Serious Business: Diminishing the Size of the Informal Sector in Medellin, Colombia

Seth Colby
The Leadership Academy for Development (LAD) trains government officials and business leaders from developing countries to help the private sector be a constructive force for economic growth and development. It teaches carefully selected participants how to be effective reform leaders, promoting sound public policies in complex and contentious settings. LAD is a project of the Center on Democracy, Development and the Rule of Law, part of Stanford University’s Freeman Spogli Institute for International Studies, and is conducted in partnership with the Johns Hopkins School of Advanced International Studies. LAD gratefully acknowledges support from the Omidyar Network.
Serious Business: Diminishing the size of the informal sector in Medellin, Colombia

Federico Restrepo Posada, the newly appointed secretary of planning in Medellin, Colombia, pondered the immense challenges in front of him. It was 2004, and the newly elected mayor, Sergio Fajardo, had tasked Restrepo with improving the relationship with the private sector and reducing the size of the informal economy—economic activities unrecognized and unregulated by the government. A large informal sector diminished the city’s growth, hurt job creation, stymied economic dynamism, and deprived the city of much-needed tax revenue. As in most Latin American countries, the majority of Colombia’s businesses and labor force operated in the informal economy.

Fajardo had won the election promising to combat high levels of poverty and violence using innovative social programs. He hoped to invest heavily in the city’s poorest neighborhoods and build trust with communities long afflicted by years of violence, criminality, and government incompetence. State-of-the-art facilities in marginalized zones would offer educational, health, and vocational services. While these programs would not be cheap, Fajardo considered them essential if he was to foster a sense of community and reverse a trend of civic decline that had taken a huge toll on the city’s well-being and its economy.

The new mayor expected Restrepo to promote job creation—the unemployment rate was 17 percent—and increase tax revenue. Restrepo seemed to be the ideal candidate for the job, having spent his whole life in business, mostly for an engineering firm called Integral S.A. He understood how business people thought, and it was his job to use this knowledge to change the way small business-owners operated in Medellin. He said, “We arrived to office saying, ‘where are the problems, and how are we going to solve them regardless of political ideology.’ Many of us were private sector people, and we brought our pragmatic approach with us to government.”

In Restrepo’s view, the fundamental issue was that most small business owners saw few benefits from being a formal business. For them, formalizing meant paying taxes, having less flexibility with hiring and firing, and having to deal with an incompetent, slow-moving bureaucracy. Restrepo had to develop policies and implement programs that would improve the government’s ability to supply useful services to businesses. If done right, the policies would induce owners to formalize their businesses and pay taxes. The increased tax base would allow the government to provide better services, which would then induce even more business owners to formalize. The challenge was developing a strategy that would jump-start this virtuous cycle.

---

*Seth Colby conducted interviews and prepared this case under the supervision of Francis Fukuyama of Stanford University. This case was developed solely as a basis for class discussion. It is not intended to serve as a historical record, a source of primary data, or an illustration of effective or ineffective management.*
Background

Medellín is a picturesque city nestled in the emerald-colored tropical valley of Aburrá. Colombia’s second largest metropolis of 2.4 million inhabitants is known as the “city of eternal spring” due to its pleasant climate that rarely deviates from 21 Celcius (70 F). The idyllic scenery contrasts with harsh realities, however. The city has suffered from high levels of violence and poverty for years. Drug-traffickers, Marxist guerrillas, and paramilitary groups have engaged in violent confrontations as they have fought for dominance over the city’s slums. The city’s most famous native was one of the world’s most infamous criminals, Pablo Escobar. As the leader of the Medellín Cartel, he controlled 80 percent of the world’s cocaine market in the 1980s. Forbes magazine claimed that he was the planet’s seventh wealthiest man, with an estimated worth of $9 billion. Escobar grew so powerful that he threatened the sovereignty of the Colombian state, kidnapping the country’s elite, assassinating a presidential candidate, bombing commercial airliners, and murdering thousands of police. By TK, Medellín had become the world’s most dangerous city (see graph 1).

