

# REFORM Toolkit

25 years of strengthening democracy through market-oriented reform

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June 2009

## Reducing Economic Informality by Opening Access to Opportunity

High barriers to market entry exclude informal entrepreneurs from the mainstream economy and erode the rule of law. Tearing down these barriers opens routes to formality and creates new opportunities for the poor. The Center for International Private Enterprise's (CIPE) response to the informal sector addresses underlying institutional failures in order to encourage entrepreneurship, preserve the rights of business owners, and improve democratic governance.

This toolkit explains the origins of the informal sector and describes methods for improving participation in markets and policymaking. It includes:

- Sources and consequences of the informal sector,
- Policy responses,
- CIPE's reform strategy, and
- Case studies of programs to reduce the informal sector in Peru, Guatemala, and Kenya.

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**The Center for International Private Enterprise (CIPE)** strengthens democracy around the globe through private enterprise and market-oriented reform. CIPE is one of the four core institutes of the National Endowment for Democracy. For 25 years, CIPE has worked with business leaders, policymakers, and journalists to build the civic institutions vital to a democratic society. CIPE's key program areas include anti-corruption, advocacy, business associations, corporate governance, democratic governance, access to information, the informal sector and property rights, and women and youth.



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## Results from CIPE Programs

CIPE and its local partners have achieved reforms that give voice to informal entrepreneurs, strengthen property rights, and reduce barriers to operating a business.

### Institute for Liberty and Democracy (ILD), Peru

Through ILD's advocacy efforts, 382,100 businesses were formalized and more than 550,000 legal jobs were created.<sup>1</sup>

### National Economic Research Center (CIEN), Guatemala

Reforms promoted by CIEN cut the paperwork to register a business by 90 percent and made property titling more affordable.

### Kenya Gatsby Trust (KGT) and the National Informal Sector Coalition (NISCO), Kenya

KGT gave grassroots entrepreneurs a voice in the drafting of the Micro and Small Enterprises Bill. NISCO and KGT helped open the public procurement process to small businesses.

## Introduction

Much of the developing world has two parallel economies: the formal, or mainstream economy, and the informal or extra-legal economy. The formal sector includes firms and activities that are legally recognized, officially recorded, and that function within a framework of formal economic institutions. The informal sector “is made up of entrepreneurs who produce legitimate goods and services without proper permits and legal status because they are locked out of the formal-legal economy by a maze of regulations, excessive procedures, high tax rates, and other barriers to market entry. Both the entrepreneurs and their employees lack protection of the law, access to formal sector services such as credit, and are prey to corrupt officials.”<sup>2</sup>

Informal businesses make vital contributions to their economies – accounting in some cases for as much as 60 percent of GDP – yet their potential is severely curtailed by their extra-legal status and high barriers to conducting business. Informal businesses are unable to access public services and formal sources of credit, are vulnerable to bureaucratic whims, and are limited to pursuing business opportunities that can be found within their circle of acquaintances. As a rule, informal entrepreneurs and their employees are denied significant opportunities that formal businesses enjoy. They have at times completely been left behind during waves of overall national growth.

The denial of economic opportunity to informal entrepreneurs and workers results in the political disenfranchisement of the same groups. Democracy and its benefits elude them because they are not legally counted and cannot voice their interests. An informal sector further erodes democracy by eroding the rule of law, leaving large swathes of the economy outside regulation and legal protection.

Opening routes to formality creates new opportunities for the poor to realize their potential and raise national competitiveness. Acquiring formal status allows entrepreneurs to access formal markets, invest with security, obtain new sources of credit, and uphold their interests in courts and policymaking. An effective route to formality, however, requires more than the alteration of entrepreneurs' legal status by decrees and registration. It requires the tearing down of barriers at the origin of informality to improve the business climate for all entrepreneurs. Such reforms expand the participation of the poor in the market economy and in public life, thus bolstering the performance and legitimacy of a democratic market system.

## Sources and Forms of Informality

A growing informal sector indicates the presence of high barriers to market entry and high transaction costs. These barriers and costs are typically caused by

badly designed laws and regulations. Some common barriers include the following:

- Fees and procedural requirements for registering a business,
- Fees and procedural requirements for titling a property,
- Permits and licenses,
- Excessive taxes,
- Regulatory burdens,
- Cartels and monopolies, and
- Barriers to exit, such as absence of a bankruptcy law.

