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## **Legal Mechanisms to empower Informal Businesses**

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*“The opposite of poverty is not wealth – it is justice. The objective...is to create a more just society, not necessarily a wealthier one. And the great question is how do we do this?”*

Leonardo Boff  
Franciscan Theologian, Brazil

**Empowering informal businesses** should be viewed as a right to be equally exercised by all men and women, including indigenous people and other vulnerable groups and those who live in margins of the lower economic strata of the society. Existence and transparency of procedures, accountability of the executive branch and public faith in the economic, judicial and executive system are pre-requisites to achieving a reasonable level of empowering informal businesses. The challenge of the legal empowerment agenda therefore, is primarily changing the systems, from being perceived as being against poor people and informal businesses – to being systems that serve their interests. In other words The Legal Empowerment (LE) agenda goes beyond the narrow approach of formalisation of property rights, reforming justice system, simplifying business regulations to a more pragmatic integrated framework wherein the state is connected to its people and it is responsive to their needs and accountable to its action. LE therefore covers broadly the following:

- Strengthening Governance from supply side (capacity building ) and demand side (supporting local or community driven initiatives)

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\* The views expressed are only those of the authors and not necessarily of the Commission

- Reforming and Transforming Institutions (inclusion, cohesion and accountability)
- Making laws (e.g. Alternative Dispute Resolution) work for the informal businesses, and
- Rights (knowledge and understanding of rights, asserting and enforcing rights collectively)

Business formalization normally consists of reducing cost of establishing a business or simplifying process of registering them. The focus of this traditional approach has been to make business formal but lacked tools to use law to empower them. The Commission's aim on *Legal empowerment of informal businesses* is however developed on the premise that the law has a set of legal tools and institutions, and if made accessible to these "extra legal" or informal businesses, it will not only simplify establishing process and reduce cost but also considerably enhance business opportunities; create decent jobs; make credit, capital and markets accessible and affordable, and most importantly make businesses visible with a legal identity.

Irrespective of how 'informal businesses' are defined, an effective strategy for "empowering" them will need to engage, coherently and seriously, with the vast assortment of rules systems in which such businesses—and development processes more broadly<sup>1</sup> are embedded. In other words, an effective legal empowerment strategy for the poor will need to go well beyond orthodox discussions of 'property rights', important as these are, to incorporate those elements—from citizenship rights and identity verification to commercial dispute resolution procedures and local governance concerns—that necessarily precede, accompany or follow them.

To the extent there is now a broad scholarly and policy consensus<sup>2</sup> on the importance of property rights for development—i.e., for encouraging investment by the poor (and others) in small business ventures; or, concomitantly, a recognition that endemic corruption, costly bureaucratic delays and weak contract enforcement all undermine capacities and incentives to make such investments—it is also important to appreciate that responding effectively to these concerns is not simply (or only) a matter of encouraging policymakers to "grant" property rights, "stamp our corruption" or make relevant line ministries "more efficient". In the most elementary sense, property rights must be given to actual people, who themselves—in order to advance and defend their access to and possession of such rights—first must be able to formally verify their personal status and identity. A crucial pre-requisite, then, to enhancing the quality of property rights is ensuring that residents/citizens have recognized documents (such as birth, death, marriage and divorce certificates) verifying such basic information as their name, age, sex and marital status.

### **Who are we talking about?**

City street vendors, rural milk hawkers, the small food cart pushers, the shoe shiners, the itinerant fix-it technician, the roadside hairdresser and food caterer – these are the informal entrepreneurs who are vibrant visible players in the poorer countries of the world. And as one observer suggest they are "the true entrepreneurs - more flexible, efficient and resilient than the overregulated and overprotected dinosaurs of the formal sector..."<sup>3</sup>. These entrepreneurs are called informal because they operate to some extent outside the realm of formal legal protection and without easy or full access to the advantages of formal financial and business support systems. They work as single person operations or as micro and family enterprises with hired workers or unpaid family workers engaged in income generating activities or IGAs. Informal IGAs are globally most often located in the retail trade sector. This and the personal services sectors are where women predominate. Other informal entrepreneurs are found in agriculture, manufacturing, transport and construction sectors. Together they comprise the vast majority of the working poor – 550 million people earning less than US\$ 1 per day (ILO 2004). Estimates suggest that half of the working poor in the informal economy are self-employed, a quarter is employed by informal enterprises or households, and another quarter is employed by formal enterprises.