Up until the 1950s, Medellín was known for being a wealthy and educated place with good universities and a dedication to civic culture. The city had been recognized as the industrial capital of Colombia since the first machinery was brought over the surrounding mountains by a team of mules in the late 1800s. Antioqueños, as the local inhabitants are called, are known for their entrepreneurial spirit and fierce sense of local pride. The locals are quick to remind visitors that the city never had access to conditions that normally facilitate economic growth, including natural resources, trade routes, or exposure to foreign capital and technologies. The key source of the city’s economic development was its people. A MIT economist had studied the origins of the city’s economic growth and concluded much the same. He wrote, “In short, we thought we found among Antioqueños the ‘puritan ethic.’”

Medellín’s upward trajectory reversed course in the late 1950s with the outbreak of a brutal civil war, known as la Violencia, that claimed more than 200,000 Colombian lives. Rural peasants seeking refuge from the violence in the countryside flocked to Medellín, and the population of the city grew nearly three-fold in 30 years (see graph 2). Rapid immigration into the city overwhelmed public services. More than a million immigrants formed squatter communities on the hillsides surrounding the city, and these lacked basic services in security, education, and health. Guerrilla and paramilitary groups, newly enriched from the growing drug trade, arrived to these marginalized neighborhoods, imposing their own type of law and order. Violence soared as the illegally armed groups and the drug traffickers fought against the government and each other. The conflicts took a huge toll on the populace and made the city seem unlivable. The government instituted martial law and imposed curfews. The number of reported homicides reached 6,349 in 1992, approximately 20 a day.

By the early 1990s, it had become obvious to the people of Medellín that that they could not coexist with the narco-traffickers and the high levels of violence. Alonso Salazar, a community leader, commented on the process, saying, “Ten years after we had warned about the trends of

---

kidnapping and criminal gangs, the state had not even developed one program to address these issues. . . . Society was paralyzed and had not attempted to develop the program necessary to stop the violence. "Leaders from civil society, the Catholic Church, and the private sector started to meet to develop a strategy to reverse the city’s fortunes. A consensus emerged that the social contract between the local government and its citizens had broken down. The government had to reengage the marginalized sectors of society and increase the presence of the state in the poor neighborhoods dominated by guerillas, paramilitaries, and drug-traffickers.

Such a strategy required a flexible and competent government that had not existed in Medellin for the past 30 years. Recognizing the need for governmental reform, Sergio Fajardo, backed by a coalition of community leaders, decided to challenge the traditional political establishment and run for mayor. Fajardo had begun his career as a math professor and received his Ph.D. from the University of Wisconsin. He and his colleagues were convinced that social development could not advance without political leadership. Fajardo remarked:

> It is the politicians who decide which changes occur in society and the city. They are the ones who possess the administrative and bureaucratic power to define priorities; they have the budgets and resources to implement them; and being elected leaders, they have the legitimacy . . . from which they can lead a process of change and convocate different societal sectors to accompany them."

Fajardo won the mayoral election in 2004 promising to develop innovative programs designed to increase opportunities for the city’s inhabitants (see chart 2). Such programs promoted access to quality education and supported entrepreneurship and a public transportation system (see chart 3). If these programs were to succeed, they would require a competent government and new sources of funding.

**The Public Policy Challenge**

The new mayor wanted Federico Restrepo to create jobs, raise tax revenue, and reengage a small and medium enterprise (SME) sector that was largely informal. The new secretary of planning and his staff faced a quandary, however. Businesses refused to pay taxes because they did not think the government had anything to offer them, but the government could not offer needed public services because businesses refused to pay their taxes. An oft quoted phrase in Medellín was, “The government is an inactive business partner,” meaning that the government takes funds away from the business but rarely gives back.

Small business owners were generally skeptical of city authorities and did not believe that the state pursued the public interest. The city administration commissioned a survey to identify the number of businesses in the neighborhoods of Castillo and 12 de Octubre. Officials wearing shirts and other garments with the official city logo went door to door, asking residents to list their formal and informal businesses. The survey identified 4,000 businesses operating in the neighborhood. City authorities found the total number of businesses to be surprisingly low,

---

5 *ibid* p48
considering that these two neighborhoods housed more than several hundred thousand inhabitants. Unsure of the results, the local government asked a local university, Corporación Universitaria ESUMER, to conduct the same study in the same neighborhoods. The new survey found 19,393 businesses operating in these neighborhoods. The discrepancy in the results demonstrated the overwhelming distrust that the local inhabitants felt toward the government.

