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## **TACKLING ENTREPRENEURSHIP IN THE INFORMAL SECTOR: AN OVERVIEW OF THE POLICY OPTIONS, APPROACHES AND MEASURES**

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The aim of this paper is to review the various policy options, approaches and measures that can be used to address informal entrepreneurship. To do this, it firstly reviews four possible policy options, namely taking no action, eradicating informal entrepreneurship, moving formal entrepreneurship into the informal economy, or transforming informal entrepreneurship into formal entrepreneurship. Revealing that transforming informal entrepreneurship into formal entrepreneurship is not only the most viable option but also the approach most commonly adopted by supra-national agencies and national governments, a review is then undertaken of how this can be achieved using either direct controls, which seek to increase the costs of informal entrepreneurship and/or the benefits of formal entrepreneurship, or indirect controls that seek to generate a commitment to compliance and greater self-regulation. It is then revealed how these approaches and their accompanying policy measures are not mutually exclusive and can be combined in various ways, exemplified by the responsive regulation and slippery slope approaches. The outcome is a comprehensive review and evaluation of the various policy options, approaches and measures available to policy-makers for addressing informal entrepreneurship along with some recommendations regarding the way forward.

Keywords: entrepreneurship; informal economy; shadow economy; informal entrepreneurship; tax compliance; public policy.

### **1. Introduction**

Recent years have seen the emergence of a burgeoning literature on informal entrepreneurship (Achua and Lussier, 2014; Aidis et al., 2006; Bruton et al., 2012; Bureau and Fendt, 2011; Kus, 2014; Mróz, 2012; Welter and Smallbone, 2011; Williams, 2006; Williams and Nadin, 2010a). This literature has analyzed not only its magnitude, including the prevalence of informal entrepreneurship (Autio and Fu, 2014; Williams, 2013) and the determinants of its variable prevalence (Dau and Cuervo-Cazurra, 2014; Siqueira et al, 2014; Thai and Turkina, 2014), but also its nature, including who participates (Thai and Turkina, 2014; Williams, 2007; Williams and Martinez-Perez, 2014; Williams and Nadin, 2010b; Williams and Round, 2007, 2008; Williams and Youssef, 2013) and their motives, such as whether they are necessity- and/or opportunity-

driven (Adom, 2014; Adom and Williams, 2012; Maloney, 2004; Perry et al., 2007; Williams and Gurtoo, 2011; Williams et al., 2009). Until now however, and despite the growing understanding of the magnitude, characteristics and rationales underpinning informal entrepreneurship, little attention has been paid to what is to be done about entrepreneurship in the informal economy. The aim of this paper is to redress this gap in the literature.

To achieve this, section 2 of this paper evaluates the array of potential policy options available for tackling informal entrepreneurship. Identifying that the overwhelming consensus is that informal entrepreneurship needs to be brought into the formal economy, section 3 then provides a conceptual framework for understanding the range of potential policy approaches and measures available for achieving this objective. This is followed in section 4 by a brief review of the direct controls that can be used to transform informal entrepreneurship into formal entrepreneurship followed in section 5 by the indirect controls that might be used to do so. Rather than view these direct and indirect controls as either/or choices, section 6 then demonstrates the various policy approaches that can be adopted which combine direct and indirect controls when tackling informal entrepreneurship, namely the responsive regulation and slippery slope approaches. Section 7 then draws conclusions about the ways forward for tackling informal entrepreneurship. The outcome is a comprehensive review of the policy options, approaches and measures available to policy makers along with some suggestions regarding how they can be combined.

Before commencing however, it is necessary to define informal sector entrepreneurship. Reflecting the strong consensus in the literature, the informal sector is here defined as monetary transactions not declared to the state for tax, benefit and/or labour law purposes when they should be declared but which are legal in all other respects (Williams and Nadin, 2010). The working definition of an entrepreneur meanwhile, is somebody actively involved in starting a business or is the owner/manager of a business (Harding et al., 2006; Reynolds et al., 2002). Informal entrepreneurs are therefore those starting a business or are the owner/manager of a business who engage in monetary transactions not declared to the state for tax, benefit and/or labour law purposes when they should be declared but which are legal in all other respects. The only illicit aspect of their entrepreneurial endeavour in consequence, is that when trading licit goods and/or services, some or all of their monetary transactions are not declared. Entrepreneurs trading illicit goods and services (e.g., drug trafficking, gun-running) are not informal entrepreneurs, but part of the separate criminal economy (Smith and McElwee, 2013).

