

POVERTY AND INFORMAL EMPLOYMENT IN ARGENTINA

Patricio Millan-Smitmans

Catholic University of Argentina

Argentina is one of the most advanced economies of the Latin America region. It has the highest human development index and the highest GDP per capita in purchasing power terms, but it is estimated that around 21% of its population lives in poverty. While the poverty rate has decreased from the high 57% level it reached during the economic crisis of 2001-02, its decline has been limited by the high rate of informal employment. Almost half of the working age population is employed in occupations that are not registered and do not contribute to the mandatory social security system. Most of them work in micro enterprises of low productivity that are themselves not registered and prefer to continue in that situation, given the high costs and low benefits of being formal. Unless this problem is directly addressed, poverty and social exclusion in Argentina will remain high. This document also presents some proposals to deal with these issues.

A. The Evolution of Poverty in Argentina

When John Maynard Keynes in 1933 suggested for the first time the creation of an international financial institution similar to the present day International Monetary Fund, the seven countries that would be the biggest shareholders with equal participation were Great Britain, United States, France, Germany, Spain, Argentina and Japan¹. This somewhat represented the relative place of Argentina in the world at that time.

The high rate of growth experienced by Argentina between 1885 and 1929 was affected by the Great Crisis of 1929 and the World Wars and gradually started to decline as the country pursued a policy of forced industrialization and import substitution. Argentina did not fully benefited from the expansion of the world economy that started in 1955 and several other countries grew more rapidly and have now a larger total GDP². In Latin America both

¹ John Maynard Keynes, "The Means to Prosperity", The Times, March 13 – 16, 1933, reprinted in "The Collected Writings of John Maynard Keynes", Vol. IX, St. Martin's Press, London, 1972.

² According to The Economist, "The World in Figures 2009", Argentina is ranked 32 in terms of the biggest economies in the world measured by total GDP.

Brazil and Mexico are now larger economies and Chile has a higher GDP per capita. While in 1990 the country changed its policies and started to open its economy and to promote private sector investments, the crisis of 2001-02 - and specially the default on its debt - has again left Argentina somewhat isolated from the main benefits of globalization. However, the country had an average annual growth rate of 8.5% between 2002 and 2008 and is still a large exporter of agricultural commodities.

Statistical information about poverty in Argentina is obtained from the Permanent Household Survey (EPH) that is carried out by the National Institute of Statistics and Census (INDEC) since the beginning of the 70s. In the early period this survey included only the Metropolitan Area of Buenos Aires, but since the mid 80s it incorporated all the large urban centers of Argentina. At the present time, 31 urban centers with a total population of about 25 million are surveyed. The Permanent Household Survey is considered to give an adequate representation of the urban population of the country, which is more than 90% of its total population.

In 2003 some important methodological changes were introduced to the Survey so there is some minor break that year in the available series. Primary data of the survey has in general been made available to all interested parties and the information was estimated to be of high quality. However, at the beginning of 2007 the Government started to interfere with the semi autonomous National Institute of Statistics and Census and the primary data of the survey was not more made available to the public. Official statistics have now become unreliable, specially the estimate of the consumer price index. Different research institutions started to make their own estimates of inflation and other economic variables. At the beginning of 2010 the primary results of the Permanent Household Survey have again been made available to the general public and the data is considered to be reliable. But the distrust and lack of confidence in official statistics still continues, especially when the consumer price index is involved.

Although the concept of poverty has multiple dimensions, we will concentrate in its standard measurement in terms of income. For this purpose, and in accordance with the pattern of consumption of the population, the National Institute for Statistics and Census has defined a Basic Basket of Food (Canasta Básica Alimentaria) that reflects a minimum amount of proteins and calories that are required to satisfy basic food needs. This Basic Basket of Food is adjusted by a coefficient that reflects the consumption of non food items (housing, transportation, health and others) that are necessary to satisfy total basic needs. This is called Total Basic Consumption Basket (Canasta Básica Total). The value of this Total Basic Consumption Basket is the poverty line in Argentina³. All individuals whose actual consumption is below the Total Basic Consumption Basket are considered to live in poverty,