Not only did the government serve a distrustful populace, it also faced competition. Gangs had a large presence in many of the neighborhoods and directly competed with the local government for dominance. A significant portion of the gangs’ revenues came from extortion payments (locally known as vacunas) collected from the local businesses. Businesses in these areas were even less likely to formalize since this meant paying two sets of “taxes,” one to the gangs and one to the government. If a business could only afford to pay one set of taxes, it would almost always pay the gangs first. The results of a local survey revealed the local business owners’ preferences. To the question, “What is the probability that you will face severe consequences if you do not pay your government taxes?” the bulk of the respondents answered “low.” When asked, “What is the probability that you will face severe consequences if you do not pay vacunas?” the bulk of the respondents answered “high.”

The new local government wagered that the inhabitants would be willing to pay taxes if they felt that their money was spent on things that ultimately improved their neighborhoods and well-being. Restrepo said, “If the city prospers, business prospers.” Businesses wanted an educated workforce, good infrastructure, efficient government services, low crime, and a level playing field. If the government could show that it would deliver these things, businesses would be more willing to give some of their revenues to the state. Cashing in on the political capital that came with his large electoral victory, the new mayor nearly doubled the tax rate for property owners and business people in 2004. Fajardo went to great lengths to demonstrate that the city’s revenues were being well spent. He significantly increased the transparency of the budgeting process and engaged in a publicity campaign, using such slogans as Aquí están tus impuestos (Here Are Your Taxes) and Los Dineros Públicos son Sagrados (Public Money is Sacred) that explained to the citizenry where their tax money was being spent.

The municipal government’s revenues were largely dependent on two types of taxes. First was a property tax. The last land survey of the city was conducted in 1988, which meant that a large area of Medellín was unregistered. Previous mayors had been reluctant to conduct another land survey, fearing the political repercussions of registering the properties and forcing their owners to pay taxes. The Fajardo administration decided to commission a new land survey and crack down on tax evasion. The local inhabitants were generally very happy to pay the new property taxes in return for a legal title to their land. The other major tax as an industry and commerce tax (similar to a sales tax), and 54,000 businesses were registered and paying this tax in Medellín in 2004. The mayor wanted to double the number of registered businesses during his four year administration.

Job creation was another important reason for taking on the issue of the informal sector. Medellín suffered from an intolerably high unemployment rate. The city could not adequately address poverty and crime without providing economic growth and job creation. Most new jobs within an economy were created by SMEs, so increasing the competitiveness of these economic
entities was a top priority for Restrepo. “Our goal was to generate additional employment, and we were going to support business and incentivize business in the ways that were required, particularly in the most vulnerable areas of the city,” he said. The challenge was to create an incentive structure that encouraged informal business owners, traditionally suspicious of government, to move into the formal sector.

The Informal Economy

Informal businesses do not pay taxes and their employees do not receive pensions, healthcare, non-salary benefits, nor do they have any basic legal rights. The size of the informal economy relative to the formal is typically high in the developing world, and Colombia is no exception (see figure 3). According to the Ministry of Trade, Industry, and Tourism, micro, small, and medium-sized business represented 99 percent of all businesses in the country, and 60 percent of these operated informally.

Economic studies have found that informal firms tend to be less productive than their formal counterparts. Informal firms are usually small and do not benefit from economies of scale. They do not have access to markets, services, and financing that promotes productivity growth. Informal companies are less likely to have formalized business plans and established accounting practices, and they do not know how to expand beyond the local market. In some circumstances, informal firms can outcompete more productive formal firms because they bear fewer costs (e.g. taxes, employee benefits). This distorts market mechanisms that naturally reward firms that exhibit higher levels of productivity. Informal workers often do not have a steady stream of income and do not benefit from many of the benefits of formal employment, such as unemployment insurance, health care, and retirement plans. This discourages individuals from making purchases and taking out loans for investment purposes, which harm aggregate growth prospects.