Transaction costs refer to costs in time, money, and risk that firms incur to complete transactions under conditions of imperfect information and uncertain rights. These conditions are common in the informal sector and may be caused by the following:

- Weak contract enforcement,
- Weak property rights systems,
- Shortages of economic and policy information, and
- Corruption.

In developing countries, the majority of small-scale entrepreneurs have difficulty negotiating bureaucratic obstacles and meeting the high costs of market entry. If compliance makes their businesses unprofitable, they are forced to operate informally in order to reduce costs. They then forgo any possible benefits of formality and find themselves limited to relationship-based transactions.

A diverse range of enterprises operate outside the formal economy. To begin with, informal (extra-legal) businesses must be distinguished from criminal activities. Informal businesses produce legitimate products but lack required permits or legal status. These firms differ in their size, structure, and level of efficiency. A portion of their activities may be formal while the remainder are informal. Some of these firms are sufficiently competitive and profitable that they could grow if they joined the formal economy, while others are inefficient and provide just enough revenue for survival.

## Consequences of Informality

High levels of informality result in severe economic, political, and social costs. These include:

**Un-democratic Policymaking:** Citizens who are excluded from the formal sector have little opportunity to voice their concerns or be counted, and thus policies are less responsive to their needs.

**Poor Resource Allocation:** A cumbersome regulatory framework discourages the efficient use of resources. Weak property rights inhibit the generation of new capital for the private sector.

**Lower Productivity:** Informal sector production tends to rely excessively on unskilled labor while underutilizing technology. High costs of market entry prevent competition from new businesses that may produce more efficiently.

**Lower Government Revenue:** Complex, costly systems of regulation and taxation create high levels of non-compliance. They reduce government revenue and with it the ability to provide public goods.

**Limited Access to Public Services:** Informal businesses and communities are often deprived of utility connections and other services. Taxpayers, however, pay more when utilities are tapped illegally.

**Weak Rule of Law:** Informal businesses cannot access courts due to their extra-legal status, whereas law-abiding businesses are frequently undercut by informal competitors. High transaction costs and lack of transparency lead to corruption instead of justice.

**Higher Poverty:** Informal sector workers tend to earn lower incomes due to lower productivity. Informal entrepreneurs have problems accessing credit and mainstream economic opportunities. Costly labor regulations discourage formal businesses from hiring additional workers.

## The Process of Formalization

Entrepreneurs' decisions on whether or not to formalize depend on their incentives. Entrepreneurs make calculated decisions as to which rules they will respect or violate based on what they can afford while staying in business, what they expect to receive in return, and the probable cost of non-compliance. Although the informal and formal sectors both have costs, in a favorable regulatory environment businesses with growth potential will prefer formality.

If benefits of formality exceed costs → join the formal economy

If costs of formality exceed benefits → remain informal

From a business perspective, formalization is at least a two-step process. The first step is to register a business, and the second is to comply with regulations to keep the business formal. Registering a company, obtaining property titles, acquiring permits, and maintaining records all involve costs. Additional requirements must be satisfied in areas such as taxes, safety, labor, and the environment.

Reforms are generally needed in several dimensions to reduce these costs and procedural requirements and encourage entrepreneurs to transition to completely formal businesses. Facilitating business registration, for example by establishing “one-stop shops” for administrative services, is a good first step. Reforms in business registration must be accompanied by other reforms that remove barriers to full participation and compliance. In addition, improvements to public services create positive incentives for formalization.

Some regulators try to eliminate informality solely through enforcement. By fining and putting companies out of business, regulators maximize the costs of operating informally. Although enforcement must be part of any solution, this narrow approach falls short in three respects. First, excessive regulation inhibits the attainment of public goals by forcing companies to operate outside the reach of regulators. Second, enforcement alone does not materially

improve the business environment for either formal or informal businesses. Third, officials tasked with enforcing regulations may have incentives to accept bribes in exchange for reducing punishments.

## Policy Responses

Dealing with informality requires an integrated, institutional response. CIPE's response to informality addresses underlying institutional failures in order to encourage entrepreneurship, preserve the rights of business owners, and improve democratic governance. An effective response builds the foundations of a market economy on three levels:

- Create incentives for businesses to join the formal economy.
- Improve the business climate.
- Improve governance.

