



SISTEMA ECONÓMICO
LATINOAMERICANO
Y DEL CARIBE



BANCO DE DESARROLLO
DE AMÉRICA LATINA



MICM
MINISTERIO DE INDUSTRIA
COMERCIO Y MIPYMES
REPÚBLICA DOMINICANA



Final Report

Economic and Technical Cooperation

*Seminar-Workshop on Experiences of Formalization of MSMEs in Latin America and the Caribbean
Santo Domingo, Dominican Republic
14 and 15 February 2019
SP/STEF-MIPYMES-ALC/IF-19*

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Printed in the Permanent Secretariat of SELA, Caracas, Venezuela.

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I. RAPPORTEUR'S REPORT

1. [The Seminar-Workshop on Experiences of Formalization of MSMEs in Latin America and the Caribbean](#), organized by the Permanent Secretariat of the Latin American and Caribbean Economic System (SELA), jointly with the Ministry of Industry, Commerce and MSMEs (MICM) of Dominican Republic and CAF-development bank of Latin America, was held in Santo Domingo, Dominican Republic, on 14 and 15 February 2019.
2. The objectives of this Seminar-Workshop were as follows: i) Share a comparative vision of the policies and programmes for formalization of MSMEs in LAC; and ii) Promote the most important experiences in Latin America and the Caribbean in the area of formalization of MSMEs.
3. Pursuant to the approved agenda, five working sessions were conducted in order to address the following topics: i) Strengthening institutional capacities to promote the formalization of MSMEs in Latin America and the Caribbean; ii) questions and remarks on the major problems, and challenges in strengthening institutional capacities to promote the formalization of MSMEs in Latin America and the Caribbean; iii) Quality of labour and social equity as benefits of formalization; iv) Questions and remarks about the main problems and challenges in the quality of work and social equity as benefits of formalization; v) Experiences and best practices in the formalization of MSMEs in Latin America and the Caribbean; vi) Questions and remarks about the experiences and good practices in the formalization of MSMEs in Latin America and the Caribbean; and vii) Towards the construction of a roadmap for the promotion and advancement of MSMEs in Latin America and the Caribbean. Prior to the closing session, a space for the presentation of conclusions, proposals and initiatives was opened in order to make progress in the formalization of MSMEs in Latin America and the Caribbean.
4. Representatives of governmental focal points for micro, small and medium-sized enterprises in the Member States of SELA, representatives of business associations of MSMEs and regional and international organizations presented their respective papers, in accordance with the approved agenda.
5. Participants included representatives of the following Member States of SELA: Argentina, Belize, Colombia, Chile, El Salvador, Guatemala, Haiti, Jamaica, Mexico, Nicaragua, Peru, Panama, Paraguay, Dominican Republic, Suriname, Trinidad and Tobago and Uruguay.
6. Participants also included the following entities: Banco Adopem; Chamber of Commerce of Jamaica (CARICHAM) and the Dominican Federation of Chambers of Commerce, among others.
7. Similarly, the event was attended by representatives of the following regional and international organizations: Central American Bank for Economic Integration (CABEI); CAF-development bank of Latin America; Center for the Promotion of Micro and Small Enterprises of Central America (CENPROMYPE); Organization for Economic Cooperation and Development (OECD); and the International Labour Organization for Latin America and the Caribbean (ILO). The [list of participants](#) is available on SELA's Web site.

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8. Speakers at the opening session included the following personalities: Mr [Nelson Toca Simó, Ministry of Industry, Commerce and MSMEs of Dominican Republic \(MICM\)](#); Mr Isidoro Santana, Ministry of Economy, Planning and Development of Dominican Republic; Mr Wilton Juma, Vice-Ministry of Labour of the Ministry of Labour of Dominican Republic; Mrs Rebeca Vidal, Chief Executive Officer and Expert in Business Development of CAF-development bank of Latin America; and Ambassador [Óscar Hernández, Main Advisor of the Permanent Secretary of the Permanent Secretariat of the Latin American and Caribbean Economic System \(SELA\)](#).
9. The Permanent Secretariat of SELA made available to participants documents and support material.
10. The photographs of the event can be seen in the [photo gallery](#).
11. The closing session was in charge of Ambassador Óscar Hernández, Main Advisor of the Permanent Secretary of the Permanent Secretariat of the Latin American and Caribbean Economic System (SELA); Mrs Rebeca Vidal, Chief Executive Officer and Expert in Business Development of CAF-development bank of Latin America; and Mr Ignacio A. Méndez Fernández, Vice-Minister in charge of Development of MSMEs of the Ministry of Industry, Trade and MSMEs of Dominican Republic (MICM).

