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# Corruption and Informality: Complements or Substitutes? Qualitative Evidence from Barranquilla, Colombia

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**ABSTRACT:** *We present results of a qualitative study based on interviews with informal vendors and experts on informality carried out in Barranquilla, Colombia, in order to investigate whether corruption and informality are complements or substitutes. It was found that it is necessary to distinguish between bureaucratic and political corruption when examining the relation with informality, as the results can be opposite. In Barranquilla, bureaucratic corruption and informality seem to be substitutes, while political corruption and informality complement each other.*

**JEL:** 017, K42

**Keywords:** Corruption, Informality, Colombia

*‘Unfortunately, it is very difficult to get accurate information about the relationship between corruption and shadow economy activities on the goods and labor market, because all individuals engaged in these activities wish not to be identified. Hence, doing research in these two areas can be considered as a scientific passion for knowing the unknown.’*

*Schneider (2006)*

## **1. Introduction**

Various studies have been carried out to capture causes and consequences of both corruption and informality, but only recently the literature has begun to look at how these two phenomena are related. Both are obstacles for reaching a sustainable development (see Aidt, 2009, for corruption, and Briassoulis, 1999, for informality). Therefore, improving our understanding of these phenomena contributes to disentangle the many still open questions related to the process of development.

Theoretically, corruption and informality can be either substitutes or complements.

On the one hand, excessive, complicated regulation and redundant formal rules, also known as ‘red tape’, may lead to corruption, as bribes are paid for example in order to avoid waiting times for licenses. Not complying with formal administrative requirements by working informally would be a way to avoid getting involved with corruption. In that sense, the informal sector may *substitute* corruption. On the other hand, corruption may also complement the informal sector. Since informal workers are not officially registered and avoid paying fees and taxes that apply for formal activities, it makes it easy for public servants to extort a bribe in order to not report them in return. If authorities work efficiently and are likely to detect informal business, resorting to corrupt activities may be the only way for informal entities to avoid punishment. Thus, the mere existence of the informal sector provokes corruption. At the same time, this is what makes the informal economy work, because public servants do not do their duty of ending informal activities. Apparently, the theoretical relationship between informality and corruption remains therefore unsettled.

What does empirical evidence tell us so far? Unfortunately, it is difficult to obtain high quality data on both corruption and the informal sector, and therefore only few empirical studies accompany theoretical modelling. This motivated us to approach the problem differently, choosing a qualitative interview method rather than the use of hard data sources and econometric estimation methods. As far as the authors know, this is a rather novel approach, as there exist qualitative studies on corruption and informality respectively but the method has not been used to investigate their relationship. Yet, it seemed a promising attempt to complement existing theories and quantitative data, as those individuals were interviewed who are directly involved.

For that reason, we designed a study consisting in personal interviews with informally working people and people who (due to their professional career) can be considered experts on informality. The interviews were carried out in 2011 in Barranquilla, Colombia, where both informality and corruption are relatively high. The most prominent and obvious cases of informality in the city that fit the definition of informality we decided to follow in our study, i.e. legal market-based activities that would require a mercantile registration, are the ambulant or stationed vendors in the streets, so that the study focuses on these vendors. Our study thus investigates specifically entrepreneurial informality.

The contribution is structured as follows. In the next section, we present the concepts of corruption and informality as used in this study, and review the literature concerned with the relationship between them. We then proceed with a brief background on the relevant Colombian context, before explaining the design and implementation process of the qualitative study, and presenting the results of the study. Finally, we conclude and provide some preliminary policy recommendations.

## **2. Corruption and Informality**

The most popular definition of corruption, as used by Transparency International and UNDP, for instance, is the abuse of public power for private benefit. Acts of corruption, in turn, can be classified in different categories. Among those are bribery, extortion, embezzlement, and fraud (Lambsdorff 2007, p. 18).

In the case of bribery, the briber makes a payment to the so-called bribee, a public official, and obtains in return an advantage, e.g. a license he is actually not supposed to obtain, a government contract although competitors provide a better service, or simply a tax reduction. Thus, from the individual's perspective corruption may be cost reducing (to the briber) or benefit-enhancing. Consequently, corruption in form of bribery involves two parts, since the briber as well as the bribee can initiate it. Also, there is always a third party that is harmed, e.g. non-corrupt competitors have to shut down their business because they cannot secure government contracts. Extortion, in turn, relates to the situation when a public official abuses his position to extract money or other favours using violence or threats. In that case, corruption is coercive rather than collusive.

Embezzlement describes the stealing of public resources by an agent that has been entrusted with administering these resources. An example would be a governor who uses tax income for private spending. In that case, no private party is directly involved, although this theft of resources harms the population since in the long run less money is left for public investment, e.g. the construction of new roads, schools or the improvement of the health system.

In the case of fraud, a public official or private agent manipulates or distorts information. Fraud, for instance, takes place when public officials engage in organized crime, such as smuggling, counterfeit, or when contracts are given to firms where public servants have a stake. Bribery often involves fraud, and fraud also often comes along with bribery, e.g., when the agent in charge of control is bribed to hush up the fraud. An example for bribery without fraud would be a public official extorting speed money without concealing his malpractice.

Another classification is grand vs. petty corruption. The former refers to corruption on high government levels, whereas the latter depicts corruption on street level, e.g. payments to low level public officials in police, custom and tax authorities. Grand corruption relates to larger yet maybe less frequent payments, whereas petty corruption tends to occur in frequent and smaller payments. Also, it may be differentiated between 'political' and 'administrative' corruption, defined according to the key actors, being either politicians or bureaucrats (Lambsdorff 2007, p. 20).

