informal economy (see William and Winderbanks, 2006, Browne, 2004; Cross, 2000, De Soto, 1989; Bogan and Darity, 2008).

This paper explores the different sociological and legislative perspectives taken by governments to deal with the informal economy. In particular, the nature of possible structures and systems are analyzed, both regulatory and non institutional. The paper argues for a more culture

embedded regulatory focus in dealing with the informal economy entrepreneurs. The informal economy dynamics are more complex than commonly understood. In particular, studies have not given proper consideration to the role of culture (in the sense of way of life) and the agent in the whole dynamics (Bartram, 2005). The conflict between humanitarianism and regulatory control, however, is mediated by attitudes of the agent entrepreneurs (Gurtoo and Williams, 2009). Most specifically, though institutional contexts are key drivers of entrepreneurship and economic development (Leff, 1979; Furman, Porter, & Stern, 2002; Nelson, 1993), cultural values in a society are likely to shape these institutions (Baum et al., 1993; McGrath et al., 1992a). Several economists (e.g., Schumpeter, 1934), sociologists (e.g., Weber, 1930), and psychologists (e.g., McClelland, 1961) have explored how culture relates to levels of entrepreneurial activity and its institutional contexts. Linking institutional and contextual factors to cultural characteristics form the second part of the literature study. It provides a more comprehensive understanding of informal sector. This has implications for employment and social policy.

## METHODOLOGY

The review steps involved an initial search of ABI INFORM (ABI Proquest) and Emerald Text (Emeraldinsight) was undertaken using basic strings like informal sector, shadow economy, development, policy frameworks and economic theories among others. The results identified additional key words like transaction costs, business venturing, agency, social contract and theoretical perspectives. These words were used for second level search on five databases, namely, ABI Inform: Proquest, EBSCO: Business Source Premier, Elsevier Science, Emerald, and Science Direct. The studies selected for inclusion in the review were: theoretical papers, which gave the frameworks to analyze the results; working papers, which ensured inclusion of current research and understanding; government documents and technical papers, which gave broad, holistic insights into current regulatory structures; and qualitative and quantitative empirical studies, to capture empirical evidence. The inclusion/exclusion decision was taken in three stages: review of title, review of abstract and review of paper/documents. Annexure 1 details the regulatory interventions studied for various country contexts.

## THEORETICAL FRAMEWORKS: DIFFERING APPROACHES

Causes of informal employment, the relevant approaches required for its comprehensive understanding, and the systems and institutions for the informal economy, are widely debated. Literature puts the debate into two broad approaches, namely, institutionalist and opportunity driven. While economics and sociology often takes the institutionalist perspective, the research on business venturing looks at informal sector entrepreneurs from the opportunity perspective. Both perspectives are illustrated below.

### **Economic**

The economic approach argues for either more, or less, regulatory structure for the informal sector entrepreneurs. The economic-libertarian perspective (sometimes also known as the private interest perspective) views the market as the best mechanism for maximizing social and economic growth (Stingler, 1971). The preference for markets (even imperfect one) is accompanied by a strong argument for regulation as serving the interest of the regulated (business). Regulators respond to the pressures of interests groups. Organized interests groups generate pressure and obtain regulations of their interest. Within this perspective state intervention in the market in the form of taxation, numerous and contradictory regulations, and red tape on permits and authorizations, are the causes of market failure and creation of alternate economies (Wilson, 1980).

Debating this view is the normative or market failure perspective. Regulations are advocated in order to improve economic efficiency and protect social values by correcting market imperfections (Hackett, 1997; Ostrom, 1990). Five types of market-failures are listed, namely, natural monopoly like in the electricity industry; externalities generated for example, in use of natural resources like water; distribution of public goods; asymmetric information due to lack of communication channels or imperfect communication channels; and high transaction costs leading to inaccessibility of several goods (Kearney and Merrill, 1998; Bromley, 1989). Anyone of these failures legitimizes regulation. The market failure theorists focus on creating sufficient police and judicial support, control on the distribution of subsidies and incentives to families and firms; and creating governance of welfare and environmental protection (Scitovsky, 1954).

Merging these two economic perspectives is the pragmatic-administrative theory which tends to see both markets and governments as the best of all possible options. Instead of dealing with the normative and philosophical questions involved in the regulation debate, the proponents of this approach concentrate on the study of the empirical, day-to-day problems of regulation as a system of governance (Shapiro, 2005). They focus on pressures on unions and firms to adhere to national labour regulations; create facilitative contracts and work conditions; and ensure compliance on the part of firms with laws.

### **Business Venturing**

The business venturing approach argues for opportunity creation for the informal sector entrepreneurs and analyses the interaction between the individual and the opportunity. Extending from the Austrian theory of opportunity, Shane (1993) explains this as an equilibrium perspective. A constant, but fluctuating flow of opportunities are created by technological, social, political, regulatory and demographic changes (Schumpeter, 1934). Hence, opportunities are created externally through the socio-governance environment (Kirzner, 1997).

Entrepreneurship develops through a concentration of individual agent characteristics, discovery of these opportunities and its exploitation (Shane, 1993, 1995). Hence, entrepreneurship is a combination of entrepreneurial actions, determined by interpretation of opportunities. This perspective complements frameworks capturing issues of population levels, environment carrying capacity and institutional factors (Stinchcombe, 1965; Aldrich, 1999; Singh and Lumsden, 1990).

Extending this understanding is the structuration perspective by Sarason et al., (2006) which argues for coexistence of the individual, the enterprise and the social system. The societal structure is virtual until the agent activates it. This perspective does not treat the agent and the opportunity as a duality. Rather society (structure) is held in the agents mind as rules and resources or norms and social conventions. Hence, the emphasis is not on the institutions and societal structures but on the agent and his knowledge. The perspective provides better interactional understandings but does not emphasize the role of outside structures like technology, regulations and culture.

The critical realist perspective looks into these lacunae and proposes agency and structure as neither dualist nor in a state of equilibrium, rather, existing relative to each other (Archer, 1995). Societal structures exist as ‘emergent’ properties created by past agents. Hence, different strata of society have distinct properties and powers, determining the relationship between the two. Advancing a causal explanation of entrepreneurship, this perspective argues for recognition of social strata at the level of agency, structure and culture (Archer, 1996, 2000).

## INFORMAL SECTOR ENTREPRENEURS: A COMPARATIVE ANALYSIS

Studies on informal sector entrepreneurs look into two broad categories, namely, institutional structure and agent dynamics. Institutional structures are regulatory as well as societal (several public agencies are imparting social security benefits to select group of workers, like group insurance, supply chain support etc.). This paper, however, only looks at the regulatory interventions, as societal structures will partly get captured through study of agent dynamics. The literature on agent dynamics reflects the nature and structure of ‘entrepreneurship’ per se. Several factors influence entrepreneurship and drive the entrepreneur, namely, culture, desire to do something innovative and creative (and therefore not necessarily economic and growth motive) and necessity (lack of alternate employment).

