Regulatory Costs and Employment in the Informal Sector of Argentina

Anna Luiza Ozorio de Almeida
and
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Human Resources Development and Operations Policy
The World Bank
ESP Discussion Papers reflect work in progress. They are intended to make lessons emerging from the current work program available to operational staff quickly and easily, as well as to stimulate discussion and comment. They also serve as the building blocks for subsequent policy and best practice papers. The views expressed here are those of the authors and should not be attributed to the World Bank or its Board of Executive Directors or the countries they represent.
ABSTRACT

This work analyzes the evolution of the informal sector within the context of recent labor market trends in Argentina. For the purposes of poverty reduction, it is useful to define the “informal sector” as consisting of self-employed workers and those in firms with less than five employees. This paper provides a theoretical model for quantifying the burden of regulatory costs and for estimating their possible impact on employment and incomes in the informal sector. Regulatory costs in Argentina are examined in great detail (in the Appendix), and compared with other costs of production for microfirms in different sectors of the economy. As an illustrative exercise, we calculate the possible costs to the public sector of a policy of deregulation for microfirms, as well as its potential benefits, i.e. the number of jobs created. While these results are not the product of rigorous statistical analysis, and therefore have no predictive value, they illustrate the magnitude of regulatory costs for the smallest firms and draw attention to their potential impact on employment and incomes in the informal sector.

Despite the widespread notion that informal businesses are successful in evading regulatory costs, this work finds that such costs may absorb as much as 21 percent of the average microfirm’s operational expenses. In some sectors, such as manufacturing and construction, the costs of regulation are about 44 percent. Deregulation of microfirms, then, might have significant potential as a strategy to generate jobs and income in a sector of vital importance to the poor.
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Errors and omissions are our own responsibility.

List of Acronyms

BCRA = Banco Central de la Republica Argentina
CEPAL = Comision Economica Para America Latina
FIDE = Fundacion de Investigaciones para el Desarrollo
ILO = International Labour Office
INDEC = Instituto Nacional de Estadistica y Censos
MTSS = Ministerio de Trabajo y Seguridad Social
OECD = Organization for Economic Cooperation and Development
PRONATASS = Programa Nacional de Asistencia Tecnica para la Administracion de los Servicios Sociales en la Republica Argentina
REGULATORY COSTS AND EMPLOYMENT
IN THE INFORMAL SECTOR OF ARGENTINA

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Introduction and Summary

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I. Trends in the Argentine Labor Market
II. Recent Evolution of the Informal Sector in Argentina
III. Policies to Reduce Poverty in the Informal Sector

PART TWO: Deregulation and Employment in Microfirms
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INTRODUCTION AND SUMMARY

Since the early 1980s, the most rapidly increasing form of employment in Argentina has taken place among the self-employed and those in microfirms (less than five employees). A relatively high proportion of these jobs are held by migrants from rural areas or neighboring countries, and by so-called “secondary workers,” primarily women and the elderly. These secondary workers seek employment in order to supplement declining family incomes. There is a need for strategies to increase productivity and incomes in this sector, but such strategies must begin by recognizing the budgetary and administrative limitations which constrain government activity. This study aims to contribute to the search for such policies through a quantitative investigation of regulatory costs and their impact on the microfirm.

Throughout Latin America, the informal sector, roughly the sum of self-employed workers and those in microfirms, is a critical source of jobs and income for the poor and those near the poverty line. For all its vastness and importance, however, it is a statistically elusive phenomenon. Definitional ambiguities, contradictions and uncertainties abound. Data, on the other hand, are scarce. Rigorous statistical analysis of the informal sector, which is desirable from the policy making perspective, is therefore virtually impossible or, at best, very costly. As a result, it is easily overlooked in the discussion of poverty alleviation and economic strategies in general. The “stepchild” status of the informal sector is further perpetuated by those who view its existence as symptomatic of the failure of Social Security programs or unenforced labor legislation, rather than as a viable arena for poverty reducing growth.

The successes of Grameen Bank and other institutions (such as BKK in Indonesia, or Accion in Latin America) have served to refocus attention on the productive activities of the poor as a starting point for poverty reduction measures. The ability of such programs to massify their lending among the poorest segments of society, while achieving significant cost-recovery figures, has inspired a wave of interest in small-scale production as a way out of poverty. The success of such programs, however, is partially attributed to their narrow focus on one single constraint facing the microfirm, the unavailability of credit, while other constraints persist. These include: lack of demand, limited skills and information, and the disproportionate burden of regulatory costs.

This last constraint, the burden of regulatory costs, is significant for the smallest firms. This study shows that, in Argentina, regulatory costs may absorb as much as 21 percent of the microfirm’s daily expenditures. In some sectors, such as Manufacturing and Construction, the costs of regulation are much higher, on the order of 44 percent of total costs. Microentrepreneurs may devise strategies to avoid costly regulations, but the evasive strategies themselves often entail high costs and foregone opportunities.

One way of illustrating the weight of such costs is to express them in terms of jobs. Simply put, how many workers could a microfirm employ if all its regulatory costs were removed? In Argentina, an across-the-board deregulation of microfirms might, under certain assumptions, generate over 250,000 jobs in small-scale manufacturing alone, and up to one million jobs in the informal sector as a whole. It should be emphasized that these figures are illustrative, and do not represent statistically rigorous predictions. Their sheer magnitude, however, indicates that employment and incomes in the informal sector may be very sensitive to regulations, notwithstanding the popular belief that informal businesses are immune to regulatory costs.
PART ONE:

POVERTY AND THE INFORMAL SECTOR

IN ARGENTINA
I. RECENT TRENDS IN THE ARGENTINE LABOR MARKET: 
THE INFORMAL SECTOR AS A LABOR MARKET RESPONSE

1.1 Introduction

The labor market has been a principal arena for Argentina's recent impoverishment. Declining investment, falling production, and high inflation were reflected in high unemployment rates and a steep fall in the real value of wages - which, in turn, plunged many previously middle class families below the poverty line. In Argentina, these families constitute the "new poor," for whom poverty is mainly the result of declining real wages or unemployment. At the same time, the labor market in Argentina is characterized by a burgeoning informal sector.¹ Impoverishment and the growth of an informal sector share at least one proximate cause: insufficient demand for labor in the formal economy. Workers expelled from formal firms and those unable to find work in such firms are absorbed into the informal sector, characterized by precarious working conditions and low wages. At the same time, declining household income has triggered the entry of "secondary" workers into a labor market which is unable to supply even "primary" workers with jobs.² For such job-seekers, the informal sector provides a means of subsistence in the absence of better alternatives.

Increasing urbanization, due to migration and urban population growth, and the changing structure of production contribute to the growth of the informal sector in Argentina. A rise in the share of employment by micro- and small enterprises (MSEs) has been reinforced by an underlying shift in employment towards another common locus of the informal sector: "tertiary" activities, which will be explained in Section 1.7. The increase in this sector's share of employment, however, has not been matched by proportionate increases in output. Such shifts imply the proliferation of low-productivity, low-wage jobs, with an increasing proportion of the job force in MSEs, especially in services, commerce and some branches of manufacturing.

1.2 Growing Urban Labor Supply

Population growth and fertility rates have been on a steady decline in Argentina since 1975, with the most drastic decrease occurring in the 1985 to 1990 period. Two trends, however, have contributed to recent growth in the labor force: rural to urban migration and an increase in rates of labor force participation, especially among women. Given slow job growth in the past 15 years, these trends have resulted in unprecedented rates of unemployment in Argentina.

Table 1.1 contains the annual growth rates of Argentina's population from 1960 to 1990, according to the Instituto Nacional de Estadistica y Censos (INDEC) and the World Bank Atlas. The population is more or less evenly divided between women and men. The table shows a continued decline in the annual population growth rate since 1977.

¹ In this context, the informal sector includes those forms of employment which are typically unregistered, low-paying jobs in small firms. By exclusion, firms in the "formal" sector are those that employ more than five employees. The rationale and implications will be explored in Chapter II.

² "Primary" workers are typically heads of households, while "secondary" workers are other members of the family whose income complements that of the primary breadwinner.
Table 1.1: The Population of Argentina: 1960–1990

<table>
<thead>
<tr>
<th>Year</th>
<th>Mid-year Population (thousands)</th>
<th>Annual Growth Rate (%)</th>
<th>Five-year Growth Rate Projection (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>20,616</td>
<td>1.65</td>
<td>1.71</td>
</tr>
<tr>
<td>1965</td>
<td>22,283</td>
<td>1.52</td>
<td>1.55</td>
</tr>
<tr>
<td>1970</td>
<td>23,962</td>
<td>1.54</td>
<td>1.45</td>
</tr>
<tr>
<td>1975</td>
<td>26,052</td>
<td>1.68</td>
<td>1.67</td>
</tr>
<tr>
<td>1980</td>
<td>28,237</td>
<td>1.61</td>
<td>1.61</td>
</tr>
<tr>
<td>1985</td>
<td>30,564</td>
<td>1.55</td>
<td>1.58</td>
</tr>
<tr>
<td>1990</td>
<td>32,293</td>
<td>1.19</td>
<td>1.11</td>
</tr>
</tbody>
</table>


1.3 Urbanization

Despite the slowdown in overall population growth, however, a long-term trend of rural–urban migration has concentrated Argentina's population in the cities — especially Greater Buenos Aires, where over half the population lives. Table 1.2 compares urban and rural growth rates in Argentina. Urban rates of population growth are positive and well above the national totals, while the rural population has been in decline since 1947. In addition to rural-urban migration, which may have slowed in recent years, simple "vegetative" growth has also increased the urban labor supply.

Table 1.2: Urban and Rural Average Annual Rates of Population Growth

<table>
<thead>
<tr>
<th>Census Period</th>
<th>Total</th>
<th>Urban</th>
<th>Rural</th>
<th>Greater Buenos Aires</th>
</tr>
</thead>
<tbody>
<tr>
<td>1914-47</td>
<td>2.1</td>
<td>2.5</td>
<td>1.4</td>
<td>N/A</td>
</tr>
<tr>
<td>1947-60</td>
<td>1.8</td>
<td>2.8</td>
<td>-0.5</td>
<td>6.1</td>
</tr>
<tr>
<td>1960-70</td>
<td>1.6</td>
<td>2.5</td>
<td>-1.4</td>
<td>3.8</td>
</tr>
<tr>
<td>1970-80</td>
<td>1.8</td>
<td>2.6</td>
<td>-0.03</td>
<td>2.5</td>
</tr>
</tbody>
</table>

Source: Riveros and Sanchez (1990).
### Table 1.3: Urbanization in Argentina by Province

<table>
<thead>
<tr>
<th>Province</th>
<th>Percent Urban Population</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1947</td>
</tr>
<tr>
<td>Capital Federal</td>
<td>100</td>
</tr>
<tr>
<td>Buenos Aires</td>
<td>71</td>
</tr>
<tr>
<td>Catamarca</td>
<td>32</td>
</tr>
<tr>
<td>Cordoba</td>
<td>53</td>
</tr>
<tr>
<td>Corrientes</td>
<td>32</td>
</tr>
<tr>
<td>Chaco</td>
<td>31</td>
</tr>
<tr>
<td>Chubut</td>
<td>25</td>
</tr>
<tr>
<td>Entre Rios</td>
<td>53</td>
</tr>
<tr>
<td>Formosa</td>
<td>23</td>
</tr>
<tr>
<td>Jujuy</td>
<td>37</td>
</tr>
<tr>
<td>La Pampa</td>
<td>31</td>
</tr>
<tr>
<td>La Rioja</td>
<td>31</td>
</tr>
<tr>
<td>Mendoza</td>
<td>50</td>
</tr>
<tr>
<td>Misiones</td>
<td>19</td>
</tr>
<tr>
<td>Neuquen</td>
<td>23</td>
</tr>
<tr>
<td>Rio Negro</td>
<td>27</td>
</tr>
<tr>
<td>Salta</td>
<td>40</td>
</tr>
<tr>
<td>San Juan</td>
<td>46</td>
</tr>
<tr>
<td>San Luis</td>
<td>39</td>
</tr>
<tr>
<td>Santa Cruz</td>
<td>36</td>
</tr>
<tr>
<td>Santa Fe</td>
<td>58</td>
</tr>
<tr>
<td>Stgo. del Estero</td>
<td>26</td>
</tr>
<tr>
<td>Tierra del Fuego</td>
<td>-</td>
</tr>
<tr>
<td>Tucuman</td>
<td>51</td>
</tr>
</tbody>
</table>

Source: INDEC (1992)

### Table 1.4: Urban Population (% of Total)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>78</td>
<td>81</td>
<td>83</td>
<td>85</td>
<td>86</td>
</tr>
</tbody>
</table>

Until 1970, Greater Buenos Aires was growing faster than both the national and urban populations. Since then, the process of urbanization has "evened-out" over the provinces, as Table 1.3 indicates. The percentage of urban population has increased in every province. Table 2.4 summarizes the effects of this process.

1.4 Labor Force Participation and Secondary Workers

Rates of labor force participation in Argentina have traditionally been responsive to wages and perceptions concerning the availability of employment. When economic activity expanded, as in the sixties, new entrants were attracted to the job market, increasing the supply of labor. By contrast, during periods of economic contraction, workers have tended to withdraw from the work force. ³

The response to Argentina's latest economic crises, however, has differed significantly from past experience. Section 1.6 will show a strong tendency to declining real wages; this fact becomes important in interpreting the behavior of labor force participation rates in the last decade. The following table shows aggregate rates of labor force participation (LFP) from 1982 to 1992, based on information from the Permanent Household Survey.

### Table 1.5: Rates of Labor Force Participation (October of Each Year)

<table>
<thead>
<tr>
<th>Year</th>
<th>Argentina</th>
<th>Greater Buenos Aires</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>37.3</td>
<td>37.5</td>
</tr>
<tr>
<td>1984</td>
<td>37.9</td>
<td>38.4</td>
</tr>
<tr>
<td>1985</td>
<td>38.2</td>
<td>38.8</td>
</tr>
<tr>
<td>1986</td>
<td>38.7</td>
<td>40</td>
</tr>
<tr>
<td>1987</td>
<td>38.9</td>
<td>40</td>
</tr>
<tr>
<td>1988</td>
<td>39.4</td>
<td>40.5</td>
</tr>
<tr>
<td>1989</td>
<td>39.3</td>
<td>40.8</td>
</tr>
<tr>
<td>1990</td>
<td>39</td>
<td>40.3</td>
</tr>
<tr>
<td>1991</td>
<td>39.5</td>
<td>40.8</td>
</tr>
<tr>
<td>1992</td>
<td>40.2</td>
<td>41.7</td>
</tr>
</tbody>
</table>

Source: INDEC (1993)

---

³ Sanchez (1987) documents this feature of the Argentine labor supply. Using regression analysis, he measures the withdrawal effect, confirming the sensitivity of labor force participation rates to the probability of finding employment. Sanchez (1982) found that increases or decreases in wages will likewise have the same sign effect on the labor supply: increasing wages will encourage growth in the labor supply, while decreasing wages will induce job-seekers to withdraw from the market.
In 1983, at the beginning of the series, labor force participation rates had reached historic lows. Since then, they began to recover, continuing their slow upward climb even through the crises of the late 1980s. A plausible explanation for recent increases in labor force participation is that the "discouraged worker" effect, which prevailed until 1983 has since been overtaken by an "added worker" phenomenon, whereby secondary workers enter the labor force in order to supplement the declining wages of primary breadwinners. The following section, which documents the decline in real wages in Argentina, will support this interpretation.

The recovery in labor force participation rates is due primarily to the entry of women, especially those aged 30 to 59. Table 1.6 compares the rates of labor force participation of men and women. Between 1980 and 1991, the rates for women aged 30 to 59 grew by over ten percentage points, while the corresponding rate for men was comparatively stagnant. As Table 1.7 shows, these gains in labor force participation are mirrored in growing rates for spouses - another indication of the "added worker" effect.

Labor force participation among the elderly is also on the rise. Those aged 60 and above, another component of the secondary work force, have increased their rates of labor force participation from 15.2 percent in 1980 to 19.4 percent in 1991. This increase among the elderly is mostly attributable to increases among older men, and may be a response to losses in the real value of pensions as will be seen in Section 1.6. In contrast to these groups, youth participation rates have been on a steady decline since 1974, as depicted in Table 1.6. Youth withdrawal from the labor force is confirmed by Table 1.8, which shows decreasing participation rates for both men and women with lower educational achievement. Overall, however, the withdrawal by youth has been overshadowed by the entry of women and the elderly, who are the principal types of secondary workers displaying an added worker response to declining real wages over the 1980s. Thus, although youth continue to withdraw from the labor force, their exit has been overshadowed by the entry of women and the elderly.

Sanchez (1987) attributes this long-term downward trend to two factors: a withdrawal effect in response to the secular decline in expected wages (defined as the wage rate adjusted by the probability of employment), and a demographic effect (aging of the population and a decline in the share of the working-age population in the total population).
Table 1.6: Rates of Labor Force Participation by Age Group

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>14–19</td>
<td>25.0</td>
<td>22.1</td>
<td>22.1</td>
<td>42.1</td>
<td>39.1</td>
<td>36.5</td>
<td>33.9</td>
<td>37.9</td>
<td>29.6</td>
</tr>
<tr>
<td>20–29</td>
<td>55.1</td>
<td>56.1</td>
<td>59</td>
<td>91.8</td>
<td>90.3</td>
<td>90.8</td>
<td>72.3</td>
<td>70.6</td>
<td>74.3</td>
</tr>
<tr>
<td>30–59</td>
<td>36.1</td>
<td>45.2</td>
<td>46.8</td>
<td>93.6</td>
<td>94.2</td>
<td>94.9</td>
<td>63.8</td>
<td>62.8</td>
<td>69.7</td>
</tr>
<tr>
<td>60+</td>
<td>6.8</td>
<td>8.3</td>
<td>9</td>
<td>26.2</td>
<td>32</td>
<td>34.4</td>
<td>15.2</td>
<td>17.8</td>
<td>19.4</td>
</tr>
<tr>
<td>Total</td>
<td>31.9</td>
<td>36</td>
<td>37.3</td>
<td>73.6</td>
<td>74</td>
<td>74.1</td>
<td>51.6</td>
<td>52.5</td>
<td>54.6</td>
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</table>

Table 1.7: Rates of Labor Force Participation by Household Status

<table>
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<tr>
<th></th>
<th></th>
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<tbody>
<tr>
<td>Head</td>
<td>37.9</td>
<td>41.3</td>
<td>43.1</td>
<td>79</td>
<td>79.6</td>
<td>80.8</td>
<td>71.7</td>
<td>72.1</td>
<td>72.2</td>
</tr>
<tr>
<td>Spouse</td>
<td>24.3</td>
<td>31.5</td>
<td>33.4</td>
<td>66.9</td>
<td>69.6</td>
<td>69.7</td>
<td>24.8</td>
<td>31.9</td>
<td>33.9</td>
</tr>
<tr>
<td>Other</td>
<td>41.9</td>
<td>40.7</td>
<td>40.6</td>
<td>63.1</td>
<td>62.4</td>
<td>62.2</td>
<td>51.9</td>
<td>50.6</td>
<td>51.2</td>
</tr>
</tbody>
</table>

Table 1.8: Rates of Labor Force Participation by Educational Achievement

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>23.1</td>
<td>27.6</td>
<td>23.8</td>
<td>70.3</td>
<td>76.2</td>
<td>59.3</td>
<td>42.2</td>
<td>56.1</td>
<td>39.4</td>
</tr>
<tr>
<td>Medium</td>
<td>27.4</td>
<td>27.1</td>
<td>29.7</td>
<td>72.9</td>
<td>69.9</td>
<td>71.6</td>
<td>48</td>
<td>46.7</td>
<td>50.1</td>
</tr>
<tr>
<td>High</td>
<td>47.9</td>
<td>52.3</td>
<td>58</td>
<td>79.4</td>
<td>80.3</td>
<td>86.9</td>
<td>62.8</td>
<td>66.1</td>
<td>71</td>
</tr>
</tbody>
</table>

Low: primary incomplete  
Medium: secondary incomplete  
High: high school and above

Source: Cortes (1993).
1.5 Labor Force Participation and Unemployment

In tandem with rising rates of labor force participation, unemployment reached an unprecedented 9.9 percent in May of 1993, according to the Permanent Household Survey. Table 1.9 lists unemployment rates for men and women in Greater Buenos Aires. In response to the scarcity of job opportunities, increasing numbers of job seekers have turned to self-employment and small firm employment, as will be seen in Section 1.7.

The unemployment rate for men has varied widely between periods, though tending toward increasingly higher levels. By contrast, their LFP rates have been slowly and steadily increasing. For women, however, unemployment has increased in tandem with higher LFP rates. According to the May 1993 round of the Permanent Household Survey, women's rate of labor force participation jumped by almost five percentage points in the last year alone—the same year that their rate of unemployment increased by five percentage points as well. During the same period, the unemployment rates of both men and women reached their highest levels in the series: 8.9 percent for men and 13.2 percent for women.

Table 1.9: Labor Force Participation and Urban Unemployment (Greater Buenos Aires)

<table>
<thead>
<tr>
<th>Year</th>
<th>LFP Men</th>
<th>Unempl. Men</th>
<th>LFP Women</th>
<th>Unempl. Women</th>
</tr>
</thead>
<tbody>
<tr>
<td>4/83</td>
<td>83.6</td>
<td>5.0</td>
<td>37.0</td>
<td>5.7</td>
</tr>
<tr>
<td>4/84</td>
<td>83.5</td>
<td>3.9</td>
<td>38.5</td>
<td>4.9</td>
</tr>
<tr>
<td>5/85</td>
<td>83.7</td>
<td>5.1</td>
<td>39.6</td>
<td>5.9</td>
</tr>
<tr>
<td>4/87</td>
<td>84.5</td>
<td>4.2</td>
<td>43.9</td>
<td>6.9</td>
</tr>
<tr>
<td>4/88</td>
<td>84.0</td>
<td>4.0</td>
<td>43.3</td>
<td>7.9</td>
</tr>
<tr>
<td>4/89</td>
<td>85.0</td>
<td>7.2</td>
<td>46.8</td>
<td>8.4</td>
</tr>
<tr>
<td>4/90</td>
<td>84.0</td>
<td>8.9</td>
<td>44.9</td>
<td>8.1</td>
</tr>
<tr>
<td>4/91</td>
<td>82.7</td>
<td>6.3</td>
<td>44.5</td>
<td>6.7</td>
</tr>
<tr>
<td>4/92</td>
<td>84.4</td>
<td>6.0</td>
<td>45.9</td>
<td>7.9</td>
</tr>
<tr>
<td>4/93</td>
<td>85.4</td>
<td>8.9</td>
<td>50.7</td>
<td>13.2</td>
</tr>
</tbody>
</table>

Source: Carta Economica (September, 1993).
1.6 The Wage Crisis in Argentina

In 1990, the purchasing power of the average wage in Argentina had plummeted to 57 percent of its 1984 value. Table 1.10 indicates that this decline, while not uniform, has affected all sectors of the economy, though public sector wages were especially hard-hit. The recovery that began in 1990 has been partial, but far more important in commerce. As of 1992, wages had only recuperated five percentage points of their former purchasing power. Periodic bouts of high inflation, which surpassed 3,000 percent in 1989, drove down the real earnings of Argentine workers during the 1980s. The existence of nominal wage contracts and the use of wage freezes as an official inflation-control measure prevented wages from keeping pace with price increases.