Shleifer and Vishny (1993) distinguish 'corruption with theft' and 'corruption without theft'. An example relates to customs officials, wherein the former case no official tariffs are paid in exchange for a bribe of lower value than the tariff, while in the latter case in addition to the official tariffs further payments are extorted by threat of harassment or refusal to provide the service. The former transaction involves a voluntary collusion between official and manager, while in the latter case the official misuses a monopoly position by threatening harassment. Bribes paid in order to speed up the provision of service are an example for corruption without theft. However, the approaches described do not exclude each other, as the examples fit also the classification of petty corruption. Grand corruption, e.g., can be 'corruption with theft' if politicians steal money from public funds, and 'corruption without theft' if government officials are selected for loyalty rather than ability, often in exchange for a bribe.

If the concept of corruption seems a bit fuzzy, the concept of the informal sector does not have a better standing. To start with, as Briassoulis (1999, p. 214) observes, there

are various names like ‘nonstandard, underground, illegal, hidden, shadow, unobserved, submerged, irregular, invisible, unofficial, parallel, silent, alternative, world underneath, and shadow state.’ Second, there is no standard definition of the phenomenon. Fortunately, Schneider (2008, p. 4) provides an extensive overview that ‘...may be helpful for developing a better feeling for what could be a reasonable consensus definition of the legal and illegal underground or shadow economy.’ Accordingly, shadow economic activities can be legal or illegal and may include monetary as well as non-monetary transactions. Still, all actions have in common that they would be taxable if reported to the authorities. His overview is summarized in figure 1. In this overview, Schneider (2008, pp. 3-4) also provides a more narrow definition of the informal sector, which corresponds to the grey boxes in the lower left corner in Figure 1:

‘...[T]he shadow economy includes all market-based legal production of goods and services that are deliberately concealed from public authorities for the following reasons:

- tax evasion or tax avoidance,
- to avoid payment of social security contributions,
- to avoid having to meet certain legal labor market standards, such as minimum wages, maximum working hours, safety standards, etc., and/or
- to avoid complying with certain administrative procedures, such as completing statistical questionnaires or other administrative forms.

(...) The definition used excludes all non-market based economic activities like neighbor help, household and do-it-yourself work.’

**Table 1:** Underground economic activities

Monetary transactions		Non-monetary transactions	
<b>Illegal activities</b>			
<ul style="list-style-type: none"> <li>▪ Trade with stolen goods</li> <li>▪ Drug dealing and manufacturing</li> <li>▪ Prostitution</li> <li>▪ Gambling, Smuggling, Fraud etc.</li> </ul>		<ul style="list-style-type: none"> <li>▪ Barter of drugs, stolen goods, smuggling etc.</li> <li>▪ Producing or growing drugs for own use</li> <li>▪ Theft for own use</li> </ul>	
<b>Legal activities</b>			
<b>Tax evasion</b>	<b>Tax avoidance</b>	<b>Tax evasion</b>	<b>Tax avoidance</b>
<ul style="list-style-type: none"> <li>▪ Unreported income from self-employment</li> <li>▪ Wages, salaries and assets from unreported work related to legal services and goods</li> </ul>	<ul style="list-style-type: none"> <li>▪ Employee discount</li> <li>▪ Fringe benefit</li> </ul>	<ul style="list-style-type: none"> <li>▪ Barter of legal services and goods</li> </ul>	<ul style="list-style-type: none"> <li>▪ All do-it-yourself work and neighbor help</li> </ul>

Source: Schneider (2008).

Obviously, within the realm of this definition lie all those people and enterprises that do not have a mercantile registration although their economic objectives would require it, which is the pragmatic definition we decided to follow in our study. There is a conceptual difference, though. According to Schneider’s definition, there may be firms with a mercantile registration that, for instance, conceal some or most of their activities to underreport taxes, or employ parts or most of their workers informally,

i.e., without submitting them to the social security or pension system. The distinction between formal and informal is thus still blurred, as there is a large grey area between the extremes of full compliance and noncompliance (Perry et al 2007, p. 3). However, we consider the criterion of a lacking mercantile registration to be the most complete, because the probability that a business does not comply with other regulations is especially high if the establishment does not have a mercantile license (Cárdenas and Mejía 2007, p. 24).

The exclusion of non-market based and illegal activities from the definition makes sense for the purpose of the study. Non-market based informal activities are usually not controlled by the state as there are no monetary transactions involved of which taxes could be withheld. There is thus little opportunity for corruption. Regarding illegal market-based activities, there are basically three reasons to exclude them from the definition. First of all, although smuggling is connected with both informal sector and corruption, it would be beyond the scope of the study to investigate the dynamics of this economic activity. Second, people acting illegally are harder to detect and probably less willing to participate in interviews on their economic activities. Third, it is simply not completely safe to interview illegally acting people, as they may feel threatened. Nevertheless, it is not impossible that interview subjects who fit the definition pursue some of those excluded activities on the side.

Now we can turn to the relationship between corruption and informality. Only little theoretical and empirical research has investigated whether corruption and the informal economy are related, and the literature is inconclusive on whether they are rather substitutes or complements. As mentioned before, corruption can be a way to make business in the official economy easier, e.g. when a bribe is paid to obtain licenses a firm is not supposed to obtain, or to accelerate administrative processes in the case of 'red tape'. Informal entrepreneurs avoid those bribes as they are not concerned with bureaucracy. In other words, informality crowds out or substitutes corruption that is often necessary or at least helpful to do business in the formal sector successfully. But informal entrepreneurs may need to pay bribes to public authorities when they get detected in order to keep working informally or in order to avoid detection in the first place. According to Dreher and Schneider (2006, p. 5), in this case '(...) *informality and corruption are likely to reinforce each other, as corruption is needed to expand shadow economy activities and – at the same time – underground activities require bribes and corruption*'. The relation between corruption and informality is then positive or complementary.