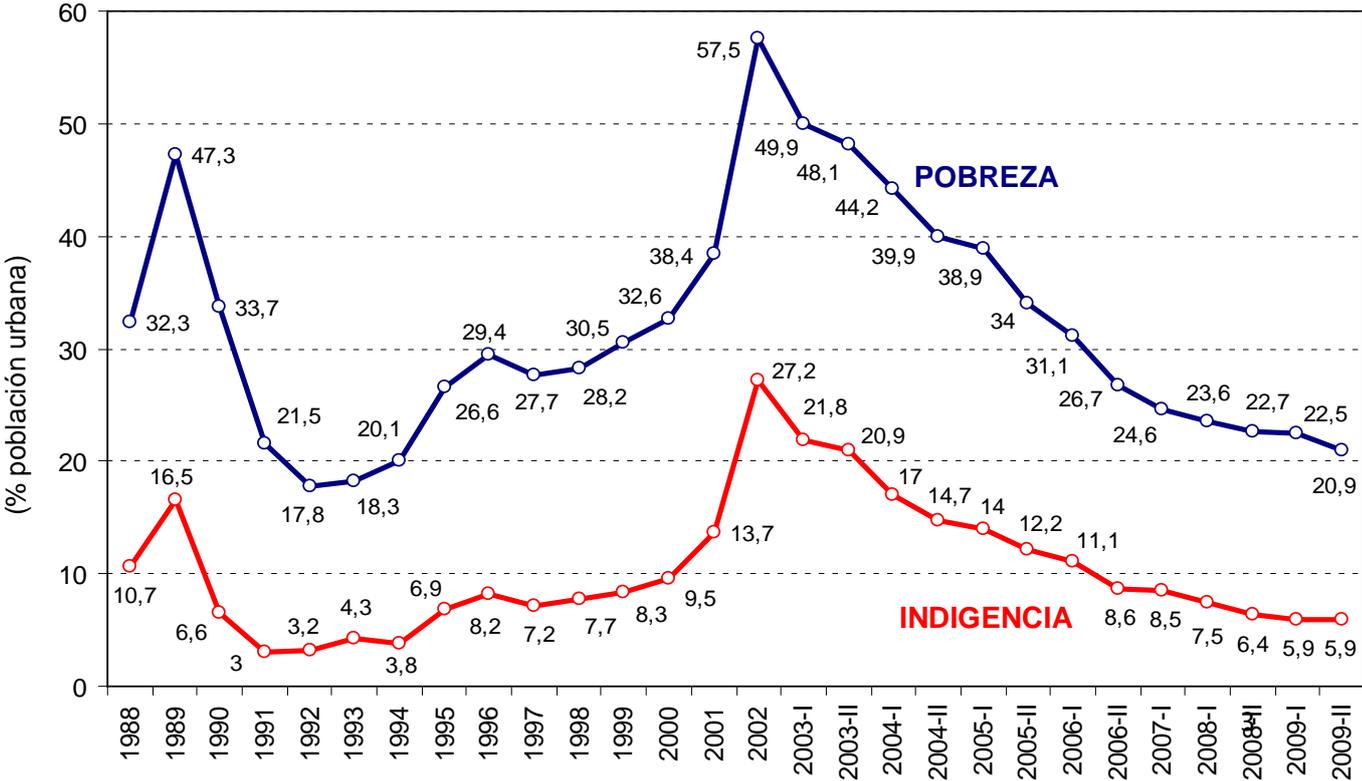
³ The World Bank uses an income of US\$ 2 per day to define the poverty line and this is more useful to undertake comparison across countries. The methodology described for the case of Argentina is widely used in many countries and is more accurate to measure poverty for an individual country.

while those below the Basic Basket of Food suffer hunger and are classified as under extreme poverty (indigents).

Given that basic food requirements and non food items vary in accordance with age and population, the Total Basic Consumption Basket must be adjusted according to the composition of an individual family to determine if a certain family falls below or above the poverty line. If total family income falls below this adjusted estimate of the family Total Basic Consumption Basket, all family members are considered to be poor. As prices of food and other consumption items increase, the required income to be above the poverty line is higher. The intervention in 2007 at the National Institute of Statistics and Census to control the official price index released by the institution, resulted in biased estimates of the official poverty rate. For this reason, we use some private research institutions estimates of inflation to calculate the poverty rate after that year.

The following graph presents the evolution of poverty in Argentina. Before 1992 the figures are for the Buenos Aires Metropolitan Area. During the first half of the 90s poverty was about 20%, but it increased to 29.4 % in 1996 with the Tequila Crisis and stood at about that level for the rest of the decade. The Argentine Crisis of 2001 brought poverty to the record level of 57.5 % in 2002 and since then it has steadily declined reaching 26.7 % at the end of 2006. As indicated, official inflation figures after that date are unreliable. Using some private estimates of inflation, poverty further declined to 22.7 % at the end of 2008 and 20.9% at the end of 2009.

GRAPH 1
POVERTY IN ARGENTINA 1988 - 2009
 (percentage of urban population)



With the exception of a short period between 1992 and 1994, the poverty rate in Argentina has never been below 20%. With the present inflation rate around 20% it is very unlikely that poverty will continue to decrease in the near future. The Government started in 2009 a new social assistance program which provided some temporary poverty relief, but since it is fixed in nominal terms its impact has already been eroded⁴. In any case, there are about 6 million people in the urban areas of Argentina that presently live in poverty and will continue to do so, unless there is some dramatic change in policies.

The data of the Permanent Household Survey also allow us to examine the characteristics of poverty in Argentina. A first important data is that 41% of the poor are children and youths below the age of 15 years. This is due to the fact that poor families have larger families than non-poor. The dependency rate in Argentina is 2.1 for poor families and 1.0 for non-poor families. Examining this result from another perspective we have that in Argentina 41% of children below 15 years live under the conditions of poverty. Given the limitations that poverty imposes on individual development and knowledge advancement this situation has and will have an important impact in the long run prospects of the country.

There is also a huge difference in the level of education between poor and non-poor. Considering the working age population (between 25 and 65 years), 65% of the poor have a low educational level (not completed high school), while the percentage for the non-poor is only 29%. But the problem is not school attendance. Both among poor and non-poor families school attendance is 99% between the ages of 6 and 12 years. There are some small differences between the ages of 13 and 17 (84% for poor and 94% for non-poor), but poor children are in general attending schools of lower quality that not provide them with incentives to finish high school and complete a minimum level of education. Therefore they abandon the educational system at an early date without the skills that are necessary for future advancement. As is well known, this is one of the vicious circle of poverty: the children of the poor receive a bad education and continue to be poor. It is evident that a profound educational reform is urgently needed in Argentina, but this issue is beyond the scope of this paper.