<table>
<thead>
<tr>
<th>Year</th>
<th>Industry</th>
<th>Construction</th>
<th>Commerce</th>
<th>Public Sector</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984</td>
<td>97.39</td>
<td>90.5</td>
<td>100.38</td>
<td>91.19</td>
<td>95.24</td>
</tr>
<tr>
<td>1986</td>
<td>90.1</td>
<td>63.44</td>
<td>91.75</td>
<td>64.16</td>
<td>83.53</td>
</tr>
<tr>
<td>1988</td>
<td>71.71</td>
<td>43.95</td>
<td>69.81</td>
<td>48.53</td>
<td>66.34</td>
</tr>
<tr>
<td>1990</td>
<td>71.14</td>
<td>71.14</td>
<td>65.68</td>
<td>32.85</td>
<td>57.18</td>
</tr>
<tr>
<td>1992</td>
<td>74.85</td>
<td>74.85</td>
<td>82.51</td>
<td>36.16</td>
<td>62.8</td>
</tr>
</tbody>
</table>

Source: Carta Economica (September 1993).

The impoverishing effects of inflation were also transmitted through declines in the real value of non-wage income sources, including pensions and family subsidies. In 1988, for example, the real value of pensions had fallen to 30 percent of its 1970 value, while the value of the typical family subsidy fell by 90 percent. The effect of these declines was especially acute for households in the lowest income group, who rely more heavily on non-wage income than the average household.

Table 1.10 depicts a severe "squeeze" on the public sector, which seems to have been a driving force behind the overall decline in the real value of the average wage. Information on the share of the public sector in total wages and employment—which is currently unavailable—is necessary to confirm such an interpretation, however.

The marked recovery in Commerce in 1992 may be the effect of a "consumption bubble" that quickly surfaced in Argentina as a result of the Convertibility Plan, which set the Peso Nuevo on a par with the U.S. Dollar and fueled the demand for imports.

Pessino (1991, draft) asserts that the inflationary effects on wages in Argentina also entail a shift in the wage profile of workers of different educational levels. Inflation not only reduces real wages, but it does so in a way that results in a worsening income distribution, as workers with lower levels of human capital suffer heavier losses.

Family subsidies are benefits which accrue to all workers in a firm (irrespective of the worker's income level), financed through taxes on wages. Workers receive a monthly sum which reflects marital status, the number of children in the household, number of children in school, etc.
The downward trend in the real value of wage and non-wage income sheds light on the
dynamics underlying the rising rates of labor force participation as documented in Section 1.4. That the
supply of labor in Argentina has increased despite the marked deterioration in the real value of wages
suggests that this entry forms part of a household survival strategy to supplement declining real
pensions and the earnings of primary breadwinners.

1.7 The Restructuring of Employment by Firm Size and Sector

The trend in Argentina toward rising employment in small and micro firms has been widely
documented. Table 1.11 illustrates the rise of small firms as employers. Although large firms
continue to employ the highest percentage of workers, their share has declined by over seven percentage
points since 1974. The share of employment among microenterprises, by contrast, has increased by
over six percentage points.

According to the Ministerio de Trabajo y Seguridad Social, employment growth in
microenterprises (firms with less than five employees) and self-employment is strongly associated with
increases in the incidence of "precarious" working conditions. In the same study upon which Table
1.11 is based, it is estimated that over 67 percent of those employed in microenterprises work under
such conditions, compared with 15 percent in enterprises with more than five employees. Although
precarious forms of employment are increasing in both large and small firms, there is a strong
correlation between growth in the microenterprise sector and higher incidence of non-standard
employment.

Employment is not only shifting in terms of firm size (from large to small), but its sectoral
distribution is changing as well. Table 1.12 depicts the changing sectoral structure of urban
employment in Argentina. As industry and construction have declined in their share of employment,
they have been replaced by commerce and services. Although the secondary sector has never employed
a majority of the work force in Argentina, increasing "tertiarization" of the labor force has implied the
proliferation of low-wage, low productivity jobs in such sectors as services and commerce, where
increases in employment are not reflected in higher output.

---

10 See MTSS (1989a), especially Table 7.
11 C.f. Cortes (1990), Ministerio de Trabajo y Seguridad Social/Programa de las Naciones Unidas para el
12 Though there are many competing definitions of what constitutes "precarious" employment, a common definition
(and the one used by the MTSS) classifies as precarious any employment situation in which the employer fails to withhold
social security taxes from the employee's wage. Those who work under precarious circumstances self-identify on the
Permanent Household Survey by indicating that the social security tax is not withheld.
13 With some variation, economic activities can be roughly grouped into:
1) the primary sector — agriculture, mining, and other extractive activities,
2) the secondary sector — manufacturing, construction, utilities, and
3) the tertiary sector — commerce, services, finance and the public sector (minus utilities).
Table 1.11: Distribution of Salaried Employment by Firm Size

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Domestic Service</td>
<td>7.8</td>
<td>6.5</td>
<td>8.1</td>
</tr>
<tr>
<td>B. Microenterprises</td>
<td>14.6</td>
<td>18.4</td>
<td>20.8</td>
</tr>
<tr>
<td>and Self-employment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small-Scale</td>
<td>22.3</td>
<td>24.9</td>
<td>28.9</td>
</tr>
<tr>
<td>Employment (A+B)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public Admin.</td>
<td>4.9</td>
<td>5.3</td>
<td>6.2</td>
</tr>
<tr>
<td>Firms with Five or</td>
<td>72.8</td>
<td>69.6</td>
<td>64.9</td>
</tr>
<tr>
<td>More Employees</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>


Table 1.12: Sectoral Distribution of Urban Employment

<table>
<thead>
<tr>
<th></th>
<th>Construction</th>
<th>Commerce</th>
<th>Services</th>
<th>Industry</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>9.4</td>
<td>18.4</td>
<td>27.8</td>
<td>30.2</td>
<td>100</td>
</tr>
<tr>
<td>1985</td>
<td>6.6</td>
<td>18.4</td>
<td>29.9</td>
<td>25.2</td>
<td>100</td>
</tr>
<tr>
<td>1991</td>
<td>7</td>
<td>20</td>
<td>32</td>
<td>24</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: FIDE (December 1991)

An examination of the National Accounts reveals that as a higher percentage of the work force has been employed in the "third sector," per-capita output in that sector has declined, as have average wages. Table 1.13 provides employment and output data for six major subsectors: two primary subsectors (agriculture and mining), three secondary subsectors (manufacturing, utilities and

14 Microenterprises = firms with less than five employees.

15 The low share of public administration in total employment reflects the exclusion of parastatal enterprises from this category. Orsatti estimates that, including all forms of state activity, employment in the public sector encompasses 5 percent of non-agricultural urban employment.
construction) and two tertiary subsectors (commerce and services). In the series selected (1980–1987) both of the primary sectors experienced diminishing employment and higher productivity, resulting in higher per-capita output. In the secondary sector as well, both employment and output per worker increased. (The exception, manufacturing, experienced a slight decline.) By contrast, in both of the tertiary subsectors, Commerce and Services, large increases in employment resulted in declining per-capita output.

Table 1.13: Sectoral Changes in Productivity and Wages

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>Q/N</th>
<th>W</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1980</td>
<td>1987</td>
</tr>
<tr>
<td>Agriculture</td>
<td>7.31</td>
<td>8.14</td>
</tr>
<tr>
<td>Mining</td>
<td>69.74</td>
<td>77.18</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>32.10</td>
<td>32.85</td>
</tr>
<tr>
<td>Utilities</td>
<td>36.63</td>
<td>41.61</td>
</tr>
<tr>
<td>Construction</td>
<td>15.64</td>
<td>17.28</td>
</tr>
<tr>
<td>Commerce</td>
<td>12.50</td>
<td>9.06</td>
</tr>
<tr>
<td>Services</td>
<td>8.65</td>
<td>7.65</td>
</tr>
<tr>
<td></td>
<td>1,511</td>
<td>1,557</td>
</tr>
<tr>
<td></td>
<td>6,573</td>
<td>10,906</td>
</tr>
<tr>
<td></td>
<td>4,108</td>
<td>3,972</td>
</tr>
<tr>
<td></td>
<td>7,873</td>
<td>9,252</td>
</tr>
<tr>
<td></td>
<td>4,343</td>
<td>5,034</td>
</tr>
<tr>
<td></td>
<td>3,768</td>
<td>2,647</td>
</tr>
<tr>
<td></td>
<td>4,307</td>
<td>3,607</td>
</tr>
</tbody>
</table>

In most cases, the movement of real average wages followed the same direction as output per capita. Wages grew in those primary and secondary sectors in which per-capita output increased, notably in mining and utilities. Similarly, the highest wages (mining and utilities) are found where output per worker is the highest. Both of the tertiary sectors, by contrast, experienced losses both in per-capita production and in the value of average wages. These results show some consistency between trends in wages and productivity. The implication for Argentina is that the trend towards employment in the tertiary sector is likely to advance the proliferation of jobs characterized by low productivity and low wages in small firms. This process is revealed in an examination of the growth and distribution of the informal sector, which will be analyzed in the following chapter.
<table>
<thead>
<tr>
<th>SECTOR</th>
<th>1980</th>
<th>1987</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGRICULTURE</td>
<td>8,971,363</td>
<td>9,592,570</td>
</tr>
<tr>
<td></td>
<td>1,226,597</td>
<td>1,178,182</td>
</tr>
<tr>
<td></td>
<td>7.31</td>
<td>8.14</td>
</tr>
<tr>
<td></td>
<td>1,511</td>
<td>1,557</td>
</tr>
<tr>
<td>MINING</td>
<td>4,179,533</td>
<td>3,917,925</td>
</tr>
<tr>
<td></td>
<td>59,933</td>
<td>50,766</td>
</tr>
<tr>
<td></td>
<td>69.74</td>
<td>77.18</td>
</tr>
<tr>
<td></td>
<td>6,573</td>
<td>10,906</td>
</tr>
<tr>
<td>MANUFACTURING</td>
<td>65,133,626</td>
<td>64,482,990</td>
</tr>
<tr>
<td></td>
<td>2,028,870</td>
<td>1,962,694</td>
</tr>
<tr>
<td></td>
<td>32.10</td>
<td>32.85</td>
</tr>
<tr>
<td></td>
<td>4,108</td>
<td>3,972</td>
</tr>
<tr>
<td>UTILITIES</td>
<td>3,708,118</td>
<td>4,935,754</td>
</tr>
<tr>
<td></td>
<td>101,226</td>
<td>118,617</td>
</tr>
<tr>
<td></td>
<td>37</td>
<td>42</td>
</tr>
<tr>
<td></td>
<td>7,873</td>
<td>9,252</td>
</tr>
<tr>
<td>CONSTRUCTION</td>
<td>17,029,288</td>
<td>13,067,545</td>
</tr>
<tr>
<td></td>
<td>1,089,044</td>
<td>756,273</td>
</tr>
<tr>
<td></td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td></td>
<td>4,543</td>
<td>5,034</td>
</tr>
</tbody>
</table>

16. These figures, taken from an exercise by CEPAL (Comision Economica Para America Latina), indicate rough orders of magnitude and show the direction of changes. It is well known that the matching-up of income figures (from National Income Accounts) with employment figures (from Census and Household Surveys) is fraught with errors and incompatibilities. Productivity measurements \((Q/N)\) derived from such an exercise will necessarily compound errors in both the numerator and the denominator.
Table 1.14, continued

<table>
<thead>
<tr>
<th></th>
<th>Q</th>
<th>N</th>
<th>Q/N</th>
<th>W</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMMERCE</td>
<td>21,932,605</td>
<td>19,467,591</td>
<td>1,754,693</td>
<td>2,148,236</td>
</tr>
<tr>
<td></td>
<td>13</td>
<td>9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SERVICES</td>
<td>25,202,534</td>
<td>26,562,919</td>
<td>2,914,068</td>
<td>3,473,691</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>8</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>4,307</td>
<td>3,607</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Q (yearly gross product) and Q/N (product per capita) are expressed in thousands of 1986 Australes, as presented by the source.
N = # of workers.
W = average yearly wage by sector, deflated by consumer price index and expressed in 1986 Australes.

1.8 Conclusion

Together, the trends described in this chapter — increasing labor force participation by secondary workers, high unemployment and declining real wages—set the stage for the emergence of the informal sector as an alternative employer for those who are unable to find work in the formal economy. The predominance of secondary workers among new job-seekers, considered alongside the decline in real wages, suggests that the motive behind increasing labor force participation is to supplement deteriorating real wages, especially in the public sector. As long as unemployment remains high, many of these new job seekers are unlikely to be successful in finding work in the formal sector, making the employment in the informal sector a “next best” alternative.

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17 Pessino (1991, draft) points out, however, that, in a highly inflationary context, informal self-employment may actually be more attractive than formal employment, due to the existence of nominal wage contracts in the formal sector which constrain the adjustment of real earnings. According to this logic, workers in the informal sector may fare better than their “formal” counterparts whose wages are fixed in nominal terms.
II. RECENT EVOLUTION OF THE INFORMAL SECTOR IN ARGENTINA

2.1 Introduction

Broad definitions of informality mask important distinctions between its different types and degrees. The informal sector is extremely heterogeneous, encompassing a wide range of occupational types and employment relationships.\(^{18}\) Forms of informal employment typically include temporary or casual employment, seasonal employment, work by short-term contract, domestic service and clandestine employment. Competing definitions of the informal sector are nuanced, whether by reference to the legal relationship between employer and employee, the firm type, coverage by labor laws, registration, fiscal compliance of the firm and other criteria.

Some fundamental characteristics of informal sector employment in Argentina, however, have been identified. According to Galin (1990), these include the "precariousness" of the employment relationship, its temporary nature, and the absence of coverage by labor laws.\(^{19}\) Such characteristics are shared by those employed in the informal sector, albeit in varying combinations and degrees. Thus, in Argentina, informality is generally considered with respect to deviation from a regulatory standard, which applies to a majority of the labor force in the country.\(^{20}\) This chapter pieces together a broad picture of the Argentine informal sector based on deviation from different regulatory standards, as chosen by the different authors and sources cited.

2.2 Size and Definition of the Informal Sector

By any measure or definition, the informal sector in Argentina is a growing phenomenon. Growth is evident, for instance, in the expansion of "unregistered" employment in the Argentine workforce. Table 2.1 reveals the rapid growth in the number of workers who indicate on the Permanent Household Survey that their employers do not withhold pension taxes and who are, therefore, classified as "unregistered." Such workers constitute almost a third of the entire work force—up from less than one-fifth in 1980. About 1.4 million people are unregistered workers in Argentina, according to the ILO.\(^{15}\) Although Buenos Aires, which contains approximately one third of the national population, has the highest number of unregistered workers, lack of registration is found also in provincial cities. All of

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\(^{18}\) Many efforts have been made to clarify the meaning of "informal" in the Argentine context. See Sanchez and Ferrero (1976) for an early work on the urban informal sector in Cordoba. C.f. also Becarría and Orsatti (1987), Marshall (1991 and 1992) and Galín (1992). Orsatti (1987) provides a summary of research done on the informal sector in Argentina.

\(^{19}\) In Argentina, "precariousness" refers to the lack of standard benefits (social security coverage, vacation, sick leave, etc.) established by legislation and collective bargaining agreements.

\(^{20}\) This is a very specific case. Argentina differs from most developing countries in that a majority of the labor force is employed in the formal sector. In many other countries, regulatory standards apply to a far smaller proportion if the labor force that is employed in the formal sector. This point will become significant in section XX below.

the cities listed on Table 2.2 have higher percentages of unregistered employment than Greater Buenos Aires as a whole.  

Table 2.1: Informal Employment as a % of Total Urban Employment  
(informality = no pension withholding)  

<table>
<thead>
<tr>
<th>Year</th>
<th>1980</th>
<th>1985</th>
<th>1992</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>18.7</td>
<td>23.7</td>
<td>32.3</td>
</tr>
</tbody>
</table>


Table 2.2: Incidence of Informality in Selected Cities (%)  
(informality = lack of coverage by union-based health plan)  

<table>
<thead>
<tr>
<th>CITY</th>
<th>% OF SALARIED WORK FORCE IN INFORMAL EMPLOYMENT</th>
<th>INDEX (Greater Buenos Aires = 100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greater Buenos Aires</td>
<td>20.2</td>
<td>100</td>
</tr>
<tr>
<td>- Federal District</td>
<td>11.8</td>
<td>58</td>
</tr>
<tr>
<td>- Surrounding Area</td>
<td>24.7</td>
<td>122</td>
</tr>
<tr>
<td>Cordoba</td>
<td>22.7</td>
<td>112</td>
</tr>
<tr>
<td>Resistencia</td>
<td>23.8</td>
<td>118</td>
</tr>
<tr>
<td>Mendoza</td>
<td>20.7</td>
<td>102</td>
</tr>
<tr>
<td>Neuquen</td>
<td>20.9</td>
<td>103</td>
</tr>
<tr>
<td>Tucuman</td>
<td>20.9</td>
<td>103</td>
</tr>
</tbody>
</table>

Source: MTSS/PRONATASS.

The low level of informality registered in the Federal District probably reflects the preponderance of public sector employment in that restricted area, and it contrasts vividly with the rates of the surrounding areas of Greater Buenos Aires, where informality is the most common. The high rates registered in Cordoba and Resistencia indicate that the phenomenon of informality, however, is not restricted to Argentina's most populous city. The "spread" of informality across different Argentine cities is consistent with the assertion that employment in the Argentine informal sector is, in part, a consequence of the rural–urban migratory trends described in Chapter I. As increases in the urban labor supply outpaced job growth, workers apparently turned to the informal sector as an employer of last resort. The preceding two tables indicate that this process has occurred throughout Argentina and now affects between 20 and 30 percent of the work force.

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22 These figures reflect the percentage of employed respondents on the Permanent Household Survey who are not affiliated with the Obras Sociales, i.e., union–based hospital system.
2.3 Firm Size and Informality

Table 2.3 shows that there is a strong correlation between firm size and informality in Argentina. Measured by the lack of employment benefits, almost 60 percent of all informal workers are either self-employed or work in firms with five employees or less. The smallest firms have both the highest incidence of informality (twice that of the nearest group, firms with 6–25 employees) and the highest share of all informal workers. About half of those employed in the 2-5 group are informal, and these workers constitute about 53 percent of the informal work force. It is interesting to note, however, that 40 percent of all informal workers are employed by firms with more than five employees. So the link between firm size and informality is strong, but not absolute.

Table 2.3: Firm Size and Informality in Greater Buenos Aires
(informality = lack of employment benefits)

<table>
<thead>
<tr>
<th># of Employees in Firm</th>
<th>Incidence of Informality (% of workers)</th>
<th>% Share of All Informal Workers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>56.2</td>
<td>6.3</td>
</tr>
<tr>
<td>2 - 5</td>
<td>50.1</td>
<td>52.9</td>
</tr>
<tr>
<td>6 - 25</td>
<td>24.4</td>
<td>30.1</td>
</tr>
<tr>
<td>26 - 100</td>
<td>9.2</td>
<td>7.2</td>
</tr>
<tr>
<td>101 - 500</td>
<td>4.7</td>
<td>2.4</td>
</tr>
<tr>
<td>500 and above</td>
<td>3.2</td>
<td>1.1</td>
</tr>
<tr>
<td>Total Informal Employment</td>
<td>-</td>
<td>100</td>
</tr>
</tbody>
</table>


Table 2.3 suggests that to maximize employment and incomes in the informal sector, policies should target firms in the 1–5 employee group, where over half of the informal work force is found. This focus will characterize the rest of this paper, which explore the potential effects of policies aimed at small firms in reducing poverty in the informal sector.

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23 The authors cited contend that 44 percent of the self-employed do not constitute part of the informal sector. These are likely to be professionals whose choice of self-employment may reflect a preference for higher earnings or for a degree of autonomy unavailable to them through wage-employment.

24 Employment benefits include vacation pay and inscripción in the employment-based health system, or Obras Sociales.

25 Excludes domestic service.
2.4 Sectoral Distribution of the Informal Sector

Table 2.4 shows the distribution of informal employment across different sectors of the Argentine economy, using the same measure of informality as in the preceding table.

Excluding Agriculture, the sectors from this table can be grouped into three broad categories. The first consists of those which register relatively high rates of informality and which, between them, make up the bulk of the informal work force. This category includes Industry, Commerce, and Communal/Personal Services (Domestic Service will be treated separately). These three sectors alone account for over 58 percent of informal employment in Argentina. In this group, Commerce has the highest incidence of informality (over 41 percent), while Industry and Services each register rates of informality on the order of 28 percent. Industry alone employs almost a quarter of the informal work force, most of whom are concentrated in light manufacturing and textiles/apparel.²⁶

Table 2.4: Sectoral Distribution of Informal Employment in Greater Buenos Aires
(informality = lack of employment benefits)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Incidence of Informality (% of salaried workers)</th>
<th>% Share of All Informal Workers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>75.1</td>
<td>0.7</td>
</tr>
<tr>
<td>Industry</td>
<td>27.8</td>
<td>24.4</td>
</tr>
<tr>
<td>Utilities</td>
<td>8.0</td>
<td>0.2</td>
</tr>
<tr>
<td>Construction</td>
<td>56.0</td>
<td>7.9</td>
</tr>
<tr>
<td>Commerce, Restaurants, Hotels</td>
<td>41.7</td>
<td>17.5</td>
</tr>
<tr>
<td>Transport, Storage, Communication</td>
<td>21.7</td>
<td>5.7</td>
</tr>
<tr>
<td>Services to Firms</td>
<td>24.2</td>
<td>6.1</td>
</tr>
<tr>
<td>Domestic Service</td>
<td>72.3</td>
<td>18.3</td>
</tr>
<tr>
<td>Communal and Personal Services</td>
<td>28.3</td>
<td>16.8</td>
</tr>
<tr>
<td>Public Administration</td>
<td>13.6</td>
<td>2.5</td>
</tr>
<tr>
<td>Total Informal Employment</td>
<td>–</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: MTSS/PRONATASS

The second set of sectors includes Utilities, Transportation, Services to Firms and Public Administration. These sectors each register "moderate" rates of informality (ranging from 8 to 24 percent), though none of them commands a notable share of the total informal workforce. Together, they account for less than 15 percent of informal employment. Though the contribution of Public Administration to informal employment is relatively small (2.5 percent), it is notable that almost 14 percent of its workers are, paradoxically, "officially informal."

Domestic service and construction merit a category of their own. Informality is particularly acute in these sectors: 72 percent of domestic servants and 56 percent of construction workers are employed without any work-related benefits. Together, they account for over 25 percent of the informal workforce. High rates of informality in these sectors may reflect their roles as points of entry into the labor force for migrants. During periods of high unemployment they also absorb excess labor supply. The typical informal worker in this sector contracts-out his labor, in a form of self-employment. Section 6, below, will address the question of migrancy in closer detail.

2.5 Estimates of Rural Informality

Table 2.4 above shows that fully 75 percent of agricultural workers in Greater Buenos Aires have been identified as informal. There are no updated official surveys, however, of the rural informal sector. The 1988 Censo Nacional Agropecuario (National Agricultural Census) provides some information on the population working on farms in Argentina. A summary of results appears in the following table. INDEC (1987) estimated that fewer than half of the non-family workers were registered employees.

<table>
<thead>
<tr>
<th>Table 2.5: Population Employed on Farms in Argentina</th>
</tr>
</thead>
<tbody>
<tr>
<td>Producers</td>
</tr>
<tr>
<td>Family Members</td>
</tr>
<tr>
<td>Non-Family Members</td>
</tr>
<tr>
<td>Total</td>
</tr>
<tr>
<td>Source: INDEC (1988)</td>
</tr>
</tbody>
</table>

Another study of rural working conditions was undertaken by the Interior Ministry between 1971 and 1974, in the form of a partial survey of seasonal employment in the Northeastern region. The Interior Ministry Survey was designed to ascertain the employment characteristics of migrants from border countries, especially Chile, Bolivia, and Paraguay. In 95 percent of the cases, no formal

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27 Given space limitations, no effort is made in this brief section to offer an inclusive treatment of this important issue.

28 Important research on rural employment is the work by Floreal Forni, Roberto Benencia and Guillermo Nieman, *Empleo, Estrategias de Vida y Reproducción: Hogares Rurales en Santiago del Estero.*
employment relationships existed, and payment—in—kind was a common form of remuneration (INDEC, 1987).