### **Why Informal Businesses need LE**

<sup>1</sup> Sage, Caroline and Michael Woolcock (2006) "Rules Systems and the Development Process", in Caroline Sage and Michael Woolcock (eds.) *Law, Equity, and Development* Amsterdam: Martinus Nijhoff and Washington, DC: World Bank, pp. 1-29

<sup>2</sup> Michael Woolcock (2007) "Some initial thoughts to on empowering informal businesses", World Bank.

<sup>3</sup> George A. Aryee: "Promoting Productivity and Social Protection in the Urban Informal Sector - An Integrated Approach. Report on Pilot projects in Bogota, Dar es Salam and Manila -Summary of activities, lessons and recommendations" ILO, third (updated ) edition Dec 2006 ISBN 92-2-110343-9

Today, most of the world's poor live in the informal economy, occupying land they do not own, working in small, informal businesses, and relying on friends for loans. They often have limited access to broader economic opportunities and are especially vulnerable to the uncertainties, the corruption and even violence prevalent outside the rule of law and have few means to settle disputes apart from bribery or violence. Without legal rights or protections, they are in a continual state of legal and political vulnerability. Informality, therefore, limits the opportunity for economic and social development for individuals, families, businesses, communities, and entire nations. Additional reasons<sup>4</sup> why informal businesses need legal empowerment include:

- small informal businesses run by poor individuals or households should be seen as a central pillar of a just society and a central strategy for reducing poverty and inequality
- most policies and the global economy privilege large firms/enterprises over small firms/enterprises
- informality is here to stay and growing and is an essential feature of the global economy
- while national governments and the international community seek to create as many formal jobs as possible and formalize as many informal enterprises and jobs as possible, the transformation from informality to formality is going to be slow and gradual at one end while informality is likely to increase, if the country lacks an enabling business environment
- the real challenge is to reduce the Decent Work “deficits” of those who work informally, especially the working poor
- commercial rights for informal entrepreneurs/operators should be seen as an essential part of a package of rights for the working poor in the informal economy that also includes property rights, labour rights, the right to social protection, and the right to be organized and represented in policy-making and rule-setting institutions and processes
- other than social protection (property, health, life, disability, old age) which is relevant for wage workers as well as the self-employed in the informal economy, commercial rights are relevant to the half of the working poor in the informal economy who are self-employed
- of the half of the working poor who are self-employed, the larger and more vulnerable group are own account operators, including: both single person operators and those who work in family businesses or on family farms
- productivity and protection can and should be promoted together
- economic policies should address issues of redistribution

### What does LE means to Informal Businesses

Empowering specific groups of informal businesses, policy makers and practitioners need to choose appropriate elements from the framework and tailor interventions to meet local circumstances<sup>5</sup>. Consider, for example, the specific conditions of one of the lowest level of informal businesses namely Street Vendors in which large numbers of working poor women tend to be concentrated.

#### Street Vendors

Common issues and challenges faced	What they want LE to do for them?
<ul style="list-style-type: none"> <li>- insecure place of work: due to competition for urban space</li> <li>- capital on unfair terms: due to dependence on wholesale traders</li> <li>- uncertain quantity, quality, and price of goods: due to dependence on wholesale traders</li> <li>- lack of infrastructure: shelter, water, sanitation</li> <li>- ambiguous legal status: leading to harassment, evictions, and bribes</li> <li>- negative public image</li> </ul>	<ul style="list-style-type: none"> <li>- secure vending sites</li> <li>- access to capital on fair terms: a loan product tailored to their daily need for working capital</li> <li>- bargaining power with wholesale traders</li> <li>- infrastructure services at vending sites: shelter, water, sanitation</li> <li>- license to sell and identity cards</li> <li>- freedom from harassment, evictions, and bribes</li> <li>- positive public image</li> </ul>