Another distinct characteristic of the poor is informality in their employment relationship. According to the data, 80% of the working age poor are workers employed without a labor contract and do not contribute to the mandatory social security system⁵. Informal workers do not have the right to paid vacations or sickness day, nor do they have health insurance or the benefits of a future pension. Their salaries are lower than those of registered workers, sometimes even below the legal minimum wage. Their employment is unstable and volatile and they have a higher propensity to be unemployed, but have no access

⁴ The maximum impact of the Universal Children Allowance introduced in November 2009 in the poverty level has been estimated at around 1.5% for 2010 with no inflation.

⁵ Among the non-poor informal employment is only 30%.

to unemployment benefits. The issue of informal employment is examined in greater detail in the section C.

There is no significant difference between households headed by women among poor and non poor, since the proportions are 33.1% and 31.5% respectively. It should also be noted that in Argentina 59% of poor families are legal owners of their houses. The equivalent number for non poor families is 69%, which is not a substantial difference. However, the houses of the poor are smaller and built with lower quality materials. Since the poor also have larger families, the result is that there are 2.2 persons per room, while the equivalent number for non poor families is 1.1. While 96% of the houses of poor families in urban areas have access to potable water, only 34% are connected to sewage systems. The lack of adequate hygienic services among the poor increases the probability of infectious diseases among their children.

B. Policies Implemented to Decrease Poverty

From a certain perspective, the substantial reduction of poverty in Argentina after 2002 is a success story. The poverty rate was cut in half in about four years and now stands at a historically low level. From another view, the high poverty rate of 2002 was the result of a deep economic crisis and the poverty rate is now similar to the one existing in the first half of the infamous decade of the 90's. The glass could be half full or half empty, but the most interesting question is to examine if poverty can be reduced below the present 20% level and what must be done to achieve this purpose. With this objective we examine what explains the reduction of poverty in recent years.

Between 2003 and 2007 Argentina had a period of sustained economic growth without parallel in its recent economic history. During these five consecutive years the annual increase in GDP was always between 8% and 9% and the country had both a primary fiscal account surplus and a current account balance of payments surplus. Until at least 2006 inflation was moderate for the standards of the country with rates of 4.4% in 2004, 9.6% in 2005 and 10.9% in 2006. A conflict with domestic agricultural producers, an upsurge in inflationary pressures and the international economic crisis complicated the situation in 2008 and GDP growth was reduced to about 4% that year. In 2009 the country experienced a drop in GDP of about 3%, but the economy appears to have regained strength and is expected to grow again in 2010, although at a much smaller rate (perhaps around 5%).

The policies of the Government were based on three basic pillars: (i) maintenance of a competitive exchange rate; (ii) maintenance of a fiscal surplus; and (iii) an active intervention in labor negotiations with the purpose of increasing salaries. After the resignation of the elected President in 2001, the replacement selected by Congress abandoned the fixed exchange rate system of the 90s (the convertibility program) and devalued the domestic currency by more than 300%. The Central Bank has actively intervened in foreign exchange

markets to keep – with some upward adjustments - the nominal value of the new exchange rate. The initial advantage of the devaluation has now disappeared but in Argentina there has not been a drop in the nominal value of the exchange rate as in neighboring countries (Brazil, Chile).

The new government was also given authority to introduce taxes on exports (retentions), which given the export recovery and growth of recent years have resulted in booming fiscal revenues. Taxes collected by the public sector are now 34% of GDP, while traditionally they used to be somewhat between 20% and 24%. Finally the Government has pursued a policy of steep increases in the minimum wage and actively participated in all labor negotiations to obtain salary increases well above the inflation rate. Between 2003 and 2008 the minimum wage has been raised by 520%, at an average annual rate above 30% and wages now stand at a record 44% of GDP.

In January 2002 the Government launched a massive social transfer program called the *Head of Households Plan* as a way to cushion the consequences of the crisis and the increased poverty, which as noted affected almost half the population. Within a short period of time, 2.2 million beneficiaries started to receive Arg\$150 per month. The eligibility conditions were to be head of a household with children below 18 years and to be unemployed. However, in practice the only cross check undertaken was with the Social Security Administration and informal workers were de facto incorporated into the program. The conditionality of the transfer was to work 4 hours per day or assist to some training program, but the implementation of this requirement was left to the municipalities, which had no authority to eliminate beneficiaries in case of non compliance.

The *Head of Households Plan* is still active and at the end of 2009 had about 800,000 beneficiaries, although no new ones had been incorporated after May 2002. After 8 years it continues to pay a nominal value Arg\$150 per month. However, beneficiaries have been encouraged to migrate to two new social transfer programs, the *Family Plan for Social Inclusion* and the *Insurance Plan for Training and Employment*. Both programs provided higher transfers.

