Policies for the formalization of micro and small enterprises in Brazil
In this focus note, we use the definition of formal employment used by the ILO Office in Brazil, which corresponds to the share of wage employees “com carteira assinada” (including domestic workers, the military, public sector employees and self-employed who contribute to social security), expressed as a percentage of total employment (see also the study of the ILO Office in Brazil “Perfil do Trabalho Decente no Brasil: Um Olhar sobre as Unidades da Federação”, available at http://www.ilo.org/wcmsp5/groups/public/---dgreports/---integration/documents/publication/wcms_206109.pdf.)

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Foreword

One of the major challenges in reducing informal employment in Latin America and the Caribbean is to facilitate the transition to formality of micro and small enterprises, which are the main generators of employment in our region.

This is a complex challenge as informality is a multidimensional phenomenon and as the reality of MSEs is highly heterogeneous. Available data indicate that informality in micro and small enterprises constitutes a major obstacle for countries in the region to advance in their social and economic development, which is why it is crucial to find solutions.

Over the last decade, Latin America and the Caribbean registered a period of sustained growth that even resisted reasonably well the international financial crisis. Urban open unemployment fell to 6.2% in 2013, the lowest figure since ILO started recording. Informality, although it was reduced over time, is persistent and still affected 47.7% of urban employment in 2012. According to ILO estimations, 60% of the workers in MSEs are informally employed.

The majority of the region’s informal workers belong to the 20% poorest segment of the population, which presents an informality rate of 72%, more than double the rate registered for the richest 20% of the population where informality is around 31%. These figures show a clear link between informality and income inequality.

How to address informality in MSEs? There is no standard recipe and that is precisely why this new series of ILO FORLAC Focus Notes seeks to encourage debate on this topic and generate discussion on different policy options to reduce informality.

The design of MSE policies needs to take into account that there is a difference between formalizing small enterprises and formalizing employment in these firms. The reality is that undeclared work also exists in an important share of registered MSEs. Therefore special attention should be paid to strategies for the creation of formal jobs in this segment of enterprises.

In order to advance towards MSE formalization, integrated and long term strategies are required that simultaneously address the multiple causes of informality, incorporating issues related to administrative, tax and labour regulations, access to social security and private sector development strategies. Policies to promote the formalization of MSEs should include strategies to increase productivity, improve norms and regulations, generate incentives for formalization and enhance government’s capacity to enforce compliance.

Key aspects include the simplification of administrative procedures for business registration, the development of adequate taxation regulations, the creation of incentives related to social security and the strengthening of information and inspection systems. For enterprises, it is important that the transition to formality makes good business sense. And for countries it is critical to take advantage of the potential of the MSE sector and its workers in order to boost sustainable economic growth.

This series of focus notes reveal that notwithstanding the complexity of the issue, positive experiences exist in several countries in Latin America and the Caribbean, which are worth reviewing and sharing with policy makers. The experiences presented in this series of focus notes also show that countries are concerned about the fact that youth and women are overrepresented in informal MSEs, either as workers or entrepreneurs.

The dissemination of these focus notes form part of the Programme for the Promotion of Formalization in Latin America and the Caribbean (FORLAC), launched by this Office in 2013. We hope that this series of notes helps in the design of policies that can give a new impulse to a topic that needs to be at the centre of the Latin American and Caribbean policy agenda.

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1. Introduction

In 2012, Brazil became the world’s seventh largest economy as measured by GDP. Between 2003 and 2013, some 40 million people were lifted out of poverty, while extreme poverty fell by 89%. The country successfully reduced inequality and, at the same time, experienced a significant decrease in the prevalence of informal employment.¹

Between 2002 and 2012, the percentage of the working population occupied in formal employment rose by 15.6%.² According to ILO data,³ by 2012, 70.2% of urban wage earners were covered by health and/or pension provisions. Among companies employing up to five people, this figure in the same year stood at 52.4%.

Micro and small enterprises (MSEs) currently account for 95% of Brazilian firms, generate some 16.6 million formal sector jobs, and contribute 20% to GDP. Over the last three decades of the 20th century, Brazil implemented a series of measures to encourage the formalization of micro and small enterprises and to promote the creation of formal employment in this segment of companies. This focus note gives an overview of these measures and presents – as far as possible – their impact on the formalization of MSEs.

