

*SHORT ESSAY***INFORMALITY IN ALGERIA**

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The informal sector is a source of concern for the Algerian government, who see it as a major obstacle to the development of economic activity in Algeria.

Despite the lack of statistical monitoring, there are indications that informality is widespread, and even a growing phenomenon.

Some Facts:

1. The employment survey carried out by the Algerian statistics office (ONS) suggests that the informal sector, proxied by the share of nonregistered workers in the wage earner population, accounted for 46 percent of total employment in 2010, up by 12 percentage points since 2001. While informal female employment fell in 2005 compared with 2001, it rose in the second half of the decade, to reach close to 43 percent of total employment, in line with informal male employment.
2. Data for the monetary sector also suggest that the informal sector represents a large part of the economy, and increased over the decade starting in 2000. In 2011, the ratio of currency in circulation (relative to M2) in Algeria was higher than in 75 percent of countries in the world, an indicator that not only underlines the insufficient development of the financial sector, but also indicates that a substantial share of transactions are conducted outside formal payment systems. Additionally, while the share of currency in circulation in proportion to the money supply fell for a sample of 101 countries between 2002 and 2011, figures show that this ratio remained stable in Algeria and increased slightly at the end of the period.

What Causes the Phenomenon to Expand?

The factors encouraging the development of the informal sector are generally well-identified and include excessive regulation of the economy, the rigidity of the labor markets, and high taxes¹. Specifically, experience in countries in the Middle East and Central Asia suggests that obstacles to the development of the formal sector include:

1. high taxes;
2. long, expensive, and complex procedures for setting up and managing companies; and
3. High employment costs, especially through minimum wages that are higher than employment productivity, or high severance costs.
4. The quality of institutions also plays a role, notably when it leads to below-standard public services or the failure to implement legislation properly.

Recent Measures Taken by the Algerian Government to Contain the Informality

The Algerian government announced, mid-last year 2015, the start of a tax amnesty aimed at integrating funds circulating in the informal sector into the banking system. “The voluntary compliance program as specified by the Complementary Finance Law (LFC 2015) is effective as of 2 August 2015”, announced the Direction générale des impôts (DGI – Bureau of Internal Revenue) in a communiqué published on its website.

The DGI invited all interested persons in the same communiqué to get in touch with bank branches to get information on the practical implementation modalities of this program.

The Additional Budget Law 2015 specifies that “the amounts deposited in the banks within the framework of this operation by any person, regardless of their situation, will be subject to a lump-sum flat taxation at the rate of 7%”, indicating however that “the sources of these funds or the transactions which generated them must be lawful and not correspond to any criminal act as defined by the Penal Code and the legislation governing the fight against

¹ See IMF 2011 *Regional Economic Outlook*, Middle East and Central Asia.

There is also a very comprehensive paper on the informal economy in developing countries where the authors cite five factors at the origin of the phenomenon. Cf. Rafael La Porta and Andrei Shleifer, *INFORMALITY AND DEVELOPMENT*, Working Paper 20205 <http://www.nber.org/papers/w20205>, NBER, June 2014

money laundering and financing of terrorism”. The deadline for this program has been set by LFC 2015 as 31 December 2016.

Many analysts estimate that losses linked to tax evasion by Algerians is about USD 4 billion per year.

Taxing the Informal Economy

According to a survey conducted in 2009 in Africa² which shows evidence that the “informal economy” – workers and companies operating outside the reach of the law or public administration – is a major obstacle to broadening the tax base and collecting direct taxes. Informality is indeed widespread in developing countries, but highest in sub-Saharan Africa. This poses a wide range of economic challenges: not only are taxes not collected, but informal firms are also often less productive and there are no labor and social protection schemes for workers. In short, high informality leads to lower economic growth and greater social exclusion. Informality often arises where the costs of legal employment outweigh the benefits for producers, employers or employees. If entry costs into a regulated economy are unaffordable, people and businesses are forced to remain outside the system (Jütting and de Laiglesia, 2009).

Table 1: Share of informal employment in total non-agricultural employment in Algeria

| 1975-79 | 1980-84 | 1985-89 | 1990-94 | 1995-99 | 2000-07 |
|----------------|----------------|----------------|----------------|----------------|----------------|
| 21.8 | | 25.6 | | 42.7 | 41.3 |

Source: Jütting and de Laiglesia (2009).

Fiscal policy in developing countries must consider capacity, incentives and segmentation. In countries where the informal sector comprises more than half of the economic activity, the question arises as to how governments can pursue fiscal policy in terms of both taxation and expenditure. On the one hand, more firms in the formal sector means increased tax collection and social security contributions for the state. On the other hand, more people covered by social security means increased liabilities for governments as employees become eligible for health insurance, pensions and other benefits where offered. In addition, the increase in tax revenue from formalizing informal firms may be smaller than expected. Indeed informal firms that enter the system are often too small and too poor to make sizeable contributions.

² African Economic Outlook, 2010.

However, value-added and sales taxes could still produce a notable increase in tax collection as these also indirectly tax informal activities³.

The quality of tax policies and tax administration also plays an important role. Complex tax codes and high compliance burdens imposed by an inefficient tax administration are powerful incentives for small enterprises to remain informal. For example, country surveys reveal that, in many African countries, bureaucracy and corruption are identified as barriers against entering the formal sector.

Tax Administration Capacity

Administrative capacity constraints have been highlighted throughout the study on Africa (African Economic Outlook, 2010) surveys a major obstacle to improving tax policy in Africa. The administrative constraints are such that they limit policy options according to the study.

- For example, in theory, relying more on income tax and exemptions on basic consumer items would enable more redistribution of resources. But where administrative capacity is weak, personal income tax is less progressive than expected. Firstly, only wages, mostly earned in large private firms and in the public sector, are taxed. Secondly, personal income earned on capital is typically not taxed. Capital, real estate income and other revenues of high earners in the informal sector are thus outside the reach of tax administration.
- For a variety of reasons, VAT exemptions in Africa are often regarded by experts to be regressive. Strategies that copy those used in countries with high administrative capacity can be counter-productive. In Morocco, before a 2005 fiscal reform, generous VAT exemptions undermined the potential of VAT introduced in 1986.

The vast majority of the African countries surveyed cite the lack of skilled staff as a major impediment to tax collection.

Besides that factor, the research on Africa shows clearly that despite great progress in adopting Information and Communication Technology to increase revenue collection in a number of countries, more can still be done. The study concludes that these initiatives require educational campaigns to motivate individuals and enterprises to use these systems.

³ Latin American Economic Outlook, 2009

Some References

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