### **Institutional Structures**

Literature on institutional structures, emphasizes transactional costs as key determinants of entrepreneurial dynamics (Williamson and Masten, 1999; Taneja and Pohit, 2000; Johnson, Kaufmann and Shleifer, 1997; Gurtoo and Williams, 2009). However, simple economic stabilization and growth does not lead to reduction in the informal sector (Johnson et al., 1997). Specific institution building is required. These are the rules and regulations affecting the entrepreneur’s economic activity and several national governments focus on designing effective institutions as providing entrepreneurs with a predictable framework of business and necessary business skills to scale up their operations. Poorly designed legislations and regulatory structures discourage obtaining formal property rights, acquiring a business permit or maintain accounting

legally and scaling up operations and investments (Coase, 1973; Niehans, 1989; North, 1992). Table 1 illustrates the country wise nature of regulatory changes and national perspectives followed. Table 2 segregates nations on nature of outlook towards informal sector entrepreneurs / enterprises

INSERT TABLE 1 HERE

INSERT TABLE 2 HERE

### **Transition economies**

The transition countries oscillate between support and control. Though scholars have argued for a re-look at the necessity approach to this economy (De Soto, 2001; Williams and Windebank, 2006), these countries also partly face informal entrepreneurship as an employment necessity. Post velvet revolution, Czech Republic has followed the path of reduction through regulatory control. The market failure perspective governs their initiatives. Regulations are instituted in order to a) improve economic efficiency and b) correct market imperfections. Several laws were amended. Changes include simplification of taxation and lump-sum tax introduction, accurately defined conditions for trade licensing, stricter conditions for businesses of foreigners and introduction of labour inspectorates and regional committees for coordinating prevention of grey economy activities (Horakova and Kux, 2003; Horakova et al., 2001, Fassman, 2002). However, high non observance of legal regulations remains (Horakova and Kux, 2003). Poland takes a pragmatic-administrative approach where options are developed at both, market and government, level. Entrepreneurship growth is promoted through regulatory and economic support in order to reduce wage differential and encourage formalization. Two institutional changes took this approach forward, namely, new labour laws with a generous social net and reduction in the number of industrial activities requiring licenses. While generous unemployment net has lead to poverty trap for several people, the informal labor diminished over time (Grabowski, 1997; 2002). Hungary has also taken a pragmatic-administrative approach, to decrease informal sector, through a phased process. Initial phase comprised reduced, facilitative regulations. The later

phased comprised strict control. In the early phase of transition, entry barriers (costs of registering a business) were low, registered businesses could deduct expenses from their taxable income, and sometimes enjoyed tax benefits as well. Majority of enterprises could follow a minimum taxation strategy, meaning they did not pay profit or income taxes and kept social insurance contribution payments at the lowest possible level (Kallay, 2000). In mid 1990s, when the early transition crisis was over, economic growth started and the number of registered businesses stabilized, the government put strict conditions for operating the business (Kallay, 2000).

### **Developing and poor economies**

Review of developing economy initiatives reflects multiple approaches. Initial non-recognition of this economy has followed a rise in recognition and specific regulatory interventions. However, the uncertainty and ambivalence in the approach is evident, namely control, facilitation or non-recognition. This uncertainty could reflect a link to another dilemma facing developing countries, that is, are the problems of this economy essentially economic /regulatory or socio-cultural (lack of opportunity, lack of access to resources and knowledge, cultural dimensions of growth and charity) which has its roots in the efficiency of governance (Gurtoo, 2008a, b). Developing nations are striving to officially recognize informal employment not as a 'problem' (though not as a 'resource' yet) and look for solutions.

Countries like India, Kenya and Ethiopia have developed a coordinated approach, amalgamating larger social issues like poverty and lack of access and skill. A comprehensive strategy is developed for micro and small enterprise with the objective of creating an enabling environment for their development (Singh and Belwal, 2008; ILO, 2004; [www.smeindia.com](http://www.smeindia.com), Wanjau, 1997; Bosire and Gamba, 2003, Gurtoo, 2008). A business venturing cum pragmatic approach gets reflected here. The Ethiopian government, in 1997, simplified the registration and licensing process, revised the investment law, and created new agencies to cater to these enterprises, on the regulatory front, and developed a network of SMEs (*BDS partners network*) to improve coordination and reduce overlap (Singh and Belwal, 2008; Andualem, 2003; ILO, 1994). India has passed The Micro, Small and Medium Enterprise Development Act, 2006, which provides for development of skills of employees and entrepreneur, providing for technology upgradation,

providing marketing assistance or infrastructure facilities, and cluster development of such enterprises in order to strengthen backward and forward linkages. The Government of Kenya provides direct assistance to individuals and small businesses, including: flexible credit schemes, encouragement of technical graduates to start their own businesses, promotion of co-operatives to access credit, group purchasing and marketing, information and assistance on new technologies, ways to encourage a culture of enterprise, reorientation of training institutions to produce entrepreneurs and risk takers and government subcontracting work to the *jua kali* (Wanjau, 1997; Bosire and Gamba, 2003).

Armenia, Peru, Bolivia, and Ecuador have taken the market failure perspective. These nations strive towards formalization through economic incentives. The tax system is relaxed and simplified for the smaller businesses. Ecuador formally defines a micro enterprise as one which does not employ more than 5 workers. These enterprises are given access to state support policies like generous tax exemptions depending on its annual income, a further discount on income if reinvested and exemption of value added tax in most cases. Micro enterprises registration follows lesser steps, i.e., register in taxpayers' registry and obtain a permit from the municipality (Klein and Tokman, 1993). Armenia, Peru and Bolivia have reformed their tax systems (simplification and exemption), reduced inspection, and reduced transaction costs (Williams and Windebank, 2006; ILO, 2006; Ivanovic et al., 2000; Lagos, 1992).

Jamaica and Cuba take the first steps towards formal recognition of the economy by clarification and segregation of relevant laws. The approach is basic and towards the economic liberty perspective. The Cuban government, in 1993, acknowledged the existence of self employment, listed 17 professions as eligible for self employment including hairdressing, taxi driving, blacksmith, mechanics, and plumbers (EIU, 1993, Tønnesson, 2001). After initial restriction on entry to 'self employment' (not people with a university degree), it was relaxed. By 1995, about 2.08 lakh workers held permits for self employment (Tejada, 1997; Tønnesson, 2001). Since 2000, government has increased the number of occupations for self employment. Jamaica distinguishes between single owner operated firms and companies. A typical micro enterprise is not considered a company and has different tax and labor obligations (Klein and Tokman, 1993).