## **2. Possible Policy Options**

Logically, there are four possible policy options available to policy-makers with regard to informal entrepreneurship. Policy-makers can either choose to: take no action; pursue the eradication of informal entrepreneurship; move formal entrepreneurship into the informal economy; or finally, transform informal entrepreneurship into formal entrepreneurship.

Even if some of these possible policy options might appear a little far-fetched at first glance, commentators have advocated all of these in recent decades. In consequence, one cannot reject any of them without evaluating their implications.

### **2.1. Take no action**

A first option is for governments to take no action regarding informal entrepreneurship. Rationales for doing nothing include that it is a seed-bed for new venture creation, a breeding ground for the micro-enterprise system and a test-bed for fledgling enterprises and therefore no action should be taken. Indeed, a 2012 survey of 595 small business owners in the UK reveals that 20 per cent report that they traded in the informal sector when starting-up their business venture, with 64 per cent stating that the main reason for doing so was to test the viability of their business venture (Williams and Martinez, 2014a,b).

The problem with taking no action however, is that entrepreneurship in the informal economy has significant deleterious implications for formal entrepreneurs (e.g., unfair competition), informal entrepreneurs (e.g., pressure to enter exploitative relationships with the formal realm), customers (e.g., lack of legal recourse if a poor job is done) and governments (e.g., reduced public revenue) (for a review, see OECD, 2015; Williams, 2014a, 2015). Until now nevertheless, there have been no known rigorous evaluations of the extent to which such deleterious impacts are valid in practice. This is a significant gap that needs to be filled in future studies. Despite this lack of an evidence-base however, the strong consensus of both scholars and policy-makers is that on balance, the deleterious impacts outweigh any beneficial impacts of informal entrepreneurship. As such, the overwhelming consensus is that taking no action is not a feasible option. Interventions are thus seen to be required to tackle informal entrepreneurship. What form of intervention, therefore, is needed?

### **2.2. Move formal entrepreneurship into the informal economy**

A second possible policy option is to shift formal entrepreneurship into the informal sector. Although not explicitly argued by any commentators, there have been policy proposals which err in this direction. Some commentators that is, have advocated a de-regulation of the formal sector in order to tackle informal entrepreneurship. This is based on the belief that informal entrepreneurship arises due to the over-regulation of the market (Sauvy, 1984; De Soto, 1989, 2001), and the objective is therefore to de-regulate the formal sector in order that all activities are performed in a manner akin to what is currently the informal sector, although they would not be engaged in informal entrepreneurship because they would be conforming to the regulations that remain.

However, there are several intransigent problems with this policy option. The view is that de-regulation reduces the informal entrepreneurship. However, there is growing evidence that decreasing the level of state intervention does not result in a formalisation of informal entrepreneurs but quite the opposite, greater levels of informal

entrepreneurship (Kus, 2010, 2014; Williams, 2013b, 2014a,b). As such, this option is not perhaps viable. Indeed, few currently advocate such a possibility.

### **2.3. Eradicate informal entrepreneurship**

Another option is to eradicate informal entrepreneurship. If informal entrepreneurs are viewed as “rational economic actors” who evade tax so long as the pay-off is greater than the expected cost of being caught and punished (Allingham and Sandmo, 1972), their eradication can be achieved by changing the cost/benefit ratio confronting those engaged or thinking about participating in informal entrepreneurship (e.g., Grabiner, 2000; Hasseldine and Li, 1999; Richardson and Sawyer, 2001). This can be achieved by raising the costs of operating as an informal entrepreneur firstly, by increasing the perceived or actual likelihood of detection and secondly, the penalties and sanctions for doing so. In this “negative reinforcement” approach therefore, the eradication of informal entrepreneurship is pursued through the use of “sticks” to punish “bad” (non-compliant) behavior.

However, whether this is firstly, practical and secondly, desirable, is open to question. On the practicality side, the issue is whether this is effective. Although some studies reveal that improving detection and/or penalties reduces informality (De Juan et al., 1994; Slemerod et al., 2001), others identify that informality increases (Bergman and Nevarez, 2006; Murphy, 2005) and thus that “it is not sensible to penalize illicit work with intensified controls and higher fines” (Schneider and Enste, 2002: 192). This is because a penalizing approach alienates informal entrepreneurs, reducing their willingness to comply and increasing informality by reducing their belief in the fairness of the system (Murphy, 2005).