Just as many of its Latin American neighbors had done, the government of Colombia pursued a reform agenda that liberalized the economy in the 1990s. Many firms not only had to be competitive on a national level; they had to be competitive on a global level. Foreign firms now had access to the Colombian market and could outcompete many Colombian firms that had survived under the protectionist policies of that past. In this new, more competitive environment, local companies had to become more productive, competitive, and growth-oriented in order to survive, regardless of their size.

Informality was a major obstacle to competitiveness as the prospects for growth and employment were severely limited. Unregistered businesses intentionally remained small so they would go unnoticed by the authorities, restricting the number of employees they hired and the markets they accessed. For example, a tax number called the RUT (Registro Unico Tributario) is required of

---

all formal businesses operating within Colombia. Without this number, a business cannot access financing, productivity enhancing business services, or formal markets. A formal business has legal difficulty paying another company if does not have this number. In effect, an informal business is limited to selling within the informal economy. Medellin could never become an internationally competitive city if the majority of the businesses operated in an area of the economy that faced these limitations.

The Challenge

Documents produced by institutions including the World Bank and the Inter-American Development Bank confirmed what Restrepo already knew about the informal sector: The country’s burdensome bureaucratic hurdles often discouraged businesses from registering. According to the World Bank’s 2004 Doing Business Report, opening a business in Colombia required 19 procedures and 60 days. Another obstacle to formality was the cost of hiring. The minimum wage was high compared to regional standards (see figure 9), and a registered business was obligated to provide social security, vacation time, and other benefits to their employees, substantially increasing the actual costs of hiring. According to these reports, the additional benefits in Colombia amounted to 51.5 percent of the employee’s total compensation. While the minimum monthly wage in Colombia was US$179.00 in 2004, the employer’s cost of hiring a full-time minimum wage worker was US$368.31. Business owners were hesitant to formalize and legally hire employees because it was very hard to dismiss them as well. Many businesses also opted not to formalize because registering their business meant that they would have to pay back-taxes.

There was little Restrepo could do about some of these conditions. Working at the municipal level, he had no control over national labor laws that mandated worker’s benefits or the minimum wage. As a businessman, he preferred to look at the problem from a cost/benefit perspective. A business owner would only opt to register with the local government when the benefits outweighed the costs. He set up a number of meetings and interviews with business owners in order to better understand the costs of being formal as well as the services they desired from the state.

Business owners frequently cited such reasons as their reluctance to pay taxes or the cost of full-time employees and their benefits. They also mentioned that they valued the flexibility that came with avoiding government regulations. For example, informal businesses did not have to comply with health, safety, and environmental regulations. A poor understanding of the formalization process also contributed to high levels of informality. Many business owners did not know all the steps in the process, where they needed to go to do them, how much the process would cost, how much time it would take, and the benefits and services that they would receive at the end of it all.

---

10 Minimum wage in 2004. Source Fedesarrollo
Regulators and state officials, on the other hand, often regarded informal business owners as selfish individuals who refused to pay taxes, but Restepo’s investigation revealed that ignorance and misinformation were important factors as well. Francisco Botero, an owner of a small business producing confectionary goods, said, “We did not know how to be legal. We didn’t know what we needed to do to be legal.”

**Rethinking Informality**

The local government and the Medellin Chamber of Commerce have traditionally played the role of rigid law-enforcers, rather than facilitators. Previously, the local government’s policy was to seek out businesses that operated illegally under the law and punish them (usually through fines). As a result, the small business community only saw the state as an added nuisance rather than a provider of useful services.

Restrepo contemplated the option of increasing the government’s enforcement capacity to crack down on illegality. Studies indicated that a large number of SMEs formalized to avoid paying fines (see figure 6). The underlying logic of this strategy was relatively straightforward. Apply enough pain on illegal business until they are forced to confirm with the law. The drawback to this approach was that it was hard to punish informal business. Many companies did not have formal bank accounts or registered assets, so the government could not easily seek financial retribution for illegal behavior. A “culture of informality” existed in Medellin. It was normal to operate illegally and outside the realm of the state; the law did not carry any moral authority.