Bangladesh and Vietnam are still in the early attempts. These countries show ambiguity in the intentions (support versus control, problem versus resource), reflected in the uncoordinated attempts and actions towards the informal sector entrepreneurs. Vietnam adopted economic reforms in 1986. Reforms included significant reallocations in labor and support for farmers (Montes, 2001). However, micro businesses face several contradictions. New tax policies and lack of capital do not allow them to expand further. However, attempts at strengthening the social security system (SSS) are underway (Turley and Selden, 1993). Similarly, in Bangladesh the informal sector enterprise is recognized and formally defined as enterprises employing less than 10 workers (Amin et al., 2003). However few policies exist. For the Bangladesh informal entrepreneurs, the pressing problems are not tax evasion as much as the economic inability to comply with the formal sector rules and regulations (Amin et al., 2003; Ullah, 2005).

### **Developed economies**

Informal sector entrepreneurs as a resource is a recent view shift for most of Europe and United Kingdom (UK). Several policies are initiated to harness their work and help them transfer their work to the formal sector. Demand side measures include direct tax incentives and service vouchers to customers. Supply side measures include voluntary disclosure opportunities, support for transition from unemployment or informal working to formal system and forming coordinating institutions for governmental action. These reflect the business venturing approach which argues for opportunity creation for the informal sector entrepreneurs, through a favorable socio-governance environment (Kirzner, 1997). However comprehensiveness of the policy varies across countries.

Countries like UK, Germany, Belgium, France and Netherlands approach the informal economy through the business venturing lens. They provide several support policies for people to sustain as well as transcend from unemployment / informal working towards formal work. In UK, policies include back to work bonus, work trial scheme and twin track initiative to get the people to move toward formal work (Ashworth and Youngs, 2002; Thomas et al., 1999, Williams, 2004a). In Germany the Ich-AG scheme, helps ease the transition from unemployment to self-employment. In 2003, over 93,000 long-term unemployed people launched a small business with

the assistance of the Ich AG scheme and by 2005, the figure was 356,000 (Renooy et al, 2004). Belgium and France run a voucher system (part reimbursement of cost by the government) in spheres where the informal economy is common (example, domestic cleaning, washing and ironing, running errands and preparing meals). By 1999, more than 100 thousand unemployed had registered in PWA and were working an average of 30 hours a week (Williams and Windebank, 2006).

North America (USA and Canada), Denmark and Italy follow a market control approach. Direct tax measures are targeted by these countries (Williams and Windebank, 2006; Pedersen, 2003). In Denmark, once an enterprise is registered, the government reimburses 40% of their costs. By 1998, about 3500 companies, mostly one person owned, had registered under this scheme (Williams and Windebank, 2006). Similarly, the Italian government facilitates enterprises regularization with respect to issues like tax, labour, safety, social security contributions and land use irregularities. In exchange, the enterprises pay reduced taxes and social contributions for three years, as well as reduced pension contributions for the previous years, to enable adaptation. America and Canada have simplified tax procedures. Voluntary disclosure schemes are designed to encourage formalization. However given the evidence of ineffectiveness of society wide amnesties (Grabiner, 2000), individual levels 'offers in compromise' for tax payment are targeted (Williams and Windebank, 2006).

### **Agent Dynamics**

How does culture relate to levels of entrepreneurial activity and its institutional contexts? This question is motivated by the observations of economists (e.g., Schumpeter, 1934), sociologists (e.g., Weber, 1930), and psychologists (e.g., McClelland, 1961) on country differences in levels of entrepreneurial activity. Characteristics of entrepreneurs and their interaction with the society form the second part of the literature study. The review reveals two broad streams, namely, attitude as an aggregate measure of entrepreneurship, and the values, beliefs and motivations of entrepreneurs across cultures. Table 3 illustrates these influences on entrepreneurship.

TABLE 3 HERE

## **Entrepreneurial attitude**

The ability to recognize an opportunity and the ability to take calculated risk is the center of these studies. General literature from several countries reflects similar findings (Nybakk and Hansen, 2008; Cramer et al., 2002; Schumpeter, 1934; Knight, 1961). Investigation of entrepreneurial orientation and proactive approach reveals a significant positive relationship with performance (Wiklund and Shepard, 2005; Zahra, 1991). Entrepreneurs are more likely to initiate a new activity and have the capacity for opportunity recognition (Schumpeter, 1934; Knight, 1961). In comparison to others, entrepreneurs believe in taking initiative, are more willing to take charge and direct others, are positively oriented toward adaptation and change (McGrath and MacMillan, 1992; Wiklund and Shepard, 2005). Entrepreneurship and innovation are positively connected (Nybakk and Hansen, 2008). Entrepreneurship motivations are often non financial outcomes such as increasing employment and involvement in a certain task (Zahra, 1993). Survival and sustainability of the existing enterprise, rather than profitability and financial improvement are often the motives.

## **Culture**

National culture is associated with different entrepreneurial characteristics (Mitchell et al., 2000; Mueller & Thomas, 2000; Scheinberg & MacMillan, 1988; Shane et al., 1991; Thomas & Mueller, 2000). Asian countries are comfortable with uncertainty and exhibit a preference for mavericks and innovators. In contrast, entrepreneurs in uncertainty-avoiding cultures like North America show preference for organizational rules and procedures and have a rational style (Shane, 1994, 1995). Research exploring association between culture and new firm-formation rate, finds cultures promoting a higher need for autonomy, a need for achievement, and self-efficacy, have higher entrepreneurship rates, because these values reward a strong work ethic and risk taking (Davidsson, 1995; Davidsson & Wiklund, 1997). Japanese firms (moderate power-distance, high uncertainty avoidance<sup>1</sup>) usually prefer wholly owned subsidiaries to joint

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<sup>1</sup> Geert Hofstede defines national culture through the five dimensions illustrated below. Power Distance Index (PDI) is the extent to which the less powerful members of organizations and institutions (like the family) accept and expect that power is distributed unequally. Individualism (IDV), the opposite of collectivism, is the degree to which individuals are integrated into groups. Masculinity (MAS), versus femininity, refers to the distribution of roles between the genders. For example, countries high on MAS are somewhat more assertive and competitive than others. Uncertainty Avoidance Index (UAI) deals with a society's tolerance for uncertainty and ambiguity. Long-

ventures, whereas American firms (low power-distance, low uncertainty avoidance) prefer joint ventures to wholly owned subsidiaries (Makino & Neupert, 2000). Managers in feminine countries, which are also low in individualism and high in uncertainty avoidance, exhibit a preference for cooperative strategies (Steensma et al., 2000; Kogut and Singh, 1988). Hence larger effort towards promotion of cooperative strategies in more masculine, individualistic, and uncertainty-accepting cultures (Germany, United States, Canada) is emphasized. Investigation of entrepreneurial motives and beliefs across cultures shows three distinct clusters of countries, when grouped by the motives of "money as means" and communitarianism (Scheinberg and MacMillan, 1988). Scoring high on the money as means and low on the communitarian motives were respondents from Australia, Great Britain, the United States, and Finland. Scoring low on both dimensions were Sweden, Denmark, and Norway. Scoring high on both dimensions were China, Italy, Puerto Rico, and Portugal. Four factors, i.e., need for independence, recognition, learning, and roles, is identified for nations high on money as means (Scheinberg and MacMillan, 1988; Shane et al., 1991).