II. CONCLUSIONS

The reflections, ideas and proposals of the speakers and participants in general, arising from the introductory remarks, the papers presented and, especially, the discussions held during the *Seminar-Workshop on Experiences of Formalization of MSMEs in Latin America and the Caribbean* (Santo Domingo, Dominican Republic. 14 and 15 February 2019), are summarized below:

1. MSMEs are one of the major forces in economic development, especially for emerging economies. In terms of their contribution to international trade, it has been noted that they:
 - i) Form part of the value chains of large local exporters, ii) Export products and services to more specialized market niches, iii) Import and distribute products from foreign MSMEs, and iv) provide support services in the chain of international trade transactions (logistics, dispatches, among others). In addition, they promote entrepreneurial activity, drive innovation and diversification, and stimulate the growth of employment. In Latin America and the Caribbean (LAC), MSMEs account for 90% of the companies, they generate more than half of the jobs and a quarter of GDP. However, they contribute little to exports and tend to specialize in products with low added value.
2. In Latin America and the Caribbean, informality is an integral part of the economic structure and, at the same time, it is an expression of lack of confidence in public institutions and a negative perception of the role of the State, of ignorance about the benefits of formality or the high costs of formalization and excessive bureaucracy. The presence of a large informal sector limits the ability of governments to implement inclusive policies for MSMEs and reach the most vulnerable segments of the population. According to the ILO, informality is the highest among the self-employed and micro-enterprises. Formalization has an impact on social development as it can contribute to improve the quality of the work and social equity.

3. In general, informal enterprises in the region do not respond favourably to the incentives from the sector's policies because they fear being persecuted for their lack of compliance and lose any advantages obtained from laws and regulations. On the other hand, these companies are not very willing to invest in the development of capabilities and fixed assets, which makes them less productive than formal enterprises. In addition, they are not interested in expanding, because if they do so, they fear being detected and subjected to regulations by the State.
4. The great challenge is how to structure a policy favouring the MSMEs sector which supports and promotes the productive transformation and that simultaneously addresses informality, responding to the basic needs of these companies.
5. It is necessary to create a broad alliance to reduce informality, which brings together representatives of the business sector, trade unions and academia, as well as local authorities and institutions of the central administration. Such an alliance would allow for an effective exchange of information and opinions with a view to reducing the level of resistance of the public towards informality. Also, participants said that it is necessary to develop a plan in the medium term, with strategic guidelines for the countries of the region, encompassing the various aspects of the informal economy, including the definition of realistic and measurable objectives, along which the simplification of procedures. Governments should focus on the reduction of the costs associated with formality and encourage companies to become formalised, implementing mechanisms that allow for visualizing the benefits of formalization, contrary to the costs and risks of informality.
6. The State, in coordination with the business sector, should develop strategies to guarantee the rights granted to workers by social security, which is essential to combat the informal economy, and narrow the gaps of inequality and social exclusion. The impact generated by formalization translates into investments and generation of employment. For such purpose, it is required to implement formalisation actions in this sector, which produces sustainable results in the long term.
7. Formalization requires the definition of cross-cutting public policies, which have an impact on a diversity of socio-economic sectors and social actors. In Latin America and the Caribbean, the formalization of MSMEs is a process that should be framed within a national strategy based on public policies that support the development of these enterprises and should involve not only the coordination and participation of the State, but also of the private sector and the academy.
8. The plurality of the actors involved in formalization also demands a diversity of approaches, perspectives and visions. The governments, international organizations, business associations, universities, trade unions and workers, among others, have different visions of formalization.
9. The public policies aimed at promoting formalization should be comprehensive and envisage the managerial, labour, tax, social security aspects, pensions, and promotion of productivity, among others, associated with their conception and development. Such comprehensiveness responds to the complexity, and the multi-sector and multi-stakeholder approach that

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characterize these companies. Likewise, such policies must be the result of an active inter-agency coordination and must point towards the consensus of all parties involved, with particular attention to Public Private Partnerships (PPPs).