2.6 Migration into the Urban Informal Sector

The urban informal sector is a frequent “point of entry” into the labor force for migrants from border countries and the interior of Argentina. Such employment typically takes the form of self—contracting. A 1988 survey of the self—employed, undertaken by INDEC, reveals the high proportion of migrants in sectors where informality is also most frequent. A summary of results appears in Table 2.6 below.

Those sectors which exhibit the highest ratios of migrants to non-migrants (construction, manufacturing, commerce and services) are the same as those which register the highest incidence of informality (cf. Table 2.4). Retail trade is a common point of entry for migrants, who make up almost half of the self—employed in Commerce. The ratio of migrants to non—migrants is also high among of the self—employed in Industry and Services. Construction, which has a 56 percent incidence of informality, is an exceptional case: the ratio of migrants to non—migrants approaches 2 to 1.

Table 2.6: Migratory Characteristics of the Self—Employed in Greater Buenos Aires

<table>
<thead>
<tr>
<th>Sector</th>
<th>Place of Birth</th>
<th>Ratio of Migrants to Non—Migrants</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Greater Buenos Aires</td>
<td>Other</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>84,226</td>
<td>71,876</td>
</tr>
<tr>
<td>Construction</td>
<td>42,373</td>
<td>77,111</td>
</tr>
<tr>
<td>Commerce</td>
<td>132,054</td>
<td>115,091</td>
</tr>
<tr>
<td>Transportation</td>
<td>22,092</td>
<td>13,744</td>
</tr>
<tr>
<td>Finance</td>
<td>74,097</td>
<td>28,021</td>
</tr>
<tr>
<td>Services</td>
<td>144,199</td>
<td>102,574</td>
</tr>
<tr>
<td>Utilities</td>
<td>3,088</td>
<td>762</td>
</tr>
</tbody>
</table>

Source: MTSS (1988)

2.7 Poverty in the Informal Sector

In 1990, the Ministerio de Trabajo y Seguridad Social and INDEC surveyed fifteen Argentine cities to determine the working conditions in the informal sector, the results of which are presented by

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29 According to the 1988 Census of the Self—Employed (MTSS, 1988), approximately 86 percent of those engaged in commercial activities sold to final consumers.

30 The available data does not distinguish between rural migrants from within Argentina and those from bordering countries. Given the importance of this issue, more work should be undertaken to identify the national origins of the informal sector.
According to this source, the "informal sector" is synonymous with the small firm sector, i.e., firms with five employees or less. Within both the formal and informal sectors, workers are differentiated by the stability of their work contracts (permanent v. temporary) and whether they are officially registered as workers. Thus, the results allow for comparisons between the formal and informal sectors, and also for assessing the relative wages and working conditions in firms of differing "degrees" of informality. According to this typology, a temporary unregistered worker in a small firm represents the extreme of informality. On the other side of the spectrum a permanent registered worker in a firm of more than five employees represents the extreme of formality. An array of categories — ranging from permanent unregistered workers in large firms to temporary registered workers in small firms — lies between the two extremes.

Low wages are one link between poverty and the informal sector. Cafferata and Roudil's analysis confirms that registration status and firm size are important determinants of earnings. The results shown in Table 2.7 portray the earnings of workers, as a percentage of the economy wide average wage. They demonstrate the persistent and sometimes extreme wage differentials between registered and unregistered workers and between those in large and small firms. Across the spectrum of firm sizes, unregistered workers earn considerably less than their registered counterparts. Similarly, across all categories (registered or not, permanent or temporary) small firms pay lower wages than large firms. At the bottom end of the spectrum, the "most informal" workers — temporary unregistered employees of small firms — earn less than half of the economy wide average wage, while even permanent unregistered workers earn only 58 percent of the average wage.

Table 2.7: Relative Wages in the Formal and Informal Sectors of Argentina

<table>
<thead>
<tr>
<th>Sector</th>
<th>Total</th>
<th>Permanent</th>
<th>Temporary</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Registered</td>
<td>Registered</td>
</tr>
<tr>
<td>Formal</td>
<td>114</td>
<td>123</td>
<td>78</td>
</tr>
<tr>
<td>Informal</td>
<td>68</td>
<td>86</td>
<td>58</td>
</tr>
</tbody>
</table>

Base: 100 = average wage of all employed workers
Source: Cafferata and Roudil (1993).

The survey appeared as a "special module" on the biannual Permanent Household Survey (Encuesta Permanente de Hogares).
The significance of such wage differentials should be judged in the context of the severe downward movement of all wages in Argentina during the 1980s. Section 1.6 of the preceding chapter showed how the deterioration in the value of real wages precipitated a process of impoverishment affecting both formal and informal workers. Such has been the decline that a newly poor class has emerged among middle-class workers in “normal” employment situations earning average wages. As the Poverty Profile of Argentina reveals, economic swings tend to have a particularly acute effect on the informal sector. Effective real wages of workers in small firms lost more of their value during the recession (up to 1989) compared with those of the formal sector, just as they recuperated more quickly once the recovery began in 1991.

The detrimental aspects of informality are compounded by the lack of retirement or health coverage, sick leave or vacation. Fully 79 percent of permanent unregistered workers are employed without any work-related benefits. The link between poverty and informality is corroborated from a variety of angles, including the distribution of job benefits across different social groups in Argentina. The Ministry of Labor and Social Security found that, in 1987, over 28 percent of low-income workers in Greater Buenos Aires were employed without retirement benefits, compared with 9 percent for better paid workers. Similarly, the proportion of informal workers is notably high in the poor districts of Buenos Aires (villas de miseria). Among salaried heads of households in poor areas, the percentage of those employed without any job benefits reached 57 percent in 1980—nearly double the average for Greater Buenos Aires as a whole.

When one considers that these last statistics correspond to a year in which the national rate of unregistered employment was “only” 19 percent (see Table 2.1), the prevalence of informality in poor neighborhoods probably increased during the past decade as the informal sector itself has grown. Thus, policies that improve employment and earnings in the informal sector are sure to have an impact in reducing poverty. Such policies are the topic of the next chapter.

2.8 Conclusion

The urban informal sector throughout Argentina has grown rapidly over the past decade, as a response to the labor market trends described in Chapter I. At present, it encompasses about a third of the workers all over Argentina, with the vast majority (59.2 percent) located in firms with less than five employees. Urban informality is concentrated in those sectors with relatively easy access (manufacturing, construction, retail trade, and services) and with a high proportion of self-employed migrants. These findings indicate that the informal sector serves as a "stepping stone" for urbanization in Argentina. Migrants from rural areas (where informal employment is the norm) and neighboring countries enter the urban labor force at the lowest end of the pay scale and without job benefits such as retirement or health coverage.

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31 C.f. Minujin (1992), who describes the emergence of the "newly poor" as a result of the ongoing economic crises in Argentina.

32 The poverty profile of Argentina was constructed by H. Lee as input to the Argentina Poverty Assessment by the World Bank (LA4HR), and is not a published document.

33 MTSS (1989d).
The next section will examine poverty alleviation strategies with a focus on the informal sector. As the informal sector has grown in the past decade, its significance as a locus of poverty has increased, and poverty alleviation strategies aimed at the informal sector are more likely than ever to reach the working poor. Part Two will offer a policy alternative specifically designed to reach the poor in this manner.
III. POLICIES TO REDUCE POVERTY IN THE INFORMAL SECTOR

3.1 Introduction

There are several ways of improving the capacity of the informal sector to employ and remunerate the poor. One way is to alleviate the physical capital constraints to small-firm production, such as in providing credit to small firms and the self-employed. Another way is to alleviate the human capital constraints of the poor, through, for example, the provision of training for workers in microenterprises. Yet another way is to alleviate final and intermediate market constraints in transactions with final products or inputs, as in the establishment of different cooperative schemes for small firms. Finally, one may explore how to alleviate institutional constraints to informal sector operations, such as in the establishment of a "regulatory floor" to business activity, exempting small businesses from a large part of their fiscal and regulatory burden. This chapter discusses these different approaches to reduce poverty in the informal sector.

3.2 Training and Credit

In the past three years or so, Argentina has experienced a proliferation of activities, both official and non-governmental, aimed at reducing the human and physical capital constraints which diminish earnings in the informal sector. A summary of some of the major programs is presented in Table 3.1. Newness is one striking feature shared by almost all microenterprise promotion programs. Many government initiatives are still in their pilot phases, including the major credit program, the Programa Global de Credito. The Interamerican Development Bank, one of the major sources of funding for small NGO projects in Argentina, reports that the majority of its "small projects" are less than one year old. Therefore, most estimates of the costs and benefits of such programs in Argentina are based on projections rather than actual performance. Comparisons between programs are also complicated by qualitative differences in their outputs. The benefits of a training program are often intangible, and the costs of different credit programs vary according to funding mechanisms and lending methodologies. Nonetheless, a schematic description of informal sector interventions provides a general picture of current initiatives, and allows for a brief examination of the role of a deregulation policy, described in Part Two, within the framework of other assistance measures.

In Argentina, as well as in other countries, programs often combine several lines of intervention. Access to a particular credit program, for example, may be contingent upon the entrepreneur's participation in a management training course. Other credit programs give priority to group proposals in order to promote collectivization. This "package" approach is evident in some of the programs described below, such as Microemprendimientos Productivos in the province of Mendoza, or in the program of Pago Unico, whereby two or more unemployed workers can claim all their unemployment benefits in one lump sum upon the presentation and approval of a small business plan. In other cases, the same organization that facilitates access to credit (e.g., IDEMI - Instituto para el Desarrollo de Microempresas) also provides managerial training for interested clients.

3.3 Training to Release Human Capital Constraints

Training programs constitute one of the most popular forms of informal sector intervention in Argentina. Most official activity in this area provides entrepreneurs with basic business management skills. The main initiative of the national government is financed by a loan from the Interamerican Development Bank, as part of a larger program, Reconversion Productiva. Like many other informal sector programs, the Microenterprise Component of Reconversion Productiva is still in its pilot phase.
Projections for 1994 suggest that the government of Argentina will provide 10,000 entrepreneurs with general management training at a cost of $1,200 for each beneficiary. Approximately 150 existing technical institutes (Institutos de Capacitacion, or INCAPs) will submit competitive bids for training contracts with the program. Upon completion of the management course, participants will be offered ongoing consultation with a management specialist on an incremental fee-for-service basis.

Other programs combine management training with the provision of productive credit for entrepreneurs, such as Microemprendimientos Productivos (a project of the Provincial Government of Mendoza) or Empresa Joven of the Municipality of Buenos Aires. These programs, examined in greater detail below, compel beneficiaries to participate in management training as a prerequisite for receiving start-up loans. In a varying approach, one institution provides both types of assistance, training and credit, but in a separated and non-compulsory fashion. At IDEMI, which administers a guaranty fund for microenterprise credits, clients are offered training in bookkeeping, accounting, stock management, advertising, and information management on a fee-for-service basis. Receipt of an IDEMI guaranty, which enables an entrepreneur to solicit a commercial loan, is not contingent upon participation in training activities. The credit components of these and other programs are examined in the following section.

3.4 Overcoming Barriers to Credit

The absence of formal financial intermediaries is one of the distinguishing characteristics of the informal sector, and the shortage of credit for microenterprises is widely considered to impose severe constraints on their establishment, growth and operations. By limiting purchases of capital goods, this absence of credit sources impedes technological innovation and productivity growth. In some cases, it forces the informal entrepreneur into restrictive production arrangements similar to the "putting out" system, whereby the final purchaser of a good also supplies the inputs for its production, or credit to purchase them. In such an arrangement, the ability of the microenterprise to diversify its operations or expand its market is constrained by the demands of its suppliers.

The Programa Global de Credito para las Microempresas (PGC) is the Argentine government's response to the shortage of credit available to informal firms. The PGC will channel a $60,000,000 line of low interest credit to commercial and retail banks willing to develop a micro and small enterprise portfolio in which the average loan size is $10,000 (with a maximum of $20,000).

Based on the average loan size, one can calculate that 6,000 enterprises will benefit from PGC loans.

35 Several forces conspire to limit the availability of credit to microenterprises. High transaction costs are at the heart of the problem. These costs are partly a function of size. It is easier and less expensive for a bank to lend one large amount to a single client than to disburse a multitude of small loans over a diverse clientele. In the performance of due diligence, a lending institution must undertake a series of costly tasks for every loan it disburses, whether large or small. Every loan application must be evaluated and processed; every loan itself must be administered and collected. The costs of small-scale lending are complicated by the lack of experience, which is an outgrowth of lenders' traditional focus on larger customers. Thus, even when a bank is willing to offer small loans, it may lack sufficient experienced loan officers to process large numbers of applications effectively.

36 $45,000,000 of the funds are supplied through an IDB loan, $15,000,000 by the national government.

37 Two outstanding features of the PGC are worth noting. First, after the initial investment, the program does not imply large outlays from the public sector. Low costs to the public sector are built into the design of the program, which limits the role of the government to supervision and administration of the credit line. Administrative costs will be recovered in the interest payments made by participating banks. The second outstanding feature of the PGC is its
The role of the government in the Programa Global de Credito is limited to supplying a line of credit for banks and inducing them to serve the informal sector. By contrast, at the Provincial and Municipal levels, the government actually acts as a bank for the informal sector, supplying credit and administering individual loans. Municipal and provincial governments train and employ loan officers to evaluate proposals while guiding their clients throughout the various phases of establishing or improving a business. Clients are typically required to participate in motivational and educational seminars that foster entrepreneurial attitudes and skills. Empresa Joven (Municipality of Buenos Aires) and Microemprendimientos Productivos (Province of Mendoza) are examples of such programs. While Empresa Joven targets a specific population — youth — Microemprendimientos Productivos is aimed at the informal sector at large.38

In Argentina, as in most countries, access to credit is severely complicated by a major regulatory constraint in the form of banking regulations. All lenders in Argentina are legally required to demand collateral worth 130 percent of the loan sought. Thus, an applicant seeking a $10,000 loan must produce a guaranty form that certifies his possession of assets valued at $13,000 to serve as collateral. This regulation imposes a severe constraint on banks by restricting the clientele they can serve. By a wide margin, most informal sector activities are labor intensive, and the entrepreneur rarely possesses enough capital equipment or personal assets to produce such a guaranty.39 One NGO program, the Fondo de Garantia para la Micro y Pequena Empresa (FOGAMI), addresses this constraint by supplying clients with a guarantee to back their loan applications. Entrepreneurs whose access to credit is limited by their lack of adequate collateral can seek the backing of FOGAMI which, for a fee, will guarantee the loan and guide the entrepreneur through the application process.

3.5 The Limits of Existing Interventions

Table 4.1 provides a schematic summary of the main informal sector interventions in Argentina. At their current level of activity, existing programs are unlikely to suffice as a means to lift the informal sector out of poverty. Considering the size of the informal sector, the demand for services and programs far outstrips their current supply. One NGO umbrella organization in Buenos Aires, the Grupo de Analisis y Desarrollo Institucional y Social (GADIS) estimates that, including both official and NGO projects, there are approximately eighty-seven entities providing different types of services to microenterprises in Argentina, reaching a maximum of eight-thousand clients. By contrast, there are

emphasis on lowering transaction costs in the provision of credit for the informal sector. Banks which participate in the program must commit a certain portion of their interest spread to the development of cost-effective lending methodologies for small loans. In this way, banks are induced to lower costs on their side of the transaction. Through this emphasis on transaction costs, the PGC attacks one of the root causes of the informal sector credit crunch.

38 In addition to credit and training activities, Microemprendimientos Productivos, a project of the of Ministry of Cooperation and Solidary Action in Mendoza, also supports a "Microenterprise Incubator," which promotes collectivisation of firms in the informal sector. Participants share a common administrative infrastructure (secretaries, office equipment, etc.) supplied by the program. By working collectively where possible, small firms are able to pool their resources, capture economies of scale in production, and overcome the competitive disadvantages imposed on them by virtue of their size. Efficiency gains from collectivisation should lower the production costs and/or increase the output of firms, thereby contributing to higher incomes for their owners and employees.

39 The regulation governing collateral could also be considered a constraint on the demand for credit, since they limit the pool of potential applicants. The effect on entrepreneurs in the informal sector remains the same, regardless of the analytical angle one chooses to adopt.
177,903 microenterprises in manufacturing alone.\textsuperscript{40} The eight thousand enterprises currently receiving some form of assistance constitute only 4 percent of micro businesses in manufacturing and perhaps as low as 1 percent of the entire informal sector. While such an estimate is obviously very rough, it indicates the persistence of a large gap in the provision of services to the informal sector. In light of its importance as a locus of poverty in Argentina, and the limited coverage of existing efforts, the need for far-reaching policies is apparent.

3.6 The Role of Deregulation: Expanding the Reach of Poverty Interventions

Existing programs are not only limited in numbers and resources, but their interventions do not address all of the constraints in the informal sector.\textsuperscript{41} Human and physical capital restraints are compounded by other institutional and informational limitations which bind small firms. As will be seen in the next chapter, the regulatory framework contains many provisions which are especially punitive to small firms and which undermine their efforts to rise out of poverty. The increasingly regressive tax structure, for example, imposes a heavier burden on small firms, whose sales are particularly sensitive to the negative effect of consumption taxes, such as the IVA (Impuesto al Valor Agregado). In a similar manner, labor and other regulations which are appropriate for large firms, can seriously hinder employment and production in the small firm sector because of its heavier reliance on labor as an input. Regulatory costs borne by small firms diminish small firm employment by a wide margin, "repressing" perhaps as many as a quarter of a million jobs in manufacturing alone.\textsuperscript{42} Before allocating scarce resources to programs that help microenterprises overcome the many barriers to their growth, the government of Argentina should first remove itself as a barrier.

Deregulation of the informal sector would fit well into an overall strategy of poverty alleviation through small firm promotion. It could provide a "missing link" in the chain of interventions because, by clearing the regulatory framework of implicit disincentives to small firm activity, deregulation would release constraints beyond the reach of training or credit programs. Rather than providing specific and self-limiting programs, it would change the underlying conditions of the economic activity of the poor, and, unlike other lines of intervention which require the existence of a specialized delivery mechanism, reach all microenterprises in one sweep without the creation of new institutions.

\textsuperscript{40} This figure based on the 1985 Economic Census (see Table 5.1 in the Annex).

\textsuperscript{41} This observation should not be taken as an indictment against existing programs. Neither is it meant to suggest that any single intervention should address the full range of problems that constrain the activity of small firms.

\textsuperscript{42} See Chapter V in Part 2.
<table>
<thead>
<tr>
<th>Name of Program</th>
<th>Official or NGO</th>
<th>Needs Addressed</th>
<th>Summary</th>
<th># of Beneficiaries</th>
<th>Unit Costs (per Beneficiary)</th>
<th>Cost to Public Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Programa Global de Credito</strong></td>
<td>Official</td>
<td>Credit</td>
<td>Provides low interest line of credit to banks for disbursement to microenterprises. Requires investment by banks to develop appropriate lending methodologies.</td>
<td>6,000</td>
<td>maximum of $20,000 (loan size), average $10,000</td>
<td>$15,000,000 total; $5,000 per loan</td>
</tr>
<tr>
<td><strong>IDEMI: Fondo de Garantia</strong></td>
<td>NGO</td>
<td>Credit</td>
<td>Administers guaranty fund to serve as collateral for entrepreneurs seeking commercial loans. Assists loan applicants in bureaucratic procedures.</td>
<td>none yet, no official projections available</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td><strong>Lump Payment of Unemployment Insurance</strong></td>
<td>Official</td>
<td>Start-up capital</td>
<td>Groups of two or more unemployed workers may apply for lump-sum payment of unemployment benefits by presenting a business plan. Participation limited to workers eligible for unemployment insurance.</td>
<td>none yet, no official projections available</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td><strong>Reconversion Productiva (Componente de Microemprendimientos)</strong></td>
<td>Official</td>
<td>Management Training</td>
<td>Trains participants in general management skills, such as bookkeeping, marketing, etc. Individual technical assistance follows group course, at discretion of participant.</td>
<td>10,000 projected</td>
<td>$1,200</td>
<td>Financed by IDB</td>
</tr>
<tr>
<td><strong>Empresario Joven</strong></td>
<td>Municipal</td>
<td>Credit, Management Training</td>
<td>Targeted to youths, aged 18 to 30. Program selects participants based on an evaluation of individual or group business proposals and provides training and credit financed by a rotating fund.</td>
<td>97 new jobs, support to 149 existing jobs</td>
<td>$830</td>
<td>$204,180</td>
</tr>
<tr>
<td><strong>Microemprendimientos Productivos, Province of Mendoza</strong></td>
<td>Provincial</td>
<td>Training, collectivisation, credit</td>
<td>A &quot;full-service&quot; provincial program that offers participants management training, credit, and collective infrastructure (computers, phones, etc.).</td>
<td>6,000 projected for 1994</td>
<td>$112</td>
<td>$734,865</td>
</tr>
</tbody>
</table>

Source: Interviews and publications provided by program administrators.
3.7 Conclusion

Poverty alleviation activities typically involve transfers of goods and services to the poor, such as housing, health care and education. Another line of intervention targets the informal sector as an operational focus for anti-poverty efforts, through the provision of training or credit. When undertaken by the public sector, both types of policies—transfers or training and credit programs—are limited by the scarcity of funds, which tends to be especially severe during periods of structural adjustment and slow growth. Although such policies are, and should be, the mainstay of a poverty reduction scheme, they need to be complemented with additional policies that result in poverty reduction without increased public spending. One such option is that of business deregulation for job creation in the informal sector. Such deregulation could significantly raise employment, at a very low cost in terms of public revenues foregone, in a sector of growing importance to the working poor. Part Two will examine this possibility in detail.
PART TWO:

DEREGULATION AND EMPLOYMENT

IN MICRO FIRMS
IV. Deregulating the Unregulated

Since Coase's seminal work on The Nature of the Firm, economists have had to grapple with the difficult problem of determining why some activities are undertaken inside a firm while others are transacted outside of it. Very small firms pose additional challenges, in that their activities are often so unstable and varied, and their transactions so interlinked, even camouflaged, that their "nature" becomes especially difficult to specify. There is no set of characteristics by which to define or describe the smallest firms, or "microfirms" aside from the obvious fact of their smallness.

Some microfirms sell directly to the final market, some sell in the intermediate market. Some supply large firms with parts and components (as in the mechanical–electrical industries), or with finished products for resale (as in the garment industry); some sell these same goods to final consumers. Some are service providers to intermediate and final consumers, such as repair, maintenance, or personal services. Some switch back and forth, depending on stage of the business cycle, type of activity, and managerial experience of their owners. Some owners learn their skills and amass their savings in the formal sector, then strike out on their own business ventures. Others learn their skills in the informal sector and then find a job in a formal firm. There is a back and forth mobility between workers in formal and informal firms, which also appears to vary with the business cycle, sector of activity, skill mix, and other features. Gender and migrant status are important for some activities, such as garments (women) and metalworking (men), though not for others, such as food services. Poverty and low wages are relatively widespread among microfirm employees, though not necessarily among their employers.

One characteristic of a high proportion of microfirms is the evasion of business regulation. However, not even evasion is homogeneous among microfirms. Some are totally clandestine, while others obtain at least some form of registry, (e.g. initiating permits) and then evade everything else. Some obey sanitary legislation, but evade labor benefits; others obey safety regulations (such as in transport services) but evade taxes. Some firms are run by owners who, although competent in their skills, cannot gain access to official permits, whether because they are illiterate, because they have not attained the necessary diploma or certification to do business in their line of operation, or for other reasons. Although the variations are endless, one generalization that can be made is that regulatory evasion is a significant part of the competitive (or survival) strategy of most small firms. This evasion leads to much of the microfirm sector being called the "informal sector" of the economy.