<sup>4</sup> Martha Chen (2006) “Legal Mechanisms to Empower Informal Businesses”

<sup>5</sup> Martha Chen 2006

In other words, informal businesses basically need the following:

- *basic commercial rights*: right to work, including right to vend; right to a work space (including public land and private residences) and related basic infrastructure (shelter, electricity, water, sanitation)
- *intermediary commercial rights*: right to government incentives and support including procurement, tax holidays, export licensing, export promotion); right to public infrastructure (transport and communication)
- *advanced commercial rights*: entity shielding rules,, limited liability and capital locking rights, mechanisms for perpetual succession of the firm and transferring its value, mechanisms to allow the use of standardized accounting, mechanisms to establish firm, manager and employee liability rights, protect minority shareholders and default rules

## **Unlocking Barriers: Legal Mechanisms to Empower Informal Businesses to leave Informal Economy**

- 1) Legal and bureaucratic procedures that allow informal operators or businesses to operate:**
  - simplified registration procedures
  - simplified licensing and permit procedures:
  - identification devices, including:
    - ID cards for individual operators
    - business identification
  - legislation – e.g., municipal by-laws – that allow street vendors to operate in public spaces
- 2) Appropriate legal frameworks that enshrine the following as economic rights:**
  - access to finance, raw material, and product markets at fair prices
  - access to transport and communication infrastructure
  - access to improved skills and technology
  - access to business development services
  - access to business incentive and trade promotion packages: tax deferrals, subsidies, trade fairs
- 3) Legal property rights:**
  - private land
  - intellectual property
- 4) Use rights to public resources and appropriate zoning regulations:**
  - use rights to urban public land
  - use rights to common and public resources: pastures, forests, and waterways
  - appropriate zoning regulations re where and under what conditions informal operators or businesses can operate in central business districts, suburban areas, and/or industrial zones
- 5) Appropriate legal frameworks and standards for what informal operators and businesses are allowed to buy and sell:**
  - appropriate laws and regulations re what are legal vs. illegal goods and services
  - appropriate product and process standards: e.g. public health and sanitation concerns re street food
  - marketing licenses for products and services
- 6) Appropriate legal tools to govern the transaction and contractual relationships of informal operators or businesses:**
  - bargaining and negotiating mechanisms/power
  - legal and enforceable contracts
  - grievance mechanisms
  - conflict resolution mechanisms
  - possibility of issuing shares, right to issue shares
  - right to advertise and protect brands and trademarks
- 7) Legal rights and mechanisms to provide informal operators and businesses with:**
  - temporary unemployment relief
  - insurance of various kinds, including of land, house, equipment, and other means of production
  - bankruptcy rules and default rules
  - limited liability, asset and capital protection
  - capital withdrawal and transfer rules
- 8. Legal right for informal operators and businesses to join or form organizations, legal recognition of such organizations, and legal right of representation of such organizations in relevant policy-making and rule-setting institutions**
  - membership in mainstream business associations
  - membership in guilds or other associations of similar types of entrepreneurs
  - representation in relevant planning and rule-setting bodies

### **How to make the formal economy accessible and enticing**

Addressing informality is a multifaceted proposition which requires a thorough understanding of the factors that create and drive informality. Any initiatives to make informal businesses attracted towards

formal economy may first need the formal sector be re-defined to accommodate many of the principles and values tolerated in the informal sector - and upon which legitimacy has been implicitly conferred. Clearly, there is no single approach to reform. The fundamental challenge is therefore to frame an incentive-based strategy that takes into account the complexity of the legal, social, cultural, political, and economic dimensions of informality — a strategy that is both bottom up and top down, fully reflecting the objectives, priorities, and concerns of the poor; a strategy that is transparent, broadly owned, and supported by an approach to effective implementation. Some of the strategies<sup>6</sup> that will help informal businesses to move towards formal economy are;

- seeks to reduce the Decent Work “deficits” of those who run informal businesses,
- includes representative voice of the working poor in the informal economy
- recognizes and addresses the bias in existing commercial policies, regulations, laws, and procedures that favor larger firms/enterprises
- seeks to extend government incentives and procurements to the smallest informal enterprises
- seeks to build backward and forward linkages on fair terms between larger and smaller firms
- seeks to promote market access and fair trade for smaller firms and enterprises
- promotes social protection for informal operators (property, health, life, disability insurance) plus retraining, life-long learning, and other support to mobility