## DISCUSSION ON CULTURE AND REGULATIONS: INTERACTIONS AND INFLUENCES

Review of legislative support in various countries highlights the complexity in isolating one determining factor from the other. Countries looking at informal economy entrepreneurs from the economic-libertarian perspective promote market economy and support their growth through the policies for small and medium scale enterprises. Countries with the normative or market failure perspective put strict regulatory control but also encourage welfare and social support schemes. From the pragmatic-administrative perspective, the regulatory framework encourages government facilitation through policy structures like counter guarantees and supply chain and market support, for the entrepreneurs to grow to an optimal level of self survival. Focusing on the two core debates of the informal economy, namely, the question of nature and extent of regulation needed and formalization-non formalization of this economy, the analysis gives insights into how agent and culture interact with institutions.

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Term Orientation (LTO) can be said to deal with virtue. Values associated with Long Term Orientation are thrift and perseverance; values associated with Short Term Orientation are respect for tradition, fulfilling social obligations.

**Nature and extent of regulations** Advocacy for strong governmental role in regulating any imbalance of power, or more specifically, the unequal relationship between big business and informal enterprises, is found in high autonomy, high individualism cultures like North America and Czech Republic. While the informal system is supported by the state, their interaction is based on market dynamics. Government role is emphasized through preference for rules and procedures (North American and Denmark). The entrepreneur is expected to take risk (reflects low uncertainty avoidance) and build collaborations for social, technical and moral support (Ecuador and Czech Republic), develop from their own employability and capabilities, expected to innovate (represents willingness to deviate from group norms i.e., individualism); and have market or external focus (reflects the value of masculinity).

The view of informal sector existence as a response to unreasonable government rules and regulations gives flexibility to the entrepreneurial system (De Soto 1989, 2001; Williams and Windebank, 2006). In such a scenario, government enters the system only as a facilitator for capability building, through its infrastructure and institutions. As a high uncertainty and risk-bearing culture (comfortable with long termism) reduction in economic vulnerability is envisaged (UK, Hungary, Poland) or development of community based welfare and economic support for the system (Kenya, India and Ethiopia). The premise is to create a strong foundation for the entrepreneur to deal effectively with the market forces. The agent is expected to respond through scoring high on money as means as well as communitarian motives. Hence, post capacity and capability building by government institutions, the enterprise is expected to contribute to national growth by entering the market dynamics, growing economically and generating employment.

**Formalization of the economy** Analyzing the issue of formalization shows the following trends. Four basic progressions control the informal sector, namely, contextual, individual behavioral, intermediaries and developmental. These progressions have a common aim to build an enterprise culture, build capability of small businesses to grow, improve access to resources and utilize the government experience and services offered to build internal capability and capacity. However,

the structures designed for this vary according to national cultural perspectives. Culture, in various forms, moderates the relationship between contextual factors and entrepreneurial outcomes, acting as a catalyst (than a causal agent) of entrepreneurial outcomes. For example, analysis shows differences in culture influencing society's legal system. Masculine societies like North America value rules and regulations and the legal system for the entrepreneurs promotes this. Similarly low uncertainty avoidance cultures like India promote support systems rather than strict rules to foster entrepreneurship (Gurtoo, 2008a, b). This suggests initiatives bound in the individual perspectives on regulations and emphasizing different motivational needs.

The contextual processes are the environment forces affecting the informal sector entrepreneur. For example, market based system is characterized by negotiated agreements and governed by optimal equilibrium between all the players in the system. In such circumstances social and welfare support takes the lowest common order (Czech Republic, Cuba). In a regulated system, the context pushes for building networks and support bases and influences their access to resources and markets (Indian, Kenya) (Varcin, 2000; Man and Lau, 2005; Todd and Javalgi, 2007).

The individual behavioral processes are the degree of risk taking or entrepreneurial behavior of the informal sector entrepreneurs (Nelson and Bruijn, 2005). Here, literature from several countries reflects similar findings. Entrepreneurial orientation has a positive relationship with performance, capacity for opportunity recognition, taking initiative, adaptation and change, and innovation (McGrath and MacMillan, 1992; Wiklund and Shepard, 2005; Nybakk and Hansen, 2008; Zahra, 1993; Cramer et al., 2002).

The intermediary and support structures are the various informal support systems for the entrepreneurs. These support structures could be formal trade unions or associations, world and national level small scale associations and networks and other support agencies in the society like NGOs and concerned citizens (Richie and Lam, 2006; Kapoor 2007; Gurtoo, 2008).

The development structures outline the possible ways to operate effectively within the market. These are the government aids and supports like incentives and welfare funds for contingencies

(Man and Lau, 2005; Kapoor, 2007; Nand, 2006). Countries with a support orientation focus on this, for example, India, Kenya, UK, and Belgium

## CONCLUSION

Research on informal entrepreneurship suggests influence of institutions and culture on entrepreneurial activity (Bruton and Ahlstrom (2002; George and Prabhu, 2000, 2002). The economic and institutional contexts drive entrepreneurship and their economic development (Leff, 1979; Furman, Porter, & Stern, 2002; Nelson, 1993). However, social and cultural factors moderate this. Hence, a three-dimensional approach towards understanding country entrepreneurial approaches that includes the regulatory (laws), cognitive (individual characteristics) and normative (societal characteristics/culture) aspects will expectedly illustrate a more comprehensive understanding of factors influencing entrepreneurship (McGrath et al., 1992b). An advantage of this approach is the explicit recognition of country differences involving more than the normative aspect of cultures or vice versa, and reduction of any mono-method bias in an approach.

This has lessons for Asia and similar country contexts. Learning from the institutional, attitudinal and cultural analysis highlights the need for a framework that can balance market dynamics, with development and governance, moderated by the cultural leanings. Following lessons are derived, as suited to Asian cultural settings: a) the market operates at three levels, individual initiative and risk taking behavior; market demand and supply balance; and capability of the operations put in place by the government; b) these market factors should combine with the Asian culture of high uncertainty acceptance, high to moderate power-distance, and masculine attitude towards gender roles; c) the perspective which promotes this approach takes the business venturing perspective where regulations are set for harnessing rather than control; d) however, the country contexts are marred by extreme socio-economic vulnerability like poverty, low skill development, low access to markets and fragmented social support; e) this requires a balance of control as well as social growth (insurance, social security etc.) that is achievable through government incentives (example, UK and Belgium).