Johnson et al. (1997) model a complementary relation as corruption in the formal sector increases the shadow economy, since it can be viewed as one particular form of taxation, driving firms underground because it becomes too costly to operate formally. In their full-employment model, workers can be either employed in the formal or in the informal sector, indicating a substitutive relation of the formal and informal economy. The authors provide empirical evidence for Transition, Latin American and OECD countries in favour of this theory, although their results point to a less significant direct impact of regulations and taxes on unofficial economy. They suggest that more important than the formal existence of taxes and regulations is how these are applied, collected and enforced, which ultimately depends on the levels of corruption. Hindriks et al. (1999) also model a complementary relation of corruption and informal activity, as taxpayers bribe inspectors to underreport tax liability once

operating underground.

In contrast, Choi and Thum (2005) model the shadow economy and corruption as substitutes. Initially, corruption drives firms underground, yet exactly this opportunity of working underground is what constraints public officials to exploit formally operating firms. This leads to a reduction of bribes and thus lowers costs of operating formally, improving official economic activity. In that sense, the informal sector complements the formal one, making the unofficial sector desirable from a welfare point of view. Bribes paid once in the shadow economy to avert investigations don't alter the findings as firms only get detected with a certain probability. Dreher and Schneider (2006) argument similarly, although dividing countries into low and high-income groups. They propose that corruption and informality in poorer countries are complements, whereas in richer countries they substitute each other (thus predicting a complementary relation for Colombia). They find empirical evidence for their theory, although they admit that results strongly depend on how the regressions were specified, pointing out that a major problem when investigating corruption and informality is the lack of high quality data.

Klein (2008) puts empirical findings and theory together in a more systematic way. In his paper, he formulates two situations that cause informality starting with an endogenous production function and defining the net expected benefit of a firm operating in the informal economy. The firm then has to face the threat of detection, and has to consider possible penalties. He further takes into account that unofficial firms can use public goods without contributing to financing them, as they do not pay taxes. In Model 1, the author assumes that a firm initially wants to operate formally, agreeing to pay the current tax rate, which it perceives as being fair when there is a good provision of public goods and services. However, these firms additionally may have to pay bribes to overcome bureaucratic inefficiencies, and thus face expected costs due to corruption, which reduce a firm's net income.

Klein (2008) follows Shleifer and Vishny (1993) and labels this situation 'corruption without theft' because in this model public officials take an additional payment to provide a service instead of selling public goods at lower than official prices without reporting it, which would be 'corruption with theft'. Thus, the higher the expected level of corruption, the higher is the incentive to migrate to the informal sector to avoid those extra payments. Consequently, informality is a substitute to corruption in the formal sector as proposed by Choi and Thum (2005) and reduces the actual corruption level. Again, one could argue that officials could still extract bribes from unofficial firms after detecting them, but that should bring these officials lower payoffs compared to extracting bribes from official firms, due to the difficulties of detecting hidden operations.

In Model 2, Klein (2008) assumes that the firm wants to evade the official tax rate because it is perceived as being unfairly high compared to the provision of public goods and services. He therefore labels that situation 'corruption with theft'. One way to evade fiscal duties would be resorting to corruption through bribing public officials. In contrast to Model 1, firms eventually end up paying less than the official rate as public officials provide services at lower than official prices without reporting it or turn a blind eye on non-compliance with legal obligations. As a result, going underground and corruption are *complements*, where corruption works as a channel

through which a firm hides part of its taxable output. Apparently, the ultimate cause of informality according to Model 2 is an unfairly high tax rate compared to the quality of public goods and services, whereas in Model 1 it is corruption that drives people underground.

Now, if operating informally and the higher the risk of detection through improved institutions or greater firm size, the more likely it is that a firm has to restore to corruption to avoid being detected and fined. Corruption and informality are complements until the costs of operating underground become too high and the firm decides to become official. Obviously, if corruption without theft in the formal sector is greater than consequent corruption with theft in the informal sphere, the net result from going informality would be less corruption. Yet if corruption with theft, which arises in the informal sphere, is greater than corruption without theft the net result is more corruption and a complementary relation.

According to Klein’s theoretical formulation, there are four possible equilibriums, shown in Figure 2. The tax rate can be perceived as fair or not and the quality of public goods and services maybe adequate or not. The matrix shows in which case corruption and informality are substitutes or complements. As Klein (2008, p. 10) points out, these predictions are in contrast with the hypotheses stated in Dreher and Schneider (2006, p. 1), where ‘...*corruption and shadow economy are substitutes in high income countries, while they are complements in low income countries.*’

**Table 2:** Relation corruption/informality according to the model by Klein (2008)

		Public Goods and Services	
		High	Low
Taxes	High	<i>Complements</i>	<i>Complements</i>
	Low	<i>Substitutes</i>	<i>Substitutes</i>

The results of Klein’s (2008) subsequent econometric analysis support the theory, using data from 87 countries for the years 1998, 2000 and 2002. For Colombia, the analysis shows that corruption and the informal sector are complements as corruption with theft in the informal sphere prevails, with the tax rate being relatively high while the provided public goods and services are of lower quality.

### 3. The Context: Corruption and Informality in Colombia

According to Transparency International, Colombia scored 3.4 in the Corruption Perceptions Index 2011. The CPI ranks countries/territories based on how corrupt their public sector is perceived to be on a scale from 0 (very corrupt) to 10 (very clean).<sup>1</sup> Perceived corruption in Colombia is therefore high.

An ample analysis of the Colombian corruption problem provides a paper by

Lambsdorff and Fink (2006). In this study, the results of 33 expert interviews complemented with existing literature paint a comprehensive picture of the complex situation. It makes clear that *politiquería* (bad politics) is the core problem in Colombia. Several factors sum up to grand corruption, which is a fundamental component of *politiquería*. First, cronyism and nepotism (*clientilismo*) play a major role when it comes to the appointment of positions. Personal relations are more important than academic degrees or a competitive selection process. Private interests also interfere with public decision-making. Campaign financing is closely related to corruption, as donations have to be paid back in form of other favours once the politician is elected into office. Finally, vote buying is a common practice.

