

EGAP STORIES OF CHANGE

ENABLING LOCAL FISCAL CAPACITY THROUGH BUSINESS FORMALIZATION

LESSONS FROM COLOMBIA

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AUGUST 2020



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EVIDENCE
IN GOVERNANCE
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The Metaketa Initiative is a **collaborative research model** with a mission to improve knowledge about critical governance issues through **rigorous field experiments**. In each Metaketa "round," the initiative coordinates multiple studies on a specific topic or intervention in a variety of countries and contexts.

The second Metaketa round focused on **formalization, taxation, and public services**, with studies in six countries exploring if demand-side behavioral interventions, which reduced upfront transaction costs that prevent people interested in entering into a fiscal contract with their government from doing so, increase formalization, access to public goods, and tax payments. Here we share the story of an experiment in **Colombia** to evaluate whether direct outreach to micro and small enterprises increases formalization rates in businesses.

The Metaketa Initiative is led by Evidence in Governance and Politics (EGAP) at the University of California, Berkeley. It is partially funded by the UK's Department for International Development and involves a global network of researchers conducting studies in countries around the world.

PROJECT COUNTRY: COLOMBIA



PROJECT TIMELINE

BASELINE: NONE
INTERVENTION: FEBRUARY 2019
ENDLINE: APRIL 2019



The Senior Research Associate and enumerators pose for a quick photo during survey implementation.

THE CHALLENGE

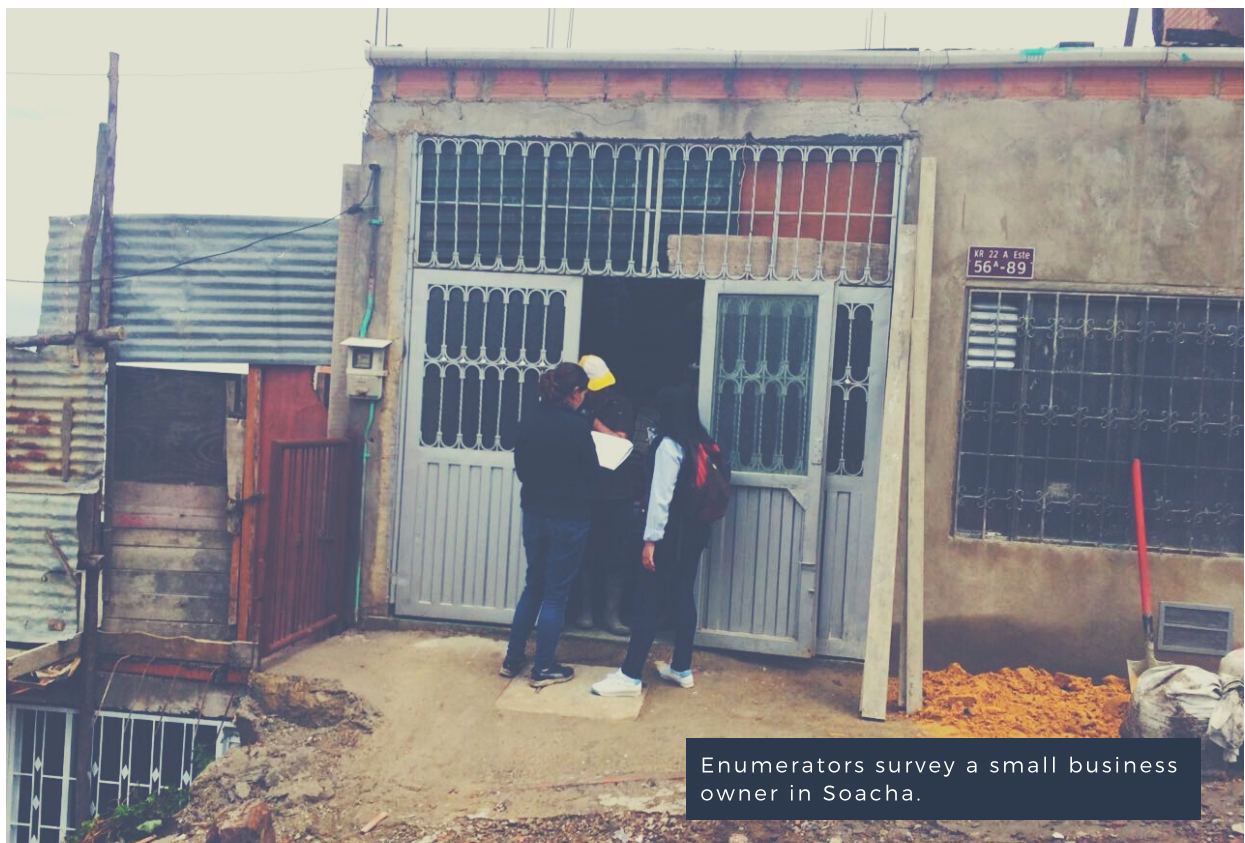
Micro and small enterprises account for a large share of employment in Colombia and other countries in the developing world. In an effort to both strengthen these businesses and increase their fiscal contributions, recent policy efforts have simplified the formalization process and reduced renewal fees. Unfortunately, many businesses remain uninformed about the process, these policy changes, and the benefits to formalizing.