Asian entrepreneurial development cannot be harnessed through a masculine country approach (regulatory control and tax incentives like Czech Republic, Germany and North America), through it is a more controllable and easier option to take for the governments. This approach also goes against Asian nature of long termism and comfort with uncertainty. Asian culture has more conducive lending towards either a pure business venture approach like UK and Belgium or business venturing cum pragmatic-administrative perspective like Poland and Hungary. In the first approach, regulation is used as a basket of choices and market dynamics are touched upon at a peripheral level to ensure smooth flow of these choices. In the second approach, while informal economy is a social 'problem' to be dealt with, the dealing is through natural progression.

In such conditions, a framework is needed where government interacts with the micro enterprise owners to provide them with basic foundational support through its existing agencies. Skills and strategy development, financial support through easy credit, and cooperative scheme for welfare are provided. This enables the entrepreneurs to expand their operations and deal effectively with the market. Market controls the interactional dynamics and societal intermediaries like NGOs and small scale associations monitor the interactions. The entrepreneurs enter the market armed with capability and capacity built with support from government agencies. They interact with the market where they benefit from the opportunities and also modify their behavior and strategy as and when required. These interactions are entirely a sum of market demand and supply, and entrepreneurs' risk taking and learning ability. During this stage, the framework also proposes support from national and international associations and unions like International Labour Organization (ILO) and World Association for Small and Medium Enterprises (WASME) for social amalgamation, larger representation and monitoring of any unjust exploitation. With adequate training, confidence, and risk taking ability the entrepreneur can move towards sustainable economic growth.

## AGENDA FOR FUTURE RESEARCH

This paper sets out to advance an integrative approach to developing initiatives for informal sector entrepreneurs. The paper contributes by developing a more comprehensive and systematic understanding of the determinants of entrepreneurship and putting the various pieces into the

perspective for a more agent and culture focus to dealing with the informal sector entrepreneurs, than economy and regulatory.

The next step in examining cultural impacts on informal businesses will require empirical research to explore and build on the proposed argument. In terms of research design and data collection, comparison of national regulatory practices and cultures from various regions of the globe could occur in a number of ways. One, case study research could prove useful, involving study of a phenomenon within its own context using multiple sources of evidence to build an in-depth understanding of the research field. Carefully constructed case studies would provide theory development and can use both qualitative and quantitative methodologies to gather and interpret data. Two, building from the initial case study approach, researchers might consider survey research to discover valid and reliable measures of relative frequency of the variables of interest. If country differences are found significant with other factors held constant, then a more complex study of cultural values and regulations as systems of control merits an exploration. Three, a single informal occupation category could also be directly compared across geographical location, and differences in policies and practices identified.

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**Table 1. Country wise: nature of regulatory changes and national perspectives followed**

<b>Country</b>	<b>Nature of regulatory changes</b>	<b>Approach</b>
Czech Republic	<ol style="list-style-type: none"> <li>1. Law amendment: adaptation of minimum wage, defined conditions for trade licensing; control on impeccability of entrepreneurs; limited contractors for labour; stricter conditions for businesses of foreigners, introduction of labour inspectorates</li> <li>2. Strict regulation enforcement against small economic entities</li> </ol>	Reduction through strict regulatory control
Poland	<ol style="list-style-type: none"> <li>1. Two dimensions of institutional change: New labour laws and social net.</li> <li>2. Law on Economic Activity (1989) reducing number of industrial activities requiring licenses and reduced governmental intervention in business field.</li> </ol>	Attracting more activity to the formal sector (reducing wage difference)
Hungary	<ol style="list-style-type: none"> <li>1. Early phase of transition: low entry barriers, incentives to register business, tax benefits, low social insurance contribution.</li> <li>2. Post transition, when early stage crisis was over, regulatory control through income declaration and reduced the role of income redistribution systems.</li> </ol>	Reduction by attracting more activity to the formal sector
Cuba	<ol style="list-style-type: none"> <li>1. In 1993, 17 occupations listed as eligible for self employment. Increased since 2000.</li> <li>2. Initial restriction on eligibility for self employment. Later removed.</li> <li>3. Farmers and craftsmen again allowed to operate in the market.</li> </ol>	Acknowledgment of the existence of self employment
Kenya	<ol style="list-style-type: none"> <li>1. National economic policy (1986): flexible credit schemes; promotion of co-operatives for access to credit, purchasing and marketing; information and assistance on new technologies; training; subcontracting of work from government</li> <li>2. 1992: establishment of support institutions.</li> </ol>	Direct assistance to small businesses (for growth)
India	<ol style="list-style-type: none"> <li>1. Recognize support services like TV repair and auto repair as formal economic activity.</li> <li>2. Enactment of law (2006) for development of skills, provide for technology upgradation, marketing assistance and infrastructure facilities; easy credit.</li> <li>3. Skill based social security schemes.</li> </ol>	Direct assistance to small businesses (to enhance their competitiveness).
Vietnam	<ol style="list-style-type: none"> <li>1. The economic renovation (1986): reallocation in labor, support for small enterprises, informal banking and irregular trading. State ownership of farmland, but farmers can cultivate as they see fit.</li> <li>2. However, several contradictory laws.</li> <li>3. Effort at strengthening social security system.</li> </ol>	No clear labor relations but supportive attitude
Ecuador	<ol style="list-style-type: none"> <li>1. Formally defines a micro enterprise</li> <li>2. Gives tax exemptions.</li> </ol>	Formalization (through incentives)

Country	Nature of regulatory changes	Approach
Bangladesh	<ol style="list-style-type: none"> <li>1. Several labor laws set recently: wages, employment, trade union, industrial disputes, working environment, and labor administration.</li> <li>2. No formal recognition or encouragement.</li> </ol>	Informal entrepreneurs as 'problem'.
Ethiopia	<ol style="list-style-type: none"> <li>1. Support strategy: training; develop ability to study the market, address product quality issues, network formation of SMEs</li> <li>2. Regulatory: simplified registration and licensing process, revised investment law, and creation of new support agencies (national and regional).</li> </ol>	Direct assistance to individuals and small business (government coordinated empowerment)
Jamaica	<ol style="list-style-type: none"> <li>1. A typical micro enterprise is not considered a company and has limited tax and labor obligations.</li> <li>2. Regulatory incentives to formalize.</li> </ol>	Reduction by attracting more activity to the formal sector
Denmark	<ol style="list-style-type: none"> <li>1. Direct tax measures: government reimburses 40% of their costs</li> </ol>	Formalization (through incentives)
Italy.	<ol style="list-style-type: none"> <li>1. Regularization Campaign (Law 383/2001): allow hidden enterprises to regularize</li> <li>2. Return incentives: reduced taxes and social contributions</li> </ol>	Formalization (through incentives)
Belgium	<ol style="list-style-type: none"> <li>1. Voucher scheme in spheres where the informal economy is common (example, domestic cleaning, washing and ironing, running errands and preparing meals).</li> </ol>	Direct assistance to individuals: incentives for growth (and formalization)
France	<ol style="list-style-type: none"> <li>1. Voucher scheme in spheres where the informal economy is common (example, domestic cleaning, washing and ironing, running errands and preparing meals).</li> </ol>	Direct assistance to individuals: incentives for growth (and formalization)
USA	<ol style="list-style-type: none"> <li>1. Simplified procedures and developed voluntary disclosure schemes.</li> <li>2. Targeted individual: offer in compromise program (OIC).</li> </ol>	Formalization (through incentives)
Canada	<ol style="list-style-type: none"> <li>1. Simplified procedures and voluntary disclosure schemes.</li> <li>2. Targeted individual: offer in compromise program (OIC).</li> <li>3. Home worker paid premium on the minimum wage</li> </ol>	Formalization (through incentives)
UK	<ol style="list-style-type: none"> <li>1. Several support policies for people to transcend from unemployment / informal working towards formal work: back to work bonus, work trial scheme, twin track initiative and employment on trial.</li> </ol>	Encourage people to work and take up formal opportunities.
Germany	<ol style="list-style-type: none"> <li>1. Government support schemes to help the unemployed start a business venture.</li> </ol>	Encourage people to work and take formal activity (self-employment).