In addition to grand corruption, petty corruption is also a problem, as '*the present laws and regulations are well designed, but poorly applied*' (Lambsdorff and Fink 2006, p. 19). Excessive regulation invites private actors to offer bribes in order to speed up administrative processes or to evade the payment of fines. Yet data collected by Enterprise Surveys show that only 2.81 per cent of the firms surveyed are expected to pay informal payment to public officials (to get things done), which is relatively low compared to 12.4 per cent in Latin America and the Caribbean and 26.6 per cent in the world. Still, 53.2 per cent of the firms surveyed identified corruption as a major constraint doing business. The survey does not explicitly distinguish grand and petty corruption but from the relatively low percentage of firms expected to pay bribes it may be inferred that grand corruption affects this perception greatly.

With respect to informality, whatever definition employed, the level of informality in Colombia is high. Compared with other Latin American countries and applying the definition presented above, Schneider and Hametner (2007) estimates for 2004/2005 that informality in Colombia amounts to 42.7 per cent of GDP. This comes close to the median of 41.8 per cent in Brazil. The largest informal economy exists in Bolivia (67.2%) and the smallest in Chile (14.9%). Defining informality as the lack of mercantile registry, referring to data from DANE for 2002/2003, Cárdenas and Mejía (2007) find that 41.1 per cent of Colombian microenterprises are informal. According to Ospino et al. (2010, p. 2) '*a significant part of job creation in Colombia occurs in the informal sector.*' By the time the present study was carried out, the national informality rate for the trimester June-August 2011 was 51,4 per cent according to DANE and in the metropolitan area Barranquilla-Soledad 59.6 per cent (in the second trimester).

There is a large amount of literature looking at the causes of informality in Colombia from a socio-demographic point of view (see, for instance, Florez (2002), Uribe et al. (2004), Cárdenas and Rozo (2009), Bernal (2009), Roldan and Ospino (2009), or Ramos and Angulo (2011)). Among the main findings is that the lower the education level, the higher the probability that people end up working informally. Yet in the context of this study it is most important to describe the institutional context of informality in Colombia. Here, Núñez (2002) finds a positive relation between informality and income taxes on labour revenue for the period 1988-1998, confirming general theories concerning the negative impact of taxes on formal work. Investigating entrepreneurial informality, in a qualitative survey with both formal and informal employers and defining informality as the lack of a mercantile license, Santa María and Rozo (2009) found that the main problem is the lack of information on

how to formalize a business, how to affiliate employees to insurance and pension systems, and how to value the potential benefits that come with it. In sum and as it was discussed by Cárdenas and Mejía (2007), especially for small and micro enterprises not only financial contributions but also the administrative workload maybe beyond the firm's capacity.

Santa Maria y Rozo (2009) also found that little confidence in the efficient use of taxes and contributions is a reason for working informally, due to perceived corruption in public spending (that is, 'grand corruption'). Moreover, only formal firms, i.e. those recorded in the commercial register, are exposed to controls by authorities, e.g. by tax investigators or the local public health departments, leading to a minor probability of being controlled at all when working informally. The expected fine for not obeying the law is consequently 'close to zero' (Fundesarollo 2011, p. 29). Naturally, controls provide incentives to offer and take bribes to avoid the payment of consequent fines and controls when formalized apparently provide a strong incentive to work informally since the informal sector underlies an even lower probability of being controlled when not complying with regulations.

#### **4. The Study Design**

In order to get a deeper understanding of how corruption and informality are connected, we chose to carry out interviews. We restricted our study to ambulant or stationed vendors occupying public space, lacking a mercantile registration but selling legal goods. This is a quite narrow focus, as there are abundant other informal activities like constructing buildings, manufacturing, transportation, solid waste collection, disposal and recycling, among others. Without a doubt, the dynamics of corruption and the impact of the respective activity on sustainable development may differ from the dynamics found in other informal vending activities, since different legislative backgrounds apply with controls more or less rigorous and opportunities for corruption are more or less frequent.

As for the location, we chose Barranquilla, Colombia. Both corruption and informality in Colombia are high. However, it has to be kept in mind that the relationship between informality and corruption may be a different one in other countries, depending on institutions, tax rates, the level and prevalent types of corruption, etc. Also, the dynamics may not only vary between countries but even among different cities within Colombia, as local governments handle informal vending activities differently. According to Doing Business Colombia<sup>2</sup>, the amount of administrative steps when doing business formally varies among cities, so that the level of bureaucratic corruption is also likely to differ. Thus, the findings for the specific situation looking at informal vendors in Barranquilla may not necessarily be applicable to other cities within Colombia or in other countries, nor to informal activities other than street vending. Yet this is a typical characteristic of qualitative research, as its objective is not to generalize but rather to investigate specific cases.

Barranquilla was chosen on the one hand for practical reasons, that is, access to experts and available local knowledge. On the other hand, Barranquilla has an intermediate risk of corruption according to data provided by *Transparencia por Colombia* for 2008/9, a situation that can be found in most of the 34 Colombian municipalities examined. As the corruption risk is neither extremely high nor low in

Barranquilla, it seemed to represent a research environment that might still allow conclusions of broader validity, quite in line with the approach to choose typical cases of interviewees as explained above. Finally, the centre of Barranquilla (*centro*) is quite typical of almost all cities in Latin America (Carrión 2000).

The interviews were conducted with three groups in order to allow the comparison of different points of view thereby increasing the validity and quality of subsequent conclusions through triangulation of the information obtained. Different yet comparable interview guides were elaborated for the different subject groups; these guides are available by the authors upon request. The interviews were conducted using a semi-structured guided interview technique allowing open responses by the interviewees and a flexible adaption of the questionnaire by the interviewer, depending on the respective situation.