A significant landmark in the creation of an enabling environment for micro and small enterprises was microenterprise statute (Estatuto da Microempresa)⁴ promulgated in 1984. For the first time, this law established the need for differential treatment of microenterprises in terms of their tax and labour obligations and in relation to access to credit and business development services.

Four years later, the new federal constitution (Constituição Federal, 1988) recognized the central role of micro and small enterprises in the economy. Article 179 calls for differential legal treatment of this segment of firms at the different administrative levels, by streamlining, eliminating or reducing their administrative, tax, social security and credit obligations.

In 1990, the autonomous small and micro enterprise development agency SEBRAE (Serviço Brasileiro de Apoio às Micro e Pequenas Empresas) was created. Financed through part of the social contributions collected on formal sector wages,⁵ SEBRAE became the single most important public agency specialized in small enterprise promotion.

In 1996, Law 9317 created Simples Federal, a program offering differential tax treatment to micro and small enterprises, through the unification of taxes and the streamlining of formalization procedures. Three years later, a new small and medium (SME) enterprise law (Novo Estatuto da Pequena e Média Empresa, 1999) established preferential treatment in terms of labour and social security regulations, credit and administrative provisions.

Despite these efforts of the government to favour micro and small enterprise growth and formalization through tax alleviation and simplification of administrative and accounting procedures, the initial results in terms of formalization were not positive. Between 1980 and 2000, the rate of informal employment in Brazil rose by 3.1%, averaging 0.2% annually. During the first decade of the present century, however, the rate of informal employment⁶ started to recede, falling from 41.7% in 2001 to 30.2% in 2011.⁷ During the same period, informal employment in companies with up to five employees dropped from 60.8% to 47.7%.⁸

The ILO Regional Office for Latin America and the Caribbean would like to thank Mario Pochmann, who prepared the document that formed the basis for this Focus Note, and Linda Deelen, for her technical coordination.

2 Based on the definition of formal employment presented in focus note 1.
5 Represents 0.6% of the wage amount. For more information see: DIEESE. Encargos sociais no Brasil. Brasilia: MTE, 2006.
6 Measured as the percentage of the urban employed population not covered by health care and/or pensions.
8 Ibid.
In short, two different approaches can be distinguished in Brazil with regards to micro and small enterprise promotion, with different results. The first approach, which predominated during the 1980-90 transitional period to monetary stability and semi-stagnation of per capita income, showed limited results. The second strategy, implemented as of the year 2000 in a context of monetary stability and economic growth, registered very positive results.

Most of the progress in terms of the formalization of micro and small enterprises occurred during a period in which the government systematically reformulated its policies towards a more conducive business environment for this segment of firms. Important measures in this regard were a complementary law (Lei Complementar 123, 2006) that created Simples Nacional, a simplified differential tax regime for micro and small enterprises. Two years later, another important benchmark was the creation of a special simplified tax regime for individual micro entrepreneurs (MEs).

The abovementioned measures, installed during the early years of the 2000s to improve the business environment for MSEs, formed part of a broader policy framework favouring economic growth, income distribution and job creation. Therefore, the dynamics of small and micro enterprise formalization in Brazil should be analyzed in this broader context, rather than in relation to any single policy, initiative or approach.

2. Policies for the formalization of MSEs

Without pretending to present the complete range of macro and micro policies that could have contributed to the formalization of micro and small enterprises, this chapter describes the main policy approaches relating to the business environment, enterprise development and access to financial services, which are likely to have had a direct impact on the formalization of this segment of firms and/or on the formalization of employment in these firms.

SEBRAE

The Brazilian micro and small enterprise support agency (Serviço Brasileño de Apoyo a las Micro y Pequeñas Empresas), funded mainly through company deductions on wages, has played a central role in the strengthening and formalization of micro and small firms. SEBRAE, which operates autonomously since 1990, is the main small enterprise development support body, offering assistance in technology development, market access, credit guarantees and local economic development, amongst others.

SEBRAE has taken a decentralized approach that enables it to respond appropriately to different regional conditions through over 700 support centres spread throughout the country. In 2013, SEBRAE provided assistance to micro and small enterprises, either individually or in groups, on 1.5 million occasions.

SEBRAE’s mandate, however, goes beyond technical and financial assistance to micro and small enterprises. Its mission to promote a competitive and sustainable micro and small enterprise sector in broad terms also gives it a role in the design and implementation of the regulatory framework for micro and small enterprises.