**Table 2. Segregation on nature of outlook towards informal sector entrepreneurs / enterprises**

<b>Country context</b>	<b>Perspective towards informal sector entrepreneurs / enterprises</b>	<b>Nations</b>
Transition	Market failure perspective As 'problem' to be tackled	Czech Republic
Transition	Business venturing cum pragmatic-administrative perspective As 'problem' to be dealt with Reduction, through natural progression	Poland, Hungary
Developing / Poor	Ambivalence in approach Recognition, but no support	Cuba, Bangladesh, Vietnam
Developing	Market failure perspective cum business venturing Control through regulatory support	Jamaica, Equator
Developed	Market failure perspective Control through government incentives	Denmark, Italy, USA, Canada
Developing / Poor	Business venturing cum economic liberty approach Harness through institutional support	Kenya, India, Ethiopia
Developed	Business venturing and economic liberty approach Harness through government incentives	Belgium, France, UK, Germany

**Table 3. Cultural influences on entrepreneurship: context wise segregation of countries\***

<b>Cultural context</b>	<b>Countries</b>	<b>Agent characteristics</b>
High uncertainty acceptance and high power-distance	South Asia	Encourages mavericks and innovators Has high rate of start-ups
Uncertainty-avoidance, high individualism, high need for autonomy	North America, Czech republic, Germany,	Preference for rules and procedures Rational innovation style High risk taking Prefer joint ventures
Moderate power-distance, high uncertainty avoidance.	Japan and East Asia	Prefer wholly owned subsidiaries
Low masculine (also high in uncertainty avoidance)	Ecuador, France, UK, Hungary, Poland	Preference for cooperative strategies.
High individualism (also low in masculine)	Australia, UK, and Finland, Jamaica.	High on money as means and low on communitarian motives
High individualism and high uncertainty avoidance, high long termism	Sweden, Denmark, and Norway.	Low on money as means and low on communitarian motives
High power distance	China, Italy, and Portugal, African countries.	Scoring high on both money as means and communitarian motives

\* With support from Hofstede, G. J. (2005). *Cultures and Organizations: Software of the Mind*. Cambridge: McGraw-Hill.

## Annexure 1. Summary of literature review: Country wise regulatory interventions

### Transition Economies: Czech Republic, Poland, Hungary

Czech Republic<sup>2</sup>: Tight control on entrepreneurship before the velvet revolution (Horakova et al., 2001). Post velvet revolution, several laws were amended - the act on employment, the labour code, the trade act, the tax administration act, the commercial code, the penal code, the act on residence of aliens in the territory of the CR, and the act on asylum. Changes include taxation policy simplification and lump-sum tax introduction, adaptation of minimum wage and labour code; and control policies like more accurately defined conditions for trade licensing; nation wide interconnection of criminal registers enabling control on impeccability of entrepreneurs, limitation of enterprise based on work force contracting, stricter conditions for businesses of foreigners; introduction of labour inspectorates and regional committees for prevention of grey economy activities. However, ineffective policy balancing, where legal regulations were enforced against small economic entities, while big companies remained unsanctioned and received subsidies, has led to limited success of these pressures, i.e. observance of legal regulations (Horakova and Kux, 2003). Other reasons cited for existence of informal economy: 1) low entrepreneur culture, and ignorance of the legality/illegality of certain activities, 2) increasing competitiveness by using undeclared work of both Czech citizens and foreigners, 3) a relatively high tax burden of both natural and legal persons, 4) collusion of enterprises and banks, granting of high-risk credits and practicing of fictive circulation of goods and services, 5) movement of laid off employees into informal economy, 6) instability of economic entities and increased uncertainty of employment, strengthens efforts to increase income through informal economic activities (Horakova et al., 2001, Fassman, 2002)

Poland: Pre economic reforms, tacitly approved by the state, Polish informal economy existed to “fill in the gaps” created by the formal system (Wyżnikiewicz, 1987). Poland initiated two dimensions of institutional change during economic reforms. First through new labour laws, social net was provided for the first time. However, it was set too generously and these relatively high unemployment benefits did not provide motivation for searching any jobs, leading to poverty trap for several people (Grabowski, 1997, 2002). Second, the Law on Economic Activity, passed in 1989, reduced the number of industrial activities requiring licenses from 28 to 6 and reduced governmental intervention in the business field. Informal labor diminished over time (Grabowski, 2002). However some of the reasons why it continues are lack of legal jobs, insufficient level of legal incomes, high taxes on income from labor.

Hungary: Hungary had a well developed system of private enterprise before economic reforms. In 1982, (Kallay, 2000), the early phase of transition, entry barriers (costs of registering a business) were low, registered businesses could deduct expenses from their taxable income, and sometimes enjoyed tax benefits as well. Majority of enterprises could follow a minimum taxation strategy, meaning they did not pay profit or income taxes and kept social insurance contribution payments at the lowest possible level (Kallay, 2000). Later on, when the early transition crisis was over, economic growth started and the number of registered businesses stabilized, the government started to send signals to the small businesses indicating the expected level of (declared) income in different trades and professions. Most of the entrepreneurs stated income just above the expected level. The result is a gradual increase of the proportion of formally declared income. Share of the informal sector has decreased in this period, with other signs like number and quality of tax returns, and less cases of non-payment problems also supporting this statement (Kallay, 2000). From the mid 1990s, to make formal work more attractive than informal work, government reduced the role of income redistribution systems. This resulted in a more stable legal and regulatory environment and an improved capacity of small enterprises to comply with the rules. The Hungarian government has declared intentions to push back the informal sector and attract more and more activity to the formal one.