The first group consisted of informal street vendors. Apart from labouring underground, they are the potential bribers in the dual relationship that constitutes corrupt actions.<sup>3</sup> Less exposed to controls is our second group, which are those informal vendors who are participating in relocation and education programmes set-up by the district's government and the Chamber of Commerce, as they are still not registered but at least have a permission to sell their products in an assigned location and will have to register in the long run, according to the government. Talking with them seemed to be important as they know perfectly well the dynamics of informality but are willing to adapt to formal rules in the future. By participating in relocation programmes they enter into relation with the government and are thus more able to compare advantages and disadvantages of informality than those who do not. The third group consisted of experts on informality. Experts are per definition not the actual objective of a study but rather a complementary operating unit to the identified target groups. Integrating expert interviews appeared crucial for two reasons. First, it made it possible to learn more about the validity of the statements made by the first two groups. Second, it could have been possible that experts had a wrong idea of actual motives and actions of informal workers and civil servants.

It is pretty much impossible to select a representative sample in terms of activity, gender, age, education, etc. when carrying out a qualitative study with personal interviews. Rather, the idea is to pick out typical cases.<sup>4</sup> In the *centro* (centre), the concentration of street vendors is extremely high, for why the majority of interviews were conducted there. For the interviews with vendors who had been relocated, the *mercado* (market) in the centre was chosen. Additionally, interviews were done with vendors who will be relocated to a soon to be inaugurated market called *Metroplaza*. A total of 25 interviews with informal entrepreneurs<sup>5</sup> were conducted (six of them already or soon to be relocated), of which the first four served as pilot interviews not used for the evaluation as the questions asked were modified afterwards.

The experts interviewed belong to different institutions. Some had done research on informality; others worked in NGOs, and some for the government. The group of experts was consequently quite heterogeneous in terms of professional background and experience with informality, which was extremely useful for the purpose of the study as they were likely to have different perceptions of, or experiences with, corruption in that context. That way it was also possible to verify the quality and the truthfulness of the obtained information within this heterogeneous group, as the

information given could be crosschecked with the rest of the interviews. Eventually, a total of eleven experts were interviewed (a complete list of interviewees is available by the authors upon request). The number of interviewees in all of the three interview groups was considered sufficient, because, as Seidman (2006, p. 55) puts it, *'the interviewer began to hear the same information reported.'*

The respective interview subjects were asked if they would like to collaborate in a research project on street selling in Barranquilla. Neither the word 'informality' nor 'corruption' was mentioned at the beginning. Also, the interviewees were informed that they would not have to interrupt their selling activity during the interview, making sure that they did not miss out on opportunities to sell their goods while supporting the study. Once a person had agreed to answer the questions, he<sup>6</sup> was informed that the interview would be taped, which did not at all represent a problem for the participants. The informal vendors were interviewed first, as their answers would probably leave open a lot of questions, which could later be clarified talking to experts. Since this was indeed the case this way of proceeding proved to be appropriate and helped to optimize the question guide used for the expert interviews.

Experts were contacted soliciting interview sessions of approximately 45 minutes in their respective offices. They were informed that the study is about the relation of the informal sector and corruption, and the theory of substitutes and complements was explained to them, without however mentioning the theoretical prediction for Colombia was not mentioned. That way, possible bias could be prevented without holding back information on what the study was all about, ensuring informed consent when asking for appointments.

The participation rate of both informal vendors and experts was high. Only four vendors did not want to take part in the study, even though they did not even know what it was all about. Thus, the topic itself cannot have been the reason. All of the experts contacted showed great interest in the study and were helpful setting up appointments with other experts whenever they did not had the time to participate personally. The interviews with vendors took between 10 and 25 minutes and with experts between 45 and 100 minutes.

The interviews were analysed according to the Qualitative Content Analysis method. Its advantage is its comprehensible and theory-guided way of proceeding, while being flexible and open to adapt the analysis to new and unpredicted aspects. Supported by the computer software MAXQDA, a category system based on the transcriptions was developed. The interviews were dealt with attaching the same importance to both the vendor interviews and the expert interviews. Every time information seemed to be relevant, a new category was opened or the information was added to an already existing category. All categories were created inductively and the only deductive criterion they had to fulfil was to be relevant for the research question. This way, the entire information obtained through the non-standardized interviews could be reduced to a manageable size of relevant information. Of course, it depends on the authors' understanding whether or not information is considered to be relevant to answer the research question. However, the interpretation process can be reconstructed as anchor examples of each category are given throughout the text, with the number of the interview and the paragraph always indicating the source of information (e.g. I7-3 for interview number 7, paragraph 3.).

Since the interviews were conducted in Spanish, all citations herein are translations made by the authors. As the idea of this qualitative study was not to select a representative pool of interviewees but rather typical cases, a quantitative analysis in terms of how *many* people contributed information to a certain category would not make sense and was thus not conducted. Also, through the interviews, we clearly found that distinguishing between bureaucratic and political corruption seems indispensable for a sufficient analysis. We therefore present our findings in a structured and narrating fashion differentiating between both types of corruption.

## **5. Results: Bureaucratic and Political Corruption**

### **5.1 Bureaucratic corruption and informality: complements**

Crucial for the amount of bureaucratic corruption occurring between public officials and informal vendors is the effectiveness of controls and punishment. In Barranquilla, if an entrepreneur does not have a mercantile registration, no institution whatsoever controls his activities (I23-75). The only existing controls are carried out by the *Secretaría de Control Urbano y Espacio Público* (Secretary of Urban Control and Public Space) in order to drive out vendors of sidewalks and public places. Generally, the intensity of these controls depends on the rigorousness of the current government and may vary among cities. For example, in Bogotá governments in the past were highly interested in keeping the public space clean, leading to many opportunities for corruption, as there was a high intensity of controls. Later, there were laxer governments letting people generate income in the streets, like it had been the case in Barranquilla before the administration period of Mayor Char between 2008 and 2011 (I24-25). Specifically, earlier governments in Barranquilla ‘made the mistake to be very permissive with public space’ (I30-27), as they would even allow people to setup their vending stands for a monthly rent of COP 10.000<sup>7</sup>, which was against the law as public space is a public good which belongs to everyone and can neither be sold nor rented (I30-3).