At the macro level Douglas North<sup>7</sup> et al suggests broadly the following framework:

- a competitive economy, which needs political openness, which produces a competitive economy; movement from limited to open access which in its turn requires rule of law imposed on the elites; political control of the military; impersonal legal system for the elites; perpetual forms of organizations for elites.
- Legal mechanisms include a competent, independent judiciary, applying the law equally and evenly on all members of the community. Essential are education of the legal profession; full publication and dissemination of legal texts including judicial decisions.
- Publicly elected parliament, independent of the executive, adopting transparent, coherent laws, including laws for the protection and facilitation of business.
- Freedom of the press, and adequately paid journalists to shelter them from bribery.
- Enforcement officers apply the law uniformly to all.
- Military is under the control of the legitimate political arm of government.
- Encourage capital formation, various business forms are quickly and cheaply formed, some to limit the owners’ liability to their investment in the business.
- Significant effort to reduce grand corruption and, ultimately, to reinforce social norms that constrain petty corruption.
- review of the entire tax regime to ensure that it is totally transparent and reasonably progressive (with no tax due at the lower end of the spectrum);
- Legal structure encouraging to potential lenders, both in the micro-finance sector and for larger loan,
- Provide a basic infrastructure, e.g., education, healthcare, protection for vulnerable workers (including protecting the right of assembly); or ensure that the private sector is capable of serving as its delegate.
- Protecting innovation
  - by applying tariffs on imports and subsidies to exports,
  - by protecting at least to some degree intellectual property rights,
  - by requiring skills-development for workers for companies or groups over a certain size, whether under ultimately domestic or foreign ownership,
  - by carefully targeting and facilitating the entry of those foreign investors who can provide know-how, and targeting those domestic industries for which the acquisition of investment is similarly facilitated. (Altenburg & Drachenfels)

### **How to make the business people’s stay in the informal economy tolerable.**

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<sup>6</sup> Martha Chen, (2006), “ Legal Mechanisms to Empower Informal Businesses”

<sup>7</sup> Douglas North

As mentioned earlier informal businesses are continuing to grow within the informal economy in most of the developing countries due to factors discussed above. Hence it is imperative to have some kind of temporary measures to make the operations tolerable within the informal economy but not necessarily encouraging measures. Briefly some measures are<sup>8</sup>:

- The governments must first satisfy its obligations under human rights norms.
- The formal, official government must work either indirectly through any ad hoc “government” within the informal economy, or directly, to provide maximum security within physical location of members of the informal economy.
- The formal courts will decide informal-economy disputes under an amnesty arrangement and to the extent possible enforce decisions of any ad hoc judicial system among informal-economy business people as though they were generally enforceable arbitral awards.
- Protect and encourage free association of micro-enterprises, including through the cooperatives and collective ownership and identity

### **Sustaining the LE Strategies and Policies**

The sustainability of the proposed reforms depends on public recognition of the changes, legitimacy within the particular cultural and social conditions where they are to be implemented. A country’s failure to account for relevant social realities in developing its formal governing institutions may prevent the successes of legal reforms that are otherwise cognizant of the larger policy aim of promoting market-driven economic growth. For example, failing to incorporate widely-accepted informal rules, such as the customary forms used in many parts of sub-Saharan Africa, into the proposed formal legal system increases the likelihood of reforms being rejected outright by the private sector<sup>9</sup>. Therefore in delineating what can be done to legally empower informal businesses so that they can better access the opportunities, finances, services and facilities of the formal sector, tailoring of policies, institutional programmes and interventions to the most disadvantaged has to be taken in consideration.