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<sup>2</sup> OECD (2002). Measuring the Non-Observed Economy – A Handbook, OECD Databases from the Ministry of Labour and Social Affairs, Prague, 2002; Government Resolution No 1044/2000 Coll., CSO Prague, 2002.

## **Developing and Poor Economies: Cuba, Vietnam, Bangladesh, Ethiopia, India, Kenya, Armenia/Peru/Bolivia, Ecuador, Jamaica**

Cuba: In 1993, the Cuban government, acknowledging the existence of self employment, listed 17 professions as eligible for self employment including hairdressing, taxi driving, blacksmith, mechanics, and plumbers (EIU, 1993, Tønnesson, 2001). These were previously performed by the informal sector (Tejada, 1997). Initially 'self employment' was restricted to people without a university degree. Especially teachers and researchers could not be self employment. However they are no longer excluded. Farmers and craftsmen were again allowed to operate in the market. These reforms saw a surge in the number of self employed (Font, 1997). By 1995, about 2.08 lakh workers held permits for self employment making every 20<sup>th</sup> member of the labour force a self employed worker (Tejada, 1997; Tønnesson, 2001). Since 2000, government has increased the number of occupations for self employment and also increased the fee for registration of such activities. This has since leveled the number to about 2 lakhs.

Vietnam<sup>3</sup>: *Doi moi*, the Vietnamese economic renovation model, was adopted in 1986, causing a surge in growth between 1991 and 1997. This included significant reallocations in labor.. *Doi Moi* has resulted in a radical change in the economy. While the state still owns farmland, farmers can cultivate it as they see fit. Additionally, support from small enterprises, informal banking, and irregular trading laid the foundations for the successful liberalization of these national economic policies (Montes, 2001). However, micro businesses face several contradictions. They have been able to move freely, in spite of the State controlled political system, but new tax policies and a serious lack of capital do not allow them to expand further. For example confusion concerning the use of street sides, pavements, and marketplaces as new official regulations forbidding the street mini-restaurants, and limits the access to the center of the cities from tricycle vehicles. However, the social security system (SSS) is slowly getting strengthened. In 1995, reforms were initiated to take account of the transformation to a market economy. The SSS saw an increase in total contributors from 2.9 million in 1995 to 4.5 million in 2002. While the coverage of the system is extending, it still largely excludes those working in informal sectors from social security protection (Balkin, 1989). The challenges to Viet Nam is the large numbers of employees without clear labor relations, i.e. not having labor contracts and insurance policies

Bangladesh: The informal sector enterprise is defined as enterprises employing less than 10 workers.<sup>12</sup> (Amin et al., 2003). 47 labor laws are now in operation. These relate to (a) wages and employment, (b) trade union and industrial disputes, (c) working environment, and (d) labor administration and related matters. Entrepreneurs evade paying taxes to avoid dealing with a cumbersome bureaucracy or because they find tax rates too high. Many street traders operate without licenses. They do so not to evade taxes, since their incomes are unlikely to be big enough to attract the tax collector, but because the authorities do not formally encourage such trading and create bureaucratic problems. In the Bangladesh informal sector, the pressing problems may not be tax evasion but the inability of members of this sector to comply with the rules and regulations (Amin et al., 2003; Ullah, 2005). The policy issue is about enabling the poor to improve their earning capacity through training, access to credit, or needed amendments to existing rules and regulations (Quasem et al., 1998).

Ethiopia: The government of Ethiopia in 1997 developed a comprehensive strategy for micro and small enterprise development with the objective of creating an enabling environment for small and micro enterprises (Singh and Belwal, 2008; ILO, 2004). This was also done to promote exports (in leather, textiles, and horticulture). On the regulatory front it simplified the registration and licensing process, revised the investment law, and created new agencies to cater to these enterprises. It created the new Federal Micro and Small Enterprise Development Agency (FeMSEDA) in 1998. In 2000, the regional governments also provided for establishment of its regional counterparts. Ethiopia follows the empowerment model, with effective coordination as an important principle. FeMSEDA provides training; develops ability to study the market and address product quality issues; and it has developed a network of SMEs (*BDS partners network*) to improve coordination and reduce overlap (Singh and Belwal, 2008; Andualem, 2003; ILO, 1994). It also coordinates with ILO to implement a Women's entrepreneur development program (ILO, 2004).

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<sup>3</sup> World Bank (1997). Country Brief: Vietnam. [www.worldbank.org](http://www.worldbank.org).

William S. Turley, Mark Selden (1993). *Reinventing Vietnamese Socialism: Doi Moi in Comparative Perspective*. Boulder: Westview Press, 368 pgs.

India<sup>4</sup>: India has passed The Micro, Small and Medium Enterprise Development Act, 2006 which facilitates the promotion and development of very small enterprises and enhancing of their competitiveness. This act provides for development of skills of employees and entrepreneur, providing for technology upgradation, providing marketing assistance or infrastructure facilities, and cluster development of such enterprises in order to strengthen backward and forward linkages. At the finance side, of the credit reserved for firms under this scheme, 60% is reserved for micro and small units. The government has also floated the Small Scale Service and Business Establishment Scheme (SSSBES) where it recognizes support services like TV repair, photograph labs, auto repair and telecommunication kiosks as formal economic activity. It has formulated a development strategy for these and similar economic activities.

Several government models exist for providing social security to specific skill sets, namely, centrally funded social assistance programs like NREGS and Jawahar Rojgar Yojana for rural unemployed; social insurance scheme, run through government bodies like Life Insurance Corporation and General Insurance Corporation, targeting employees of shops and commercial establishments; agriculture landless labour, and construction workers; and social assistance through welfare funds, for the workers in occupations for whom no direct employers-employee relationship exists like agricultural workers, cashew workers, coir workers, fisherman, toddy-tappers etc.

Kenya: The informal economy in Kenya is known as *jua kali* (hot sun). The Government of Kenya began to incorporate the informal economy into national economic policy since 1986. It provided direct assistance to individuals and small businesses, including: flexible credit schemes, encouragement of technical graduates to start their own businesses, promotion of co-operatives to access credit, group purchasing and marketing, information and assistance on new technologies, ways to encourage a culture of enterprise, reorientation of training institutions to produce entrepreneurs and risk takers and government subcontracting work to the *jua kali* (Wanjau, 1997; Bosire and Gamba, 2003). In 1992, the policy was modified to include establishment of a large number of institutions. Since then the sector has benefited from measures specific to it, including introduction of entrepreneurship education and Small Business Centres. However, no government body coordinates the efforts. *Jua kali* policy needs to integrate as part of overall technology and industry policy (Bosire and Gamba, 2003).