It can also be questioned whether the eradication of informal entrepreneurship is desirable. If informal entrepreneurship is recognized as a breeding ground for the micro-enterprise system and a seedbed for enterprise culture, this sphere is a potential asset that needs to be harnessed (e.g., Williams, 2006). Seeking its eradication will therefore eliminate precisely the entrepreneurship and enterprise culture that governments are seeking to nurture. The consequent challenge for policy-makers is to “join-up” their policy approach towards informal entrepreneurship with their agendas to nurture enterprise culture and entrepreneurship. Indeed, unless achieved, then governments with each new initiative to eradicate informal entrepreneurship will destroy precisely the entrepreneurship and enterprise culture that they wish to foster.

### **2.4. Transform informal entrepreneurship into formal entrepreneurship**

Rather than take no action, transfer formal entrepreneurship into the informal economy or stamp out informal entrepreneurship, a final possibility is to transform informal entrepreneurship into formal entrepreneurship (Dekker et al., 2010; European Commission, 2007, Renooy et al., 2004; Small Business Council, 2004, Williams, 2006; Williams and Nadin, 2012a,b, 2013, 2014; Williams and Renooy, 2013). The positive

impacts of legitimizing informal entrepreneurship vary according to whether formal and informal businesses, customers or the government, are considered.

So far as formal enterprises are concerned, transforming informal entrepreneurship into formal entrepreneurship would stop the unfair competitive advantage of informal businesses over those playing by the rules (Evans et al., 2006; Renooy et al., 2004). It would also enable the business community to pursue a “high road” rather than “low road” approach by shifting towards greater regulatory standards on working conditions such as health and safety and labor standards (Grabiner, 2000; Renooy et al., 2004; Williams and Windebank, 1998). For informal entrepreneurs meanwhile, the key benefits of legitimizing are manifold. They can escape the pressure to enter exploitative relationships with the formal realm (Gallin, 2001; Williams and Windebank, 1998) and achieve the same levels of legal protection as formal entrepreneurs (ILO, 2014; Morris and Polese, 2014). They are also able to secure formal intellectual property rights for their products and processes (De Beer et al., 2013) and overcome the structural impediments which prevent them from expanding such as their lack of access to advice and support as well as capital (ILO, 2014).

For customers, the advantages of legitimizing informal entrepreneurship are that such customers benefit from legal recourse if a poor job is done, have access to insurance cover, enjoy guarantees with regard to the work conducted, and have more certainty that health and safety regulations are being followed (Williams and Martinez, 2014c).

Finally, for governments, the benefits of transforming informal entrepreneurship into formal entrepreneurship are that it improves the level of public revenue, thus enabling governments to pursue higher expenditure on social protection and integration projects (Williams and Windebank, 1998). It also facilitates a joining-up of the policy approach towards informal entrepreneurship with the more general policy approach towards harnessing entrepreneurship and enterprise culture (Dekker et al., 2010; European Commission, 2007, Small Business Council, 2004).

## **2.5. Summary of possible policy options**

This review of the four possible policy choices available towards informal entrepreneurship reveals that the first option of taking no action is unacceptable. This would leave intact the current negative impacts on formal entrepreneurs (e.g., unfair competition), informal entrepreneurs (e.g., the inability to gain access to credit to expand), customers (e.g., no guarantee of health and safety standards) and governments (e.g., taxes owed are not collected). Secondly, transforming formal entrepreneurship into informal entrepreneurship is undesirable because there is little evidence that de-regulation reduces informality and third and finally, eradicating informal entrepreneurship is unacceptable since it results in governments repressing and eradicating precisely the entrepreneurial endeavor and enterprise culture that they otherwise wish to foster. Transforming informal entrepreneurship into formal entrepreneurship thus appears to be the most viable policy choice. How, therefore, can this be achieved?

### 3. Policy Approaches and Measures

To understand the diverse array of policy approaches and measures available for transforming informal entrepreneurship into formal entrepreneurship, Table 1 sets out a heuristic conceptual framework. This distinguishes between direct and indirect controls. Direct controls seek to transform informal entrepreneurship into formal entrepreneurship by ensuring that benefits of operating in the formal economy outweigh the costs of working in the informal economy. This is accomplished either by using deterrence measures to increase the costs of non-compliance (“sticks”) and/or by making the conduct of formal entrepreneurship more beneficial (“carrots”). Indirect controls meanwhile, shift away from using “sticks” and “carrots”, and instead focus on developing the psychological contract (or what might also be called the social contract) between the state and its citizens in order to encourage a commitment to compliance among entrepreneurs and therefore greater self-regulation.