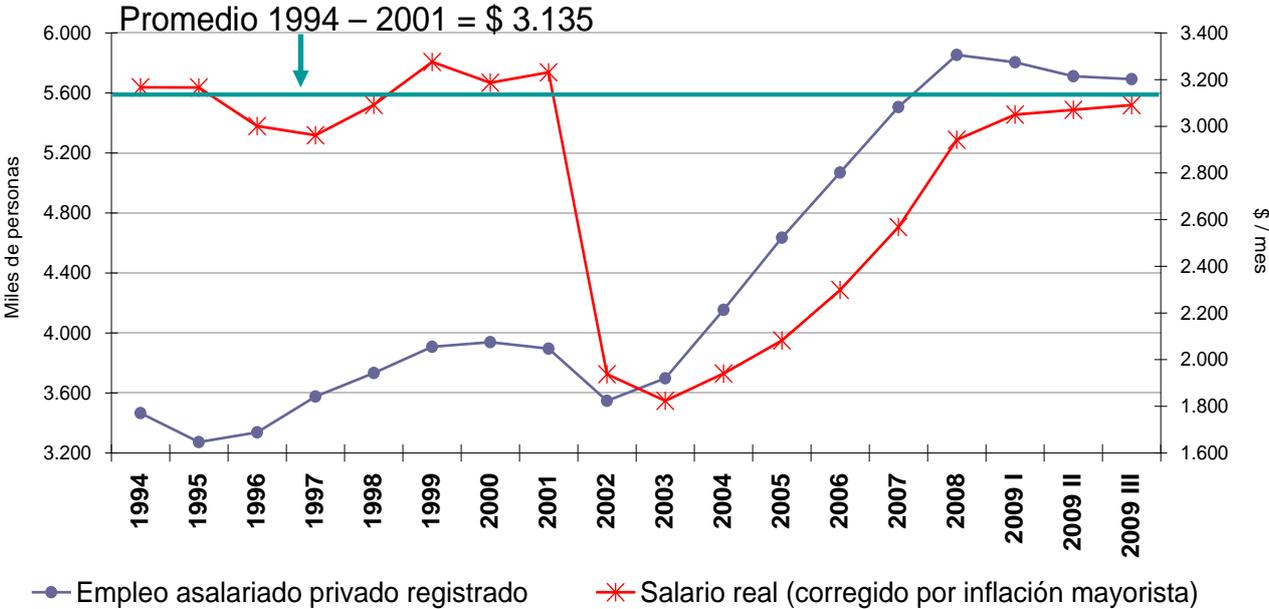
The *Family Plan*, established in 2005, paid a fixed amount of Arg\$155 plus Arg\$30 per child, with a maximum limit of Arg\$305 per month per family. There is no conditionality associated and the only restriction is that household income must be below the minimum wage. However, participation is restricted to 2 years. The *Insurance Plan* pays Arg\$225 per month for 18 months and Arg\$200 during the last 6 months of participation and beneficiaries are provided with special services to support their employment search.

By the end of 2009 there were about 500,000 beneficiaries in the *Family Plan* and 126,000 in the *Insurance Plan*, but the first one was replaced in November 2009 by the introduction of the *Universal Children Allowance* paid by the Social Security Administration. Basically this extended the children allowance received by registered workers (Arg\$180 per child for incomes below Arg\$ 2,400 decreasing to zero for income above Arg\$4,800) to all informal workers receiving less than the minimum wage (Arg\$1,500).

Evidently the above described policies were a great success in stimulating growth and reducing poverty, although favorable international conditions also helped. But eight years after the worst crisis in the Argentine economy the issue is not recovery but sustainability. As can be seen in the following graph, in 2002 real wages were reduced from Arg\$3,200 per month to Arg\$1,900. There was a further decline in 2003. This substantial reduction in real wages encouraged the persistent rise in employment that has occurred.

By the end of 2008 real wages were again at almost the same average level of the period before the crisis and formal registered employment has ceased to grow. There was even a small reduction in 2009. As labor costs have increased the comparative advantage of domestic manufactures has disappeared. Industrial production declined by 9% in 2009 and there are some internal demands for a new devaluation to restore the previous competitiveness. The overall fiscal surplus has also vanished: public sector expenditures grew in 2009 at an annual rate of 29% while revenues were only 12% higher, including social security contributions that increased by 51%⁶. While inflationary pressures were somewhat reduced in 2009 due to the mild recession, the inflation is expected to be above 20% in 2010 and trade unions are pressing for wage increases above that level.

GRAPH 2
ARGENTINA: PRIVATE REGISTERED EMPLOYMENT AND REAL WAGES
 (real values of 2009 prices)