In terms of public policies, SEBRAE has not only played a leading role in the design of the general law on micro and small enterprises (Lei Geral da Micro e Pequena Empresa), but has also trained public officials in applying the law, particularly at the municipal level. SEBRAE, the national confederation of municipalities (Confederação Nacional de Municípios, CNM) and the national association of mayors (Frente Nacional de Prefeitos, FNP) joined efforts to create a national network of local development agents, thereby enhancing cooperation between local governments and technical support bodies in the creation of a favourable business environment for micro and small enterprises.

Together with the Bank of Brazil, SEBRAE runs a credit guarantee fund (FAMPE) for micro and small enterprises that provides guarantees worth up to 80% of the extended loan amounts. Since its
creation in 1995, the fund has assisted about 150,000 micro and small enterprises. Another example of a more innovative approach to credit guarantees is the Serra Gaúcha mutual guarantee association, created with SEBRAE’s support and with the participation of 32 municipalities, which has facilitated access to credit worth BRL 12 million, benefitting 350 micro and small enterprises.

SIMPLES NACIONAL

In the spirit of articles 146, 170 and 179 of the federal constitution, which establish preferential treatment for micro and small enterprises, in the early 1990s several policy initiatives sought to streamline and standardize the regulations for small and microenterprises in the country.

In 1996, the *Simples Federal* Law 9317 simplified tax regulation for micro and small enterprises by creating an integrated system for the payment of tax and social security contributions. This law allowed the unification of five different federal taxes plus the employer’s contribution to social security into one single payment. The amount paid by each enterprise depended on the level of annual sales and the type of economic activity. The system exempted small businesses from having to maintain accounting ledgers. On its own, however, this law turned out to have little impact on the formalization of MSEs.

As of 2000, formalization picked up significantly with the passing of a complementary law (*Lei Complementar 123, 2006*), which became known as the general law for micro and small enterprises. This law created an upgraded version of *Simples Federal*, known as *Simples Nacional*, which helped to further reduce bureaucracy, combining eight different taxes affecting small firms into one single payment.

Firms eligible under *Simples Nacional*, sometimes known as *Super Simples*, are (i) microbusinesses with gross annual income of up to BRL360,000 and (ii) small businesses with gross annual income ranging from BRL360,000 to BRL3.6 million. Since the *Simples Nacional* came into effect in July 2007, replacing *Simples Federal*, all companies that want to subscribe to the system, have to register with the national tax authority (*Super Receita Federal*).

*Simples Nacional* allows companies to file a single simplified annual tax declaration, replacing the tax and social security declarations that they until then had to present at the federal, state, and municipal levels with a monthly payment which varies according to the economic activity. The general law, moreover, exempts micro and small enterprises from paying additional social contributions required at the federal level, and reduces a few other fiscal obligations.

The implementation of *Simples Nacional* required the cooperation of states and municipalities, which under the previous *Simples Federal* continued to levy taxes on the movement of merchandise and services (*Imposto sobre Operações Relativas à Circulação de Mercadorias*), interstate and intermunicipal transport and communications services (*Serviços de Transporte Interestadual e Intermunicipal e de Comunicação*, ICMS), and other services (*Imposto sobre Serviços de Qualquer Natureza*, ISS). For the new system to take effect each state had to adapt its own legislation and sign agreements with the *Receita Federal*. The same procedure was required at the municipal level in relation to the ISS tax.

Under *Simples Nacional*, the single tax payment incorporates and replaces the separate payment of corporate income tax (*Imposto de Renda das Pessoas Jurídicas*, IRPJ), contributions to the social integration program and the public service employee fund (*Programas de Integração Social e de Formação do Patrimônio do Servidor Público*, PIS/PASEP), social contributions on net income (*Contribuição Social sobre o Lucro Líquido*, CSLL), social security tax (*Contribuição para Financiamento da Seguridade Social*, COFINS), a tax on manufactured goods (*Imposto sobre Produtos Industrializados*, IPI), employers’ contributions to pensions and social security (*Contribuição Patronal Previdenciária para a Seguridade Social*, INSS), a tax on circulating merchandise, interstate and intermunicipal transport and communications (*Imposto sobre Operações Relativas à Circulação de Mercadorias e Sobre Prestações de Serviços de Transporte*

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9 Brazil’s internal revenue agency is called the *Receita Federal.*
Instead of paying each tax or contribution separately, according to different calculation methods and payment schedules, taxpayers contribute a single monthly amount, which varies according to gross revenue over the previous 12 months and the type of economic activity performed. The single tax significantly simplifies accounting practices in small firms.