Yet, in the past decade steps have been taken to not only recover public space but also to lift people out of informality, which has been growing ever since, as it was confirmed by virtually all interviewees. As for that, in 2005 a census was taken in order to find out about the number of informal vendors in the centre of Barranquilla. About 5.000 vendors were counted, and when the census was repeated in 2011 the number of vendors had grown to roughly 10.000, not including those who work in other parts of the city (I32-7, I30-7). All those who appear in the census count with so-called ‘legitimate confidence’, which grants permission to remain in their spot to all those who were allowed by former governments to carry out their activities in public space or to those who have been working in the street for ‘a long time’, often decades (I29-8). These vendors have the right to remain where they are until the government provides ‘a better or equal alternative’ (I31-7), making them eligible for being relocated to markets or buildings with adequate water and electricity installations and to be capacitated for formal working activities through government-financed education programmes.

Thus, all these informal vendors do not rely on bribing officials as they are officially allowed to be in the public space and no other institutions control them. Yet, this situation is only typical of the current politics in Barranquilla. In the 1980’s and

earlier (I5-52, I18-81), before legitimate confidence was granted and when informality in general was not actively being tackled, the vendors who were not renting a spot from the government did have problems with the public space controls: 'Every Saturday they came and if you did not give them 2000 or 1000 Pesos they told you to leave!' Also, there were often fights between vendors, who tried to defend their business, and policemen, who were accompanying the governmental inspectors. Usually, however, vendors would pack up their things and run (I5-52).

This scenario is also typically to be observed nowadays, as there are still vendors who do not have legitimate confidence. Farmers who come to the city looking for a better life (I30-3) and people who have to flee from the armed conflict in the interior of the country, so-called *desplazados* (displaced), end up selling food or other things in the streets and occupy anew public space that already has been recovered through relocation actions (I28-7). People cannot find work because there is no sufficient job offer, because their education level is too low (I22-2) and/or the pay is too low (I29-4), so that even people who graduated from school or university may choose to work informally as their income is eventually higher (I1-4). Moreover, to setup a business formally requires administrative work, which many are not capable of. It also comes with monetary costs and the diversity of taxes and contributions in Barranquilla are relatively high, so that complex regulation is an additional incentive to work informally (I24-17).

Whatever might be the individual's reason, the overall quantity of informal vendors in Barranquilla has been growing, as all interviewees confirmed. The officials of the Secretary of Urban Control and Public Space are in charge of keeping them from invading public space (I30-11). If they detect vendors without legitimate confidence, they are supposed to charge a fine according to the size of the person's stand and confiscate (imperishable) goods and stands, which will be given back when the fine is paid (I31-15). The fine is usually around COP 80.000 or 90.000, but not a single one of the interviewed vendors has ever redeemed confiscated goods, as they simply cannot afford it (I10-22, I3-22).

Usually, the vendors just pack their bags and run away, coming back after the public space controls have passed, making the whole situation appear like a game (I24-25). The vendors warn each other when the officials are arriving and it even happens that they defend each other violently when their goods are about to be confiscated, for why the controllers are always accompanied by a group of policemen (I26-29, I29-42, I15-36). It hardly ever happens that bribes are offered, as the vendors neither can afford it nor have the intellectual capacity to negotiate with the officials (I24-25, 27). If bribes are paid, they amount to COP 1000 or COP 2000, or even just an orange (I3-49, 50), as they cannot afford more (I29-7). Those who could afford more because they have bigger businesses do not need to pay bribes as they are usually in the census and count with legitimate confidence (I30-17). Moreover, even if the vendors as potential bribers were able to make attractive offers, they would need a partner (bribee) for the corrupt transaction. Yet, for the several thousand informal vendors without legitimate confidence in Barranquilla, there are exactly 26 officials plus the accompanying policemen, which frankly is 'an insignificant number' (I31-27) compared to the number of vendors. Altogether, one can say that a complementary relation between corrupt bureaucratic transactions with theft in the informal sphere as modelled by Klein (2008) does exist, although number and amounts of payments are

‘eventually not interesting’ (I26-11).

Additionally, informality also seems to cause bureaucratic corruption without theft in the formal sphere, a peculiarity that so far has not been considered in any theoretical model. Since informal vendors occupy sidewalks in front of formal stores and restaurants, potential customers can either not pass on the sidewalk to reach the formal establishments, or directly buy from informal vendors at lower prices instead. Therefore, it has happened that formal vendors have called the public space officials paying them a bribe and asking them to keep the sidewalks in front of *their* shops clear (I10-59). In that case, informal vendors do not even have the chance to bribe the officials to avoid being driven away, as the officials already have been bribed before getting there; and this with presumably higher amounts of money than an informal vendor could ever pay. Since these corrupt activities are caused by informality they should be considered complementary to it, even though the corruption does not take place inside the informal sphere, so that the causality runs only in the direction from informality to corruption and not the other way round.

## **5.2 Bureaucratic corruption and informality: substitutes**

Doing business formally still requires a lot of paper work, although the fact that many formalities related to the registration in the Chamber of Commerce can be completed online nowadays has reduced contacts between officials and entrepreneurs. Also, in banks and offices video cameras have been installed, which helps to keep officials from preferential treatment of individuals (I28-35, I22-52, I32-19). However, not all do have internet access and not all formalities can be completed online. In that case, people have to get in line to complete formalities personally and there is evidence that people pay extra money to get preferential treatment (I28-25, I32-19), which is corruption without theft. A short anecdote by an informal vendor might illustrate such a case: The vendor wanted to get a new identity card as he had lost his old one. Arriving at the office he was told that the official in charge is not available, but if he pays COP 5000 it can be arranged that the responsible person comes back to his office. The vendor paid, and paid another COP 15.000 to obtain the actual identity card right away and COP 5000 to a colleague of the official that had arranged the issuing of the card (I6-55).