10. An integrated framework of public policies should address the following aspects: i) Promotion of the fundamental labour rights and principles, which among other things, should support efficient inspections that ensure the safety and health on the labour scene, the organization and representation of employers and workers to foster social dialogue, strategies for sustainable development, the eradication of poverty, inclusive growth, job generation, income security, effective minimum wage policies and an environment that encourages business investment; ii) Promotion of sectoral policies, iii) Equality and elimination of all forms of discrimination and violence, iv) Entrepreneurship v) Transition of units of the social and solidarity-based economy, vi) Local development strategies in rural and urban areas, including regulated access to public spaces and natural resources, vii) Generation and/or improvement of incentives for the formalization and the improvement of administrative capacities and reduction of the costs to encourage compliance, viii) Establishment of an appropriate legislative framework, ix) Extension of social security coverage, x) Access to education and job skills development, xi) A regulatory framework that promotes an inclusive financial sector, xii) Services for enterprises, xiii) Facilities for access to markets, xiv) Increase of productivity, xv) Strengthening the available infrastructure, xvi) Updated and timely technical support, and xvii) An efficient judicial system.
11. In the field of public policies, it is necessary to combine the specific support for MSMEs with continuous improvements in the overall business environment, and that governments find the optimum combination of policies.
12. The impact evaluation of public policies on the formalization of MSMEs is essential in order to determine where priorities and resources for those enterprises must focus.
13. Experience indicates that formalization tends to increase in periods in which there are changes in the productive structure and not only in the implementation of public policies.
14. The Public Policy Index for MSMEs being developed by SELA and the OECD, with the support of CAF-development bank of Latin America, is an important tool to measure and generate indicators in order to improve policies for micro, small and medium-sized enterprises in Latin America and the Caribbean.
15. The formalization processes and policies must adapt themselves to the new realities of the labour market and the new paradigms of employment and enterprises. Public policymakers must consider the changes brought about by the Industrial Revolution 4.0 and the information technologies. Such policies require consensus and social support on the basis of a shared vision. The main challenge is coordination and management, and this, in turn, requires leading organizations and effective mechanisms of public-public and public-private coordination.
16. Other required steps are the following: facilitate the transition of workers and economic units from the informal economy to the formal economy; promote the creation, preservation and sustainability of enterprises and decent jobs in the formal economy; prevent the

informalization of formal jobs; facilitate the entry of young people into the labour market; increase the participation of women and vulnerable groups in labour markets; increase productivity and competitiveness of the work force; foster relationships among production units, favouring partnerships and the formation of productive chains to sell services or goods; and train MSMEs to participate in public administration procurements.

17. In addition, we must underscore the benefits associated with formalization which can be accessed. It is also necessary to disseminate the advantages that formalization offers to MSMEs and the State. Legislative matters require the design of an updated regulatory framework that facilitates the proper functioning of MSMEs, as well as the definition of clear rules of the game among public and private actors. It is also important to create special regimes for MSMEs, minimizing the differences that may occur as regards the rights of workers.
18. Inter-institutional coordination is important for the formalization strategy. For this reason, it is necessary to strengthen the national units responsible for formalization processes, develop good coordination channels in order to avoid duplication of efforts and facilitate joint and complementary work. Similarly, inter-institutional coordination facilitates obtaining results without duplication of efforts; improves the efficiency of programs and expenditures of ministries; links inter-institutional policies aligned to the objectives of the government; prevents isolated or fragmented work of the various institutions through an integrated approach; improves the articulation of political authorities focused on structural reforms, both economic and social reforms; and provides a roadmap to the private sector and civil society concerning the objectives of the State in the fight against the informal economy with a view to achieving the objectives related to inclusive economic growth.
19. In order to reduce the inequality gap and combat informality, it is necessary to ensure social security by implementing employment formalization actions that produce long-term sustainable results. Through a coordinated strategy, the impact of formalization will encourage investment and job creation.
20. The following are some trends that can be observed in the region's experiences with formalization, associated with social security:

Simplification of procedures: integration of contributions into a single fiscal declaration and payment, simplification of worker registration, declaration and payment; expansion of forms of payment and collection by different means.

Special regimes:

- Lower contributions from taxpayers (with subsidy from the government or differentiated services); integrated quotas (e.g. unified taxation or *monotributo*“).
- Change of objective scope of application (fixed quota systems).
- Periodicity of payments (adjusted to the business cycle of the enterprise or sector).
- Partial exemptions.
- Gradual implementation of obligations.
- Mitigation vis-à-vis economic crises.