Simplistic responses to this complex issue do not work. Enforcement without reform pushes business deeper into the informal sector. Supporting informal entrepreneurs without encouraging formalization does little to encourage productivity, growth, and rule of law. Formal policies are important, but should reflect local realities and probably work best when they respect traditional or customary practices. All rule-making and reforms should be preceded by analysis of the benefits and costs to entrepreneurs and society.

Depending on local needs, the following specific measures are likely to be priorities.

**Simplify Business Procedures:** Simplify the procedures required to obtain business permits and licenses, and make them affordable to all entrepreneurs.

**Encourage Participatory Lawmaking:** Establish transparent, inclusive decision-making procedures and provide opportunities for the public to comment on existing and proposed regulations.

**Streamline Legal Codes:** Clarify and streamline legal codes by eliminating duplicative or superfluous laws.

**Reform Property Rights Systems:** Make private property rights accessible to all citizens, clearly defined, and strongly enforced.

**Reform Tax Systems:** Simplify tax systems, reduce excessive rates, and reduce record-keeping burdens.

**Reform Labor Laws:** Allow employers greater flexibility so they are more willing to hire.

**Reform Government Agencies:** Reform overly bureaucratic agencies and strengthen their capacity to administer laws efficiently, effectively, and inexpensively.

**Provide Essential Business Information:** Make information available to all citizens on how to start a business, how to form a commercial entity, and the rights and responsibilities of entrepreneurs.

## CIPE's Reform Strategy

Private sector organizations play key roles in promoting reforms to achieve formalization and open markets. Informal and formal sector associations, economic think tanks, and the media all have distinct roles. The common elements of CIPE's efforts to reduce informality are local ownership of the reform process and a focus on advocacy. CIPE has found the following steps to be effective in generating reforms to reduce transaction costs and level the playing field for all entrepreneurs.

1. Identify the obstacles to formality and the sources of high business costs. Because informal

economic activities tend to escape measurement, special effort may be needed to survey informal entrepreneurs. Calculate the economic impact of laws and regulations on transaction costs and the size of the extralegal sector.

2. Raise awareness about barriers and costs among the private sector, the public, and the policymaking community. Demonstrate the benefits of removing these barriers and expanding formal markets.
3. Mobilize businesspeople and the public to advocate for legal and regulatory reforms that will reduce these barriers and costs. Obtain grassroots input into priorities and solutions. Ask informal operators what they need to enter the formal sector and succeed.
4. Propose specific legal and regulatory reforms. Ensure that reforms incorporate positive incentives to participate in the formal sector in addition to negative incentives against informal activity. Perform a cost-benefit analysis of reform proposals.
5. Conduct an advocacy campaign. Open a dialogue between policymakers and the private sector, engage the media, and explain the private sector's priorities.
6. Support the implementation of reforms, working with policymakers as necessary, and monitor how reforms reshape actual costs and incentives.

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## Notes

- <sup>1</sup> CIPE supported ILD's advocacy initiatives with funding from the National Endowment for Democracy. The United States Agency for International Development provided principal funding for ILD's programs.
- <sup>2</sup> John D. Sullivan, "The Informal Sector, Development and the Global Economy," Course Syllabus, Johns Hopkins University, Paul H. Nitze School of Advanced International Studies, Fall Semester 2004.



## Making the “Extralegal” Legal in Peru

# Institute for Liberty and Democracy

by Nafisul Islam

In the early 1980s, Hernando de Soto, a successful businessman and economist, left Europe to visit his native Peru. During his trip, he was struck by the disparity between the vibrant entrepreneurial spirit of the people and their desperate poverty. To find the reason for this gap between motivation and result, he decided to open a small garment factory in Lima. His first step was to hire four university students who would complete the bureaucratic procedures necessary to obtain a business license. After 289 days and a cost 32 times the average monthly minimum wage, they received the license. This experiment convinced de Soto that it was expensive and time-consuming bureaucratic procedures that kept people out of formal markets and in the informal sector. To investigate this problem in more depth, and hoping to find a solution, de Soto founded a think tank, the Institute for Liberty and Democracy (ILD).