Most tellingly, Restrepo’s investigation into the roots of the informal economy revealed that the issue was not black and white. It was not as if a business was either formal or informal; rather, there were grades of formality. A small business could have a tax ID number but not offer formal contracts to its employees or use official accounting measures. To reverse these practices, government policies needed to facilitate the gradual transition to formality. Unfortunately, the policies in place imposed a rigid structure that discouraged firms from adopting productivity-enhancing practices. As Miguel Echeverri, an advocate for SMEs in Medellin, explained, “The interests of SMEs in this country do not have much representation in the government. Policies are made with large companies in mind, often at the expense of the small and medium ones.”

The current law defined informal businesses as those that operate illegally and formal businesses as those that operate legally. Restrepo wanted to develop a policy framework that would reflect the complexities that existed in the real world. The concepts of illegality and informality were often used interchangeably, but the secretary advocated a new policy that distinguished between the two terms. A business that was legal conformed to the minimum registration and taxation requirements set out by the law. A formal business conducted itself in a professional manner that encouraged higher levels of productivity. The Medellin Chamber of Commerce ultimately developed the following definition for a formal business:

A formal business not only complies with the legal requisites placed on a productive entity; it should also administer, govern, and conduct itself in a
serious manner that conforms to the needs of the modern business world in order to guarantee sustainability and permanence in the market.\textsuperscript{12}

The definitional shift prompted an important change in thinking. Informal companies were not illegal companies, which connoted criminal activity and exclusion; rather, they were companies that had yet to reach their productive potential. It was much easier for a government to work as a partner with an underproductive business than with an illegal business.

**Learning how to be a better partner**

Restrepo and his team had to construct a government that could provide an array of quality services to support the diverse needs of the SME sector. Studies have found that informality is higher in countries where people have a low opinion of government effectiveness and high corruption (see figure 1).\textsuperscript{13} Many small business owners in Medellin complained that the government only looked after the rich. People in wealthier neighborhoods had access to better police services, education, and health. In contrast, the police refused to enter into some poor neighborhoods, much less provide around-the-clock security. Reducing the inequality of service delivery to business owners from marginalized neighborhoods was a priority for Restrepo.

A large informal economy was a result of a government that failed to live up to the fundamental social contract by which individuals pay taxes in return for public services. The burden of renovating the local government did not fall exclusively on Restrepo. His boss, Sergio Fajardo, campaigned on a platform to remake the social contract and increase government efficiency and transparency. Fajardo had already taken a big step in reforming government through a number of measures that increased the transparency of the budget. The populace was responding well to the “Here Are Your Taxes” campaign. The government had also introduced new participatory budgeting measures stipulating that 6 percent of the city’s budget be given to local communities to use for local projects.

The city government was engaging in significant infrastructure projects in the city’s poor neighborhoods, building high-quality libraries, schools, and public spaces. “Architecture sends an important political message,” said Fajardo. “When you go to the poorest neighborhood and build the city’s most beautiful building, it gives a sense of dignity.” Restrepo wondered if he could use these spaces to promote business development. Non-governmental organizations (NGOs) had been working with SME’s in these neighborhoods for years. Some of these institutions were micro-finance organizations; others provided services and training to help small-scale entrepreneurs. Perhaps the local government could serve as a coordinating entity that would ensure the efficient utilization of resources. Restrepo considered the idea of building and staffing business centers alongside the other public works that the mayor was building. Business owners would learn such basic skills as business registration, accounting, marketing, and management. Given that much of the expertise and staffing would come from local NGOs and the Chamber of Commerce, the cost of the centers would be manageable (see figure 10).

\textsuperscript{12} Ibid p 12

Most business owners want to grow their business and increase their revenues, yet the growth potential of an informal business is highly restricted. Restrepo contemplated a strategy that would encourage business owners to act in a more professional and “formal” manner that would rest heavily on incentives, such as increased access to markets and other business services. “Better access to markets” was one of the most common responses to the survey question, “Why did you formalize your business?” A small business-owner explained, “If we work legally we can sell our product in other areas of the city and the country. If we work illegally, we can only sell locally. [Moreover], people trust our products more if we operate as a legal entity. It’s good for business.” Using such a strategy, the local government would help companies find new national and international markets. There had even been talk of reforming the city’s contracting process, making it easier for small local firms to bid on government contracts. Increasing the availability of business services might also be a part of this strategy. For example, the city would work to increase the coverage of the state-owned microfinance institution Banco de Oportunidades.