Table 1 Typology of policy approaches and measures for addressing informal entrepreneurship

Approach	Method	Measures
Direct controls: deterrents (“sticks”)	Improved detection	Data matching and sharing Joined up strategy Joint operations
	Increased penalties	Increased penalties for evasion
	Increase perception of risk	Advertising the penalties for informality Advertising the effectiveness of detection procedures
Direct controls: Incentives (“carrots”)	For start-ups	Simplification of compliance Direct and indirect tax incentives Supply chain responsibility Support and advice to start-ups
	For established informal entrepreneurs	Supply-side incentives (e.g. society-wide amnesties; voluntary disclosure; smoothing transition to formalization) Demand-side incentives (e.g. service vouchers; targeted direct taxes; targeted indirect taxes)
Indirect controls: reduce asymmetry between formal and informal institutions	Change informal institutions (values, norms and beliefs)	Tax education Normative appeals Education and awareness raising of benefits of formal entrepreneurship
	Change formal institutions (laws, regulations and codes)	Procedural fairness and justice Redistributive justice Wider economic and social developments (e.g., social protection, equality, growth strategies for quality employment, entrepreneurship support)

Here, we consider each approach in turn in order to highlight the array of measures available for transforming informal entrepreneurship into formal entrepreneurship.

#### 4. Direct Controls Approach

The conventional policy approach for tackling the informal economy in general and informal entrepreneurship more particularly, is to use direct controls. As the OECD (2008: 82) summarize, “Combating informal employment requires a comprehensive approach to reduce the costs and increase the benefits to business and workers of operating formally”. To evaluate this direct controls approach therefore, firstly, the use of deterrence measures to detect and punish non-compliant (“bad”) behavior (i.e., informal entrepreneurship) is reviewed followed secondly, the use of incentives (or what might be better called “bribes”) that make it easier to undertake and reward compliant (“good”) behavior (i.e., formal entrepreneurship).

##### 4.1. Deterrence measures

During the early 1970s, Allingham and Sandmo (1972) argued that the non-compliant, such as informal entrepreneurs, are rational economic actors who evade tax when the pay-off is greater than the expected cost of detection and punishment. To deter them therefore, the objective is to change the cost/benefit ratio facing those participating or considering participation in informal entrepreneurship (e.g., Grabiner, 2000; Hasseldine and Li, 1999; Job et al., 2007; Richardson and Sawyer, 2001). When using deterrence measures, this is achieved by increasing the actual and perceived risks and costs associated with participation in informal entrepreneurship firstly, by raising the perceived or actual likelihood of detection and/or secondly, increasing the penalties and sanctions for those caught. This is therefore a “negative reinforcement” approach; it seeks to use “sticks” to punish non-compliant (“bad”) behavior.

A large and expanding body of literature nevertheless, reveals that raising the penalties or the probability of detection does not lead to greater compliance (Feld and Frey, 2002; Murphy, 2005; Varma and Doob, 1998; Shaw et al., 2008; Webley and Halstead, 1986). Instead, it increases non-compliance, not least due to a breakdown of trust between the state and its citizens (Ayres and Braithwaite, 1992; Murphy and Harris, 2007; Tyler et al., 2007; Williams, 2001). Indeed, the most telling rebuttal of the use of deterrents is the finding that many voluntarily comply even when the level of penalties and risks of detection would suggest that they should not if they were truly rational economic actors (Murphy, 2008). Obviously, other factors must be at work engendering this commitment to compliant behavior that lie beyond the level of deterrents.

Another reason for caution regarding the use of deterrents is that they have a range of unintended and unwanted broader impacts. As already mentioned, they lead to one hand of government deterring precisely the entrepreneurial endeavor and enterprise culture that other hands of government wish to nurture. When this is combined with the recognition that punishing non-compliant (“bad”) actions is not necessarily the most effective means of changing the behavior of informal entrepreneurs, the result has been that many have begun to question the value of such measures. New measures have thus emerged.



#### **4.2. Incentive measures/“bribes”**

With the growing recognition across governments that the goal is to transform informal entrepreneurship into formal entrepreneurship, rather than eradicate it, there has been a shift away from deterrence measures and towards providing incentives to encourage informal entrepreneurs to legitimize their endeavor (Small Business Council, 2004; Williams, 2006). Put another way, rather than punish “bad” (non-compliant) behavior, measures have been sought that reward “good” (compliant) behavior, rather than taking it as given. When tackling informal entrepreneurship, and as displayed in Table 1 above, these measures take two forms.

On the one hand, a range of measures can be introduced that provide incentives for entrepreneurs at the business start-up stage to establish their ventures on a formal basis. These measures can include the simplification of compliance so as to make it easy to do so, the use of direct and indirect tax incentives that make it beneficial to start-up formally, and the provision of support and advice to entrepreneurs about how to start-up formally.