From 1981 to 1984, de Soto and his small research team at ILD talked to the poor in Peru’s shantytowns and compiled figures describing their businesses. The numbers confirmed a prevalence of economic informality in Peru. Fifty-six percent of all business, 86 percent of the bus service, and 60 percent of grocery retail in Peru were carried out in the “extra-legal” sector. “Peru had become two nations – one where the legal system bestowed privileges on a select few, and another where the majority of the Peruvian people lived and worked outside the law, according to their own local arrangements.”<sup>1</sup>

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**“We put into place all the legislation and mechanisms required to bring into the law most extra-legal real estate and business.”**

**–Hernando de Soto**

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People conducted business outside the law because the bureaucratic regulations made it impossible to operate within it. As a result, they were denied opportunities to invest in businesses and participate in the formal economy. Even those people with thoughts of entrepreneurship could not trade beyond a circle of people who knew and trusted them.

De Soto came to realize that it was also the absence of formal property rights that explained why “people who have adopted every other Western invention, from the paper clip to the nuclear reactor, have not been able to produce sufficient capital to make their domestic capitalism work.”<sup>2</sup> He believed that people could be empowered by using their existing assets to benefit themselves and their communities. The poor of Peru possessed urban land and housing worth \$17 billion, but a majority of the people who possessed these assets did not have the legal titles to them. Consequently, people were not able to use their homes as collateral to obtain loans for business development. “Without a title, there is no way to build a system of securitization that gives them access to credit or water, telephones or electricity,” said de Soto.<sup>3</sup> ILD estimated that in 1989 the

poor in Peru held \$80 billion in untitled assets, assets that de Soto dubbed “dead capital” because they could not be invested to create new wealth.

## Partnership for Advocacy and Legislative Reform

The first ever partnership of the Center for International Private Enterprise (CIPE), and one of its most successful, was with ILD. Beginning in 1984, CIPE helped ILD design an economic reform agenda and advocacy campaign based on increased citizen participation in decision-making. ILD’s slogan for the campaign was “289 days” – the time required to legally create a small business – succinctly conveyed the scope of the administrative barriers and legal discrimination experienced by small-scale entrepreneurs. Through a range of advocacy and communications activities, ILD established working relationships with many informal sector groups that became strong advocates for ILD’s legislative proposals. The research and proposals of ILD also found support among government officials who represented a broad range of political parties at the municipal and national levels.

In 1986 de Soto published *The Other Path: The Invisible Revolution in the Third World*, which offered the poor an alternative to revolution: entrepreneurship. The title of the book and its policy prescriptions were a direct challenge to the vision of Peru’s violent insurgency the Shining Path. De Soto identified weak institutions as the primary barrier to entrepreneurial growth and highlighted the importance to development of institutions such as contract law, financial markets, and the judicial system. The book became a bestseller and was translated into 20 languages. The following year, de Soto introduced his ideas to multilateral organizations and reformers at the first international conference on the informal sector, organized by CIPE.

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**300,000 small enterprises were integrated into Peru’s formal economy. The time needed to register a business was cut from nearly 300 days to less than one day.**

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As part of its advocacy program, ILD drafted its own cost-benefit analyses of economic issues, which were published in various magazines with a combined readership of around 1.2 million Peruvians. These analyses covered topics such as access to credit, land titling, simplification of administrative procedures, and access to public information. The papers also included ILD’s easily understandable proposals for legislative alternatives in these areas.

ILD created an ombudsman’s office, the *Balcon de Todos* (Balcony for All), in order to institutionalize direct access to lawmakers. The office received complaints, motions, and suggestions from citizens regarding the legal and bureaucratic problems they faced, and referred these to the attorney general’s office. ILD researched the complaints, prepared economic and legal analyses, and proposed laws as solutions. This consultative program represented ILD’s willingness to take initiative in setting a legislative agenda that would benefit a majority of Peru’s citizens.