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- Reduction of tax evasion and promotion of the continuity of contributions.
 - Requirement of compliance with obligations regarding social security for administrative acts.
 - Subsidiary liability in subcontracting relationships.
 - Entity in charge of retaining contributions in subcontracting relationships.
 - Incentives for collaboration.
 - Integration of taxes and social security contributions.
 - Incentives for complying with payments in a timely and continuous manner.
 - Fiscalization approach (more preventive and less punitive).
 - Incorporation of technologies, exchanges of information.
 - Single identification codes; role of business associations, the organized sectors and social control; dissemination and information campaigns.
21. The rules governing formalization should envisage the provision of positive and negative incentives for MSMEs. Compliance with negative incentives and sanctions must be mandatory but progressive in order to preserve relations with State institutions. Therefore, it is advisable to select appropriate, non-confrontational regulatory models. It is also necessary to strengthen the inspection systems of government institutions, so as to enhance the possibilities of collecting taxes and ensure taxpayer registration, within the special treatment to be offered to MSMEs.
22. With respect to simplification of procedures, the objective is to reduce bureaucracy and improve procedures through initiatives such as the single windows for business registration. Simplification must be conceived as a comprehensive process that addresses the various stages of the process of formalization, before, during and after, also considering the shutdown process for MSMEs through the payment of contributions under the figure of the unified tax payment (monotributo).
23. There are a series of benefits for MSMEs once they achieve their formalization. Firstly, they gain access to sources of financing and guarantees; secondly, formalization allows for generating an institutional framework and governance within the ecosystem of MSMEs. Concomitantly, institutionality allows for offering accompaniment and advisory during the exporting and internationalization process, and provides these companies with channels of financing, guarantees, bank loans, accompaniment and advisory during the exporting process for the formation of regional value chains.
24. Other benefits for MSMEs include: access to social security and the health system, participation in training, training and updating of human resources programmes, particularly as regards the issues of business model, accounting, auditing, fiscalization, access to markets, and business management in general, as well as timely access to key information and participation in public or government procurement.
25. Incentives to reduce informality include: i) facilitating access to financing; ii) tax stimulus through cost simplification and flexibility of obligations; iii) adaptation of national legislation to international recommendations issued by the Organisation for Economic Cooperation and Development (OECD); iv) advisory as regards digital transformation; and, v) simplification of

the regulatory framework linked to its development. In addition, tax benefits were highlighted as part of a comprehensive package which, inter alia, includes advisory and training, and tax deductions should be granted for a reasonable time and should not be withdrawn without prior notice.

26. Among social security incentives, immediate action is needed to remedy unsafe and unsanitary working conditions, promote the protection of occupational safety and health, and extend it to employers and workers in the informal economy. Through the transition to the formal economy, members should progressively be able to extend social security, maternity protection, decent working conditions and a minimum wage. In addition, they should also be able to extend social insurance coverage to persons employed in the informal economy and, if necessary, to adapt administrative procedures, benefits and contributions, taking into account their capacity to contribute, establish and maintain national social protection floors, pay attention to the needs and circumstances of the people engaged in the informal economy and their families, and encourage the provision of quality and affordable childcare and other care services.
27. It is important to consider the gender issues in the policies for formalization of MSMEs that are being implemented in the region, as well as the discussions in forums and meetings such as this regional seminar.

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Working on a roadmap to promote and bolster MSMEs in Latin America and the Caribbean. Conclusions, proposals and initiatives to advance the formalization of MSMEs in Latin America and the Caribbean

Preliminary findings within the framework of this event and the most recent literature on the subject prove that formalization requires an approach of mixed and comprehensive policies. In light of the best practices brought forward, it is evident that informality is a heterogeneous event. Therefore, its characterization may vary, according to the demographic settings and business structures, among others. Leading formalization policies in middle income economies requires comprehensive and sustained interventions for longer periods, as compared to some other policies aimed at changing the productive structure of MSMEs. Such reforms ought to be guided by a clear formalization strategy, with the joint efforts of government agencies, under a coordinating entity. Furthermore, it was acknowledged that informality *per se* cannot be totally removed, but efforts should be made to phase it out.

Based on a revision of the sessions held during this seminar, any State interventions to expand and improve the quality of business formalization in LAC countries should go around the following non-exclusive action lines:

1. Simplified regimes
 - Sole tax (unified taxation): simplified tax schemes with access / link to social security.
 - Integration of social sole taxes: scheme for socially vulnerable workers.
 - Better and ampler coverage of tax-exempted social security for MSMEs and direct dependents.
 - Complementarity of tax simplification and tax collection increase.
 - Simpler administrative procedures for start-ups.
 - Insolvency policies for divestitures as simple as possible.
2. Inspection of the workplace
 - Institutional strengthening and consolidation of strategic partnerships (considering the demographic approach).
 - Furtherance of business formalization and culture of compliance.
 - Smart monitoring (institutional human resources).
 - Utilization of ICTs.
 - Sanctioning or dissuasive models.
3. Quality labour insertion and increasing competitiveness
 - Supply of technical-vocational training for entrepreneurs and MSMEs.
 - Sectoral policies with a high informal impact (domestic policies, agriculture, among others).
 - Use of ICTs as novel incentives for insertion and relaxed formality.
 - Involvement of scholars in business training and entrepreneurship.
4. Differentiated policies according to types of productive structures
 - Simplification of the process of business incorporation.
 - Regulatory and administrative improvements per strata.

- Reduction of tax evasion by means of incentives and low-cost controls.
- Dissemination and informational and educational campaigns.