On the other hand, a range of measures can be introduced that provide incentives for established informal entrepreneurs to make the transition to formal entrepreneurship. Such measures can take the form of either supply-side measures targeting informal entrepreneurs or demand-side measures targeting their customers and providing them with incentives to use formal rather than informal enterprises. Firstly, therefore, supply-side measures that in effect seek to “bribe” informal entrepreneurs to make the transition to formal entrepreneurship can be used, such as the use of society-wide amnesties, voluntary disclosure schemes and the introduction of schemes that facilitate them to undergo a smooth transition to legitimacy. Secondly, there are demand-side measures that again in effect “bribe” customers to use formal rather than informal enterprises when sourcing goods and services. These include the use of for example service vouchers and targeted direct and indirect tax incentives (see Williams, 2015).

#### **5. Indirect Controls Approach**

The problem with using direct controls to alter the cost/benefit ratio confronting informal entrepreneurs is that they are not only expensive but also often ineffective (Alm, 2011). Rather than “bribe” somebody to be compliant for example, it has been recognized that a more effective approach is to engender a commitment in them to being compliant so that they engage in self-regulation. The result has been a move beyond the use of “sticks” and “carrots” and the adoption of indirect controls to improve the psychological contract between the state and entrepreneurs (Alm et al., 1995; Torgler, 2003; Weigel et al., 1987; Wenzel, 2002). The intention is to engender willing or voluntary commitment to compliant behavior rather than force entrepreneurs to comply using threats, harassment and/or bribes (Kirchler, 2007; Torgler, 2007, 2011).

To understand the tools used in this approach, it is first necessary to recognize that there exists an institutional incongruity between the laws, codes and regulations of formal

institutions and the norms, beliefs and values of informal institutions. Informal entrepreneurship occurs when the norms, values and beliefs (informal institutions) differ to the laws and regulations (formal institutions), resulting in what formal institutions deem to be illegal activities being seen as socially legitimate in terms of the norms, values and beliefs of entrepreneurs (Williams and Shahid, 2015). To tackle informal entrepreneurship therefore, there is a need to reduce this asymmetry between the formal and informal institutions. This can be achieved either by changing the informal institutions and/or the formal institutions.

### **5.1. Changing the informal institutions**

To change this institutional asymmetry, one approach is to change the norms, values and beliefs of potential and existing entrepreneurs regarding the acceptability of working in the informal sector so that these are in symmetry with the laws, regulations and codes of formal institutions. This can be achieved by improving tax knowledge using awareness raising campaigns about the costs of informal entrepreneurship and benefits of formal entrepreneurship work, and normative appeals.

#### **5.1.1. Improving tax knowledge**

Educating entrepreneurs about the benefits of formality is important if the norms, values and beliefs are to be in symmetry with the codified laws and regulations of formal institutions. To do this, entrepreneurs require two types of education. Firstly, there is the need to educate entrepreneurs about what the current system requires them to do by providing information regarding their responsibilities. A significant portion of tax evasion is unintentional, resulting from a lack of knowledge, misunderstandings and a false interpretation of their responsibilities (Hasseldine and Li, 1999; Natrah, 2013). A solution in consequence, is to provide greater information to entrepreneurs (Internal Revenue Service, 2007; Vossler et al., 2011).

Secondly, and more broadly, entrepreneurs also need to be educated about the value and benefits of paying taxes in order to prevent intentional evasion by developing their intrinsic motivation to comply. A solution to reduce intentional evasion in consequence, is to educate entrepreneurs about where their taxes are spent. This can be done by informing them of the current and potential public goods and services they receive (Bird et al., 2006; Saeed and Shah, 2011). Signs such as “your taxes are paying for this” on civil construction schemes (e.g., new roads) are one way of doing so by conveying a clear message of where taxes are being spent. Signs in hospitals, schools, medical centers and on ambulances can also be used in this regard.

#### **5.1.2. Awareness-raising campaigns**

A further way of changing attitudes towards compliance is to raise awareness by informing either: entrepreneurs of the costs and risks of operating in the informal economy; potential customers of the risks and costs; entrepreneurs of the benefits of

being formal, and/or potential customers of the benefits of using the formal economy. Indeed, the evidence is that such advertising campaigns are effective and cost efficient. In the UK, an evaluation of the advertising campaigns run by the tax office reveals that as a result, some 8300 additional people registered to pay tax who would not have otherwise done so, paying tax of £38 million over three years, providing a return of 19:1 on the expenditure of £2 million. This compares with an overall return of 4.5: 1 on the £41 million a year spent on all its compliance work in 2006-07 (National Audit Office, 2008).