ILD was instrumental in drafting and advocating new legislation throughout the late 1980s. Peru’s Administrative Simplification Law was approved by the Peruvian Congress in 1989 as a direct result of ILD’s research and public advocacy efforts to simplify, reduce, and eliminate lengthy governmental bureaucratic procedures. ILD’s recommendations that were included within the law ranged from reducing passport and import registration fees to simplifying requirements for receiving retirement benefits. Another law drafted by ILD and enacted in 1988 was the Popular Mortgage Law. The law was designed to provide access to credit for informal landowners, who had previously received a mere

0.4 percent of the credit available from banks. The new law enabled Peruvians to obtain titles to their homes and thereby the ability to use their homes as collateral for a bank loan at market interest rates. Following the law's approval, ILD provided assistance to the government to ensure the proper administration of the law. ILD also helped draft regulations to be included in a new Property Rights Law, and created a property registry suited to the circumstances of landholders in shantytowns.

## Success at Home for a Model Abroad

ILD has achieved tremendous results not only in Peru, but has also spurred reforms in countries as diverse as Brazil, China, and Thailand. Hernando de Soto has convinced numerous heads of state to implement institutional reforms, and many non-governmental organizations and think tanks have adopted ILD's approach to reform and advocacy.

As a result of ILD's domestic efforts, 300,000 small enterprises were integrated into Peru's formal economy, accounting for 560,000 legal jobs and contributing an added \$300 million in tax revenue. Moreover, the time needed to legally register a business was cut from about 300 days to less than one day. "After six years of listening to the poor, the ILD was actually in a position to help them," said de Soto. "We put into place all the legislation and mechanisms required to bring into the law most extra-legal real estate and businesses."<sup>4</sup>

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### Notes

<sup>1</sup> Jeremy Clift, "Hearing the Dogs Bark," Finance & Development 40:4, International Monetary Fund (Dec. 1, 2003). 58

<sup>2</sup> Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000), p. 7.

<sup>3</sup> "An Interview with Hernando de Soto," *Economic Reform Today* 1 (1996).

<sup>4</sup> Hernando de Soto, *The Other Path: The Economic Answer to Terrorism* (New York: Basic Books, 1989), xxvi.

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## Overcoming Exclusion in Guatemala

# National Economic Research Center

From 2004 to 2007, the National Economic Research Center (CIEN) changed the perception of the informal sector in Guatemala and influenced reforms that encouraged business registration and property formalization. Three-quarters of Guatemala's work force, and the majority of the indigenous population, operated in the informal sector. Because the state was never designed to serve informal sector groups, it excluded them from legal, economic, and policy processes. Apart from the tax authority, government institutions were practically non-existent for informal businesspeople, even the courts and security. Most businesspeople experienced high transaction costs and low benefits from formal institutions.

Given the cultural and institutional realities in Guatemala, CIEN Economic Director Hugo Maúl identified two priority tasks for overcoming exclusion and strengthening democratic institutions. First, Guatemala “must recognize, be familiar with, and respect the existence of plurality and cultural processes that make it possible for people of different cultures to live together peacefully. Second, it must complement the informal institutions with formal institutions that promote the positive aspects of informal arrangements.”

## Assessment of the Informal Sector

The Center for International Private Enterprise (CIPE) hosted a one-day conference on the informal economy in 2005 to bring the benefit of CIPE's partner experiences in Latin America to the Guatemala program. Lessons from Venezuela's Center for the Dissemination of Economic Knowledge enriched CIEN's advocacy framework, while Peru's Institute for Liberty and Democracy guided the program's research methodology. CIEN also studied existing evidence on the economic practices and realities of Guatemala's indigenous communities.

In an effort to gain deeper insights into the informal sector, CIEN conducted a survey among 1,200 informal businesspeople in five cities. The survey addressed perceptions of the benefits of becoming formal, the presence of state institutions, and the relationship between ethnicity and informality. CIEN's findings indicated that informality was not a cultural phenomenon in Guatemala, but rather was caused by the absence of a state presence, high transaction costs in becoming formal, and the exclusion of various groups – including but not limited to indigenous groups – from policymaking.

CIEN separately interviewed 200 entrepreneurs selected from indigenous broccoli producers, informal vendors, and women handicrafts exporters in order to assess obstacles to joining the formal economy and operating a business. The interviews focused on the costs and benefits of becoming

formal and how people in the informal economy perceived the central and local government. The interviews revealed, for instance, that the costs of formalizing a business in some cases represented more than 18 months' profit.