Armenia, Peru, Bolivia: Armenia has taken the initiative to introduce a new inspection law and simplified its tax procedures (Williams and Windebank, 2006). The inspection law regulates the inspection agencies formed for inspecting commercial and non commercial businesses. The law reduces the number of agencies allowed to perform inspection, regulates the limiting, reason and number of inspections per year and gives space to invite own experts during inspection. The tax laws exempt the smaller business from several tax procedures. The Administrative Simplification Law 1989 in Peru, reduced procedural steps and red tapism streamlined administration and reduced transaction costs (ILO, 2006; Ivanovic et al., 2000). In Bolivia when the tax system was reformed, the rate of registration for micro enterprises reached 90 percent (Lagos, 1992).

Ecuador<sup>5</sup> distinguishes between a craft and a micro enterprise. It defines micro enterprise as one which does not employ more than 5 workers. These enterprises are given access to state support policies (through CONAUPE – *Corporacion Nacional Apoya a las Unidades Populares Economicas* and UNEPROM – *Unidad Ejecutora del Programa de Microempresas*). The crafts have priority access to state credit, tax exemptions and allows for differential labour conditions. However in terms of registry, micro enterprises have to follow lesser steps (register in taxpayers' registry and obtain a permit from the municipality). It also gets generous tax exemptions depending on its annual income, a further discount on income if reinvested and exemption of value added tax in most cases. However, in matters of safety, health and labour welfare all establishment come under the legal purview irrespective of their size, like, minimum wage, working hours and contribution to social security.

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<sup>4</sup> From [www.smeindia.com](http://www.smeindia.com)

<sup>5</sup> Emilio Klein and Victor E. Tokman (1993). Informal sector and regulations in Ecuador and Jamaica. Working Paper No. 86 (OCDE/GD(93)130) Research programme on Governance and Entrepreneurship. OECD Development Centre.

Jamaica<sup>6</sup>: Jamaica distinguishes between single owner operated firms and companies. A typical micro enterprise is not considered a company and has different tax and labor obligations. For the micro enterprise, it has to register through the revenue board and requires all people associated with it to be registered too. A national insurance and an income tax number has to be obtained and each enterprise is assigned a business enterprise number (BENO). These are considered the first step towards formalization. In matters of safety, health and labour welfare, Jamaica is similar to Ecuador. All establishments, irrespective of size, come under the law for minimum wage, working hours, contribution to social security and protection against arbitrary dismissal.

### **Developed Economies: Denmark, Italy, Belgium, France, North America, United Kingdom, Germany**

Denmark: Direct tax measures are targeted by Denmark (Williams and Windebank, 2006; Pedersen, 2003). The Home Services Scheme of Denmark, in 1994, promoted the development of individual owner enterprise providing household services and offered job opportunities for low skill job seekers. Once a person registers its enterprise the government reimburses 40% of their costs. By 1998, about 3500 companies, mostly one person owned, had registered under this home services scheme (Williams and Windebank, 2006).

Italy: From 2001 to 2003, the Italian government implemented a law known as the Regularisation Campaign (Law 383/2001), which allowed hidden workers and enterprises to regularise their situation with respect to issues such as tax, labour, safety, social security contributions and land use irregularities. In exchange, they paid reduced taxes and social contributions for three years, as well as reduced pension contributions for the previous years, to enable them to adapt. Hidden workers were given two options: to declare their irregularities and immediately pay all (reduced) taxes and contributions owing, or to engage in gradual 'regularisation'. In total, this campaign produced some 1,794 declarations and 3,854 new regularised workers (Meldolesi, 2001). Furthermore, in 1990 and for a limited period, wage realignment contracts were adopted in Italy where trade unions and business associations were allowed to determine a minimum wage at local level (Baculo, 2006).

Belgium and France: Voucher scheme through local employment agencies is popular in Belgium and France. The government provides the customers with vouchers to use formal sector labor, especially in spheres where the informal economy is common (example, domestic cleaning, washing and ironing, running errands and preparing meals). Service vouchers are a means of paying for everyday personal services. Each voucher pays for an hour of work from certified companies that hire unemployed people. At first, the unemployed person can be hired by the company on a part-time, temporary basis. After six months, the company has to offer the worker a permanent employment contract for at least half-time employment if the person was registered as unemployed. The household pays using the vouchers, the difference is paid to the company by the government. The household can recover 30% of the price of the voucher in their tax returns. By 1999, more than 100 thousand unemployed had registered in PWA and were working an average of 30 hours a week (Williams and Windebank, 2006).

USA<sup>7</sup> and Canada: North America has worked towards simplifying procedures and developed voluntary disclosure schemes to encourage small businesses to formalize. However given the evidence that society wide amnesties have not been effective (Grabiner, 2000), these countries have targeted individual levels 'offers in compromise' about tax to be paid (Williams and Windebank, 2006). If the tax payer is unable to pay a tax in full, and an installment option is not agreeable, they can use the offer in compromise program (OIC). Voluntary disclosure quadrupled in Canada when Revenue Canada introduced this scheme (Bajada, 2002). Moreover, a law in Canada, mandates payment of a 10 percent premium on the minimum wage to home workers as compensate for the costs of production they have to bear by working at home.

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<sup>6</sup> Emilio Klein and Victor E. Tokman (1993). Informal sector and regulations in Ecuador and Jamaica. Working Paper No. 86 (OCDE/GD(93)130) Research programme on Governance and Entrepreneurship. OECD Development Centre.

<sup>7</sup> United States Bureau of the Census, Census of Business: 1935 Retail Distribution Vol. 6, (Washington, DC: Bureau of the Census, 1937).

UK: UK provides several support policies for people to transcend from unemployment / informal working towards formal work. The government has created the back to work bonus, work trial scheme and twin track initiative to get the people to move toward formal work (Ashworth and Youngs, 2002; Thomas et al., 1999, Williams, 2004a). In 'Back to Work Bonus', people returning to work from benefits receive money in place of benefits lost. In the scheme called Work Trials, people over the age of 25 who are unemployed for over six months can take a job for up to 15 days and stay on benefits. In 'Twin Track' scheme allows people to earn while claiming benefits (CESI and Boundaries Unlimited, 2006). In addition, schemes have been introduced to try to allay people's fears about returning to unstable jobs. One such scheme is Employment on Trial, where people can return to previous levels of Jobseeker's Allowance if they leave a job more than four weeks after starting. These schemes are expected to help in averting people from working and claiming without declaring income; and encourage people on benefits to take up formal opportunities.

Germany: The Ich-AG scheme was introduced to help ease the transition from unemployment to self-employment. This initiative aims to help the unemployed start a business venture. Individuals receive a monthly subsidy for three years. In the first year, they receive 50% of the average unemployment benefit level; this is reduced to 30% in the second year and to 20% in the third and final year. In 2003, over 93,000 long-term unemployed people launched a small business with the assistance of the Ich AG scheme and by 2005, the figure was 356,000 (Renooy et al, 2004). Similar program is run in Netherlands called the Bbz (*Besluit Bijstandverlening Zelfstandigen*) providing social security for self employed (Williams, 2004b).