A recent study in Bogotá, for example, found that a majority of businesses do not even know about business licenses; over 10 percent of informal businesses wrongly assumed they had already formalized (Galiani, Meléndez and Navajas Ahumada 2017). Research from other contexts finds that direct outreach and support to micro and

small enterprises can substantially increase formalization rates.

Drawing on these findings, researchers Darin Christensen (UCLA) and Francisco Garfias (UCSD) evaluate whether outreach directly to micro and small enterprises increases formalization rates in businesses found just outside southern Bogotá. The team also paired this outreach with additional support that helped businesses realize the benefits of formalizing.

“DOES PROVIDING INFORMATION AND AN OFFER TO ASSIST FORMALIZING INCREASE FORMALIZATION?”



Enumerators survey a small business owner in Soacha.

RESEARCH DESIGN



This study takes place in Altos de Cazucá, Soacha, a low-income commune on the southern border of Bogotá. Cazucá was first established during the 1970s, and its growth is attributable to migrants who can no longer afford to live in Bogotá and internally displaced people fleeing conflict in other parts of the country.

The team partnered with Innovations for Poverty Action and a local organization that promotes business formalization in the area and implemented two interventions:

1.) An in-person visit by a trained agent, who encouraged formalization by sharing information about the potential benefits of registering and providing a detailed explanation of the steps and documentation required to register

2.) In addition to treatment 1, the agent provided an invitation to a business development workshop that covered marketing, contracting, strategy, and legal support, as well as provided more detailed assistance for formalization and suggested relevant services provided by the local chamber of commerce

RESULTS

The results from this randomized experiment in Colombia measure small and positive impacts of the intervention on formalization and on actual registration rates with the Bogotá Chamber of Commerce. The increase was only statistically significant in the second treatment arm. The study tracked 804 businesses using a mix of administrative and survey data and found a 2 and 5 percentage point increase in business registration from the two interventions. The study also finds that treated businesses believe that informal businesses are more likely to be detected and punished, which leads to divergent responses. One possible explanation for these patterns is that some firms cut back on investments to cover the costs of formalizing, while others change their business practices to better evade heightened monitoring.

This study is most similar to the Brazil study that formed part of this Metaketa round. The Brazil project also focused on the formalization of small businesses, which included in-person information sessions at the place of business as well as an offer to assist with registering forms and obtaining a tax registration identification number.

While these two studies look at comparable programs, their results differ. In Colombia, there was a weak latent demand for formalization; the intervention did not increase the intent to formalize. Additionally, the promise of collective benefits was not incentive enough to formalize. While the government offered benefits in exchange for taxation, individuals did not want to be the only ones paying for this assistance while their neighbors received these benefits free of charge. In the Brazilian study, in

contrast, there was a moderate latent demand for formalization and the potential for individualized benefits went a long way towards incentivizing business owners to formalize. In this context, once entrepreneurs begin paying taxes they have access to social security benefits, which include sick pay, maternity leave, and retirement opportunities.

804

Number of businesses tracked.

2 & 5

Business registration increased by 2 and 5 percentage points from the two interventions.

LESSONS + IMPACT

One of the most important lessons learned from this project is that individualized incentives matter. That is, providing access to tangible benefits like a workshop about the steps to formalization and additional individualized business coaching in exchange for formalization may have a substantial impact. Furthermore, making these benefits exclusive to the individual rather than collective goods can go a long way in getting small business owners to formalize.

The researchers and staff from Innovations for Poverty Action, one of the implementing partners, shared the results of this study with the Bogotá Chamber in Commerce, one of the policymaking institutions that were briefed about the results. After a particularly fruitful meeting, the

Chamber decided to replicate in Bogotá the intervention that had been carried out in Cazuca. Plans for scaling this project are underway.

Key takeaways from this project and the other studies that form this Metaketa round suggest that formalization is attractive to individuals when governments offer valuable personal benefits, such as access to retirement income in exchange for formalizing. Furthermore, easy processes—for example, a one-time online sign-up that can be done with relatively little assistance—are crucial for formalization to occur. Finally, and perhaps importantly in the case of Colombia, it is critical to understand the ways in which businesses may react to the punishments they could face for not formalizing.

QUESTIONS FOR FURTHER CONSIDERATION

As researchers and practitioners continue to study how to lower the barriers to formalization, here are a few questions for further consideration:

- Do people benefit from formalization, and do these benefits outweigh the costs?
- Can they access similar benefits in the informal sector?
- How costly and complex is the process, and what is the likelihood of enforcement?
- Do politicians and bureaucrats benefit from formalization?



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LEARN MORE

For additional information about this study, visit the [project webpage](#).

For more on the researcher / implementing partner relationship, read [Partnership Lessons 3: Colombia Business Formalization with Innovations for Poverty Action](#).

Explore other projects in the [Metaketa II round](#).

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AUGUST 2020