CIEN also held six focus groups for a total of more than 100 informal entrepreneurs at “La Terminal” market in Guatemala City, following the model of CIPE’s National Business Agenda approach. These focus groups gathered grassroots input on the most important obstacles to doing business and ways to remove them. This process allowed the entrepreneurs in the market to reach consensus on their priorities and incorporate their preferred solutions into a credible advocacy document.

## Advocacy Campaign

CIEN published its findings in its book *Informal Economy: Overcoming the Barriers of an Exclusionary State*. The book recommended a set of governance reforms such as increasing transparency in policy formulation, improving communication channels with the informal sector, raising the central government’s presence at departmental and municipal levels, and encouraging citizens’ participation in politics. Instead of greater regulation and tax burdens in response to informality, CIEN called for tangible benefits in exchange for formalization. CIEN specifically recommended reforms to reduce the cost of formalizing real estate and businesses, recognition of informal commercial practices, and revisions to minimum wage and labor regulations.

To raise awareness of the benefits of business formalization, CIEN held a conference and presented its book at meetings in six cities across Guatemala with association leaders. Its active media campaign – comprising 7 press conferences, 11 television shows, 21 radio shows, and 32 articles – reached an audience of several million people. With the cooperation of the National Institute of Statistics, CIEN’s information convinced policymakers and the public that informality is the rule rather than the exception in Guatemala.

CIEN reached more than half the members of the Guatemalan Congress by sharing its research and recommendations in an edition of its legislative bulletin. It also approached several Congressional committees, among which the Committee on Indigenous Affairs was particularly receptive. CIEN’s visit to this committee influenced Congress to reform laws regarding titling and land registration.

La Terminal market’s business agenda was first presented to participants from the focus group meetings and market leaders. The agenda was then presented at a general assembly of La Terminal’s informal vendors in addition to more than 400 people at town hall meetings. The agenda even guided a public debate on informality, organized by CIEN, among indigenous and informal leaders, an academic expert, the president of the Economic Commission of the Congress, and the director of economic planning for Guatemala City. After several months of negotiating, CIEN helped informal vendors and municipal authorities agree to changes in policies for sanitation, security, and the organization of vendors on streets and sidewalks.

## Impact on Business Registration and Property Rights

CIEN's public advocacy campaign produced significant changes to reduce the barriers to formalizing a business. In 2006, the government implemented a "single-window" system for registering a new business, which reduced paperwork by 90 percent and the number of required office visits from 15 to just 3. The cost of registering a business dropped to less than \$50. With these changes, the number of registered businesses jumped by 24 percent between 2006 and 2007. Most of the 8,000 new firms represented businesses that were previously informal, now joining the mainstream economy.

The dialogue with the congressional Committee on Indigenous Affairs, bolstered by CIEN's media campaign, set the stage for approval of the Cadaster Law (real estate registry law) in 2006. This law on titling and land registration was the first step in the formalization of property rights in Guatemala, especially among indigenous communities.

Using statistical evidence later published in its book, CIEN demonstrated that the system of property titling imposed high transaction costs on informal owners. With the cooperation of the Association of Housing Builders and Developers, CIEN's legislative recommendations resulted in a reduction of a 12 percent tax on property transfers to 3 percent. The reforms to facilitate the registration of property boosted the construction of homes by 40 percent. Continuing its advocacy, CIEN produced another victory when Congress passed the Real Estate Guarantees Law. This law opened up access to credit for thousands of small businesses by allowing them to use non-fixed assets (in addition to land and buildings) as collateral.

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## Strengthening the Voices of the Jua Kali in Kenya

# National Informal Sector Coalition and the Kenya Gatsby Trust

Since 2004, the Center for International Private Enterprise (CIPE) has worked with its Kenyan partners to bring grassroots, informal entrepreneurs into the national and local policy discussions that affect them. One partner, the National Informal Sector Coalition (NISCO), has emerged as an organized voice for the sector. Another partner, the Kenya Gatsby Trust (KGT), has facilitated a better-informed, more inclusive dialogue on the implementation of policies for small business development.

*Jua kali* is the popular term for the informal sector in Kenya. Literally meaning “under the hot sun,” the term suggests the severe conditions under which micro-entrepreneurs and their employees labor. The jua kali sector encompasses small-scale entrepreneurs and workers who lack access to property rights, training, and good working conditions.