Moreover, once an entrepreneur is registered in the Chamber of Commerce, his activities are monitored not only by the Chamber itself but also by the tax authority DIAN (*Dirección de Impuestos y Aduanas Nacionales*) and, if the business requires it, by INVIMA (*Instituto Nacional de Vigilancia de Medicamentos y Alimentos*), which is the National Control Institute of Drugs and Food and controls hygienic standards e.g. in restaurants or supermarkets (I23-61, 71). The business thus becomes not only more visible for the customer but also for the state, and formal entrepreneurs are consequently exposed to far more controls than informal ones. Naturally, non-compliance with laws and regulations comes with fines. But these fines can apparently be avoided if one has ‘friends’ (I23-79) in the right office. This avoidance of fines in exchange for a favour is eventually corruption with theft, as the state loses the money it would obtain if the legal fine were charged. Having in mind that formal enterprises are usually bigger than informal ones, their solvency is also greater, so that it is likely that bribes amount to more than COP 2000 which is a common sum paid by informal vendors (if anything is paid at all) as described above.

To sum up, all these complicated formal controls and administrative procedures (I10-6) that provide opportunities for corruption are avoided when being informal. Thus, informal business substitutes bureaucratic corruption with and without theft in the formal sphere. Comparing the situation in the informal and the formal sphere, the total number of corrupt transactions and the amounts of money being paid or favours exchanged are apparently much higher in the formal sphere, so that the substitutive relation seems to outweigh the complementary effect.

However, not a single one of the informal vendors stated that the high cost of corruption due to 'red tape' is the actual reason for working informally. That can be for two reasons. First, none of them ever was formally active with his business nor had considered it. Thus, they do not know how many corrupt transactions they eventually avoid. Second, and more importantly, the informal vendors interviewed completely lacked a clear concept of what is corruption. When being asked the question 'What is corruption, in your opinion?', a representative example of an answer was 'I think that is the politicians because they steal the money' (I1-48) or 'the government is corrupt' (I3-58). They are aware of that corruption is an eminent problem in Colombia; yet giving oranges to public servants to avoid having the cart or merchandise confiscated is not considered corruption (I11-64). It is rather considered a sign of humility and mutual collaboration, as in exchange for a small favour the officials let them do their work to be able to provide for their families (I3-64). They are widely unconscious of the fact that they themselves take part in the corrupt game, either actively paying small bribes and/or passively as they avoid red tape and thus opportunities for corruption.

### **5.3 Political corruption, mentality and informality**

The relation between political corruption and informality might be less obvious, yet it exists. The theoretical models implicitly suggest that informality and *bureaucratic* corruption are substitutes or complements, as it is always a public servant who grants a service or turns a blind eye in exchange for a bribe. Yet, corrupt politicians who siphon tax money out of funds ('political corruption with theft') cause distrust among the taxpayers, so that these may eventually decide to not contribute to the system and operate informally (I28-47).

Further, political considerations maybe the reason for less rigorous actions against informality, as the vendors are citizens with the right to vote and if the government suppresses them they are likely to vote against it or cause complications like demonstrations and fights (I25-21, I26-37). Less subtly, informal vendors are a target group for active vote buying during elections, as their votes are easy to buy because they simply need the money and do not know much about politics (I15-67). Often, politicians buy votes through the directors of the vendors' unions.<sup>8</sup> They pay an amount of money or promise to let the vendors work in public space without controls if the members of the union vote for them in exchange. Consequently, this even provides an incentive for politicians to maintain informality (I5-48, I29-46).

Also, the government's relocation programmes are cost-intensive. Buildings have to be bought or markets have to be constructed. To get the vendors out of informality in the long run, capacitating programmes have to be financed, which also include seed capital, either in form of merchandise or cash to compensate the income loss while taking part in trainings on how to do formal business and to alleviate the vendors'

debts<sup>9</sup> (I28-11, I30-3)). These programmes are complicated to manage and failed in the past because the vendors lost their customers after having been relocated and consequently abandoned the assigned space again, a problem which is now intended to be solved through negotiations and discussions between the unions' representatives and the government (I14-62, I21-40). Altogether, when, how much, and for what exactly money is spent is highly unclear and it has been the obvious case that investments did not really bear fruits. For example, after years of negotiations (concerning infrastructure like electricity, the arrangement and characteristics of the stalls etc.) with the vendors associated to the union ASOVESUR, these vendors were finally supposed to be relocated to a market called *Metroplaza* in late summer of 2011. Yet, until today the constructions have not been finished and the vendors remain in their old place. Of course, by no means do we accuse the government of corruption, but the reason of the delay is unclear to the citizens and the vendors themselves suppose that the money (COP Mio. 2300) has been diverted by the government (I21-46, 48). Apparently, programmes to reduce informality may provide opportunities for corruption or at least, due to their complexity and their lack of transparency, arouse the impression that money does not reach its destination.

In addition, political corruption actively shapes the people's mentality, as the image of a governor has a multiplier effect in the society and trickles down to the least significant position in the administrative machinery. Corruption on high government levels affects the entire society: 'If they break rules, I can break them as well' (I22-44). Corruption has obviously a lot to do with the people's attitude and lacking respect towards rules, which eventually also paves the way for informality; the crux of both phenomena lies in the disrespect of rules and is an 'eminently cultural question' (I26-2). The answer of one informal vendor to the question why he does not want to formalize summarizes this well: 'Why would I do that? Nobody does. So I don't do it, either' (I14-40). Also, it is considered a great advantage of informal work that 'it is not like in a formal business where you have to comply with rules and schedules' (I5-44).