Analysts often mistake lack of regulatory compliance with "more freedom" to operate, or with some other advantage of operating outside the law supposedly enjoyed by the informal sector. However, the existence of an unobeyed regulatory framework is far from a bonus to evaders. Regulations penalize evading firms and their workers by delegitimizing them before society. Although the vast majority of microfirms conducts legal activities (e.g. sewing, repairs, etc.), it is subject to harassment, persecution, and violence by official and "unofficial" authorities. Gangs and extortionists take over small business districts to extract payments in the absence of official protection for non-regulated activities. The degree of such violence can reach extremes, such as in the widely publicized killing of children street vendors in Rio de Janeiro. Such extremes, though sporadic, draw attention to the fact that microfirms are under constant threat and pay considerable sums to gain the right to go about their businesses peacefully.
By "deregulating the unregulated," a government may reduce costs incurred by the poor, whether in their official or unofficial transactions. Such a policy, to be put into effect, would have to selectively determine which regulations to maintain and which to eliminate: a Byzantine task to say the least! Business regulation is composed of a maze of contradictory, overlapping, and exceedingly obscure laws. Such impenetrability is quite useful in conferring power to enforcers and in allowing corruption to spread. As de Soto has shown in the case of Peru, small entrepreneurs must exert considerable effort to wade through legal requirements, set up shop, and keep open in oppressive regulatory environments.

In recent years, Argentina has begun a major effort to clean up its own "messy" regulatory environment. The objective of this study is not to comment upon that work, or to monitor its progress, which requires a command of specific legal fields of expertise and experience with that specific society and its modus operandi. As can be seen in the Appendix, the web of regulations is very complex. The objective here is not to do lawyers' work, but economic analysis. This study provides tentative initial estimates of the costs of regulation and regulatory evasion for the smallest firms. It expresses those costs in terms of employment in order to illustrate the potential gain to microfirms of a deregulatory policy. As stated in the Introduction, these figures are not statistically rigorous predictions. Rather, they express the magnitude of the problem, from the firm's point of view.

In many ways, Argentina is a good case study by which to initiate a general study of deregulation and informal sector employment. The Argentine informal sector is notoriously small, compared to that of other Latin American countries. The savings to microfirms generated by a deregulation policy in Argentina should, therefore, represent a lower-bound estimate of the benefits to be gained from such a policy. As will be seen below, the estimated employment gain turns out to be quite large. This result suggests that deregulation could have potentially high benefits for other countries, where poverty and the informal employment are both more widespread than in Argentina.

The next section presents a simple model that estimates approximate costs and benefits of deregulation for the informal sector. The following section will apply this model to the case of Argentina. The Appendix presents the main business regulations in effect in Argentina today and quantifies their cost to microfirms.43

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43 The Appendix, written by Argentinean consultants for this project, provides extensive information on Argentinean business regulations and comments on recent changes or likely reforms
V. A MODEL OF DEREGULATION

1. Introduction

In order to undertake an economic analysis of policies that can improve the lot of the working poor in Argentina's informal sector, one must first place the issues within a broader theoretical framework. There are several ways of improving the capacity of the informal sector to employ and remunerate the poor. One way is to alleviate the physical capital constraints to microfirm production through, for example, the provision of credit. Another way is to alleviate the human capital constraints of the poor, through, for example, the provision of training for workers in microenterprises. Yet another way is to alleviate final— and intermediate—market constraints in transactions with final products or inputs, as in the establishment of different cooperative schemes for small firms. Finally, one may explore how to alleviate institutional constraints to informal sector operations, such as in the establishment of a "regulatory floor" to business activity, exempting the smallest businesses from a large part of their fiscal and regulatory burden. This final approach will be investigated in this and the following sections.

To simplify the analysis, it will be considered that microfirms react to economic constraints, imposed upon them by the market or by the surrounding institutional system, according to standard microeconomic behavior. There is a long literature on the small firm sector that takes into consideration the cultural, social, and household aspects of the behavior of very small firms, where production and consumption are often intertwined: family labor being an important part of total labor input, family savings an important part of total available resources, and family contacts an important part of marketing strategy, etc. This section, however, will be limited to an analysis of the microfirm as a "unit of production," independent from the "unit of consumption," taking microfirms and the self-employed as conventional microeconomic decision-makers in the market. This approach permits the identification of an additional set of policies that could have a positive impact on income and employment in developing countries. By investigating how regulations add to microfirm costs, one can explore the possibility of deregulation as a strategy for poverty reduction in the informal sector. Before proceeding with the case of Argentina, therefore, it is necessary, in this section, to identify relevant characteristics of firm behavior in general.

This section discusses the different types of costs incurred firms in general, and in the informal sector in particular. It also presents a simple model for calculating the costs and benefits of a policy of "across the board" deregulation of the smallest firms. Part 2 details the economic and regulatory costs incurred by firms in general. Part 3 presents a simple model of market behavior and interactions between small and large firms over different stages of the business cycle. Part 4 presents a simple formula for the calculation of costs and benefits of deregulation.

Chapter VI, following, applies this model to empirical evidence with respect to firms in Argentina. The principal conclusions and policy implications of this exercise are sketched in Chapter VII.

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4 For a recent review of this literature in general and in Latin America, see Turnham (1992), Tokman (1992), respectively.
The main conclusion derived from the analysis done in this section is that deregulation could significantly increase employment in the informal sector at a very low cost in terms of revenues foregone for the public sector. The policy relevance of this conclusion is immediately apparent when one considers the growing need, in Argentina and in the rest of Latin America, for finding poverty-reduction strategies that are "affordable." Tightening budgetary constraints in the post-adjustment era severely limit the range of options facing governments. The objective here is to expand that range, and complement public expenditure programs, mostly aimed at the "dire" poor, with a non-spending approach, aimed at the working poor. Those who become impatient with microeconomic simplifications may skip this section altogether and turn to Section V for a continuation of the discussion of the Argentine case.

2. Costs

There are four types of costs incurred by firms. They are discussed in the following paragraphs:

2.1 Economic Costs

Monetary and non-monetary fixed and variable costs, together, compose a firm's economic cost schedule. In the absence of a regulatory environment, economic costs are the basis for deriving total average costs (AC) and marginal costs (MC) necessary for analysis of firm behavior in the product market.

1) **Monetary fixed costs** are actual outlays for equipment, premises, construction, installations, initial stocks of inputs (and maybe outputs), down payments, advance lump sum rentals and "good will", royalties, franchises, recruiting, hiring, and training labor, principal repayments plus interest rates on start-up or investment loans outstanding, contractual arrangements that imply outlays with suppliers, clients and others, plus additional transactions necessary for initiating or expanding a business in the absence of any regulation, institutional requirement, or business legislation.

2) **Non-monetary fixed costs** are the opportunity cost of non-market resources used to start up or expand a business. The resource in question may be the entrepreneur's own time or that of another. Time, whether that of the owner or any of his employees, is valued at the average wage rate. Other resources of one's own may be extractive (such as fishing, fuelwood, mineral, herbal, etc.), scrap, or previously-owned articles (used in former businesses or in the household), or other, all of which are valued at the respective average market price.

3) **Monetary variable costs** are actual outlays on labor (wages and benefits), purchasing intermediate inputs, paying rents and public utilities, spending on repairs and maintenance, paying interest on credits on current transactions from suppliers, clients, or financial institutions, and all other transactions necessary to keep a business going in the absence of any regulation, institutional requirement, or business legislation.
4) **Non-monetary variable costs** are the opportunity costs of non-market resources used to maintain the current operation of a business, analogously to (b), above. Again, the resource in question may be own time or other. Whatever the case, it should be valued at average market cost (respectively, the wage rate or price). Finally, market interlinking in the product-input-credit markets (as in supplier- or client-credits and other arrangements) may generate non-monetary variable costs in the form of income foregone, due to lower product prices or higher input prices.

2.2 Regulatory Costs

Regulatory costs are all the costs that a firm incurs because the regulatory environment exists. Thus, if deregulation were to occur, these costs would be done away with or diminished considerably. In the presence of regulations, their costs are added to a firm's fixed and average cost schedules and influence the firm's microeconomic decision-making, specifically with respect to derived demand for labor.\(^45\)

5) **Regulatory costs** are total outlays if all regulations were complied with, i.e. if all licenses, taxes, fines etc. were paid to “official authorities”. They may be fixed or variable. Fixed regulatory costs include registries, licenses, fees, contracts with public authorities regarding zoning regulations, public utilities provisions, enforcement of labor- and other legislation regarding start-up and/or expansion of a business. Variable regulatory costs entail paying taxes, renewing fees, licenses, registries, and otherwise complying with legislation regarding current operation of a business.\(^46\)

6) **Evasion** are outlays not made by the firm; they are the difference between total regulatory costs and compliance. All firms comply with some regulations and not with others, though smaller firms tend to greater evasion than larger ones. Evasion are revenues foregone by official authorities. Evasion may refer to fixed or variable costs, depending on the nature of the regulation being evaded.\(^47\)

7) **Evasion costs** are expended by the firm because of its evasions, i.e., made because the firm is not complying with some or all regulations. Such costs may be (a) outlays made by the firm, or (b) opportunity costs incurred.

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\(^45\) Multi-country studies of regulatory frameworks and their cost implications for small firms have recently been undertaken by both the International Labour Office (ILO) and the Organization for Economic Cooperation and Development (OECD). In a study on Zambia, the ILO found that an overwhelming majority of survey respondents drawn from the informal sector indicated that regulatory costs imposed significant constraints on their set-up and operations (ILO, 1990).

\(^46\) In addition, regulatory costs should include the purchase or use of more expensive premises, equipment, or processes because of official requirements, when cheaper alternatives are available in the market. These cost increments may add considerably to average and marginal costs, but they are hard to observe directly.

\(^47\) In addition, evasion occurs when sub-standard premises, equipment, inputs, and processes are used instead of those required by pertinent regulations. As noted in the previous footnote, these values are difficult to observe directly, though they may be a substantial part of the “saving” due to evasion.
(a) Evasion outlays made by the firm consist of payments consist of bribes to official inspectors, or of "protection" fees to "vigilantes", gangsters and other "unofficial authorities" who impose their own regulations in whole neighborhoods, stretches of sidewalks, lines of business etc. Although such costs are typical of illegal activities (such as prostitution, drug trafficking, gambling) they are also imposed on legal but unregistered (i.e. "informal") activities. Evasion costs are not owed to government and their removal would not represent revenue foregone by official authorities. Evasion costs may be (i) fixed or (ii) variable:

(i) Fixed costs entail bribes paid to enforcement authorities, or "protection" fees paid to local gangs, or other illicit payments necessary to initiate or expand the business.

(ii) Variable costs refer to similar payments necessary to keep a business going.

(b) Evasion opportunity costs refer to additional expenses incurred because of resorting to unregulated resources. These costs may also be fixed or variable. Though they may be considerable, their covert nature makes them hard to quantify empirically.

(i) Fixed evasion opportunity costs include long run strategies to avoid compliance, whether by official or "unofficial" (e.g. "vigilante") authorities. An example is the need to reduce visibility by avoiding vertical expansion. An increase in plant size may, in some cases, bring in economies of scale, which must be sacrificed so as not to call attention to the firm (and its evasions). By resorting to "lateral expansion", i.e., multiplication of small plants, one may be generating diseconomies of scale, because of need for increasing communications, supervision, quality control etc..

(ii) Variable evasion opportunity costs unfavorable relative prices in current transactions, such as: higher interest rate payments resulting from use of money-lenders rather than banks; lower productivity resulting from use of scrap rather than new parts, equipment, and raw materials; higher prices for inputs and lower prices for outputs resulting from under-registration; lower quality, quality control, and therefore price may result from direct extractivism rather than regulated purchases of inputs; and so on.

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46 Despite these empirical difficulties, however, Maipose (1990) finds that these costs are perceived by small firm owners to be significant and that they include lack of access to infrastructure and support services.

49 If the loan is for start-up, this would be a fixed cost.

50 These unfavorable "terms of trade" also frequently result from market interlinking, whereby one's final client "advances" raw materials and/or loans for equipment etc. in return for lower product price. This type of arrangement resembles the "putting out" system during the industrial revolution, is still widespread today with respect to the marketing of products originating in the informal sector. Examples of this arrangement in Mexico City and Uruguay are documented in Portes, Castells and Benton (1989).
In any given market, all firms incur variable combinations of the above costs, some of which may permanently or temporarily be zero. The proportion of different types of costs for different types of firms is determined by the operation of the market, as described in the next section.

3. Market Structure and the Informal Sector

Suppose a homogeneous good or service is supplied by a large number of very small firms, all of whom are price takers in product and input markets. Every unit has fixed and variable costs, as listed above, that display "normal" average and marginal characteristics. In any given sector there tends to be a continuum of firm sizes, from micro and small to medium and large, in different proportions. Figure 1 represents such a market, according to the conditions presented below.

3.1 Economic Costs: T

The long run average cost (monetary and non-monetary) curve for the market as a whole is given by T. T is determined by technology and other economic costs (listed in 2.1.A above). For simplicity of exposition, only two firm sizes will be referred to: large (L) and small (S). Q_L and Q_S refer to the quantity a typical firm of each size brings to market. T represents economic costs (excluding regulatory and evasion ones) actually incurred by firm size, though not necessarily paid for in monetary outlays. Thus, T can be observed empirically.

Under conventional competitive conditions, prices, wages, interest rates, and other costs would be the same throughout the economy. Under such "ideal" conditions, T would display the usual downward-rightward sloping curvature only if economies of scale exist (i.e. if larger firms would have cost advantages over smaller firms). If such were the case, one would not usually expect small firms to be an important presence, unless some form of market concentration behavior were being practiced by large firms. Given competitive equilibrium, however, i.e., barring "collusive" market behavior, small firms will tend to be more important in markets where economies of scale are relatively less important. That is, small firms will tend to operate in production processes where average costs of small units of production are similar to those of large units. In this case, long run average economic costs, T, will tend to have a rather weak curvature downward to the right.

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31 The assumption of homogeneity in the product market will be relaxed later in the exposition.

32 These are "U" shaped well behaved average cost and rising marginal cost curves in the relevant region of production, carrying all standard assumptions.

33 One might then expect that large firms would be reaping economic profits by relaxing barriers to entry for small firms, allowing prices to rise until they cover small firms's (higher) average costs. This does not mean that existing large firms would allow entry by outsider large firms into the same market, however, as such large entries would reduce prices and eliminate economic profits by large firms. Thus, only the so called "small firm fringe" would be tolerated. See classic works on pricing and structure of production in markets where large and small firms coexist, such as Bain (1951, 1969) and Sylos-Labini (1980).
In dualistic, or heterogeneous economies, where prices, interest rates, input costs, and wages are different in different segments of the economy, then "true", or "competitive" average costs are never obtained. Wherever economies of scale do exist, small firms tend to compensate for lower factor productivity by paying lower wages, purchasing lower quality inputs etc. As a result, small firms' "observed" average costs deviate from (become lower than) what would have been their own average costs under competitive equilibrium. As they approximate the average costs of large firms, economies of scale become somewhat masked in observed survey data. Thus, empirical observations of T from enterprise data tend to display constant returns to scale, or weak economies of scale, even in sectors where increasing returns might be expected.

3.2 Regulatory Costs: R

Given a regulatory environment, if all firms complied with all existing regulations, i.e., if regulatory costs (in 2.2 (5) above) were paid by all, the long run average regulatory cost curve for the market as a whole would be R. This curve may or may not slope downward from the left, depending on whether regulations do or do not contain indivisibilities, which, in turn, may or may not introduce, or emphasize, increasing returns to scale in the sector as a whole. In the absence of economies of scale in regulatory costs, R+T will tend to be parallel to T. If no firm were to comply with existing regulations, i.e., if all were complete evaders, then the long run average cost curve for the market as a whole would, again, be T. Once all regulations are known, R+T can be plotted above T, even though R is an "ideal", probably never achieved in practice.

Most firms practice some evasion (as in 2.B.6 above), though smaller ones probably proportionately more than larger ones. To the extent that firms "choose" to evade some, rather than to comply with all regulations, then their average long run cost of compliance curve is given by C. This is somewhere between R and T, though the exact location is a matter for empirical observation. The gap between C and T be relatively small leftward, indicating greater evasion by small firms; the gap between C and R may narrow rightward, indicating greater regulatory compliance by large firms.

In addition to costs of compliance, firms also incur costs of evasion. The average long run cost of evasion curve is given by E, which must lie between C and R. This refers to costs incurred in addition to compliance, yet provoked by evasion, as listed in (2.b.7), above. This is the "real" average cost curve for firms in the market. However, due to the difficulty of observing evasion costs, the location of E cannot be specified with precision. Enterprise surveys, and other forms of direct field work, can only observe C instead.

Legislation can introduce indivisibilities, such as when the expense or time input for registry, licensing, or otherwise complying with a requirement is similar across different firm sizes. Then the cost per unit of output of that requirement will be larger for small firms than for large ones. This will generate an average cost curve that is downward sloping from the left, more sharply so than is shown in Figure 1.

In a study undertaken for the Organization for Economic Cooperation and Development, Journard, Liedholand Mead (1992) found that the level of compliance to applicable regulations depends both on the type of regulation and characteristics of the small firms involved. In Niger and Swaziland, compliance is highest with respect to registration and licensing, and lowest regarding taxation.

Evasion may thus be an additional strategy for reducing the effect of technical and regulatory indivisibilities in raising unit prices of small firms. Preliminary empirical observations do suggest that unit regulatory costs are relatively higher in small firms than in large ones. See Cortes and Marshall (1993).
Thus, $T$, $C$, and $R$, are observable empirically, while $E$, the “real” long run average cost curve, that incorporates all types of costs incurred by the firm, is not. The behavior of firms in response to changes in $E$, however, can be observed and analyzed empirically.

Points $1_s$ and $1_L$, along $E$ are the profit maximizing points, where short run marginal costs (MC) equal short run minimum average costs (AC), for small firms and large firms, respectively. If all firms are price takers, then the market demand schedule perceived by each is a horizontal line, as in $P$. Unit profit is given by the distance between $P$ and $R$ (ideal), $P$ and $C$ (observed), and $P$ and $E$ (real). Competition in the product market jointly determines product price and total quantity transacted. For firms of each size, this determines quantity, income, costs, and profit per enterprise.

3.3 Product Market and Labor Market

Assuming no technical, economic, or regulatory barriers to entry in the market, new firms will be formed as long as owners (self-employed or employers) cover their opportunity costs in the labor market. As long as owners' remuneration is greater than or equal to what they would earn if they were employed in large firms, they may “choose” to self-remunerate in small firms. In conditions of full employment, then, the opportunity cost for small firm employers can be taken to be the wage rate in large firms. Owners' self remuneration is the firms' net profit. This is given by the area between $E$ and $P$. If the owner is self-employed, this area represents his/her take home pay. If there are unpaid family workers, some non-market intra-familial distribution mechanism will be resorted to, though there is no way of observing it from conventional enterprise surveys. If some part of net profit is invested back into the firm, this cannot be observed either, as surveys usually do not present such information. Owners probably pay themselves more than they do other family workers. However, in the absence of such information, one has to assume equal earnings for all, and take this value to be the “imputed wage” ($w'$).

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57 To unclutter Figure 1, the short run average and marginal cost curves that cross long run average costs $E$, at points $1_s$ and $1_L$ are omitted.

58 In order to keep “out of the way” of cost curves, $P$ is drawn, somewhat “optimistically”, way above costs. This would imply large economic profits in this market, which is not at all necessary for the argument.

59 Total market demand is downward sloping and imposes a limit to total quantity supplied at each price. This is not shown in Figure 1, since $P$ is the individual demand schedule perceived by each individual (price taking) firm at the prevailing price.

60 There is a large literature on the motivations of small firms' owners, showing that many dislike wage employment and prefer the relative autonomy of being their own boss while others have cultural, life cycle, gender, ethnic, or other motivations to choose being owners rather than large firm employees. See references in ILO (1992).

61 In conditions of unemployment, small firm owners may not be “choosing” what they do; they may be simply not finding a job in a large firm. In this case, their opportunity cost in their small firm should be the going wage rate in large firms discounted by the probability of finding a job at that rate.

62 The Argentinean economic census of 1985 does not contain this information. Enterprise surveys in other Latin American countries do, such as, for instance, those of Brazil.
Small firm entries (and exits) occur when net profit in small firms rises above (or falls below) average wages in large firms. Some small firm entries come from former employees in large firms, some from the previously unemployed, some from the previously economically inactive. Likewise, some small firm exits go to employment in large firms, others go to the pool of unemployed or economically inactive. The movement of workers between large and small firms, and into or out of the labor force, during phases of economic expansions and contractions, will be discussed in the next sub-section.

The area between C and T multiplied by number of firms of each size, represents total revenue actually collected from the firms in this market from all contributions, taxes, fines, dues etc. The area between R and C, multiplied by number of firms of each size, represents total revenue foregone due to evasions. The area between E and C, multiplied by number of firms of each size, represents evasion costs paid to “non–official” authorities. The area between E and T, multiplied by total number of firms, represents total regulatory cost actually incurred by the firms in this market, some paid to “official authorities”, some paid to “unofficial authorities”.

The “informal sector” is loosely defined as that part of the a market where evasion is proportionately greatest. According to Figure 1, this would be somewhere near Qs. It is not particularly meaningful to set hard and fast boundaries for the informal sector, however. From the policy point of view, it is far more relevant to analyze how evasion by small firms behaves during economic expansions and contractions, as will be done in the next section.

3.4 Entries, Exits and Evasion During Economic Expansions and Contractions

In any given market, firms of different sizes compete dynamically among themselves during general economic (1) expansions and (2) contractions. This affects entries and exits into/out of the market and regulatory evasion by small firms, as follows:

1) During general economic expansions, final demand rises, as does intermediate demand for productive factors. The combined effects of such shifts in (a) final and (b) intermediate demands is summarized below:

(a) With rising final demand, P should shift upward, raising product price. This may make room for some (higher cost) small firms to enter and/or for regulatory compliance to increase, bringing C closer to R for pre–existing firms.

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63 In all of the following discussion, it is assumed that there will be no entries by large firms. Such events fundamentally alter the preexisting structure of production and cannot be taken into account by a model intended to deal with the small firm part of the market.

64 In the absence of macro policies that alter conventional sectoral market behavior, one can allow for rising final demand to raise prices. See Footnote 16 below, on this issue.

65 If expansion provokes entry of large firms, however, price may not rise. Due to large increases in Qd, price may even fall. In this case, a part of the small firm contingent may have to squeeze costs, including regulatory costs, or even be expelled from the market altogether. As price falls, increasing evasion will bring C closer to T. This may not be in the interest of pre–existing large firms, as it may reduce economic profits for all. In this sense, a “small firm fringe” may be desirable for large firms, as it masks large firm profits and reduces inducements to entry by other large firms.
In the beginning of the expansion, capacity utilization increases for all and some large firms may subcontract small firms to accommodate increased final demand. This subcontracting may increase regulatory compliance among small firms. After rising demand has been sustained for a while, large firms may decide to increase own capacity and reduce subcontracting. If rising net profit among small firms becomes greater than (possibly) rising wages in large firms, there may be a tendency for entry by owners who were formerly workers in large firms.

(b) With rising intermediate demand for factors, labor remuneration (wages and/or benefits) and other fixed and variable costs rise. T shifts upward (pulling E and R along with it). Depending on whether this upward shift in costs is (i) greater or (ii) smaller than that of final demand, then small firms’ entries, exits, and evasion will be different:

(i) If rising cost is greater than rising final demand, T shifts upward by more than P does (pulling E and R along), then small firms may have to squeeze costs, including regulatory costs. As evasion increases, this brings C closer to T. However, this may raise the cost of evasion itself, pulling E away from C. As net profit for small firms is squeezed, it may fall below large firm wages, provoking an exit of small owners to wage employment in the large firm sector until a new equilibrium is reached.

In sum: compliance falls and exits occur.