Kenya has few policies to address the needs of the informal sector. The few policies that have been established, such as Sessional Paper No. 2 (2005), have not yet been implemented. Informal entrepreneurs further face difficulties in accessing information about the policies, laws, and rights that affect them. Not knowing their rights, they are vulnerable to arbitrary and harsh treatment by authorities. Jua kali businesses have therefore felt a need for a forum to collectively represent their concerns and voice their inputs to the government.

## Enhancing the Capacity of Associations

In numerous regions of Kenya, jua kali businesses formed associations to protect themselves from government abuse, provide services to business, and improve access to property, credit, and infrastructure. The creation of locally based voluntary associations provided an opportunity for informal businesses to be represented in the policymaking process. However, most associations lacked the capacity to carry out these functions effectively.

To build the capacity of jua kali associations, CIPE organized a one-week professional and organizational development workshop for 40 association leaders in Nairobi in November 2004. The participants acquired skills for leadership, financial management, strategic planning, membership development, and marketing. Several associations subsequently capitalized on the skills and strategies that their leaders acquired during the workshop to improve the professionalism of their organizations and enhance benefits for their membership.

Most of the associations that participated in the CIPE training began holding regular elections. Some of them succeeded in increasing their membership by offering improved financial services and small loans to members, in addition to information and health services. After the CIPE workshop, several associations approached municipal councils to obtain joint licenses for their members. These licenses allowed businesses to operate at a lower cost without harassment and allowed the authorities to collect taxes from association members.

## **Coalition-Led Reform**

As an outcome of the workshop, participating associations decided to form a new grassroots coalition in order to give a common voice to the informal sector. The National Informal Sector Coalition (NISCO), formed in 2005, is a multi-sectoral association that brings together jua kali associations across Kenya. The coalition performs functions such as improving human resources, promoting networking, and influencing policies that affect its members. It plays a key role in the survival of member associations and small enterprises by harnessing the power of joint action.

Within a short period since its creation, NISCO gained recognition and engaged the government. A delegation from NISCO met with Kenya's vice president and the permanent secretaries to come up with a strategy for the small business sector. NISCO obtained a commitment from the government to set aside 10 percent of procurement contracts for small businesses, which previously never had the opportunity to participate in government tenders. The government also agreed to take combined action with NISCO to enhance job creation. NISCO followed up by delivering a comprehensive proposal to the permanent secretaries for rapid reform. The coalition moreover gained land for a large hawkers market in Nairobi, advocated for stronger property rights and improved utility services, and obtained commitment from the government for a \$27 million loan fund for informal businesses.

Once NISCO was established, from 2007 to 2008 CIPE worked with NISCO to develop its organizational capacity and its ability to strengthen member associations through organizational assessments, training, and technical assistance. CIPE's advice helped NISCO to strengthen its internal governance, create a five-year strategic plan, and become a more effective advocate for the sector. Over the course of the year, NISCO recorded a 25 percent growth in membership. NISCO obtained representation on the governing council of the National Taxpayers Association and participated in the development of the Nairobi South District Development plan and the national HIV/AIDS Workplace Policy.

## **Strengthening Policy Support for Micro and Small-Scale Entrepreneurs**

In a separate CIPE project, the Kenya Gatsby Trust (KGT) coordinated private sector input into Ministerial Stakeholder Forums on the implementation of micro and small business policy. To bring grassroots voices into the discussion, KGT created six thematic working groups that linked more than 300 sector representatives with regional and national business representatives who were participating in the ministerial forums. In support of KGT's efforts, the Kenya Institute of Public Policy Research and Analysis (KIPPRA) prepared simplified versions of Sessional Paper No. 2 and draft legislation to raise policy awareness among small business owners.

KIPPRA analyzed the institutional and policy frameworks governing micro and small-scale enterprise in Kenya, and compared them against international experiences and best practices. Based on this analysis and stakeholder input, KGT and KIPPRA made recommendations for policies and their implementation. Many of these recommendations were included in the draft Micro and Small Enterprises Bill of 2008. Working toward the realization of promises of small business participation in public procurement, KGT was also invited by the Ministry of Finance to serve on a steering committee to resolve this issue. In this manner, KGT and CIPE have helped bridge the gap between grassroots entrepreneurs and policymakers toward the implementation of the country's vision for small business development.

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