### 5.1.3. Using normative appeals

Normative appeals to entrepreneurs to declare their activities are another potential way forward. Their effectiveness however, depends in part on the nature of the appeal made. Chung and Trivedi (2003) examine the impact of normative appeals on a friendly persuasion group who were required to both generate and read a list of reasons why they should comply fully and compared with a control group not asked to do so. The participants in the friendly persuasion groups report higher earnings than the control group.

## **5.2. Changing the formal institutions**

Besides changing the norms, values and beliefs of entrepreneurs in relation to compliance in order to align these with the codes and regulations of formal institutions, policy can also seek to change the formal institutions to align with the norms, values and beliefs of society. This is particularly important in societies in which there is a lack of trust in government, such as due to public sector corruption (European Commission, 2014) or in societies where entrepreneurs do not believe that they receive back from government what they expect. Two types of change are required so far as formal institutions are concerned. Firstly, there is often a need to change internal processes in the formal institutions to improve the perception amongst entrepreneurs that there is tax fairness, procedural justice and redistributive justice. Secondly, there is often a need to change the products of formal institutions by pursuing wider economic and social developments. Here, each is considered in turn, starting with the changes required in internal processes.

### 5.2.1. Enhancing procedural justice

Procedural justice refers to the extent to which entrepreneurs perceive the government to treat them in a respectful, impartial and responsible manner (Braithwaite and Reinhart, 2000, Murphy, 2005; Taylor, 2005; Tyler, 1997, Wenzel, 2002). This has a significant effect on compliance. If entrepreneurs view the tax administration as treating them in such a manner, then entrepreneurs are more likely to be compliant (Hartner et al, 2008; Murphy, 2003; Murphy et al., 2009; Torgler and Schneider, 2007; Wenzel, 2002). As Wenzel (2006) finds, compliance was significantly higher among taxpayers perceiving there to be interactional fairness. Being treated politely, with dignity and respect, being given a say, and having genuine respect shown for one's rights and social status all

enhance compliance (Alm et al., 1993; Feld and Frey, 2002; Gangl et al., 2013; Hartner et al., 2008; Murphy 2005; Tyler, 1997, 2006; Wenzel, 2002).

### 5.2.2. Improving procedural fairness

Procedural fairness refers to the extent to which entrepreneurs believe that they are paying their fair share compared with others (Kinsey and Gramsick, 1993; Wenzel, 2004a,b). Entrepreneurs receiving procedurally fair treatment are more likely to trust the authorities, accept its decisions and follow its directions (Murphy, 2005). The fairness of the tax system is one of the most important determinants of whether they do so (Bobeck and Hatfield, 2003; Hartner et al., 2007, 2011; Kirchgässner, 2010, 2011; McGee, 2005, 2008; McGee et al., 2008; Molero and Pujol, 2012). Conversely, where there are grievances among entrepreneurs that they are not receiving fair treatment, non-compliance increases (Bird et al., 2006).

### 5.2.3. Developing redistributive justice

Redistributive justice refers to whether entrepreneurs believe they receive the goods and services they deserve given the taxes that they pay (Kinsey and Gramsick, 1993; Kinsey et al., 1991; Richardson and Sawyer, 2001; Thurman et al., 1984). Taxes are the prices paid for the goods and services provided by government. The question for the moral evaluation of taxes is whether this price corresponds to the value of these goods and services (i.e., whether it is seen as “just”), namely whether there is a “just price” (Kirchgässner, 2010). Entrepreneurs are more likely to be non-compliant and break the psychological contract with the state, the less they perceive the tax system as fair. To achieve compliance therefore, the tax system must be seen as fair. If entrepreneurs do not receive the goods and services they believe they deserve given the taxes they pay, then non-compliance increases (McGee, 2005). The result is that governments need to educate entrepreneurs about where their taxes are spent. In situations where entrepreneurs do not know, or do not fully understand what public goods and services are provided with their taxes, then compliance is lower than in situations where citizens are more fully aware of what public goods and services are received and they agree with how their taxes are spent (Lillemets, 2009). There is a need therefore, for government to explain how taxes are spent and to elicit agreement regarding the public goods and services provided by government.