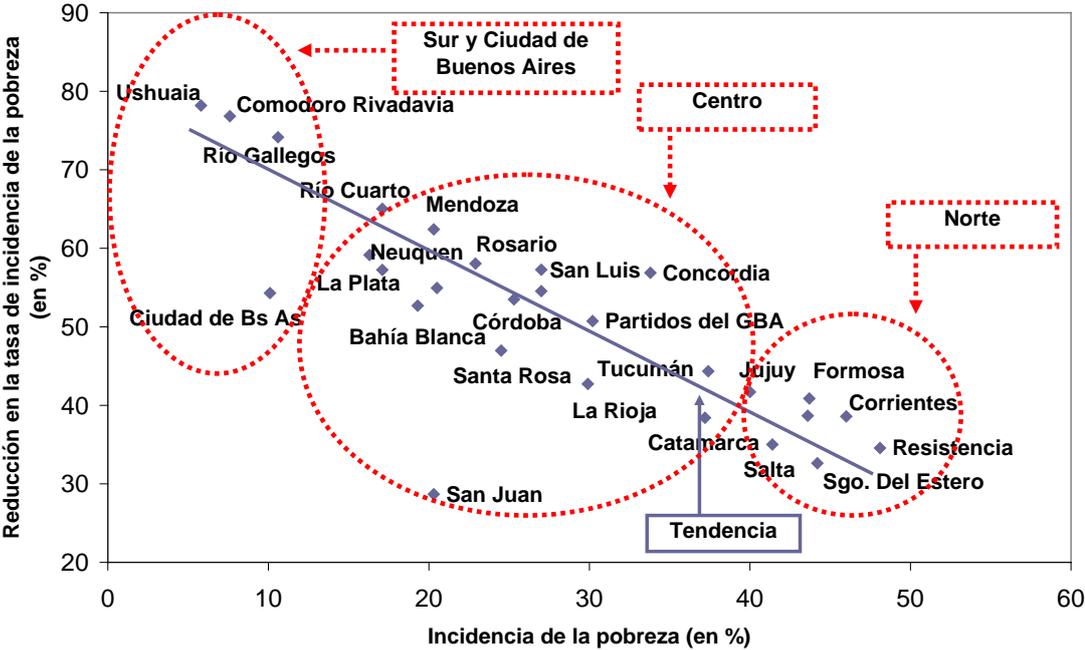


⁶ A low primary surplus was achieved with the nationalization of the private pension funds at the end of 2008.

The analysis indicates that poverty reduction was mainly the consequence of sustained growth with low initial wages and active government intervention in wage negotiations. Both were helped by macroeconomic stability and favorable international conditions, especially during the first years after the crisis of 2001-02. The impact of these policies was stronger in the more advanced regions of the country, where there is less informal employment. As can be seen in Graph 3, the provinces of the Northern part of the country (Corrientes, Formosa, Misiones, Chaco - Resistencia, Santiago del Estero, Salta, Jujuy), where the incidence of poverty is higher, had lower reductions in the level of poverty. These are provinces that also have high rates of informal employment, sometimes reaching above 50% of the labor force, and therefore were less impacted by the policies of the government that mainly operated through formal labor market arrangements. The issue of the high prevalence of informal employment is examined in the following section.

GRAPH 3

ARGENTINA: POVERTY REDUCTION BY URBAN CENTERS 2003 – 2006



C. Informal employment in Argentina

While in most developed countries the concept of “undeclared workers” is associated with illegal immigrants and the evasion of income tax and social security payments, in most developing economies informal employment is a somewhat normal and acceptable means of subsistence, especially for the poor. Informal work is not concealed and is carried out quite openly, sometimes by street vendors but mostly in small shops, restaurants and workshops that are visible and publicly advertise their activity and try to attract customers. Since income taxation only starts at a relatively high minimum level of income, most of these workers, if registered, would only be required to contribute to the mandatory social security system.

There are different definitions of informal employment. According to a “productive” definition, the informal sector includes all self employed workers and members of micro enterprises of less than 5 workers. These are firms where capital accumulation and the underlying productivity are very low and that have limited opportunities to grow and to engage in any type of relations with the State. In many countries they are subject to special tax regimes and are exempted or have a special treatment in the existing labor and social security regulations.

According to the “legalistic” definition of informal employment, all workers that do not have rights to a pension linked to their employment are considered to be informal. These will include self employed autonomous workers, salaried workers in the private and public sectors and unregistered domestic workers employed by households. Although empirical studies show a great correspondence between both definitions⁷, for all purpose in this document we use the legalistic definition of informal employment.

All countries have developed institutions and legislation that protect families from adverse shocks and events - such as illness, disability, maternity, old age and the loss of jobs – and that regulate working conditions – such as working hours, paid vacations, sick leave, unjustified dismissals and safety at work. Informal workers do not “legally” enjoy any of the protective mechanisms of the State, although in “practice” they may have some of the benefits in some limited way. Workers in the informal sector in general have lower wages than those that are formal and may also receive salaries that are below the legally established minimum. Because these workers have lower levels of education, they also have lower levels of productivity and are almost way classified as unskilled workers. Some observers have argued that they also have smaller incentives to invest in training and the promotion of their human capital accumulation. It has also been established that in many cases informal employment increases the probability of being poor, makes persons more vulnerable to economic cycles

⁷ Gasparini, Leonardo and Leopoldo Tornarolli, “Labor Informality in Latin American and the Caribbean: Patterns and Trends from Household Survey Microdata”, Working Document No. 46, Centro de Estudios Distributivos, Laborales y Sociales (CEDLAS), Universidad Nacional de La Plata, June 2007.

and health problems and, in general, acts as a strong impediment to improve living conditions and leave poverty. It is also the principal cause of social exclusion and of the existence and maintenance of fragmented societies.

According to a traditional view, informal workers are excluded from the socially established protective mechanisms because the regulatory burden and the costs of becoming formal are too high⁸. Small firms are in fact prohibited of becoming formal because of entry regulations, excessive taxes and social security contributions, high administrative costs of compliance with established rules and procedures, high minimum wages and other rigid labor regulations. A complementary view, stresses that firms make implicit cost-benefit analyses whether to become or not formal and may perceive insignificant benefits in engaging with the regulatory and tax institutions of the state⁹. In this view, the high level of informality is a clear case of “state failure” in the design and implementation of the social protection mechanisms. In any case, both reducing the costs and increasing the benefits of formality would allow increases in productivity in previously informal firms as they gain access to new markets and services and will decrease the present segmentation of labor markets and the overall social exclusion.