Simplifying the business registration process would also help address the issue of informality. When the new government took office, the Colombian government required a long process to start a business. The laws that mandated such a complicated process were mostly made at the national level, but there was room for reform at the local level as well. Medellin was not a top performer on the Ease of Doing Business surveys within Colombia. The index ranks cities using an aggregated indicator that measure the costs of starting and operating a business (see figure 11). Restrepo could work to reduce the costs and time required to complete these procedures. Rather than requiring an entrepreneur to travel all over the city to open a business, Restrepo could locate all the offices that oversee these procedures in one centralized location. He was even considering granting a local tax amnesty for unpaid taxes if a business owner registered his or her business and began paying taxes. These measures were designed to reform the municipal bureaucracy in order to reduce the amount of time and money that it takes to start a business.

**Selecting a Policy Strategy**

The secretary of planning had accumulated plenty of evidence about the size and negative consequences of the informal sector in Medellin. Now he had to decide on a realistic strategy that would address and resolve some of the problems he had discovered. One of his biggest challenges, no matter what strategy he recommended, would be to obtain “buy-in” for his proposals from diverse and often competing interest groups. New and unproven ideas were a particularly hard sell to local political stakeholders. As a key advisor to Restrepo, Juan Miguel Higuita said, “City council members were used to paying for soccer fields and stop lights. Getting them to pay for programs with no track record of success was difficult.”

The mayor made it clear that all policies should conform to his larger governance philosophy of public inclusion. Restrepo could identify several different policy options, but he would have to set priorities given the limitations of money, staff, and time.
The Leadership Academy for Development (LAD) trains government officials and business leaders from developing countries to help the private sector be a constructive force for economic growth and development. It teaches carefully selected participants how to be effective reform leaders, promoting sound public policies in complex and contentious settings. LAD is a project of the Center for Democracy, Development and the Rule of Law, part of Stanford University’s Freeman Spogli Institute for International Studies, and is conducted in partnership with the School of Advanced International Studies at Johns Hopkins University.
General Statistics:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Founded:</strong></td>
<td>1675</td>
</tr>
<tr>
<td><strong>Population</strong></td>
<td>2,450,000 inhabitants (2005)</td>
</tr>
<tr>
<td><strong>Age</strong></td>
<td>70% of population between the ages of 5 and 44 years, 6% over 65</td>
</tr>
<tr>
<td><strong>Contribution to National GDP</strong></td>
<td>Medellin contributes 8% of GDP, Valle de Aburra contributes 11%</td>
</tr>
<tr>
<td><strong>GDP/capita</strong></td>
<td>US$3,794, highest of any major city in Colombia</td>
</tr>
<tr>
<td><strong>Business Density</strong></td>
<td>25 business firms/ 1,000 inhabitants (second highest in Colombia). Medellin is the top exporting state in Colombia</td>
</tr>
</tbody>
</table>

Graph 2

Population of Medellin
Graph 2

**Number of Homicides in Medellin**

![Graph showing the number of homicides in Medellin from 1987 to 2003.](image)

Graph 3

**Informal Economy in % of GNP (2000)**

![Graph showing the informal economy as a percentage of GNP for various countries in 2000.](image)

Data Source: World Bank
Chart 2: **Principles for Public Governance**  
*(From 2004-2007 Medellin Development Plan p 16)*

- Public money is sacred.
- Public management should transparent. The administration publicly documents all activities, when they are done, and the amounts involved.
- Do not make political compromises for bureaucratic or economic interests.
- Do not use the power of the state to silence opinions different from ours.
- The example of the authorities is the principal teaching tool for civic transformation.
- Planning should not include improvisation.
- Efficiency, sustainability, and impact in the policies and programs.
- Community relations are open and clear, and they develop through citizen participation.
- The public interest prevails over private interests.
- The people that work in the municipal administrations are honest, capable, and committed to the city’s projects.
- The development of the city is a pact between the local administration and all its citizens.
- The solidarity and cooperation are the basis for relations between the city, the region, the state, the nation, and the international community.
- Trust between the people in the administration is essential to guarantee the legitimacy of the state.
- Human life has the highest value, and there is no idea, nor proposition that merits the use of violence to achieve it.