## **5.3. Changing the products of formal institutions: wider economic and social developments**

To achieve a high-commitment culture and self-regulation amongst entrepreneurs, it is also necessary to change the products of formal institutions in terms of the wider economic and social developments pursued (Vanderseypen et al., 2013; Williams and Renooy, 2013, 2014). Until now, there have been three contrasting theoretical standpoints

regarding what broader economic and social developments are required to reduce informal entrepreneurship.

Firstly, the “modernization” thesis purports that informal entrepreneurship decreases as economies modernize and develop and therefore that economic development and growth is required to reduce the level of informal entrepreneurship (ILO, 2012). Secondly, the “neo-liberal” thesis asserts that the prevalence of informal entrepreneurship is a direct result of high taxes, public sector corruption and state interference in the free market and therefore that tax reductions, resolving public sector corruption and reducing the regulatory burden are required (De Soto, 1989, 2001; London and Hart, 2004; Nwabuzor, 2005; Sauvy, 1984; Schneider and Williams, 2013). Third and finally, the “structuralist” thesis argues that the pervasiveness of informal entrepreneurship is the outcome of inadequate levels of state intervention in work and welfare. The focus therefore should be less upon transforming informal entrepreneurship into formal entrepreneurship and more upon introducing social protection, reducing inequality and pursuing labor market interventions to help vulnerable groups (Castells and Portes, 1989; Davis, 2006; Gallin, 2001; Slavnic, 2010; Taiwo, 2013).

Recent years have witnessed evaluations of these competing perspectives (Vanderseyppen et al., 2013; Williams, 2013a, 2014a,b,c,d; Williams and Renooy, 2013, 2014; Williams et al., 2013a). Analyzing the relationship between cross-national variations in the level of informal entrepreneurship and cross-national variations in the various aspects of the broader economic and social environment deemed important by each perspective, Williams (2013a) finds that informal entrepreneurship is lower in wealthier economies with stable high quality government bureaucracies and those with lower poverty levels, more equality, greater levels of social protection, more effective redistribution via social transfers and greater state intervention in the labor market to protect vulnerable groups.

## **6. Joining-up the Direct and Indirect Control Approaches**

To tackle informal entrepreneurship, it is not solely an either/or choice between the use of either direct or indirect controls. Although the focus of most national governments until now has been upon the use of direct controls, especially the use of punitive measures that seek to increase the costs of participating in informal entrepreneurship by increasing the risks of detection and levels of punishment (see OECD, 2015; Williams, 2015a), this does not mean that the solution is therefore to shift towards the use of either “bribes” or indirect controls as the solution. These approaches and measures are not mutually exclusive.

Indeed, there has been growing recognition that even if indirect controls are a useful and innovative means of transforming informal entrepreneurship into formal entrepreneurship which could be usefully adopted (Williams, 2014a; Williams and Renooy, 2013), they insufficient on their own. Direct controls are also required. For example, governments may seek to change the culture of government departments, such as tax offices, towards a more customer-oriented approach and introduce public

campaigns to elicit greater commitment to compliance, whilst simplifying regulatory compliance for business start-ups and introducing incentives for established informal entrepreneurs (e.g., amnesties, tax deductions). However, and at the same time, and in relation to those who fail to comply, they may also need to pursue improvements in the probability of detection and tougher sanctions for those subsequently caught.

The current debate therefore, is not so much over whether to use direct or indirect controls. The emergent consensus is that both are required. Rather, the major issue is determining which specific policy measures in each approach are most effective and what is the most effective way of putting these measures together in various combinations and sequences to engender effective compliance. For example, measures to improve detection through inspections are currently often combined with campaigns to raise awareness. Tougher sanctions furthermore, often follow amnesties and voluntary disclosure schemes. However, whether these are the most effective combinations and sequences are not known. Despite this, two particular approaches have come to the fore in recent years in the literature that provide ways of combining these policy approaches in particular sequences, namely the responsive regulation approach and the slippery slope framework.

### **6.1. Responsive regulation**

Responsive regulation engages entrepreneurs to openly think about their obligations and accept responsibility for regulating themselves in a way that is consistent with the law. This is an approach that seeks to win their “hearts and minds” in order to engender a culture of commitment to compliance so that they regulate themselves rather than need to be regulated by external rules. Nevertheless, although this approach gives primacy to the use of indirect controls, it does not exclusively limit itself to such measures (see Braithwaite, 2009).