The results for the first semester of 2009 of the Permanent Household Survey indicate that 39% of the economically active population of Argentina has an informal employment. This figure includes non registered salaried workers, self employed persons with no professional background, non registered domestic employees and workers that do not receive a wage. Another 9% of the work force was unemployed at that time, but for most of them the last job was as an informal worker¹⁰. In spite of the extraordinary growth of the economy noted above and of the policies applied, almost half of the active population of the country still cannot find a “decent” job and has employment difficulties. It is interesting to note that 80% of the informal workers have incomes that situate them below the poverty line.

The majority of informal workers appear to be involuntarily in their present job category. According to a special module on informality attached in 2005 to the regular Permanent Household Survey, 87% of informal salaried workers in the Greater Buenos Aires indicated that the fact that they could not find another job was relevant for them being in their current status. Some of them had considered independent work but were unable to move ahead in that category or found that type of work more unstable or less rewarding, but most of them searched for a job as a registered worker. While independent work may be attractive for some because of greater flexibility and autonomy (for example women raising children) and for entrepreneurial motives, 59% of workers in the category indicated that they were there because “they could not find a job as a salaried worker”. The survey also revealed that 96% of

⁸ De Soto, Hernando, “The Other Path: The Invisible Revolution in the Third World”, 1989.

⁹ Perry, Guillermo et al, “Informality: Exit and Exclusion”, The World Bank, 2007

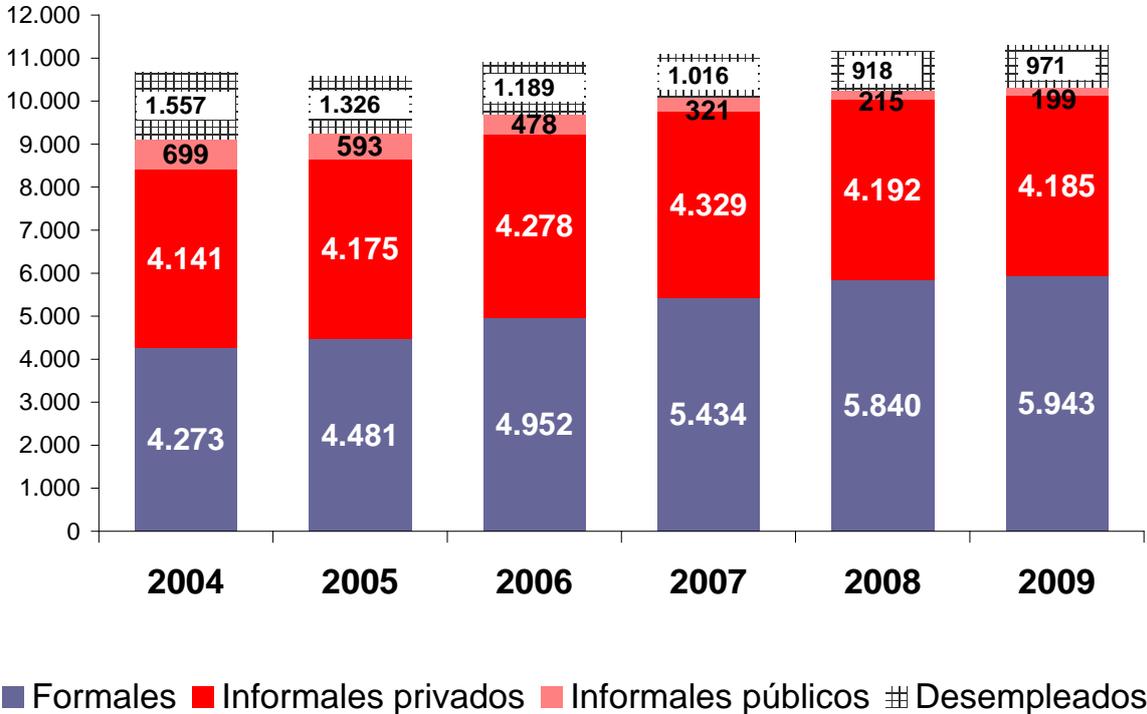
¹⁰ Less than 10% of the unemployed report that their last job was as a registered worker.

the informal salaried workers do not contribute to the social security system because this alternative was “not offered to them by his employer”. This result directly links informal employment to the problems of small unregistered microenterprises that we will examine below.

As can be seen in the following graph, the number of registered salaried workers in Argentina increased from 4.3 million in 2004 to 5.9 million in 2009, at an average annual rate of 6.5%. However, the substantial increase in formal employment that occurred was only able to absorb some of the unemployment that existed at the beginning of the period and some of the new entrants to the labor force. The number of unregistered salaried workers remained fairly constant at 4.2 million during the entire period. These results point out the existence of some structural problem in the Argentine labor market and the need to introduce new and different policies to reduce the absolute number of informal workers.

GRAPH 4
ARGENTINA: INCREASES IN EMPLOYMENT BY CATEGORIES 2004- 2009

(first semester of each year - thousand of workers)



As indicated above, without taking into consideration the unemployed, informal workers represents 39% of the economically active population of Argentina. The great majority of these workers (52%) are employed in a small microenterprise of no more than 3 workers¹¹. In these microenterprises the “owner” is a worker that undertakes a job similar to that of the other workers, but exercises some leadership over the others. The capital of these microenterprises are workers tools and instruments, but there is no specific return to capital as in a traditional enterprise. These are not enterprises that operate under the logic of “capital plus work”, but on a relation of “work plus work”.