(ii) If rising cost is smaller than rising final demand (T, E, and R all shift upward by less than P does), then small firms may “invest” short term economic profits into increasing compliance, bringing C closer to R, and E closer to C. As net profit for small firms expands, it may rise above large firm wages, provoking entry of small owners out of large firms as well as from the unemployed or economically inactive. This may continue until new entries drive price back down to the new equilibrium cost levels.

In sum: compliance rises and entries occur.

2) During general economic contractions, final demand declines, but so does intermediate demand for productive factors. The combined effects on final and intermediate demand is summarized below:

(a) With falling final demand, product price is lowered, which may also squeeze small firm costs and/or drive out small firms. Increasing evasion, once more, brings C closer to T. Some large firms reduce subcontracting of small firms before reducing own capacity utilization and before laying off their own workers.

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66 See (2) below, where subcontracting leads to increasing evasion among small firms during downturns in economic activity.

67 Falling product price may not accompany economic contractions, as the “stagflation” experience of many poor and rich countries has shown over the last two decades, especially during the 1980s. The model above is flexible enough to accommodate such variants, though space limitations prevent a full, explicit presentation of all of them.
Alternatively, large firms may resort to subcontracting of small firms to evade regulatory costs in own plant. As net profits fall among small firms, some owners may want to give up and look for employment in large firms. Since the probability of finding a job in large firms may have decreased as well, they may remain where they are and "take the squeeze".

(b) With falling intermediate demand, costs are lowered, i.e. labor cost (wages and/or benefits) and other fixed and variable costs fall, shifting T, C, and R downward. Depending on whether this downward shift in costs is (i) greater or (ii) smaller than that of final demand, then entries, exits, and evasion by small firms will be different:

(i) If costs fall by more than final demand (T, E, and R all shift downward by more than P does), then small firms may enjoy short term economic profits and even increasing compliance, bringing C closer to R, and E closer to C. Net profits may then rise above large firm wages, bringing in entries from former large firm employees. This process may go on until new entries drive price further down to the new equilibrium cost levels.

In sum: compliance increases and entries occur.

(ii) If costs fall by less than final demand (T, E, and R all shift downward by less than P does), then small firms may have to squeeze costs, including regulatory costs. If evasion increases, this, again, brings C closer to T, and pulls E away from C. Net profits may fall below large firm wages and provoke exits searching for large firm employment. Since the probability of finding such jobs also declines, owners may "sit tight" where they are despite declining incomes.

In sum: compliance falls and exits occur.

Simplifying the argument, one would expect that:

1) during expansions—net profits increase for small firms, large firms increase "compliant" subcontracting of small ones, entries occur, and regulatory compliance increases, unless small firms get priced out of intermediate markets by large firms.

2) during contractions—net profits decrease for small firms, large firms increase "evasive" subcontracting of small ones, regulatory evasion increases, and exits occur, unless owners find themselves trapped into their small firms, with poor employment prospects in large firms.

Qualifications in previous note apply here as well.
4. Costs and Benefits of Deregulation

4.1 Deregulation

In many countries, employment is growing by less than is needed, given the growth in labor supply. Given the insufficiency of unemployment compensation, "excess labor supply" swells the small firm sector with low income employment. In terms of the above model, one would say that employment grows more in evading (usually smaller) firms than in complying (usually larger) firms. Evasion seems to be increasing throughout the market, all firms tending to become "more informal" 69, yet there is still a marked tendency for small firms to be the most absorptive of the "excess labor supply".

Much of the attention paid to the informal sector is directed toward the microfirm segment, which is especially "porous" to entry pressures during economic contractions. Workers laid off from large firms, or workers who have been unemployed, or economically inactive, start up their own small firms, effectively generating a form of "spontaneous unemployment compensation" cum "spontaneous social safety net" in the private sector of the economy. To "squeeze in" during contractions, new entrants must compress monetary and non-monetary, fixed and average costs, as well as compliance with existing regulations. This entails, among other strategies, compressing labor remuneration (lowering T) and increasing evasion (shifting C closer to T), which, in turn, increases the costs of evasion (pulling E away from C).

Aggravated evasion and lower wages among increasingly "informal" small firms implies worsening poverty among informal sector workers. To reduce this incidence of poverty, then, one must deploy policies that increase small firms' incomes and wages. A broad spectrum of such strategies has been reviewed by a growing literature on poverty reduction.70 This section deals with only one of them: business deregulation.71

Suppose that a reform program institutes a "regulatory floor" on several requirements, much as an income tax "floor" is common for income levels below a given threshold. Such a policy would relieve small firms of many regulatory costs. Perhaps regulatory incidence could be made to rise gradually, according to firm size, or some other mechanism would be instituted for "graduating" out of the program.72 I.e., after the reform, small firms will be expected to pay nothing and large firms are to pay all of (fixed and average) regulatory cost. A simplified version of such a reform, assuming total deregulation for small firms, and total obligation for large firms,

During the past decade, the increase of "informal" employment has taken many forms in developing countries. In Argentina, there has been an increase in unregulated employment not only in small firms, but also in large, "formal" enterprises. This trend has been called an increase in "precarious" employment.

Deregulation as a poverty reduction strategy is not prominent among the sources cited in the previous footnote. This study aims precisely to enhance this topic in the general debate on poverty reduction policies. The present section does not deal with concrete measures and decisions, such as which regulations are necessary for consumer protection, etc. The objective here is merely to provide a basis for assessing the quantifiable costs and benefits of any such policy.

This is a thorny issue as there may be a tendency to trap small firms inside their exemption.
is represented by the area left of the wavy boundary arbitrarily drawn to the right of S, to represent the small firm sector in Figure 1.73

Deregulation does away with compliance and evasion costs for small firms, flattening E and C onto T. R is now a broken line that begins at the intersection of T with the vertical axis, goes to the (wavy) small firm boundary, weaves up to R itself, then proceeds rightward horizontally, as before. This reform increases net profits among small firms, by an amount equivalent to area A multiplied by the number of such firms. Such profits signal new entries, whether from workers moving out of the large firm sector, or from the previously unemployed or economically inactive. Such entries persist until they drive demand and price down to the new market clearing level, from P to, say, P'.

As a result of deregulation, a larger number of small firms now supplies the market. Demand for labor increases, be it due to increasing numbers of self-employed or to increasing number of small firms and their employees. If the supply of labor is infinitely elastic, employment increases at the going wage rate. If there is any elasticity to labor supply, then employment and wages both rise among small firms. Variations on the number of new firms/new jobs created depend on the expansion and contraction dynamics of the broader economy, as summarized in section 2.3, above.

4.2 The Cost of Deregulation

The cost of deregulation is borne by both the (i) public and the (ii) private sectors, as follows:

(i) The area labeled B, between C and T, multiplied by the number of small firms, represents foregone revenues due to deregulation. These are the total cost of the deregulation policy to the public sector. Evidently, this cost will tend to be greater wherever compliance costs were greatest. Note that, because of evasion costs, deregulation reduces revenues for the public sector (area B) by much less than it saves on costs for firms (area A).

(ii) The area labeled D, between P and P', multiplied by the number of firms of each size, represents net profits foregone. These are the total cost of the deregulation policy to the private sector, large and small.

The total (private and public) cost of deregulation is, thus the sum of areas: B + D = DRC. Although deregulation does not have a direct bearing on public expenditures, it does have an indirect cost to the public sector, in terms of foregone revenues (B) and a "distributive" cost, in terms of profits foregone by the private sector. The cost per job created due to deregulation is DRC divided by the number of "standard" jobs generated by this policy.

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A discussion of how progressive regulatory incidence should be with increasing firm size, or how to design such a policy, is not possible here, due to space limitations.
4.3 The Benefit of Deregulation

The benefit of deregulation is the extent of employment creation and/or wage increase it affords. With deregulation, costs fall (from point 1 to point 2 in Figure 1) for small firms, though not for large ones. This raises small firms' derived demand for labor, according to given conditions:

(1) Marginal product rises (MPₜ) for all factors, including labor, and shifts small firms' demand for labor rightward for each wage level (wₜ). Given the symmetric relationship between Marginal Costs and Marginal Products (MP = w/MC) the extent of the shift in demand for labor increases with the level of wage rate among small firms and with the percentage cost reduction afforded by deregulation.

(2) As each firm expands production, there may or may not be a proportionate increase in the demand for labor, depending on the homogeneity and/or factor neutrality of the output elasticity of demand for factors.

(3) With increased production, from new entries and from preexisting firms, p falls for everyone (from p to p', in Figure 1). This fall in product price would tend to shift derived demand for labor by all firms leftward at each wage level. The extent of this leftward shift depends on the percentage of final demand that is supplied by small firms and the elasticity of demand for final product in the market as a whole.

(4) New entries, especially among small firms, provoke a rightward shift in market derived demand for labor. The extent of this rightward shift depends on the elasticity of labor supply to small firms for owners (at the going imputed wage w') and workers (at the going wage rate w), whether they be coming from large firms, or the pool of unemployed and/or inactive workers.

To estimate the effect of deregulation on job creation in the informal sector one should have empirical estimates of:

(1) the proportion of regulatory costs in total costs
(2) expansion-elasticities (factor–neutral or factor–biased),
(3) final product demand elasticities, and
(4) labor supply elasticities.

74 Expansion paths that are homogeneous (to the first degree) retain constant factor proportions as firms increase output. They can be represented as straight lines from the origin in factor-space. Expansion paths that are factor biased increase the proportion of one or more factors of production, to the detriment of others, as firms increase output. Increasing intensity of one (or more) factors can be represented as paths that curve toward corresponding axes. For example, vertical expansion, obtained by increasing the size of one plant, tends to be labor–saving, while lateral expansion, obtained by increasing the number of small plants, tends to be labor–using.

75 The greater the elasticity of demand, the greater the fall in price when quantity supplied increases, the greater will be the leftward shift in derived demand for labor. Engel curve estimations around the world show that, generally, foodstuffs and wage goods have low elasticities, while services have high elasticities of final demand. So it is likely that small firms, which have proportionately more service providers than large firms, will be in sectors where there is high elasticity of final demand. This will aggravate the leftward movement of derived demand for labor and reduce the employment generating effect of deregulation.
With the exception of (1), on which there is very little information, there is a wealth of empirical literature and accumulated policy experience to draw upon to the effect that, among small firms:

(2) product expansion will tend to be relatively labor intensive,
(3) product expansion will have a small effect on depressing final market price,
(4) labor supply to the informal sector will be relatively elastic.

On the basis of these general results, one may expect that deregulation should increase employment and wages among small firms.

The increase in employment (dN) obtained, at the given wage rate (w), depends on the total cost reduction (dT) provoked by deregulation. Given the relationship between Marginal Product (dQ/dN) and Marginal Cost (dT/dQ):

1) \( \frac{dQ}{dN} = \frac{W}{dT/dQ} \). By rearranging terms, one can see that
2) \( dN = \frac{dT}{W} \). In percentage terms, this becomes:
3) \( \frac{dN}{N} = \left( \frac{dT}{TT} \right) \cdot \left( \frac{TT}{W} \right) \), (where \( W = wN \))

Such estimates of job creation imply that all of the cost reduction (dT) goes to employ more workers at the going wage rate. However, as derived demand for labor shifts rightward (because of cost reductions provoked by deregulation), any inelasticity of supply of labor to small firms will drive wages upward. A more realistic estimate, of employment increase with wage increase among small firms, eludes the limitations of this study.

Section V will estimate (1), the proportion of regulatory costs in total costs, and will yield an estimate of the employment benefit of deregulation in the informal sector.

4.4 Costs and Benefits of Deregulation

The impact of deregulation on reducing poverty in the informal sector can be tentatively measured, as the number of jobs created (dN), attained at a cost of DRC/dN per job. Such measurement allows for comparisons between the results of deregulation and those of other social policies, as long as these results are also translated into numbers of beneficiaries and costs per beneficiary. The next Section attempts a preliminary measurement of the costs and benefits of deregulation for the informal sector in Argentina.

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76 See section 4, below, for an estimate of the cost of regulations for the informal sector.

77 This formulation assumes no adjustment in final price, infinite elasticity of supply of labor to the small firm sector, no labor-saving output elasticities, no investment, savings, or consumption from increased net profits. In sum, one assumes that firms leave their expansion path to absorb all of the cost reduction by raising employment. Some of these assumptions may be relaxed in subsequent versions, depending on the availability of data and the possibilities for econometric estimation of derived demand and supply curves for labor. Given the data sets available for this work, this is the only procedure possible.
FIGURE 1

[Diagram with labeled axes and sections.]
VI. THE CASE OF ARGENTINA

In any given market, all firms incur variable combinations of the costs detailed in section IV, some of which may permanently or temporarily be zero. The proportion of different types of costs for different types of firms is determined by the operation of the market. What makes a firm “informal” is a high proportion of evasion and, probably, a high proportion of “evasion costs” in total costs. One expects that informality, so defined, should be more significant among smaller than larger firms. Deregulation would contribute to reducing poverty in the informal sector to the extent that it would afford a significant cost reduction for small firms. This section proposes a preliminary estimate of the extent of this cost reduction, and of the benefit of deregulation for the informal sector in Argentina.

The main findings are that regulatory costs of small firms in Argentina correspond to approximately 23 percent of total costs, with much higher costs in manufacturing and construction, wherein regulatory costs constitute about 44 percent of total costs. An across-the-board deregulation program might subtract approximately 1 percent of revenues, yet add perhaps as many as 585,000 jobs to the informal sector in Argentina. At a still very preliminary stage of research, one could propose that the benefit of deregulation might lie somewhere below an upper bound of 4 million new jobs in the informal sector. Taking into account other variables, such as the propensity of small firms to allocate cost-savings to capital or labor in certain proportions, will probably lower these estimates. While they constitute an upper boundary, these results illustrate one possible response to a drastic reduction in regulatory costs for the Argentine informal sector.

1. Sources of Information

In order to carry out an analysis of the benefits and costs of deregulation for the informal sector, information is needed from enterprise surveys that cover both small and large firms. Such information, however, is not easy to come by, as each data source has its advantages and disadvantages:

— Economic surveys have the advantage of containing information on costs and incomes; but have the disadvantage of not covering the smallest firms in the size distribution of establishments.

— Population data, as other household based surveys, have the advantage of covering most of the labor force that works in small firms and of informing on their wages and other forms of remuneration; but have the disadvantage of not covering costs and other variables related to the production process.

— Small scale “qualitative” and/or “participatory” and/or “beneficiary” surveys of small firms would have the advantage of informing on evasion costs. This may be the only way to get at the “underworld” of the informal sector, where so many of the poor do their business. Yet such surveys have disadvantages as well, as they: (a) generally do not aim at systematic collection of firm-level microeconomic information, which is needed for comparing policy alternatives, and (b) tend to be too small to cover much of the heterogeneity typical of small firms.
Given that no data source is ideal, the only alternative is to resort to firm-level surveys wherever available, and to complement their shortcomings by referring to other sources when possible. In Argentina, the only countrywide firm-level survey that includes small and large firms is the Economic Census of 1985. This body of information is used in the next section. Since the economy contracted considerably during the late 1980s, before starting to grow in the early 1990s, the economy that is covered by this census is not necessarily much smaller than that which is in place today. Although most of employment creation since 1985 has been in small firms, which are generally underrepresented in firm-level surveys, one may surmise that included firms (and self employed workers) are not too different from excluded ones.  

2. The Economic Census of 1985

For practical purposes, one may take the cut-off point regarding “small firms” (S) to refer to units with five employees or less, plus the self employed. All other firms are lumped into a “non-small”, or “large” category (L). For each firm size (S, L), the information needed is listed below:

- $\#$: number of firms
- $N$: employment per firm
  - $N_1$: number of wage employees
  - $N_2$: number of non-wage workers plus employers
  - $N_3$: number of non-wage workers
- $Q$: average output, or value of goods supplied per firm
- $T$: average economic cost per firm
  - $W$: wage bill per firm
  - $NW$: non-wage economic costs per firm
- $C$: average compliance cost per firm
- $R$: average regulatory cost per firm
- $E$: average evasion cost per firm
- $TT$: total cost per firm
- $p$: average, or unit, price
- $Y$: average income per firm

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78 This assumption will be partially supported by comparisons between census figures and a “spot check” done on small firms in Buenos Aires in 1993, as explained in the Appendix.

79 Average regulatory cost per firm in the informal sector in Argentina is calculated in Table 4 ($R = .21TT$), based on the information contained in the Appendix, and used in the calculating Tables 1, 2, and 3.

80 Average evasion cost is calculated, by “rule of thumb”, to be half of regulatory cost ($R/2$), and this figure is used in Tables 1, 2, and 3.

81 Total cost is Economic cost plus compliance cost plus evasion cost ($TT = T + C + E$), and this figure is used in Tables 1, 2, and 3.
and their principal ratios, such as:

- \( Q/N \): average labor productivity
- \( R/TT \): proportion of regulatory cost to total cost
- \( E/TT \): proportion of evasion cost to total cost
- \( C/TT \): proportion of compliance cost to total cost
- \( T/TT \): proportion of economic cost to total cost
- \( W/TT \): proportion of wage bill to total cost
- \( w \): average wage rate = \( W/N1 \)
- \( NP \): net profit = \( Y - TI \)
- \( NPR \): net profit rate = \( (NP/Y) \cdot 100 \)

These variables are presented in Tables 6.1, 6.2, and 6.3. Except for \( E \) (evasion costs) and \( R \) (regulatory costs), which are derived from original data sources, all variables are calculated from the Argentinean industrial census of 1985.

Table 6.1 shows that small firm employment \( (N_0) \) is a small percentage (15%) of that of large firms covered by the census. This percentage is smaller than that derived from household data, because of the notoriously high omission rate of the smallest firms in the economic census. Among the small firms that are captured by the census, there are more than twice as many unpaid workers \( (N_2) \) as salaried workers \( (N_{1s}) \). Food processing and metalworking are the two sectors with the largest number of small firms \( (NI) \), according to the census.

Table 6.2 shows that there was an average of 2.4 workers per small firm \( (N_0/\#) \). The wage bill \( (W_0) \) was a relatively small cost item (according to Table 5.3, \( W/T = .1525 \) for small firms, vs. .1994 for large), among those discriminated, mainly because non–wage workers predominate in small firm employment.

Table 6.3 also shows that productivity \( (Q/N_0) \) among small firms was less than a third of that in large firms. Interestingly, the yearly net profit rate among small firms nears that of large firms \( (NPR_0 = 31 \text{ percent}; NPR_{1s} = 28 \text{ percent}) \), though this estimate should be treated with care. It is based only upon information on compliance costs. If evasion costs are taken into account, the result would be to lower the NPR of both large and small firms. Also, since evasion costs are probably higher for smaller firms, their inclusion would probably lower small firm profits relative to large firms. Based on reported costs in the Economic Census, however, it seems that, by compressing compliance and wage costs, small firms remain competitive with large ones in the market.

Table 6.3 also indicates that, among small firms, the wage bill \( (W_0) \) is a small percentage of total cost \( (W/TT = .1015) \), though higher than compliance costs \( (C/TT = .0622) \). Again, low labor costs result from the heavy recourse by small firms to family workers, as mentioned earlier. Economic costs \( (T/TT) \) were about 67 percent of total costs. The next section compares these figures to a spot check on the economic and regulatory costs of small firms in Buenos Aires in 1993.

\[ \text{See next section and Table 4.} \]
Graph 1 presents a scatter of provincial averages with respect to total cost (T) and compliance costs (C). The line shown on the graph results from a simple regression of economic and compliance costs per unit of output (T and C) on output per firm (Q).\textsuperscript{81} The downward slope suggests that economies of scale may be present, though they do not appear to be very strong.

3. Alternative Cost Estimates

Regulatory, compliance, evasion, economic, and total costs were directly estimated for the informal sector as a whole in 1993, according to the procedures presented in the Appendix.

Regulatory costs, R, were obtained from registries, legal codes, and accountants offices. They were calculated for all the principal regulations imposed on business activity in Argentina. Although such payments are never made in entirety, they serve as an upper bound by which to conjecture about evasion costs for the smallest, “informal” establishments.

Compliance costs C, are observed from two sources: one is actual effective payment of taxes and wage benefits, as declared to the economic census. The other is a simple “spot check” of the accounts of a very few small firms, as described in the Appendix.

Economic costs, T, are also observed directly from two sources: the economic census and a “spot check”, as described in the Appendix.

Evasion costs, E, are predominantly illegal and often dangerous, not only to practice, but sometimes even to observe! They could not be studied directly, as were regulatory costs R, because respondents reveal evasions only under very sensitive, quasi–anthropological, qualitative–quantitative, survey procedures. The range within which they vary, however, is known: (i) Since one would not pay bribes beyond the cost of legal fees, E must lie below R. (ii) Since one would pay “unofficial authorities” only for fees one is not complying with legally, E must lie above C. Thus, E, evasion costs, should lie between C, compliance costs, which are observed directly as practiced by firms, and R, regulatory costs, which are also observed directly, as stated in law. Although one cannot yet tell exactly where is E within these limits, one can, as a first approximation, suppose that it may lie somewhere down the middle between R and C in Graph 1. For the sake of expediency, then, in E is taken to be (R-C)/2.

The spot check also informs on fixed (or start–up) costs, which the census does not cover, as the census informs only on variable costs. Regulatory costs are also a somewhat smaller percentage of fixed costs (Fix R/TT = .18). An overall estimate of regulatory costs as a percentage of total costs may be obtained by: (i) applying the going interest rate to fixed costs and (ii) adding the result to variable costs, to obtain “current” costs, as is done in Table 5.4 (Cur R/TT = .21).\textsuperscript{2} Thus, as a first approximation, one may propose that, under the assumption of full compliance regulatory costs correspond to approximately 23 percent of costs in the informal sector.

\textsuperscript{81} (C+T)/Q = .75 - .189 \times 10^8 Q/\# + e

\textsuperscript{2} This procedure amounts to supposing that the small firm owner can borrow to start a business, at the current interest rate. In Argentina, at the moment, the informal sector interest rate is approximately 18\%, which is the figure used in Table 4.

According to section 5.2, there are public and private costs of deregulation (DRC) for the Informal Sector. The private costs of deregulation are profits foregone by large and small firms. These are caused by declining price in response to output expansion by small firms recently deregulated. Given the small percentage of small firms in total market supply (compare $Q_s$ to $Q_L$ in Table 6.1), and the probably high price elasticity of informal sector products, this private cost can be expected to be very small.\(^{45}\)

The public costs of deregulation are revenues foregone by official authorities. These correspond to the compliance costs actually incurred prior to deregulation. According to Table 6.1, if a drastic reform were to do away with all regulations at once, the percentage of total revenues that would be lost from small firms is negligible: $\text{DRC} = 2$ percent of business and commercial taxes and regulations. This can be seen as follows:

\[
\begin{align*}
a) \ (C)_s &= 9,226,016 \\
b) \ (C)_s+L &= 444,094,448 \\
c) \ (a)/(b) &= \frac{1}{55} = .02
\end{align*}
\]

This 2 percent, however, would only be subtracted from those revenues originating in business taxes and regulations. Other sources of income, such as personal taxes, would remain intact. Based on a back-of-the-envelope calculation, one can estimate that such revenues constituted approximately 55 percent of total government income.\(^{46}\) Thus, a closer approximation of the total costs of deregulation to the public sector can be obtained by multiplying $.02 \times .55 = .011$. The result indicates that deregulation of small-scale manufacturing firms would imply the loss of about 1 percent of total revenue to the national government.

Converting the value of $C_s$ to a 1993 dollar equivalent is a very tricky undertaking. Argentina has experienced two bouts of hyperinflation and two currency renominations since the 1985 Census. Sharp changes in relative prices as a result of inflation have been reinforced by large increases in the prices of public utilities. Alternatively, one can convert Argentine pesos into U.S. dollars. In 1984, the year on which figures from the 1985 Census are based, the average exchange rate was U.S. $1.00 = 97.33$ pesos Argentinos. Thus, one can calculate that, in that year, the total revenue foregone by the public sector due to regulation, in 1984 dollars, would have corresponded to:

\(^{45}\) One should add to this private cost the income foregone by "unofficial authorities" when deregulation does away with the bribes and other illegal payments that sustain them.