***Pillar 1: Adopt an inclusive and integrated approach to economic development such that there is legal recognition and empowerment of informal businesses.***

Legally empowering small informal businesses run by poor individuals or households should be seen as a central pillar of a just society and a central strategy for reducing poverty and inequality. This means that policies and global economic privilege which is geared at present to the elites and large enterprises have to change to become inclusive of the billions at the bottom of the economic pyramid. These billions are the producers and consumers who make markets profitable for the privileged. Their share has to be duly recognized through much greater public and private sector cognizance and support to small firms and enterprises. Informality with its flexibility and space for millions to engage productively in economies is here to stay. Official and legal response needs to recognize what works in this sector and strengthen and integrate these innovations into an inclusive integrated approach to wealth creation.

***Pillar 2: Support legal empowerment through a package of commercial rights underlined in policies and instituted and enforced through regulatory bodies.***

Commercial rights for informal entrepreneurs/operators include but are not limited to property rights, labour rights, the right to social protection, the right to be organized and represented in policy-making and rule-setting institutions and processes and the right of access to justice in transparent and equitable manner. The rights of the more vulnerable groups the own account operators, including both single person operators and those who work in family businesses or on family farms must also be addressed. These commercial rights should address all categories of informal enterprise and include

- i) *basic commercial rights*: right to work, including right to vend; right to a work space (including public land and private residences) and related basic infrastructure (shelter, electricity, water, sanitation)

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<sup>8</sup> Claire Dickerson, “Some views on LE for Informal Businesses” 2007

<sup>9</sup> USIAD, Ibid, 2006

- ii) *intermediary commercial rights*: right to government incentives and support (including procurement, tax holidays, export licensing, export promotion); right to public infrastructure (transport and communication)
- iii) *advanced commercial rights*: relevant for larger more advanced informal enterprises

**Pillar 3:** *Reduce Decent Work “deficits” of those who work informally.*

This means support to informal businesses in the form of :

- participation in policy processes of a representative voice of the working poor in the informal economy
- recognition and correction of the bias in existing commercial policies, regulations, laws, and procedures favoring larger firms/enterprises
- extension of government incentives and procurements to the smallest informal enterprises
- facilitation as appropriate of backward and forward linkages on fair terms between larger and smaller firms
- promotion of market access and fair trade for smaller firms and enterprises
- social protection of informal operators through property, health, life, disability insurance)
- adequate and relevant retraining, life-long learning, and other support to labour mobility

**Pillar 4:** *Broaden access of informal business to financial Services and support innovation in financial products and processes*

This requires that there be

- awareness in both formal and informal credit systems of the way the working poor use credit and the barriers and often inappropriate rules in formal lending procedures
- legal and administrative processes in place which make the processing of collateral including social collateral cheaper, transparent and faster
- legally recognised and mutually negotiated risk mediation processes in place for both the lenders and borrowers from informal business
- support to innovation in financial products and services with a view to deepening their outreach

**Pillar 5:** *Engage in evidence based policy and regulatory reform.*

There are now hundreds of good practice examples that illustrate how the constraints of informal businesses have been successfully addressed around the world. These examples should be studied and lessons learnt be grouped according to what constraint or need was being addressed and the policy lesson which can be drawn from the experience. The policy reform which ensues should be participatory and targeted to the realities of the different sub-sectors in the informal economy.

## Conclusions

This paper has outlined how the process towards greater legal empowerment and formalization can and may take different forms. These can include expanding **formal employment opportunities and creating incentives** for informal enterprises to formalize. These incentives are in fact the removal of barriers. This removal can result as in greater legal empowerment and movement towards formalization. The incentives would include

- simplified **registration procedures and progressive registration fees**
- a supportive **investment climate and a business enabling environment**
- fair **commercial transactions** between informal enterprises and formal firms
- appropriate **legal and regulatory frameworks**, including
  - enforceable commercial contracts
  - private property rights
  - more equitable use of public land
  - tax- funded **incentives, including: government procurement, tax rebates ,tax-funded subsidies and incentive packages.**

These incentives to “go legal” have to be supported at the same time by appropriate and customized financial, business development, and marketing services. Mechanisms and financing arrangements to provide social protection to informal producers have to be put into place and policy and institutional reform undertaken in a participatory manner. The participation of informal entrepreneurs would be best ensured through proactive and iterative dialogue on an ongoing basis with representatives of associations of informal entrepreneurs.