In general, as opportunities and markets evolve, an originally independent worker decides to hire additional supporting workers, generally among family members and young persons with no experience and low qualifications. In other cases, some persons jointly open a small store, commerce, restaurant or repair business where they all work. The unstable and precarious characteristic of the employment that they all have is a direct consequence of the unstable nature of the activity they undertake. This imposes restrictions on the remunerations, both of the principal worker and of his fellow workers. They do not earn a fixed amount but a share of the proceeds of the business.

Most of these microenterprises of 3 or less workers are themselves unregistered and can only offer informal employment, although in some very limited cases in Argentina the principal worker may declare himself to be self employed and pay a special tax called “monotributo”, which we will examine latter. As is explained in the traditional view of informal employment, the burden of the regulatory and tax system on them is overwhelming and they cannot cope with it. Is there an alternative? The crucial issue to reduce informal employment in Argentina is to design and implement an adequate tax and labor regulatory framework specially adapted to the characteristics and implementation capacity of the small microenterprises. It will be an almost impossible task to further reduce poverty without tackling the issue of informal microenterprises and employment.

We have used as a break point for microenterprises the limit of 3 workers because this is what is presently established in Argentina for them to be eligible for the simplified tax regime called “monotributo”. A higher number would be reasonable and seems to be the practice in most other countries, where the limit is normally set at 5 or 10 workers. Evidently this would allow us to reach a higher percentage of the informally unemployed.

¹¹ Only 30% are employed in enterprises of 4 or more workers, while 19% are domestic employees providing household services and workers without salaries. If we consider only salaried workers, 55% of them are employed in enterprises of less than 5 workers and an additional 20% in those with 6 to 10 employees.

D. The regulatory environment for microenterprises

Argentina has a complex and unfriendly regulatory environment for all types of business enterprises. The *Doing Business 2010* report of the World Bank ranked the country as number 118 between 183 economies. The country has been losing ground since it was classified as 112 in the 2009 report. When the specific issues of starting a business or paying taxes are examined, the situation is worse since the country is ranked as 138 and 142 respectively in the same 2010 report.

The country does not have a special procedure to register microenterprises. According to the World Bank data it will require 15 different procedures, take 27 days and costs 11% of GDP per capita to register a business. The costs are high and the procedures especially burdensome for a small microenterprise, which would be required to interact with about 10 different public sector institutions.

The huge gap that exists between total unit labor cost for enterprises and actual “take home” salaries acts as a strong incentives to keep workers unregistered. Employers must paid social security and health insurance contributions that are 23% above nominal salaries, while workers are subject to a discount of 13% un their gross salaries. In many cases they choose the split the differences and remain informal. While the old age social security system was originally a fully contributory system, this is not any more the present situation and a very high percentage of the resources now come from general taxation. To encourage employment creation, Argentina should follow in this area the example of reforms introduced in Australia, New Zealand and Denmark, countries that have eliminated or substantially reduced the financing of pensions through workers contributions.

The health insurance contributions goes to mutual organizations (“obras sociales”) managed by trade unions. For large number of workers these health services exist only in paper or are of low quality and they have no choice but to use the free public health system. In 1996 a reform was introduced to allow workers a choice between different mutual workers organizations instead of being mandatory affiliated to that of their sectorial trade union. However, under pressure from trade unions, this limited choice can only be made once every three years and under very stringent conditions. The end result is that many workers consider the health insurance contribution as another tax and separately pay a private sector health plan.

Microenterprises in Argentina can benefit from a unified and single federal tax (“monotributo”) that replaces the value added and income taxes. However, the conditions are rather stringent¹² and the administrative procedures for a small microenterprise of 3 or less

¹² Besides the need that total annual sales be below Arg\$300,000 (equivalent to about US\$75,000) for a microenterprise of 3 workers, they are also required to occupy a space of less than 200 square meters, consume less than 20,000 KW of electricity, not to be direct importers and have unit prices below Arg\$ 2,500.

workers will require that they hire some specialized accounting helper to undertake the necessary monthly paperwork that must be presented to the authorities. What is worst is that the government periodically changes the rules of the “monotributo” to make eligibility harder and increase the tax payments and this is a strong disincentive to get into the system: since you do now the real intentions of the authorities it is always better to remain in the shadows. Besides that, microenterprises will have to separately pay provincial and municipal taxes, albeit some provinces have established their own simplified tax system. Evidently there are some positive aspects in a unified tax, but as it stands now in Argentina it is not very friendly and only provides limited incentives to incorporate a microenterprise into the formal economy.

There is no special treatment for microenterprises in labor regulations and they are supposed to apply the some norms and follow the same procedures of large enterprises. According to the World Bank *Doing Business 2010* report, Argentina has very high redundancy costs, estimated at 95 weeks of salary when the cost of advance notice, severance payments and other penalties are added¹³. Microenterprises have very high labor rotation (5 and 3 times bigger than large and medium enterprises respectively) and if they become formal would be required to incur in prohibitive severance costs. Also there is a highly centralized bargaining structure for wage negotiations according to main sectors, where some large enterprises sit at the table and make agreement for all of them. The results of these negotiations would have to be followed by all microenterprises that are registered, but their peculiarities and interests have never been taken into account.