\(^{46}\) This figure is based on information from the Dirección Nacional de Investigaciones y Análisis Fiscal. According to this source, total net revenues for the government in 1984 (same date as information collected for the Economic Census) were $1,179,949$ millions of Argentine Pesos, including tax and non-tax income. Of these, approximately $648,170$ were from business related taxes, such as internal taxes, taxes on international trade, and employer contributions. The ratio of business tax revenue to total revenue is .55.
Given any selectivity in deciding which regulations to maintain and which to eliminate, the revenue foregone by deregulation would be even smaller. Thus, the public sector would surely barely “feel the pinch” if there were to be a policy of some deregulation of small firms.

These calculations are based on the manufacturing census, which, as mentioned previously, tends to undercount the smallest firms and excludes Services and Commerce. Average size, and regulatory compliance, among omitted firms is probably smaller than that of included small firms. So, even though the percentage of small firms in the economy as a whole is probably larger than in the census, the percentage revenue foregone will surely not be larger than DRC = 1.2 percent.

5. Benefit of Deregulation: Empirical Estimate

According to section 5.3, the benefit of deregulation is the increase in employment it may afford, which is given by:

3) \[ \frac{dN}{N} = \frac{dTT}{TT} \cdot \left( \frac{TT}{W} \right)^2 \]

Since TT can be factored out of the denominator and the numerator, the resulting equation would be:

3.a) \[ \frac{dN}{N} = \frac{dTT}{W} \]

Tables 6.1 to 6.3 provide rough orders of magnitude from the economic census, for estimates of absolute and percentage employment increases (dN and dN/N), in the hypothetical case of a drastic deregulation that would totally eliminate compliance and evasion costs (C + E).

a) \[ d(TT) = (C+E) \text{ (from Table 6.1)} = 49,532,174 \]

b) \[ W \text{ (from Table 6.1)} = 15,052,702 \]

c) \[ \frac{dN}{N} = \frac{a}{b} = \frac{49,532,174}{15,052,702} = 3.29 \]

d) \[ dN = (c) \times N \text{ (from table 6.1)} = 3.29 \times 177,903 = 585,301 \]

At the firm level, the employment increase can be calculated as follows:

e) \[ \frac{dN}{N} = \frac{c}{N} \text{ (c) x N/#} = 3.29 \times 2.4 = 7.8 \]

The census, thus, estimates that an across the board deregulation could provoke a sizeable increase of employment among small firms. Based on its very limited coverage, of only 177,903

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87 For a less complicated formula, \( \frac{dN}{N} \) can be simplified as follows. The long form is retained in the text in order to show, step by step, how the calculation leads to the result.

\[
\frac{dN}{N} = \frac{(dTT/TT) \times (TT/W)}{dTT/W}.
\]
workers, this increase would correspond to about \( dN = 585,301 \) workers in all. If one supposes that deregulation could have a similar effect on other sectors of informal activity, such as commerce and services, where approximately three fourths of informal workers are located (see Cortes and Marshall, Appendix), one could project that the total effect of deregulation on the informal sector could approach two million jobs created. At the expense of $94,791,082 (U.S.) in annual revenues foregone by the state, the creation of 585,301 jobs would cost approximately $162 (U.S.) per job. Even allowing for dollar inflation since 1984, the cost-effectiveness of such a policy is obvious, especially when compared with other employment programs, such as training and make-work projects, some of which are discussed in the following chapter.

Great care should be taken in interpreting these results, however, and two important parameters of the calculation should be borne in mind. First, the deregulation "tested" in the foregoing analysis implies the complete and indiscriminate elimination of ALL types of regulations, including labor and health codes. Obviously, upon the implementation of a deregulatory program, hard choices must be made in order to achieve the correct balance of regulation and efficiency. The goal should be to have a regulatory framework that is appropriate to the sector, rather than the complete dismantling of all business codes for small producers. A less extreme case of deregulation would imply that the cost-savings to employers, expressed in the ratio \((C+E)/TT\), would be lower than that used in the preceding estimate, with a resulting "deflation" of its job-creating effect.

A second limitation built into the preceding estimate involves an assumption about firm behavior as a response to deregulation. It has been assumed thus far that ALL the cost-savings applied to small firms would be directly transferred to the wage bill, with wages given by the market. A more realistic (and more complicated) model would allow for some of the cost savings to be directed toward investment in physical capital and the purchase of other inputs as production expands. An appropriate multiplier might be derived from the capital/labor ratio, though such refinements are beyond the scope of the current paper. The inclusion of such a variable, like relaxing the assumption of "full deregulation," is likely to dampen somewhat the employment effect of this model.

Neither of these caveats, however, are likely to change the fundamental conclusions of the present study. First, regulatory costs are a very large proportion of the total costs of small firms. Secondly, employment in small firms is potentially very sensitive to changes in the cost structure. A simple comparison of two ratios, \((C+E)/TT\) vs. \(W/TT\), illustrates this point: effectively incurred regulatory costs \((C+E)/TT = .3341\) are more than three times total labor costs for the small firm \((W/TT = .1015\). That is, for every dollar spent on wages in the informal sector, three dollars are spent on compliance and evasion. By eliminating this burden, under admittedly very strict assumptions, a full deregulation could spur an employment increase in small-scale manufacturing by a half million jobs. If similar results were to occur in commerce, services and construction, one might expect the job creation to approach two million in the informal sector as a whole.
As upper bound estimates, then, the benefit of deregulation must lie somewhere between the very wide interval that spans 585,301 new jobs in small firms covered by the manufacturing census and perhaps two million new jobs in the informal sector as a whole. Further work is still needed to narrow down this interval to more policy relevant proportions and to obtain more precise estimates of the effects of deregulation.

6. Conclusion

The main finding of this chapter is that deregulation of informal firms could have a substantial employment creation effect, obtained at a minimum cost for the public sector. The calculations presented are very preliminary and represent an initial stage of analysis. They are offered as a basis for discussion and to elicit suggestions for further work on this issue, for Argentina as well as for other country case studies underway. In the case of Argentina, these results are especially relevant given the current period of economic expansion under way. Although the employment effect in large firms and the public sector is not expected to be very large, the growth of jobs in small firms may be considerable. According to the analysis in Section 3.4, above, one would expect rising internal demand to expand the small firm segment of the market, whether independently or in units subcontracted by larger firms. Thus, a policy of facilitating small firm formation, such as by streamlining regulatory requirements, as well as by other means, would increase derived demand for labor in the small firms where the poorest workers are employed. This would have an impact in terms of poverty reduction during a period expected to be of insufficient employment creation, despite the upturn in economic activity.

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Subsequent work on better data sets may yield more precise empirical estimates of firms' employment-response to cost reductions. See footnote 70, above, on the assumptions involved in the above estimations, imposed by current data constraints. Despite such shortcomings, the direction and the employment impact of deregulation is clear from the results obtained so far.
Graph 1: Economic and Compliance Costs (C) per Unit

- T/Q
- C/Q

US $ per unit vs. value of average yearly output (US $)
Table 6.1: Sectoral Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>All Sectors</th>
<th>Food Processing</th>
<th>Textiles</th>
<th>Metalworking</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Small</td>
<td>Large</td>
<td>Small</td>
<td>Large</td>
</tr>
<tr>
<td># of Firms</td>
<td>73,349</td>
<td>36,027</td>
<td>19,817</td>
<td>8,618</td>
</tr>
<tr>
<td>N</td>
<td>177,903</td>
<td>1,203,902</td>
<td>54,470</td>
<td>306,160</td>
</tr>
<tr>
<td>N1</td>
<td>54,520</td>
<td>1,119,906</td>
<td>15,540</td>
<td>283,156</td>
</tr>
<tr>
<td>N2</td>
<td>123,383</td>
<td>83,996</td>
<td>38,930</td>
<td>23,004</td>
</tr>
<tr>
<td>N3</td>
<td>50,034</td>
<td>47,969</td>
<td>19,113</td>
<td>14,386</td>
</tr>
<tr>
<td>W</td>
<td>15,052,702</td>
<td>501,518,855</td>
<td>3,543,741</td>
<td>100,242,909</td>
</tr>
<tr>
<td>NW</td>
<td>83,670,740</td>
<td>2,014,102,008</td>
<td>22,223,736</td>
<td>576,952,128</td>
</tr>
<tr>
<td>T</td>
<td>98,723,442</td>
<td>2,515,620,863</td>
<td>25,767,477</td>
<td>677,195,037</td>
</tr>
<tr>
<td>C</td>
<td>9,226,016</td>
<td>434,868,432</td>
<td>980,378</td>
<td>45,709,507</td>
</tr>
<tr>
<td>T + C</td>
<td>107,949,458</td>
<td>2,950,519,295</td>
<td>26,747,845</td>
<td>722,904,544</td>
</tr>
<tr>
<td>R</td>
<td>89,838,332</td>
<td></td>
<td>23,448,404</td>
<td></td>
</tr>
<tr>
<td>E</td>
<td>40,306,158</td>
<td></td>
<td>11,234,013</td>
<td></td>
</tr>
<tr>
<td>C + E</td>
<td>49,532,174</td>
<td></td>
<td>12,214,391</td>
<td></td>
</tr>
<tr>
<td>TT</td>
<td>148,255,616</td>
<td></td>
<td>37,981,868</td>
<td></td>
</tr>
</tbody>
</table>

Source: INDEC, 1985 Censo Economico (Resultados Definitivos)

For small firms: \( R = (\cdot 21)T, \quad E = (R - C)/2, \quad TT = C + E + T \)

All monetary variables (W, NW, T, R, E, C, C+E, TT, and Y) are in thousands of 1985 Pesos Argentinos.
Table 6.2: Per-firm Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>All Sectors</th>
<th>Food Processing</th>
<th>Textiles</th>
<th>Metalworking</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Small</td>
<td>Large</td>
<td>Small</td>
<td>Large</td>
</tr>
<tr>
<td># of Firms</td>
<td>73,349</td>
<td>36,027</td>
<td>19,817</td>
<td>8,618</td>
</tr>
<tr>
<td></td>
<td>17,518</td>
<td>10,001</td>
<td></td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>2.4</td>
<td>33.4167</td>
<td>2.7487</td>
<td>35.5256</td>
</tr>
<tr>
<td>N1</td>
<td>0.7433</td>
<td>31.0852</td>
<td>0.7842</td>
<td>32.8563</td>
</tr>
<tr>
<td>N2</td>
<td>1.6821</td>
<td>2.3315</td>
<td>1.9645</td>
<td>2.6693</td>
</tr>
<tr>
<td>N3</td>
<td>0.6821</td>
<td>1.3315</td>
<td>0.9645</td>
<td>1.6693</td>
</tr>
<tr>
<td>W</td>
<td>205</td>
<td>13,291</td>
<td>179</td>
<td>11,547</td>
</tr>
<tr>
<td>NW</td>
<td>1,141</td>
<td>55,905</td>
<td>1,121</td>
<td>66,461</td>
</tr>
<tr>
<td>T</td>
<td>1,346</td>
<td>69,826</td>
<td>1,300</td>
<td>78,008</td>
</tr>
<tr>
<td>C</td>
<td>126</td>
<td>12,071</td>
<td>49</td>
<td>5,265</td>
</tr>
<tr>
<td>T + C</td>
<td>1,472</td>
<td>81,897</td>
<td>1,350</td>
<td>83,274</td>
</tr>
<tr>
<td>Y</td>
<td>2,120</td>
<td>113,431</td>
<td>2,021</td>
<td>113,734</td>
</tr>
<tr>
<td>R</td>
<td>283</td>
<td>-</td>
<td>273</td>
<td>-</td>
</tr>
<tr>
<td>E</td>
<td>78</td>
<td>-</td>
<td>112</td>
<td>-</td>
</tr>
<tr>
<td>C + E</td>
<td>204</td>
<td>-</td>
<td>161</td>
<td>-</td>
</tr>
<tr>
<td>TT</td>
<td>1,550</td>
<td>-</td>
<td>1,462</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: INDEC, 1985 Censo Economico (Resultados Definitivos)

For small firms: R = (0.91)T, E = (C-R)/2, TT = C + E + T

All monetary variables (W, NW, T, R, E, C, C + E, TT, and Y) are in thousands of 1985 Pesos Argentinos.
### Table 6.3: Ratios

<table>
<thead>
<tr>
<th>Variable</th>
<th>All Sectors</th>
<th>Food</th>
<th>Textiles</th>
<th>Metalworking</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Small</td>
<td>Large</td>
<td>Small</td>
<td>Large</td>
</tr>
<tr>
<td>Q/N</td>
<td>856</td>
<td>3,309</td>
<td>725</td>
<td>3,147</td>
</tr>
<tr>
<td>NPR</td>
<td>.3057</td>
<td>.2780</td>
<td>.3321</td>
<td>.2678</td>
</tr>
<tr>
<td>C/T</td>
<td>.0935</td>
<td>.1729</td>
<td>.0380</td>
<td>.0675</td>
</tr>
<tr>
<td>W/T</td>
<td>.1525</td>
<td>.1994</td>
<td>.1375</td>
<td>.1480</td>
</tr>
<tr>
<td>C/(T+C)</td>
<td>.0855</td>
<td>.1474</td>
<td>.0367</td>
<td>.0632</td>
</tr>
<tr>
<td>W/(T+C)</td>
<td>.1394</td>
<td>.1994</td>
<td>.1325</td>
<td>.1387</td>
</tr>
<tr>
<td>(Y-TT)/#</td>
<td>98</td>
<td>-</td>
<td>104</td>
<td>-</td>
</tr>
<tr>
<td>E/TT</td>
<td>.2719</td>
<td>-</td>
<td>.2958</td>
<td>-</td>
</tr>
<tr>
<td>R/TT</td>
<td>.6060</td>
<td>-</td>
<td>.6174</td>
<td>-</td>
</tr>
<tr>
<td>(C+E)/TT</td>
<td>.3341</td>
<td>-</td>
<td>.3216</td>
<td>-</td>
</tr>
<tr>
<td>C/TT</td>
<td>.0622</td>
<td>-</td>
<td>.0258</td>
<td>-</td>
</tr>
<tr>
<td>T/TT</td>
<td>.6639</td>
<td>-</td>
<td>.6787</td>
<td>-</td>
</tr>
<tr>
<td>W/TT</td>
<td>.1015</td>
<td>-</td>
<td>.0933</td>
<td>-</td>
</tr>
<tr>
<td>TT/Q</td>
<td>.9741</td>
<td>-</td>
<td>.9621</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: Tables 1 and 2.

NPR = (Y-T-C)/Y  
Q/N and (Y-TT)/# are in thousands of 1985 Pesos Argentinos.

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The NPR reflected in this table, especially for small firms, is probably an over-estimate. As the table indicates, NPR is calculated by subtracting economic and compliance costs from total income and dividing the result by total income. Due to the unavailability of data on large firms concerning evasion costs, they are excluded from both large and small firms in order to supply a basis for reliable comparison. This exclusion probably disproportionately inflates the NPR of small firms, because evasion, and the costs associated with it, are probably more widespread among small firms.
## Table 6.4: Regulatory Costs in the Informal Sector

<table>
<thead>
<tr>
<th>Component of the Informal Sector</th>
<th>Retail Trade</th>
<th>Construction</th>
<th>Manufacturing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>R</td>
<td>704.5 675 -802</td>
<td>307.5 923.5 979</td>
<td>797.5 539 683</td>
<td>652.6 679.6 797.1</td>
</tr>
<tr>
<td>TT</td>
<td>3,450 5,045 5,666</td>
<td>500 2,124 2,214</td>
<td>5,400 1,459 2,431</td>
<td>3,514 3,138 3,770</td>
</tr>
<tr>
<td>R/TT</td>
<td>0.29 0.13 0.14</td>
<td>0.62 0.44 0.44</td>
<td>0.15 0.48 0.28</td>
<td>0.18 0.23 0.21</td>
</tr>
<tr>
<td>Comp/inf. sector</td>
<td>0.3 0.3 0.3</td>
<td>0.15 0.15 0.15</td>
<td>0.25 0.25 0.25</td>
<td>0.25 0.25 0.25</td>
</tr>
<tr>
<td>[(R/TT)* (comp/inf. sector)]</td>
<td>0.9 0.04 0.04</td>
<td>0.09 0.07 0.07</td>
<td>0.04 0.12 0.07</td>
<td>0.18 0.23 0.21</td>
</tr>
</tbody>
</table>

Source: Appendix
APPENDIX

REGULATORY COSTS
IN THE URBAN INFORMAL SECTOR
OF ARGENTINA

Rosalía Cortés and Adriana Marshall

December, 1993.
CONTENTS

DIMENSION AND EVOLUTION OF THE URBAN INFORMAL SECTOR

INCIDENCE OF REGULATORY COSTS IN THE URBAN INFORMAL SECTOR

RECOMMENDATIONS

APPENDIX
The group composed of the self-employed without employees, employers and workers in micro-firms (of up to five employees) and family labor provides an initial estimate of the urban informal sector (UIS). On the basis of data from the population census, in 1980 32.6 percent (about one million and a half) of the employed urban labor force were in the informal sector, not considering within it the 6.6 percent (of EAP) in domestic service. The self employed were the largest segment in the UIS (18.5 percent of EAP). But the above estimate of the UIS includes middle and high income occupations (such as professionals, high income shop owners, etc.), which clearly are not informal jobs: 11.4 percent of the self-employed and 9.4 percent of the employers were professionals, managers, teachers, and other categories that cannot be counted as belonging to the UIS (Population Census, INDEC, 1980). If this set of occupations is excluded, the share of the UIS is cut down to about 30 percent.

The economic sector with the largest share of informal labor was retail trade (61 percent), followed by construction (52 percent), and transportation (30 percent), while the proportion was lowest in social and personal services (19 percent), which probably can be explained by the important weight in this latter sector of employment in public social services.

The size and structure of the UIS in the country as a whole cannot be seized for more recent years as data from the 1991 population census on the labor force are not yet available. INDEC's household survey (Encuesta Permanente de Hogares [EPH], INDEC) provides updated information for 24 large urban centers. This information is available with some detail for Buenos Aires and its metropolitan area, and to a lesser extent for other provincial cities.

According to the household survey (EPH, in Beccaria and Orsatti, 1990), in Buenos Aires (Capital and 19 districts) the informal sector - defined as above but without excluding middle and high income occupations - represented, as a proportion of the employed workforce, 31.2 percent in 1974, 36.5 percent in 1980 and 39.3 percent in 1988. In early 1991, it amounted to about 36.8 percent (data from EPH, unpublished), while an estimate for late 1991 amounted to 39.5 percent (data from EPH in Morano, 1993). When excluding from the employed EAP those who ignored size of establishment, the share of informal jobs rises to about 45 percent. In brief, in Buenos Aires the informal sector experienced some growth in the 1970s and 1980s as a proportion of employment. In terms of worker status, it is not apparent any significant change in the composition of the informal sector. In 1991, own-account workers represented 21.7 percent of employment and family workers 0.8 percent. Some 9 percent of the employed EAP were wage earners working in establishments between one and up to five persons (own estimates for 1991, based on EPH). Considering wage earners in particular, 19 percent were employed in micro-firms. These figures result from calculations in which totals include those who did not know the size of the establishment in which they were working. The proportions reached, respectively, 11 percent and 22 percent if totals do not include those who ignored the size of the establishment.

1 This is a rough estimate, as some categories are not comparable strictly speaking.
2 Unless indicated otherwise, domestic service will be excluded from our estimates of the informal sector and its components.
3 These figures might not be strictly comparable with those in Beccaria and Orsatti (1990).
In 1989 the proportion of non-wage earners (the sum of own-account workers, employers and family workers) in employed EAP in thirteen large urban centers ranged from 38 percent in Córdoba to 18 percent in La Rioja, and in all of them, with the exception of Córdoba, was lower than in Buenos Aires (30 percent) (EPH, 1989). It is not possible to assess with available data the weight of wage earners employed in micro units in those cities after 1980.

In Buenos Aires, in 1991, the proportion of employed EAP working in micro-firms (including own-account workers) varied across economic sectors: it reached 72 percent in construction, 66.4 percent in commerce, and about 30 percent in manufacturing and transportation. Micro-firms were overrepresented only in construction and commerce. Economic distributions of the components of the informal sector differ: while almost half of family workers were employed in trade, the self-employed were concentrated in services (including domestic service) and commerce (EPH data for 1990), and wage earners working in micro-firms concentrated in retail trade (31 percent) and manufacturing (24.6 percent) - textiles, clothing and footwear, metals and woodworking mainly - followed by construction (13.2 percent) (EPH, unpublished 1989 and 1991).

The survey of self-employed workers (without employees) conducted in 1988 (INDEC, 1989) permits to gauge better their main features and to identify those who belong to the UIS. Self-employed male workers were more numerous in retail trade (23 percent), construction (18 percent), repair services (15 percent) and finance (12 percent). Women were mainly in retail trade (31 percent) and the garment industry (20 percent), and then in personal services (11 percent) and finance (9 percent). Low income (poorest 40 percent) self-employed males were concentrated in retail trade (29.5 percent), construction (24 percent), and repair services (18 percent), followed by manufacturing (14 percent). Women worked more often in manufacturing (41 percent), most of them in the garment industry and retail trade (29 percent). Low-income self-employed workers were overrepresented in manufacturing, retail and repair services. Over half of the self-employed in manufacturing, and 44 percent of those working in construction, were within the 40 percent lowest income stratum; in retail trade the proportion in the low-income stratum reached 49 percent, and 45 percent in repair services.

As there are no data on the income distribution of micro-firm wage earners, a way of defining more precisely the informal component of this group is to exclude workers in those economic activities that are known to have a higher average income, such as finance, business services, education and real estate. The remaining wage earners in micro-firms amount to 8 percent of employed EAP.

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4 Here EAP includes those who did not declare size of establishment.

5 According to the economic census (INDEC, 1985) micro establishments, that represented 67 percent of all manufacturing establishments, employed only 5 percent of manufacturing workers. But note that it is usually considered that small firms are underrepresented in this census.

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The informal sector may be approached alternatively through the analysis of the degree of compliance with social security and other regulations.\footnote{Contributions to the social security system are compulsory for all categories of workers.} Data from the 1988 survey of the self-employed show that over 50 percent did not contribute to the pension scheme.\footnote{Totals include 7 percent of retired workers who for that reason are not obliged to contribute.} Among the self employed in construction evasion amounted to as much as 70 percent, and in transportation to 63.4 percent; in manufacturing to 59 percent; in services to 56 percent; and in commerce to 50 percent. In addition, only 29.1 percent of the self employed declared having registered his/her activity as legally required. The figure was much lower in construction (only 2.4 percent), manufacturing (17 percent) and services (19.6 percent). By contrast 53 percent in commerce and 54 percent in transportation had officially registered their activities. Among wage earners in micro units, evasion of contributions to the pension scheme\footnote{In the household survey wage earners declare whether contributions to the pension scheme are deducted from their salaries by employers or not.} grew from 47 percent in 1980 to 67 percent in 1988. In manufacturing micro-firms it increased from 46 percent in 1980 to 72 percent in 1988, and in commerce from 32 percent to 61 percent (Beccaria and Orsatti, 1990). The reforms to the tax system implemented as from 1991 may have reduced evasion.

Conclusions

1. The population census of 1980 indicated that the UIS broadly speaking represented some 32.6 percent of the urban labor force in the country as a whole; there is no comparable information allowing to seize the evolution of this group at the national level. In Buenos Aires, during the eighties, the share in total employment of the sum of self-employed, micro-firms (employers and wage earners) and family workers increased, and in late 1991 it amounted to 39.5 percent of the employed EAP.

2. It seems appropriate to consider that the UIS strictly speaking is composed by micro employers, family workers, the poorest 40 percent among the self employed, and most wage earners in micro-firms \_ as we assume that the majority receive low wages, are employed in precarious conditions, and are not registered with the social security system.