The Australian Tax Office for example has gone some way to adopting this responsive regulation approach. In the first instance indirect controls are used to facilitate voluntary self-regulated compliance, followed by persuasion and only as a last resort for the small minority who refuse to be compliant does it use punitive measures (Braithwaite, 2009; Job et al., 2007). In other words, this approach is based on a regulatory pyramid. This sequence’s the measures used from the least intrusive at the bottom which are used first to the most intrusive at the top which are employed as a last resort. It is founded upon the belief that tax authorities do not need in the majority of cases to pursue the coercion option at the top of the pyramid to engender compliance. Instead, it commences with the indirect control measures at the bottom of the pyramid and only if these do not work with some groups, then the level of intrusiveness escalates up the pyramid until it reaches the policy intervention that elicits the desired response of compliance. This is founded upon the recognition that there exists a continuum of attitudes towards compliance and different policy responses can be therefore temporally sequenced starting with indirect controls and moving through bribes to sanctions.

Of course, whether this ordering is the appropriate combination and temporal sequence is debatable. Until now, there has been no evaluation of whether this

sequencing is the most appropriate and/or effective means of engendering compliance. Although it seems logically to be the most appropriate and effective, no evidence-base currently exists of whether this is the case.

## **6.2. Slippery slope framework**

Another way of combining direct and indirect controls is to adopt the “slippery slope framework” (Kirchler et al., 2008). This distinguishes two types of compliance approach, namely voluntary compliance (akin to an indirect controls approach) and enforced compliance (akin to a direct controls approach). Voluntary compliance is viewed as occurring where there is trust in the authorities. Enforced compliance, meanwhile, is viewed as requiring the authorities to have power (i.e., the ability to get citizens to do what they were before not going to do, in the way in which the authorities wish them to do it). When there is neither trust in authorities and authorities have no power, then informal entrepreneurship will be prevalent.

To tackle informal entrepreneurship therefore, one can either increase the power of authorities and/or trust in the authorities. The direct controls approach, as shown above, puts the emphasis on increasing the power of authorities, whilst the indirect controls approach puts more emphasis on increasing the trust of authorities. In practice, however, these are not mutually exclusive approaches. Both can be used together to engender compliance. The slippery slope framework accepts this and seeks to combine both in order to elicit formal entrepreneurship.

Wahl et al. (2010) randomly presented participants with one of four different descriptions of a fictitious country, in which the authorities were depicted on the one hand, as either trustworthy or untrustworthy and on the other hand, as either powerful or powerless. Their results reveal that participants paid significantly more taxes when both power and trust were high. They additionally revealed that voluntary compliance was highest when the authorities were both trustful and powerful, while enforced compliance was highest when authorities were portrayed as powerful, but not trustworthy. This is further reinforced by two additional surveys of real-world taxpayers (Muehlbacher et al., 2011a,b). The outcome is that a combination of both greater trust in authorities and the greater power of authorities is seen to be a potent combination. Grounded in this finding, the suggestion is that pursuing both is the most effective means of tackling informal entrepreneurship (Kogler et al., 2015).

## **7. Conclusions**

This article has reviewed what might be done to tackle informal entrepreneurship. To do this, it has reviewed four possible policy options, namely taking no action, pursuing the eradication of informal entrepreneurship, moving formal entrepreneurship into the informal economy, or transforming informal entrepreneurship into formal entrepreneurship. This has revealed that doing nothing would leave intact the current negative impacts on formal entrepreneurs (e.g., unfair competition), informal

entrepreneurs (e.g., the inability to gain access to credit to expand), customers (e.g., no guarantee of health and safety standards) and governments (e.g., taxes owed are not collected). There is no evidence, moreover, that de-regulation of the formal sector tackles informal entrepreneurship, whilst eradicating informal entrepreneurship would result in governments repressing and eradicating precisely the entrepreneurial endeavor and enterprise culture that they otherwise wish to foster. Transforming informal entrepreneurship into formal entrepreneurship is thus revealed to be the most viable policy choice.

To show how this can be achieved, this article has shown that either direct controls or indirect controls can be used, and the various direct control measures have been reviewed along with the various indirect controls that might be employed. This has revealed that the currently dominant approach of using direct controls that seek to improve detection and increase punishment is a rather limited approach and that there is a much larger toolkit available for tackling informal entrepreneurship. The various tools, moreover, are not mutually exclusive. To show this, the final section of this article has outlined various ways of combining direct and indirect controls when tackling informal entrepreneurship, namely a responsive regulation approach and a slippery slope framework. The outcome is that a comprehensive review has been provided of the various policy choices, approaches and measures available to policy makers along with some suggestions regarding how they can be combined. If this paper thus encourages governments to experiment with a wider array of measures for tackling informal entrepreneurship, then it will have achieved its intention. If it also encourages more research on the most effective means of combining and sequencing these measures, then it will have achieved its wider intention.

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