In many countries, micro and small enterprises are excluded from all or from portions of the existing labor regulations. A study by the International Labour Organization indicates that 10% of its 178 member states directly exclude micro and small enterprise from the overall application of labor laws and regulations¹⁴. In others, the more common examples of exemptions are some of the rules related to occupational safety, the requirements of written internal labor rules, consulting mechanisms with workers and establishment of trade unions and workers councils. In several South East Asian countries, enterprises with less than 10 workers do not pay social security contributions, although their employees received the benefits established in the national system. In Denmark the minimum wages vary according to the size of the enterprise. In Australia statutory redundancy payments are not mandatory in enterprises with less than 15 workers. In the United States the recent health sector reform included a special treatment for small enterprises.

¹³ Redundancy costs are 45 weeks of salary in Brazil, 52 weeks in Mexico and Chile and 17 weeks in Peru.

¹⁴ Fenwick, Colin, John Howe, Shelley Marshall & Ingrid Landau, “Labour and Labour – Related Laws in Micro and Small Enterprises: Innovative Regulatory Approaches”, International Labour Office, SEED Working Paper No. 81, 2007

In past years, the labor legislation of Argentina was modified and some form of special treatment for small enterprises was incorporated, but the results were poor and the adjustments were always abandoned after a short period. The peculiarities of microenterprises have never been considered in an integral and comprehensive manner, with all their characteristics and complexities. Partial adjustments to a complicated regulatory environment are bound to fail; especially if the perception is that the measures will be short lived. Given the present circumstances, for microenterprise to become formal and register a new integrated and holistic approach to labor regulations is needed. The new procedures should address and solve the issues that crucially affect compliance and provide adequate benefits and incentives for them to operate formally.

In the design of the new system, the issues related to the real possibilities of compliance should play a major role. If the objective is to incorporate microenterprise in the formal economy it does not make sense to establish something theoretically appropriate but not easily implementable by the intended beneficiary. The emphasis should be in simplicity of procedures and eventual benefits. While the new rules should include sanctions for non compliance, given the limited enforcement capacity, they will have a limited effect and the real basis for compliance will always be the benefits that the microenterprise would eventually obtain from becoming formally. In 1996 the Shanghai Municipal Government started a special program to help what were called “informal labor organizations” with advice, training opportunities, support for obtaining credit, social insurance and other benefits, but without requiring them to register formally with the national authorities. After 5 years, a survey found out that 25% of them had voluntarily decided to register.

An argument frequently put forward against the idea of separate labor legislation for microenterprises is that there would be two classes of workers, one with full and the other with limited social protection. This is a fallacious argument because it is the present complicated and burdensome system the one that encourages the differences among workers that is actually present. The special statute for microenterprise will incorporate unprotected workers to what is considered to be essential, but will simplify compliance by those that cannot cope with the complex characteristics of the present system. The proposed new system will improve social equity and will incorporate to the protective system those that needed it most because they had fewer opportunities to accumulate knowledge, social relations and other advancement opportunities.

The proposed new labor statute should recognize the different and nontraditional nature of most microenterprises. As indicated above, most of them do not operate under the logic of “capital plus work” and are based on a group of interrelated workers with very little capital that operate under the logic of “work plus work”. There is no return to capital per se as in traditional enterprises and the new regulations should recognize this particular situation. In other areas, most governments recognize the special characteristics of microenterprises and

have special programs for them, such as focused credit and training programs. This is socially acceptable, but the reality is that in developing economies most of the intended beneficiaries of these programs cannot access them because they are not officially registered as a microenterprise.

The establishment of a limit for microenterprise to be eligible for the special labor and tax regime could create a “size trap”. Microenterprises will not like to grow beyond the limit so as not to fall under the general regime and pay higher costs. The ideal solution would be to introduce an overall simplification of the present system, eliminating bureaucratic procedures and unnecessary requirement for all enterprises, but this may not be politically feasible. The special system for microenterprises is a second best solution motivated by the realities of political feasibilities.

E. Conclusions

Further poverty reduction in Argentina requires a continuation of the high growth and employment creation process of recent years, but a more detailed analysis of the data reveals that this would not be a sufficient condition. The new jobs should be in occupations with high productivity where wages are higher, although this is made difficult by deficiencies in the educational system and the high percentage of workers and poor persons employed in small enterprises. Productivity improvements must also reach small microenterprises, which at the present time are mostly unregistered and outside the scope of all public sector programs, but are the only employment alternative for almost 50% of the working age population. Some fundamental changes in the tax and labor regulation system to reduce the costs and increase the benefits of being “formal” in these enterprises are required.

Particular issues to be included in the new legislation are the following:

- (i) Simplified registration procedures for microenterprises, including the establishment of a “one stop office” for all national, provincial and municipal registration requirements and a substantial reduction in registration fees and other related costs;
- (ii) A simplified tax and social security payment system based on a more friendly version of the present national “monotributo” and including all local governments taxes and contributions. Emphasis should also be given to reduce the burden of the required monthly payments;
- (iii) A reduction of the large gap that presently exists between gross labor payments at the enterprise level and takes home salaries of workers. An interesting

alternative would be eliminate all social security contributions by microenterprises;

- (iv) The replacement of the present high cost severance payment for redundancy with a new unemployment insurance system and strengthened active labor programs to help the unemployed find a new job¹⁵;
- (v) The establishment of a special statute for microenterprises to regulate labor relations, eliminating unnecessary bureaucratic procedures and rules that cannot be complied with by them.

May 27, 2010

¹⁵ A special unemployment insurance system to replace severance payment for the highly volatile group of construction workers was introduced some years ago. The Danish “flexi security” labor model also provides some interesting ideas on how to better balance different employment protection measures without creating disincentives.