3. The poorest 40 percent self employed work primarily in retail trade and in manufacturing (basically in clothing), followed by repair services and construction; wage earners in micro-firms too work predominantly in retail trade and manufacturing, and thirdly in construction.

4. Evasion of social security contributions gives another view on informality: non compliance in 1988 was very large (over 50 percent) among the self employed, particularly in construction and transportation, followed by manufacturing. It was even higher among employers of micro-firms, as contributions from wages were not deducted to 67 percent of wage earners in these units. Evasion of registration among the self employed was also very high (70 percent), and its incidence was greater in construction, manufacturing and services.
5. The magnitude of the urban informal sector can be estimated to lie between a maximum defined by worker status, and lower values defined either by compliance with regulations or by income or some proxy of income. The estimate of informality among the self employed according to compliance with registration and social security contributions does not necessarily coincide with the poorest self employed. It might be safer to focus the analysis of informality in Buenos Aires on the poorest 40 percent self employed (9 percent of employed EAP), added to labor in micro-firms excluding finance, business services, real estate and similar activities (8 percent of employed EAP), microemployers and family workers. The sum of all of these categories totalled about 21 percent of EAP in 1991.
REFERENCES


__, *Censo Nacional de Población y Vivienda*, 1980.

__, *Encuesta Permanente de Hogares* (EPH), unpublished, several years.

__, *Censo Económico 1985*, Manufactura, Resultados Definitivos.

INCIDENCE OF REGULATORY COSTS IN THE URBAN INFORMAL SECTOR

Tables 1 and 2 summarize monetary and time costs derived from regulations that affect the starting-up, operation and commercialization of different economic activities. In these tables we indicate the legal norms regulating each one of the activities typical of the UIS (retail trade, construction, garment industry, repair, street vending and taxi cabs).

Tables 3, 4.A, 4.B and 4.C are based upon case studies, that provided information on, inter alia, initial capital requirements and type of premises and equipment required, gross income, volume of sales and types and amount of economic costs. In all these cases, regulatory costs were estimated assuming total compliance with legal norms. The activities selected are those which, according to data presented in the preceding chapter, are most typical of the UIS. These activities concentrate the majority of low-income self-employed workers and wage-earners employed in micro-firms (excluding those wage-earners engaged in activities where medium and high incomes predominate). The activities, all of them in Buenos Aires city (Federal Capital), are exemplified by 1) small retail stores (kiosk/grocery) in a low-income area (managed by either an own-account worker with no help or the owner and one wage earner); 2) repair services (shoes, appliances, etc.), where the operative structure is basically similar to that of the retail store; 3) construction contractors or subcontractors (contratista), who usually employ between three and five workers and who work either in large construction sites (e.g. apartment buildings, to which they provide the “cuadrilla” – a small team of construction workers), or directly for private costumers (for instance, to rebuild or renew private houses); and 4) garment (jeans in this example) manufacturers (“talleristas”), who often have three sewing machines and employ three workers in small workshops within their own homes.

The estimated incidence of regulatory costs that appear in tables 3 and 4 (A., B. and C.) IS BASED ON THE ASSUMPTION OF TOTAL COMPLIANCE WITH LEGAL NORMS.

Table 3 shows the impact of regulatory costs associated with the initiation of each activity relative to initial capital requirements including those derived from state regulations.

The impact of regulatory costs associated with starting up is greater the more precarious initial requirements are in terms of premises and equipment (table 3). Activities differ also in the weight of initiation costs (exclusive of regulatory costs) relative to annual gross income: 5.5 percent in the kiosk/grocery store and 10.7 percent in the garment workshop. The construction contractor practically has no initiation costs. The volume of initial capital is a good indicator of how easy is to enter into each sector.

Tables 4.A, 4.B and 4.C. reveal the impact of regulatory costs associated with operation and commercialization, in relation to 1) gross income, 2) profits, 3) economic costs and 4) total costs.

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9 Regulations are detailed in the appendix.
10 Information comes from interviews to accountants and other persons involved in each economic activity.
11 The typical situation in these retail stores is to employ just one wage earner.
12 That is why this case was not included in table 3.
The three cases studied (kiosk/grocery, construction contractor and garment workshop) suggest that the incidence of **TOTAL COMPLIANCE WITH REGULATORY COSTS** on 1) to 4) varies according to economic activity (see Tables).

The possibility of generalizing these results from case studies to each of the economic sectors analyzed here is seriously hindered by the fact that each sector is very heterogeneous, particularly in the case of the garment industry. Therefore, the examples presented here are scarcely representative, not only of the UIS at large but also of each one of the sectors selected for analysis. In retail trade, the impact of regulatory costs in fact varies according with scale of operations and geographic location, even within Buenos Aires city. Construction contractors differ according to the market for which they work and according to whether their employers are construction firms or individuals. Garment workshops differ according to the specific garment manufactured, type of firms or intermediaries that give them work, machinery, required labor skills, etc.

In what follows we present tentative estimates on the incidence of regulatory costs, associated with operation and commercialization, in the UIS as a whole, **ON THE ASSUMPTION OF TOTAL COMPLIANCE**, with reference to Buenos Aires city.

This exercise considers, on the one hand, the composition of the UIS according to worker status and, on the other, its economic structure. The universe to which this exercise refers is composed of the poorest 40 percent self employed workers (29 percent in retail trade; 25 percent in manufacturing; 22 percent in repair and 16 percent in construction; the rest in other activities), and of employers and wage-earners in micro-firms of up to five workers (30 percent of these latter are in retail trade; 25 percent in manufacturing; 13 percent in construction; 6 percent in repair services and the rest in other activities). The UIS, defined as the sum of the EAP employed in firms with 1 to 5 workers (excluding domestic service), is composed of 60 percent self-employed workers, 30 percent wage earners, 8 percent employers, and 2 percent family help. If we restrict the UIS to low-income self-employed workers and low-income wage-earners in micro-firms plus employers and family help (i.e. excluding medium and high income activities as described in the preceding chapter), micro-firms' wage-earners represent 51 percent of the UIS, low-income self-employed 34 percent; employers (micro-firms) 13 percent, and unpaid family help 3 percent (data from EPH, 1988).

The economic distributions of low-income self-employed workers and of wage earners in establishment with up to five workers are similar. Therefore, the first assumption in this exercise is that one sole economic distribution is representative of the UIS as a whole. This distribution nears that of the self-employed workers owing to the fact that, as we have seen, they constitute 60 percent of all informal workers.

The second and very far-fetched assumption is that the incidence of regulatory costs in garment workshops may be generalized to all manufacturing activities.

The last assumption is that it is possible to assign to economic activities not analyzed in this study the weighted average of the incidence of regulatory costs that emerged from the case studies.
In this way, we arrive at four estimates of the incidence of operation and commercialization regulatory costs \( R \) (ALWAYS ON THE ASSUMPTION OF TOTAL COMPLIANCE WITH REGULATIONS), relative to: 1) gross income \( GI \), 2) profits \( P \), 3) economic costs \( T \), and 4) total costs \( TT \).

1. **Incidence on gross income:**

   \[ \text{IRGI} = \frac{\text{sum}(IRSGI*S/UIS)}{\text{sum}(S/UIS)} \]

   where \( \text{IRGI} \) is the incidence of regulatory costs on gross income; \( \text{IRSGI} \), the sectoral incidence of regulatory cost; and \( S/UIS \), the proportion of each economic sector in the UIS.

   Example: (without wage earners in retail trade)

   \[ \text{IRGI} = \frac{\text{retail trade } (11.2*30) + \text{construction } (33*15) + \text{manufacturing } (19.8*25)}{(30+15+25)} = 18 \text{ percent} \]

   Following this procedure, IRGI amounts to 18.9 percent in the UIS as a whole.

2. **Incidence on profits:**

   \[ \text{IRP} = \frac{\text{sum}(IRSP*S/UIS)}{\text{sum}(S/UIS)} \]

   where \( \text{IRP} \) is the incidence of regulatory costs on profits; \( \text{IRSP} \), the sectoral incidence of regulatory costs; and \( S/UIS \), the proportion of each economic sector in the UIS.

   Example: (without wage earners in retail trade)

   \[ \text{IRP} = \frac{\text{retail trade } (70.7*30) + \text{construction } (136.5*15) + \text{manufacturing } (34*25)}{70} = 71.7 \text{ percent} \]

   IRP for the UIS as a whole is 71.7 percent. This figure could be interpreted as profits and/or wages forgone owing to regulatory costs.

3. **Incidence on economic costs:**

   \[ \text{R/T} = \frac{\text{sum}(IRST*S/UIS)}{\text{sum}(S/UIS)} \]

   where \( \text{R/T} \) is the incidence of regulatory costs on economic costs; \( \text{IRST} \) the sectoral incidence of regulatory costs on economic costs; and \( S/UIS \), the proportion of each economic sector in the UIS.

   Example: (without wage earners in retail trade)

   \[ \text{R/T} = \frac{\text{retail trade } (15.4*30) + \text{construction } (77*15) + \text{manufacturing } (90.5*25)}{70} = 55.4 \text{ percent} \]

   R/T for the UIS as a whole is 55.4 percent.
4. Incidence on total costs:

\[ R/TT = \frac{\sum (IRSTT \times S/UIS)}{\sum (S/UIS)} \]

where R/TT is the incidence of regulatory costs on total costs; IRSTT the sectoral incidence of regulatory costs on total costs; and S/UIS, the proportion of each economic sector in the UIS.

Example: (without wage earners in retail trade)

\[ R/TT = \frac{\text{retail trade (13.4*30) + construction (43.5*15) + manufacturing (47.5*25)}}{70} = 32 \text{ percent} \]

R/TT for the UIS as a whole is 32 percent.

The information examined so far shows the substantial impact of taxes, including employer contributions to social security, and of other costs associated with labor in relation to gross income, profits, economic costs and total costs.

The remaining regulatory costs, not originated in taxation, have little impact in terms of both money and time consumed. Although some procedures, such as those to obtain municipal permits, might paralyze, at least for some time, installation of a retail trade store, a mechanism to facilitate this process emerged: ad hoc intermediaries (called “gestores”), whose services are reasonably priced and who may resort to illegal dealings (such as bribes to municipal officers), that do not seem to be too costly. The most important and expensive regulations are those concerning sanitary and public health aspects, derived from the code that regulates production, distribution and commercialization of foodstuffs and from other codes that refer to public health, and which obviously cannot be removed or reduced.

SO FAR WE HAVE EXAMINED THE IMPACT OF REGULATORY COSTS UNDER THE ASSUMPTION OF TOTAL COMPLIANCE WITH LEGAL OBLIGATIONS. But, in practice, the degree of compliance is far from total, and it differs according to the nature of the obligation and to economic activity.

There is a wide variety of manners in which regulatory costs are circumvented, and also the extent of evasion varies. The greater or lesser visibility of each economic activity influences directly the degree and form of evasion, since visibility facilitates control. Because of this reason, retail stores may be controlled much better than workshops operating within private houses or construction contractors who do not have working premises. This does not mean that retail trade stores do comply fully with regulations; in fact, they fulfil formalities attached to obtention of permits to operate and registration, while evading partially the costs of taxation by means of the systematic under-declaration of sales and gross income and of clandestine employment of labor. Operations of construction contractors and of garment workshop owners do not depend on public’s access, and therefore usually they do not comply with neither starting-up formalities nor regulations concerning employment of wage earners.

The degree and type of compliance are determined also by legal sanctions, and by the behavior of controlling institutions (frequency of inspections, and degree of corruption among inspectors) in regard to infractions.
Table 5 describes the costs associated with different degrees of compliance with regulations, and the cost of the more frequent forms of evasion in retail trade.\textsuperscript{13} Penalties (see appendix) range from fines to closings (the duration of which depends on how serious the transgression is and on how many times it had occurred), embargo, and prison.

The cost of evasion in each activity is extremely heterogeneous, depending on income levels, visibility, location, among others. Given this heterogeneity, to estimate on the basis of the cases studied a weighted average of total and partial evasion costs in the UIS as a whole seems to be senseless. Such coefficient would not really reflect the actual situation.

The feeble empirical basis of the above calculations of regulatory incidence makes it necessary to stress once again that the estimated costs of regulation cannot be generalized to the UIS as a whole; to arrive at more reliable estimates comprehensive empirical research is indispensable.

\textsuperscript{13} This information comes from interviews to key informers.
Table 1. Starting-up Regulatory Costs According to Activity

<table>
<thead>
<tr>
<th>Regulations</th>
<th>Cost</th>
<th>Time</th>
<th>Retail</th>
<th>Constr.</th>
<th>Manuf.</th>
<th>Servic.</th>
<th>Street</th>
<th>Trans</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$</td>
<td>4 hs.</td>
<td>Kiosk/</td>
<td>Contract</td>
<td>Garment</td>
<td>Workshop</td>
<td>Repair</td>
<td>Vending</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Grocery</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Registration</td>
<td></td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>- self-employed</td>
<td>46.5*</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>retirement scheme</td>
<td>139.5*</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- CUIT</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- SURL</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sanitary book</td>
<td>5 each</td>
<td>4 hs.</td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Invoices (book)</td>
<td></td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>- purchase</td>
<td>90</td>
<td>2d**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- authoriz. DGI</td>
<td></td>
<td>0.5h</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IVA books</td>
<td>63</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Registration Taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>M.C.B.A.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Gross</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Registration National</td>
<td></td>
<td>2 hs.</td>
<td></td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Industrial Registry</td>
<td>30</td>
<td>4 hs.</td>
<td></td>
<td>-</td>
<td>-</td>
<td>x</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Permits</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>premises#</td>
<td>1d</td>
<td>x</td>
<td></td>
<td>-</td>
<td>x</td>
<td>x</td>
<td>permit for street</td>
<td>x***</td>
<td></td>
</tr>
<tr>
<td>- with &quot;gestor&quot;</td>
<td>500</td>
<td>10d*</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- without &quot;gestor&quot;</td>
<td>400</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Registration Labor Ministry</td>
<td></td>
<td>4h</td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>-books (records and wage earners)</td>
<td>60</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* The first figure corresponds to manual workers with no employees; the second figure, to employers.

** Waiting time until the permit is granted.

*** MCBA driving license; vehicle permit; technical inspection and vehicle’s city registration; compulsory insurance; the duration of waiting time and of time consumed in procedures varies.

# Sanitary regulations demand investment, which varies according to activity and which is highest in the case of production and sales of foodstuffs.
<table>
<thead>
<tr>
<th>REGULATIONS</th>
<th>Cost</th>
<th>time</th>
<th>RETAIL</th>
<th>CONSTRUCTION</th>
<th>MANUFACTURING</th>
<th>SERVICES</th>
<th>STREET</th>
<th>TRANS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes on premises</td>
<td></td>
<td></td>
<td>kiosk</td>
<td>contractor</td>
<td></td>
<td></td>
<td></td>
<td>***</td>
</tr>
<tr>
<td>- Real estate, etc.</td>
<td>accord. to state valu.</td>
<td>2 hs.</td>
<td>x</td>
<td>-</td>
<td>x</td>
<td>x</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Labor</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(contributions to social security plus others)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- renewal</td>
<td>53%</td>
<td>1.5 d.</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>sanitary book</td>
<td>wage bill</td>
<td>5 each</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- legal declarat. SURL</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retirement contrib.</td>
<td>46.5</td>
<td>2 hs.</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>self-employed and employers</td>
<td>139.5</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Renewal sanit. bk.</td>
<td>5 each</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxes on:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- gross income</td>
<td>1.5% o</td>
<td>1 h.</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>-</td>
</tr>
<tr>
<td>- profits</td>
<td>3%</td>
<td>2 hs.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6%**</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Renewal</td>
<td></td>
<td>4 hs.</td>
<td></td>
<td></td>
<td>-</td>
<td>x</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>National Industrial Registry</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Renewal</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>permits and licenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value Added Tax (IVA)</td>
<td>18% of sales</td>
<td>2 hs.</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>-</td>
</tr>
</tbody>
</table>

* In the case of sales of foodstuffs it is necessary to add costs linked with sanitary maintenance of premises and equipment.
** See details in Appendix.
*** Tax on vehicles' city registration.
### TABLE 3: STARTING-UP COSTS ACCORDING TO ACTIVITY

Regulatory costs based on assumption of total compliance with legal norms
Illustrative cases in Buenos Aires city

**AVERAGE COSTS IN PESOS**

<table>
<thead>
<tr>
<th>STARTING-UP</th>
<th>KIOSK/ GROCERY*</th>
<th>REPAIR*</th>
<th>GARMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rent premises</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- per month</td>
<td>350</td>
<td>350</td>
<td>reforms in home of workshop owner</td>
</tr>
<tr>
<td>- deposit</td>
<td>700</td>
<td>700</td>
<td>400</td>
</tr>
<tr>
<td>Equipment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>-new</td>
<td>1500 to 2000</td>
<td>500</td>
<td>4500</td>
</tr>
<tr>
<td>-used</td>
<td>1000 to 1200</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Initial purchase of goods</td>
<td>1200</td>
<td>-</td>
<td>500</td>
</tr>
<tr>
<td>REGULATORY COST</td>
<td>704.5</td>
<td>704.5</td>
<td>797.5</td>
</tr>
<tr>
<td>REGULATORY COST/ STARTING-UP COST (%)</td>
<td>15 #</td>
<td>31</td>
<td>13</td>
</tr>
<tr>
<td></td>
<td>17**#</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* These are premises located in a low-income area.
** Kiosk/grocery with wage earner.
# Total cost was estimated on the basis of average cost of new equipment.
TABLE 4: COSTS OF OPERATION AND COMMERCIALIZATION, AND REGULATORY COSTS BASED ON TOTAL COMPLIANCE - Case Studies

4. A. KIOSK/GROCERY IN A LOW-INCOME AREA OF BUENOS AIRES CITY
(estimated maximum monthly costs in pesos)

<table>
<thead>
<tr>
<th>GROSS INCOME</th>
<th>6000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>costs $</td>
<td>time</td>
</tr>
<tr>
<td>OPERATION COSTS</td>
<td></td>
</tr>
<tr>
<td>- goods</td>
<td>4000</td>
</tr>
<tr>
<td>- rent</td>
<td>350</td>
</tr>
<tr>
<td>- electr.gas.tel.</td>
<td>20</td>
</tr>
<tr>
<td>OPERATION COSTS: LABOR</td>
<td></td>
</tr>
<tr>
<td>- wage (one employee)</td>
<td>330</td>
</tr>
<tr>
<td>REGULATORY COSTS</td>
<td>10h</td>
</tr>
<tr>
<td>- real estate, etc.</td>
<td>13</td>
</tr>
<tr>
<td>- gross income tax</td>
<td>180</td>
</tr>
<tr>
<td>- self empl. contrib.</td>
<td>46.5</td>
</tr>
<tr>
<td>- with employee</td>
<td>139.5</td>
</tr>
<tr>
<td>- accountant or equiv.</td>
<td>50</td>
</tr>
<tr>
<td>- over-rate IVA*</td>
<td>360</td>
</tr>
<tr>
<td>- others</td>
<td>25.4</td>
</tr>
<tr>
<td>REGULATORY COSTS: LABOR (social security)</td>
<td>2h</td>
</tr>
<tr>
<td>Monthly legal declaration</td>
<td>-</td>
</tr>
<tr>
<td>PROFITS</td>
<td>955.1</td>
</tr>
<tr>
<td>- with no employee</td>
<td>347.1</td>
</tr>
<tr>
<td>REGULATORY COSTS/GROSS INCOME (%)</td>
<td>total time</td>
</tr>
<tr>
<td>- with no employee</td>
<td>11.2 regulat.:</td>
</tr>
<tr>
<td>- with employee#</td>
<td>15.9 13h</td>
</tr>
<tr>
<td>R/T (%) (with no employee)</td>
<td>15.4</td>
</tr>
<tr>
<td>R/TT (%) (with no employee)</td>
<td>13.4</td>
</tr>
<tr>
<td>cont. table 4.A.</td>
<td></td>
</tr>
<tr>
<td>REGULATORY COST/PROFITS(%)</td>
<td></td>
</tr>
<tr>
<td>- with no employee</td>
<td>70.7</td>
</tr>
<tr>
<td>- with employee</td>
<td>274.5</td>
</tr>
</tbody>
</table>

* Non registered IVA-responsible store owners have to pay an over-rate of 9 percent of purchases.
** Includes an extra 3 percent of wage bill for an additional (private) retirement scheme for employees in commerce.
# If tax on profits is included, the increase in incidence is negligible.
## It is assumed that the volume of sales with or without employee is the same.
### TABLE 4: OPERATION AND REGULATORY COSTS

#### 4.B. CONSTRUCTION CONTRACTOR WITH THREE WAGE EARNERS, BUENOS AIRES CITY (Monthly average costs in pesos)

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GROSS INCOME</strong></td>
<td>2800</td>
<td></td>
</tr>
<tr>
<td><strong>OPERATION COSTS</strong></td>
<td>1200</td>
<td>time</td>
</tr>
<tr>
<td>Wages (three wage earners)</td>
<td>1200</td>
<td></td>
</tr>
<tr>
<td><strong>REGULATORY COSTS</strong></td>
<td>923.5</td>
<td></td>
</tr>
<tr>
<td>Sanitary book</td>
<td>20 annual/12 = 1.7</td>
<td>4h</td>
</tr>
<tr>
<td>IVA Books, book invoices</td>
<td>63/12 = 5.3</td>
<td>5.3</td>
</tr>
<tr>
<td></td>
<td>80/12 = 7</td>
<td></td>
</tr>
<tr>
<td>personal employer contribs.</td>
<td>139.5</td>
<td>2h</td>
</tr>
<tr>
<td>Accountant or equiv.</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>Legal declaration</td>
<td>-</td>
<td>1h</td>
</tr>
<tr>
<td>Social security contribs. and other labor costs</td>
<td>636</td>
<td>2h</td>
</tr>
<tr>
<td>Gross income tax</td>
<td>84</td>
<td>2h</td>
</tr>
<tr>
<td><strong>PROFITS</strong></td>
<td>676.5</td>
<td></td>
</tr>
<tr>
<td>regulatory costs/gross income (%)</td>
<td>33</td>
<td></td>
</tr>
<tr>
<td><strong>R/T (%)</strong></td>
<td>77</td>
<td></td>
</tr>
<tr>
<td><strong>R/TT (%)</strong></td>
<td>43.5</td>
<td></td>
</tr>
<tr>
<td>regulatory costs/ profits (%)</td>
<td>136.5</td>
<td></td>
</tr>
</tbody>
</table>

**Note:**
- **R/T** represents the ratio of regulatory costs to income.
- **R/TT** represents the ratio of regulatory time to total time.
- **Regulatory costs/gross income (%)** and **regulatory costs/profits (%)** indicate the percentage of regulatory costs relative to gross income and profits, respectively.