However, it can be observed that within Colombia the people's attitudes vary significantly. For example, 'people in the state of Santander are more diligent and rule orientated. Towns are cleaner and nicer and there is a lower informality rate. You feel as if you were in a different country' (I26-40). The informality rate there is according to DANE about 10 per cent lower as in Barranquilla, where it was 59.5 per cent in the second trimester of 2011, and Santander is according to *Transparencia por Colombia* (2010) the state with the lowest corruption risk in Colombia. Of course, getting rid of political corruption does not mean that there is no more informality (I25-31), but political corruption obviously complements informality not only directly e.g. through vote buying but also indirectly through an impact on people's mentality.

## **6. Conclusion**

Choosing a qualitative interview method as a means to investigate the relation between corruption and informality, we found that the question whether the phenomena are complements or substitutes requires a distinction between political

and bureaucratic corruption, because it is possible that the respective relations differ, as it was the case in Barranquilla. This new aspect suggests itself to be modelled in further theoretical research. It was also recognized that findings could be different in other cities or countries, depending on policies on informality, the amount of administrative workload when operating formally and last but not least, on how the researcher defines informality.

In Barranquilla, under current political conditions, and with informality specifically defined as we did in this study, bureaucratic corruption and informality seem to be net substitutes, as the number of cases of corruption as well as the amount of money or favours exchanged seem to be smaller in the informal than in the formal sphere. Extensive administrative workload when doing formal business is not only a reason for people to work informally but provides also opportunities for corruption and can thus be considered red tape. In consequence, it is advisable to further simplify administrative procedures and to reduce contact between officials and citizens in order to reduce corruption in the formal sphere and to promote formal entrepreneurship. Making it possible to register a business online was a first utile step towards that direction.

Moreover, we found that the informal vendors have a rather fuzzy concept of what is corruption. A valuable recommendation may thus be to explicitly include an anticorruption training or at least to promote the creation of awareness of corruption in the capacitating programmes that are carried out in the context of relocation programmes. This seems to be an important measure if one wants to avoid that people who pass from informality to formality adapt themselves to – and thus maintain – a bureaucratic system that provides frequent opportunities for corruption.

In contrast to the substitutive relation with bureaucratic corruption, informality and political corruption rather complement each other in Barranquilla. Firstly, to preserve votes and to avoid conflicts with several thousand vendors, politicians do not exercise all the authority they might be able to in order to diminish informality. Secondly, due to their neediness and often ignorance about politics, informal vendors represent an easy target group for vote buying, so that informality facilitates political corruption to some extent.

Further, it can be strongly recommended to make costs and schedules of as well as entities involved in relocation programmes transparent and accessible for the public. This would not only reassure taxpayers and informal workers that the government is seriously tackling the problem of informality, but also increase accountability and prevent suspicion of corruption. Greater transparency can be implemented on relatively short-notice, while reforming the administrative system and educating people supposedly takes more time.

Finally, the general mentality of citizens also affects corruption and informality as both have in common that rules are disobeyed, and the tendency to do so seems to be stronger in Barranquilla than in other parts of the country. This is a fundamental problem (and certainly not only in Barranquilla) for which a solution has yet to be found. Reducing political corruption, in other words converting the government into a good example for citizens, would certainly help.

## Notes

1. In 2012, the ranking methodology of the CPI was updated, making possible the reflection of changes over time at country level. This also changed the CPI scale, which as of then runs from 0 (highly corrupt) to 100 (clean).
2. See: <http://www.doingbusiness.org/data/exploreconomies/colombia/>
3. As for that, it seemed valuable to interview potential bribees, too. Thus, another group considered was formed of civil servants who are supposed to control the informal vendors' activities and to impose fines if necessary. Unfortunately, it was impossible to talk to civil servants who actually control the vendors' activities.
4. Clearly, precisely the lack of a complete representative pool of interviewees may be a reason for criticism. For example age, sex, education level or type of informal activity may also have an impact on the individual's perception of or participation in corrupt practices, making it difficult to secure validity. Yet this is a typical characteristic of qualitative studies and validity was increased through the triangulation method.
5. One interviewee was not a vendor but a retired policeman who was working as informal taxi driver. During a casual conversation it turned out that he knew a lot about informality in general and he was consequently included in the interviews.
6. Three of the interviewees were women, two of them experts. In the rest of the paper, for the sake of simplicity and no other reason, the male noun will be used.
7. COP 1000 are equal to EUR 0,42 at the time of the study.
8. There are 16 identified unions of informal vendors in Barranquilla. Their members are all part of the census and have thus the right to remain in their places until the government provides an equal or better alternative. The unions' directors represent the vendors in the discussions with the government in order to find an alternative that satisfies the vendors' needs at work.
9. To get the informal business started a person often needs 'a tutor, someone who teaches him' (I1-12). Later, depending on the initial capital the person already owns, he needs some kind of credit to finance a stand and the things he wants to sell. Those credits are provided by so-called 'pagadiarios' (pagar means 'to pay' and diario 'daily') (I32-25), who provide the vendors on a daily basis with cash or merchandise (I9-44, I10-16). At the end of the day or week these pagadiarios collect the repayment and/or the extremely high interests they charge (oftentimes 20% and more) (I28-19). As time goes on, many cannot help persisting to work for their patrón (patron), the person who initially taught them how to do business and often rented them a stand or gave a monetary credit in the beginning. Simply, the vendors are tied to them through debts (I18-52), which they can never completely repay due to the high interest rates. Apparently, in the informal sphere exist highly sophisticated, well-organized structures (I24-38) established by groups that take advantage of the neediness of others. The existence of these mafias (I24-38) shows that informal vending is not only an innocent means of temporary income generation of a 'few hundred persons who come with their bags of avocados to the city' (I24-1). Given the issue of vote buying, a relationship between these mafias and the political market for votes seems quite likely.

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