<table>
<thead>
<tr>
<th>Chart 3</th>
<th>Examples of Social Programs Proposed by Fajardo Administration</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Develop public transportation infrastructure that would connect the marginalized neighborhoods to the more prosperous areas to increase labor mobility.</td>
</tr>
<tr>
<td></td>
<td>• Construct state-of-the art library facilities in the poorest areas of the city which were designed to beautify the community, increase community interaction, and offer public services like education, health, security, and local business support.</td>
</tr>
<tr>
<td></td>
<td>• Increase trust in local government through enhanced transparency, community participation, and communication.</td>
</tr>
<tr>
<td></td>
<td>• Promote access to quality education, particularly in disadvantaged neighborhoods.</td>
</tr>
<tr>
<td></td>
<td>• Support business entrepreneurship through partnerships with universities and the establishment of incubator parks.</td>
</tr>
<tr>
<td></td>
<td>• Create business competitiveness by fomenting and supporting five strategic industrial clusters, which are i) Energy and Electricity ii) Textiles, Design, and Fashion iii) Construction iv) Trade Fairs and Conventions, and v) Medical and Dental Services.</td>
</tr>
</tbody>
</table>
FIGURE 4

Informality versus Inequality

% of population without a pension

Gini coefficient

Source: Author's estimates, based on World Development Indicators 2006.
Note: Figure shows partial correlations controlling for GDP per capita at PPP.

FIGURE 5

Advantages of formalization reported by IFC-surveyed firms

Avoid paying fines
Compliance with the law
Avoid paying bribes
Gain new clients
Improved access to credit
Operation on a greater scale
Legal power to demand contracts is upheld

Source: Investment climate surveys 2006.

FIGURE 6

Central government tax revenue and GDP per capita

Total tax revenue (% of GDP)

Log GDP per capita

Source: Author's estimates, based on World Development Indicators (2006) and Tarcz (2000).
FIGURE 7

Tax morale and state capture

Source: Author's estimates, based on data from World Development Indicators 2006 and Latinobarómetro 2004.

Note: Figure shows partial correlations controlling for GDP per capita at PPP. State capture is proxy for an indicator of the perception about the economy being run according to the interests of a few. To construct the indicator we ask: In general terms, would you consider that the country is governed according to the interests of a few, or is it governed for the benefit of the country?

FIGURE 8

Self-employment and quality of institutions (governance)

Source: Author's estimations, based on World Development Indicators, Worldwide Governance Indicators, World Bank 2005; and investment climate surveys, 2005.

Note: Partial correlations controlling for GDP per capita at PPP. Government effectiveness index measures the quality of public service provision, the bureaucracy, the competence of civil servants, the independence of the civil service from political pressures, and the credibility of the government's commitment to policies. Higher values correspond to a more effective government.
Figure 9
Minimum wage as a percentage of GDP/capita

Figure 9 from Fabio Sanchez Torres and Oriana Alavarez Vos (2011). “La informalidad laboral y los costos laborales en Colombia 1984-2009. Diagnostico y propuestas de politica.” Documentos CEDE # 36
### Figure 10
Estimated Costs of Coordinating Entity

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Onetime Costs</strong></td>
<td></td>
</tr>
<tr>
<td>Construction Cost</td>
<td>$ 102,500</td>
</tr>
<tr>
<td><strong>Annual Costs</strong></td>
<td></td>
</tr>
<tr>
<td>Operating Costs/ year</td>
<td>$ 50,417</td>
</tr>
<tr>
<td>Labor Costs/ year</td>
<td>$ 33,690</td>
</tr>
<tr>
<td>sub-total</td>
<td>$ 84,107</td>
</tr>
</tbody>
</table>

Estimated # of centers: 14

Source: Alcaldia de Medellín
Figure 11: Ease of Doing Business in Medellin