**Total Time**
- Regulatory: 11h
### TABLE 4. OPERATION AND REGULATORY COSTS

4. C. GARMENT WORKSHOP, BUENOS AIRES CITY  
(estimated monthly average costs in pesos)

<table>
<thead>
<tr>
<th>GROSS INCOME</th>
<th>4200</th>
</tr>
</thead>
<tbody>
<tr>
<td>costs $</td>
<td></td>
</tr>
<tr>
<td>time</td>
<td></td>
</tr>
<tr>
<td>OPERATION COSTS</td>
<td></td>
</tr>
<tr>
<td>electricity, gas, telephone</td>
<td>20</td>
</tr>
<tr>
<td>OPERATION COSTS: LABOR</td>
<td></td>
</tr>
<tr>
<td>wages (three employees)</td>
<td>900</td>
</tr>
<tr>
<td>REGULATORY COSTS</td>
<td></td>
</tr>
<tr>
<td>real estate, etc.</td>
<td>13</td>
</tr>
<tr>
<td>gross income tax</td>
<td>126</td>
</tr>
<tr>
<td>personal empl. contributions</td>
<td>139.5</td>
</tr>
<tr>
<td>accountant or equivalent</td>
<td>50</td>
</tr>
<tr>
<td>others</td>
<td>27.2</td>
</tr>
<tr>
<td>REGULATORY COSTS: LABOR (social security)</td>
<td>477</td>
</tr>
<tr>
<td>Monthly legal declaration</td>
<td>-</td>
</tr>
<tr>
<td>PROFITS</td>
<td>2447.3</td>
</tr>
<tr>
<td>REGULATORY COSTS/GROSS INCOME (%)*</td>
<td>19.8</td>
</tr>
<tr>
<td>R/T (%)</td>
<td>90.5</td>
</tr>
<tr>
<td>R/TT (%)</td>
<td>47.5</td>
</tr>
<tr>
<td>REGULATORY COSTS//PROFITS (%)</td>
<td>34.0</td>
</tr>
</tbody>
</table>

* If the tax on profits is added, the increase in incidence is negligible.
TABLE 5: DIFFERENTIAL COST ACCORDING TO DEGREE OF COMPLIANCE WITH REGULATIONS

Case study: kiosk/grocery store

<table>
<thead>
<tr>
<th></th>
<th>cost of total compliance</th>
<th>average real behavior</th>
<th>cost of sanction</th>
<th>cost of evasion</th>
</tr>
</thead>
<tbody>
<tr>
<td>permit</td>
<td>$400-500 10 days of waiting</td>
<td>$500 10 days of waiting</td>
<td>closing embargo</td>
<td>$10-20 per month</td>
</tr>
<tr>
<td>gross income tax</td>
<td>$180</td>
<td>$91**</td>
<td>- intimat. - paym. in installments or either embargo</td>
<td>cannot be wholly evaded**</td>
</tr>
<tr>
<td>books (accountant)</td>
<td>$50</td>
<td>$50</td>
<td>up to $500 3 days closing</td>
<td>$150 for 1 month &amp; a half delay to comply</td>
</tr>
<tr>
<td>contribut. retirement scheme for wage earners</td>
<td>$119*</td>
<td>0</td>
<td>- see appendix on regularizat. - few inspect.</td>
<td>$100 for a delay to comply</td>
</tr>
</tbody>
</table>

* Contributions for social security in Commerce: 36 percent of wage bill.
** Actual practice is partial compliance: gross income is under-declared so as to reduce taxable income, and pay only the minimum stipulated by law (see appendix).
RECOMMENDATIONS

In recent years, several government initiatives affected three areas of relevance for the informal sector: labor policy, social security, and taxation. Some of these measures affected also registration.

I. Labor policy. During 1993 the Executive produced at least four projects of reform of the Labor Code. The aim of all three projects is to deregulate the labor contract and facilitate dismissals, through the introduction of new and less costly forms of temporary contracts among others.\(^1\) At first sight, the reforms apply to all firm sizes alike.

Impact: Labor law reforms may be expected to reduce regulatory labor costs and give more flexibility to employers (of all firm sizes) to handle the volume of employment according to changes in the level of economic activity. Those reforms which would imply the expansion of precariousness (for instance, widespread use of temporary contracts) would be adverse to UIS workers.

II. Social security. The retirement scheme was reformed in late 1993. Wage earners were given the option to contribute either to private funds or to the state controlled fund. This reform did not bear upon employer contributions. However, in November-December 1993 the Executive proposed to cut down employer contributions to the retirement scheme by 30 to 80 percent, depending on the geographic location of the firm (distance from Federal Capital). This project still has to be discussed and approved in Parliament.

Impact: The reduction of social security employer contributions (payroll taxes) obviously will imply lower regulatory costs for all firms, including micro-firms.

**Recommendation 1.** The UIS should benefit further from a restructuring of social security financing. Currently, the retirement system and the *obras sociales* are financed by employer and employee contributions. Even if the reduction of employer contributions to the retirement scheme is approved, we recommend to eliminate employer contributions of low income small firms (those where the volume of gross income does not exceed a stipulated maximum). It should be stressed that coverage of wage earners working in micro units should be maintained. To this end, micro-firm employers still would have to register their employees, ensuring in this way that they would have access to social security. This scheme for curtailing social security costs in low income micro-firms while preserving wage earners' coverage in fact means that the financing of social security will be shifted onto medium and big firms. However, medium and big firms might resort to fictitious subdivisions in order to benefit from the tax exemption. Hence, the implementation of this reform demands stricter, and more efficient and intense state controls.

The amendment should not be made extensive to the *obras sociales*. In the existing system, each *obra* is financially autonomous; resources available to each *obra* depend on the volume of worker and employer contributions in each economic sector. A centralized entity redistributes funds to individual *obras sociales* when necessary. If micro-firms' employer contributions to this scheme were eliminated, neither the fund nor worker contributions would

\(^{1}\) It is not clear as yet which will be the definitive items included.
be able to replace lost revenues. For example, revenues of the obra social in the garment industry, with a large concentration of micro-firms, would suffer the impact of the loss of a substantial portion of contributions.

III. Taxation. Tax reforms in 1991-93 have contributed to increase further the weight of indirect taxes in total tax revenues. Moreover, the category of "non taxable" income brackets was suppressed; in the past this category had benefitted low-income groups who, in this way, had been exempted from paying taxes on personal income.

Impact: Ongoing tax reforms will have a negative impact on UIS income as, according to our analysis of regulatory costs, indirect taxation, together with payroll taxes, have the greatest incidence in total costs.

Recommendation 2. A tax reform specifically addressed to the informal sector (micro-firms with and without employed labor) must be made in the context of a broader reform of the tax structure. The shift towards a pattern based mainly on progressive taxation on personal income would undoubtedly benefit the group of informal firms that are currently burdened by the cost of indirect taxes. Further, given the fact that wage earners and other low income groups represent a substantial portion of the UIS's market, rebates to indirect taxes that affect wage goods consumption would also favour the UIS.

IV. Since 1991 the government simplified registration requirements (see Appendix).

Impact: Whereas the simplification of requirements at the DGI (including labor obligations) raised the volume of registrations, it did not result in an increased registration of employed workers.

Recommendation 3. The above changes did not include municipal regulations. Municipal requisites for the initiation of a business do not result in blatant time losses, except in the case of controls and permits concerning food, pharmaceutical products and other goods and services affecting public health (cosmetics, natural health products, beauty shops, manicures, etc.) and elimination of dangerous residues. In these cases the granting of permits can take many months.
We recommend centralization of procedures to obtain the different permits; this would facilitate and speed up the process, helping also to eliminate corruption. Controls should not be relaxed; quite the contrary: it is necessary to broaden and to intensify them to prevent public health hazards.
APPENDIX

STATE REGULATIONS

This appendix provides a synthesis of state regulations affecting the activities of the urban informal sector. State regulations include laws, decrees, edicts and other legislative items at the national, the provincial, and the municipal levels. In view of the extreme variety of provincial and municipal legal regulations in Argentina, which diverge between provinces and between cities and departments within one same province, we have focused the analysis on national regulations and on the municipal regulations of Buenos Aires, the most populated city of Argentina. National government regulations influence economic activities in the country as a whole, while municipal regulations affect exclusively the Municipalidad de la Ciudad de Buenos Aires (MCBA).

STATE REGULATIONS AFFECTING:

1. INITIATION COSTS

1. Registration, permits, licenses

Legal requirements for starting a manufacturing, commercial or service business in the Capital are:

a. At the General Tax Agency - Dirección General Impositiva (DGI) - individuals or societies should:

- register as own-account workers (autónomos) and pay the first monthly contribution to the retirement scheme for own-account workers, the Dirección Nacional de Recaudación Previsional (DNRP)

- procure their Tax Identification Code (Clave Unica de Identificación Tributaria - CUIT);

  - if they employ labor, both employer and employee/s must register at the Sistema Unico de Registro Laboral (SURL).

b. For the initiation of a (de facto or legal) society the latter has to register at the DNRP and obtain the CUIT number.

c. After the two registration numbers are obtained, applicants have to get special invoices from the printer. The estimated volume of gross income of the petitioner determines his/her fiscal obligations: when gross income falls under a certain amount, the person or society is labeled in the DGI as “non registered”, and must print type 'C' invoices. When the person or society's gross income exceeds that amount, they are labeled as “registered”, and invoices type 'A' and type 'B' are required. In turn, this affects other fiscal obligations, that will be described in other sections.

d. Further, it is necessary to register and authorize invoice's numbers at the DGI office.
Other requirements:

e. Registration at the Dirección de Rentas de la Municipalidad de Buenos Aires for the regular payment of Gross Income, a tax directly levied by the municipality.

f. Obtention of a sanitary book in a public hospital of the area, compulsory for all the people working in the business (employers and employee(s)).

g. To follow the necessary steps for obtaining habilitation of premises and of business in the Municipality.

Activities that need habilitation or permit have to adjust to various codes: Urban Planning, Construction, and Habilitation and Verifications.

In addition, when foodstuffs are produced or sold, it is necessary to comply with the Argentine Food Code. If foodstuffs are of animal origin, it is necessary to comply with the national Animal Vigilance (Policía Animal) stipulations.

The Building Code of the Municipality of Buenos Aires regulates general aspects as well as aspects which are specific to certain activities.

For commercialization activities, there is a classification that includes 11 categories, with particular requisites in relation to the dimensions and characteristics of the premises, illumination, ventilation, sanitary services (for the staff and/or the public):

- shopping centers
- food shops
- department stores
- supermarkets (both selling various items and exclusively food)
- markets with retail shops
- shops selling or serving food
- retail shops selling processed food and/or canned beverages and food shops serving food in public parkings
- shops processing foodstuff for immediate consumption
- establishments fractionating, canning and/or packaging of food and/or beverages
- big shops, self-services of non food items and shops with access of public and not classified above.

For manufacturing activities - excluding the processing of foodstuff for immediate consumption - the code specifies 8 categories. Premises where food is produced must comply with more requirements than the rest:

- kitchen of at least 10 square meters
- glazed tiles covering the wall (height: at least 2 meters)
- external ventilation
- three deposits separated by at least a partition for raw materials, containers and garbage
- the deposits must be either oil-painted or tiled
- the room assigned to sales must have at least 16 square meters
- at least one toilet with two chambers
- if food is consumed within the premises, at least two toilets are required: one for men and one for women.
If aerial space in the street is used, or chairs and tables or similar elements are placed in the street, it is compulsory to pay a tax (tariff) determined yearly by special regulations (Ordenanza Tarifaria), before the obtention of the corresponding permit.

For obtaining municipal habilitation it is necessary to submit: — rental contract or papers certifying ownership of premises
- photocopy of registration at the Dirección de Rentas de la Municipalidad
- registration numbers in the social security and tax registries - - identification cards of the person/s that will work
- condominium regulations guaranteeing that businesses are allowed, if business is to take place in a condominium building
- ad hoc invoices for correct use of the premises and plans signed by professionals, duly registered at the Engineer's Professional Council. Non compliance with these habilitation norms is sanctioned with fines, and/or closure until compliance with regulations, and/or arrest or impounding.

h. In the case of installation of workshops, the person in charge must register as such in the corresponding office of the Ministry of Labor (Ministerio de Trabajo y Seguridad Social), presenting identification card, photograph, ad hoc book to register information concerning his/her employees (previously authorized in other office of the same Ministry), a book of records, rental contract or property certificate concerning the premises where the activity will take place, and names and documents of the future wage earners plus an authorization of the workgiving firm/s. To register as 'tallerista' the person in question must employ at least two employees.

i. There are specific norms regulating street vending.
Municipal norms classify sales in the public places in “own-account sales in public places” and in “sales for third parties”. The latter falls out of the scope of this appendix, because it refers to waged work.

On the other hand, preferential permits are distributed to handicapped persons, for sales in public areas with fixed locations.

The executive department of the MCBA distributes precarious permits, which are personal and cannot be transferred to others, for a maximum period of six months, and which are renewable. Those applying for a permit have to present three photographs, identification card, updated sanitary book, registration in the retirement system of independent workers and certificate of present address in the city of Buenos Aires, with at least 18 months of residence.

Those who obtain permits must be personally in charge of the business, and must ask for an authorization enabling them to employ a permanent assistant. In this case, the assistant must submit: identity card, and certificate of present address in Buenos Aires city.

The MCBA grants a maximum of 500 permits to own-account street vendors, giving priority to those who have longer experience in the activity concerned, as evidenced by the certificate of personal contributions to the corresponding retirement scheme, with date of affiliation and amount of contributions effectively made. In addition, they must submit a family and social report, provided by the Undersecretary of Social Action of the MCBA (Subsecretaría de Acción Social), showing that the applicant's family socioeconomic status is low.

To obtain the permit the applicants must register at the Municipal Registry for Own-account Street Vendors.

In what foodstuffs are concerned, the code restricts street vending to a narrow variety of goods (water and non alcoholic beverages, in their original packaging and served in disposable
glasses, peanuts, etc.). Street vendors are not allowed to sell under any circumstances icecream, coffee, tea or other infusions; sales of these goods have to follow the norms regulating street vending in hands of third parties. Food processing in the street, and preparation and consumption of foodstuffs by the salespeople and their assistants are forbidden. Production may be completed in view of the public before the sale only in the case of a few products: peanuts, chestnuts, etc. Further, uniforms must be clean.

j. With respect to freight transport in general and of foodstuffs and dangerous substances in particular, there are some regulations that should be complied with annually for the habilitation of the vehicle (which are similar to requirements due for premises).

k. The MCBA has limited the amount of taxi-cab licenses awarded; the municipal permit is granted only in case a licensed taxi leaves the activity. An alternative is to buy the license from a person or firm owning a licensed taxi; in this case the applicant must pay for this license and register as owner; then, he/she should register at the DGI to obtain the CUIT number. Together with the stipulations that are common to any habilitation, the taxi license requires an insurance policy covering third persons, and personal and work accidents. In order to obtain habilitation cars must undergo technical inspection.

2. Compulsory insurance: there are no legal obligations in this respect for habilitation of the workplace.

3. Legal requisites to obtain public subsidies and credit: it does not apply.

4. National Industrial Registry: those in manufacturing activities must register within the first 30 days after their initiation. Registration must be renewed yearly.

II. OPERATION COSTS

1. Workplace

   a. Insurance: they do not apply.

   b. Taxes: “real estate” is a municipal tax that is calculated on the basis of the property’s fiscal valuation (both land and building). Generally the tenant has to pay this tax, which adds to rental costs.

2. Labor

   a. Payroll taxes: employers are due to make monthly contributions and to withhold and deposit wage earners’ contributions to social security. Employer contributions to the retirement scheme, to the corporate health system (obras sociales) and to family allowances represent 33 percent of the wage bill, while those of workers and employees are 16 percent of wages.

      The composition of employer contributions is as follows:
      - contributions to the retirement scheme                         16 percent
      - contributions to the obras sociales                           6 percent
- family allowances 7.5 percent
- INSSJyP (National Institute of Social Services for Pensioners and Retired) employment fund 2 percent
(unemployment subsidy) 1.5 percent
Total 33 percent of wage bill

Wage earners' contributions are as follows:
- contributions to the retirement scheme 10 percent
- INSSJyP 3 percent
- Obra social 3 percent
Total 16 percent of wage

These contributions can be paid at any DGI office.

b. The law on work injuries determines that every employer is responsible for psycho-
physical damage, death, total and permanent incapacity, and partial and temporary incapacity,
suffered by wage earners while working. The law defines the amount of the compensation
applicable in each case. The employer has no legal obligation to obtain an insurance policy for his
employee's potential work injuries; in practice, insurance are widespread among big and medium
size firms, but not among small and micro-firms.

c. Registration of the work relationship

If the employer does not register the work relationship or if he/she deliberately shortens
the length of work relationships, he/she has to pay to the worker a compensation amounting to 25
percent of the remuneration received since the beginning of the relationship, in accordance with
prevailing norms. This compensation cannot be lower than three times the monthly salary resulting
from the application of the Labor Code (1976).

If the employer declares a wage lower than the actual wage perceived by the worker, he
will have to pay a compensation amounting to 25 percent of the remuneration received and not
registered, indexed.

These compensations apply when the worker or the trade union urges the employer to
register the work relationship. If the employer dismisses the employee without justification within
a time span of two years after notification he/she must pay a compensation that doubles the one
corresponding to dismissal.

d. Dismissal

- Advance notice of lay-off. Employers are obliged to notify dismissals one month in
advance in the case of contracts of indefinite end if the worker has been employed for at least five
years in the firm, and two months in advance if the period of employment has been longer.
Advance notice may be replaced by compensation. During the advance notice period workers are
entitled to a two-hour leave daily with no reduction in wages or to accumulate such hours in one or
more complete days.

- Lay-off compensation. Employment contracts may be terminated by both employers and
workers, with the limitations usual worldwide. Compensation applies to workers with more than
three-month employment in the firm and amounts to one wage per year of service or fraction
exceeding three months. It is computed on the basis of the best ordinary and usual monthly
remuneration received during the latest year or period worked if shorter than one year. There is a
maximum given by three times the monthly sum of the average of all earnings per year of
employment as stipulated in the collective agreement that applies to the legal or conventional working day exclusive of seniority benefits. The maximum corresponding to workers not covered by collective agreements, with variable earnings or paid on a percentages basis is computed considering the most favourable collective agreement that applies to the establishment where the worker is employed.

In cases of dismissals due to force majeure, bankruptcies or lack or reduction of work not attributable to the employer, compensation is half the normal one. The same applies to heirs in the case of workers’ death. When the employee terminates employment due to just causes, he is entitled to ordinary compensation plus compensation due for one month advance notice. Half the ordinary compensation also applies at the end of fixed term contracts, if length of service has been of at least one year. Special regulations apply to “promoted” contractual modalities.

e. Paid holidays and 13th wage. There is a 13th annual wage. Holidays - paid annual rest period - should be for a minimum and continued period and apply to workers employed at least during half the working days in the calendar year; if this minimum requirement period was not reached it corresponds one day rest each 20 days of effective work. Holiday lengths are of 14 days if employment has not exceeded five years; 21 days if it has exceeded five years but has lasted less than ten; 28 days if it has exceeded ten years but has lasted less than 20; 35 days when it has exceeded 20. The calculation of holiday pay is fixed by law.

f. Special leaves: paid leave applies in cases of birth, marriage, death of spouse and other immediate relatives, exams during high school and university studies.

g. Overtime working: pay for working overtime in excess of 8 hours daily or 48 weekly should amount to 50 percent over the usual wage (with some exceptions) in the case of ordinary working days, and to 100 percent in the case of Sundays, holidays and Saturdays after 1:00 pm.

h. Paid legal rests: they apply from 1:00 pm Saturdays to 12:00 pm Sundays, and during national obligatory holidays.

i. Several limitations apply to women’s employment, for instance during pregnancy, lactation and unhealthy work, as well as to the employment of minors (less than 14 years old).

j. Minimum wage: all workers older than 18 years are entitled to earnings at least equal to the minimum wage, which does not consider family allowances.

k. Collective agreements: employers should respect basic wages and the other regulations established in collective agreements that apply to each economic activity (or firm, depending on what applies).


m. Contractual modalities regulated by specific rules: the Ley de Empleo stipulates reductions from 50 to 100 percent of employer contributions to the retirement and family allowances schemes for “promoted contractual modalities”. These include:
- fixed term contracts to stimulate employment creation
- fixed term contracts due to initiation of a new activity
- contracts to acquire work practice for the young
- training contracts for the young

These contracts should be confirmed in the SURL at the Labor Ministry. Workers employed under these modalities should not exceed 30 percent of regular personnel in the establishment; the proportion goes up to 50 percent in firms with between 6 and 25 employees, and to 100 percent in firms with up to 5 workers, with a maximum of 3 workers.

n. Cooperatives are regulated by specific rules: the Instituto Nacional de Acción Cooperativa requires work cooperatives to provide social security benefits to their members. To that end they should, among others
- contribute to the retirement scheme corresponding to the self-employed or other legal scheme;
- provide money allowances to members in case of illness and accidents, and to members or their heirs in cases of partial or total inability and death due to professional illness or accidents; such allowances should be comparable to those stipulated by legislation for workers in general employed in the same economic activity;
- implement a system to ensure health care of their members and their families; obligations concerning illnesses and accidents may be replaced by appropriate insurance schemes.

3. Machinery and equipment

Reliability: The Argentine legal metric system applies to all activities using weight and measurement instruments; this is controlled by the Municipality of Buenos Aires. These instruments should be kept in perfect sanitary and maintenance conditions, and with the seal of the initial control, granted only when the instrument model had been approved previously. These instruments should be controlled periodically.

4. Output

Taxes: all owners of a shop that sells goods or services, or of a manufacturing establishment should periodically declare and pay taxes at the DGI and the Dirección de Rentas de la Municipalidad de Buenos Aires, carry systematic registration of activities in the adequate books (Impuesto al Valor Agregado (IVA)-Ventas y el IVA-Compras), and inform annually on sales and registered activity.

The municipal Gross Income tax (Ingresos Brutos),

15 taxes monthly total gross income; the tax rate varies according with economic activities: trade, restaurants, hotels, transportation, communications, warehousing, services to the public, business services, personal and household services (repair, laundries, direct personal services), 3 percent; retail sales of meat, milk, eggs, fresh fruit, cheese, bread and the like, 1.5 percent (except for ordinary table wine and beverages in general, that pay 3 percent). Manufacturing production pays also 1.5 percent. If the owner had registered as “IVA responsible”, the rate is computed on gross income less the IVA (18 percent).

There is, however, a minimum monthly payment, that varies according to activity:

Small kiosk $ 69
Retail shops $ 107
Manufacturing $ 65
Services $ 91

Taxis are exempted from this tax.

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15 Cooperatives are regulated by specific rules concerning this tax, that are of no relevance here.
The tax on profits (sales minus expenditures) differs according to profit stratum; family responsibilities (wife and children and/or other relatives) are deductible. This tax was modified starting in August 1993, and some changes have not been fully legislated as yet. The non taxable minimum was eliminated, and the minimum rate was increased from 6 percent to 11 percent of profits, but other exemptions are considered.

5. Other operative costs

a. Each new receipts booklet should be authorized by the DGI.

b. Employers and the self-employed should contribute monthly to the retirement scheme for their own retirement.

c. Rates for public utilities differ according to whether the user is a household, a commercial shop or a manufacture establishment.

d. Renewal of permits. In the case of street vending renewal of permits must be requested at least 15 days in advance of expiry of permit; requirements for renewal: identity card, renewed Sanitary book, and certified retirement scheme contributions. Taxis and cargo transportation require an annual technical inspection to renew registration and permits.

e. Sanitary controls: specific regulations (for foodstuffs, hairdressers, etc.) concern sanitary requirements in relation to personnel, instruments, worksite, containers (including labels) and product. Transgressions are penalized by the Municipality of Buenos Aires, with fines, and/or closing of establishment, and/or prison.

f. The SURL requires from the employer an annual legal declaration at the DGI.

III. COMMERCIALIZATION COSTS

1. Minimum and maximum prices: rates for taxis are fixed by the Municipality of Buenos Aires.

2. Volume requirements: not applicable.

3. Regulations on purchases and sales: not applicable.

4. Transportation requirements: see requirements for registration and permits for cargo vehicles.

5. Taxes on sales: the rate of the national Value Added Tax (Impuesto al Valor Agregado - IVA) on sales amounts to 18 percent. Business with annual sales lower than 140 thousand pesos in the case of selling goods and 96 thousand in the case of selling of services and in manufacturing, may register as “non-registered IVA responsible”. Small business registered as “non VAT responsible” do no pay the VAT. Instead, they have to pay 9 percent over the value of their purchases.

6. “Law of commercial loyalty” (Ley de lealtad comercial): it regulates identification of goods, original names, publicity and advertising.
7. It is mandatory to exhibit prices.

8. Sanitary controls described in 5.e. are applicable.
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