One advantage of Simples Nacional was that it actually reduced the amount of tax to be paid by small firms. Most micro and small enterprises that opted for the regime, saw their tax contributions reduced by between 20% and 50%, depending on the type of economic activity performed and the levels of sales. According to studies carried out by SEBRAE (2009), 32% of entrepreneurs confirmed that Simples Nacional had reduced their total tax burden, while 40.4% thought it had remained the same. To some extent, these different perceptions reflect the structural heterogeneity that characterizes the micro and small enterprise sector in Brazil.

It is important to mention that under Simples Nacional, the employees working in micro and small enterprises continue to enjoy the same rights and benefits as other formal wage earners. A key feature of the system, therefore, is that it reduced the administrative burden on companies without producing negative consequences in terms of workers’ rights and benefits in small firms.

By 2012, more than four million micro and small enterprises had opted for the Simples Nacional regime. A study by the IZA Institute for the Study of Labour showed an increase in income and employment among registered companies. Through a quasi-experimental design it was observed that companies registered with Simples Nacional were carrying out more permanent and capital intensive operations, and hiring more employees.

Figure 1: Number of micro and small enterprises registered with Simples Nacional, 2007-2012 (thousands)

Aside from the increase in the number of formalized micro and small enterprises, tax revenues also rose significantly, as small scale production units moved out of the informal sector. Tax revenues under Simples Nacional went up from BRL8.3 billion in 2007 to BRL46.5 billion in 2012.

These figures suggest that the creation of a special tax regime for small businesses helped to increase formalization without lowering tax revenues. On the contrary, the country experienced a considerable increase in the amount of taxes collected amongst micro and small enterprises.

Figure 2: Total tax revenues under Simples Nacional, 2007-2012 (billions of BLR)


Law on Individual Microentrepreneurs

With the promulgation of complementary law 128 of 2008 (Lei Complementar Micro Empreendedor Individual) on individual microentrepreneurs (IME), Brazil took another major step forward towards the formalization of micro enterprises and own account workers. The implementation of this law has significantly increased social protection coverage of workers employed in small businesses in Brazil.

Under the IME law, entrepreneurs and own account workers with a gross annual revenue of less than BLR60,000, who are neither owners or partners of another firm, and who hire no more than one employee, can register as individual microentrepreneurs. Formalization starts when the entrepreneur registers with the microbusiness portal (Portal do Empreendedor), which automatically leads to the inscription of the business in the national register of legal entities (Cadastro Nacional de Pessoas Jurídicas), making it easier for the entrepreneur to open a bank account, request a loan, or issue legally recognized bills.

Upon registration, the microentrepreneur receives an official microenterprise certificate (Certificado da Condição de Microempreendedor Individual, CCMEI) and a provisional operating license covering the next six months. During this period, the competent municipality has the obligation to evaluate the application and, when all conditions are met, issue a permanent operating license. Granting operating licenses a priori (except in the case of high-risk activities), followed by ex-post verification, has proven to facilitate the formalization of micro and small enterprises.

The individual microentrepreneur pays a fixed monthly amount, which includes BLR5 for the municipal ISS, BLR1 for the state ICMS, and BLR33.90 for the national social security institute (Instituto Nacional do Seguro Social, INSS). The individual microentrepreneur is exempted from other taxes and contributions, such as the IRPJ, PIS, Cofins and IPI, mentioned above. The INSS contribution is 5% of the national minimum wage, compared to a rate of 20% of monthly gross income established in the general regime for own-account workers. Payments must be made monthly using a form specifically designed for this purpose (Documento Único de Arrecadação, DUA).

The benefits of being registered as an individual microentrepreneur include access to a basic state pension, disability and survivor benefits, health and maternity protection as well as a family

15 Ibid.
allowance in the event of imprisonment or death of the household’s bread winner. Medical care is provided through the public system (Sistema Único de Saúde, SUS), as is the case for workers affiliated to the general regime. Microentrepreneurs wanting to access other benefits provided under the general regime, such as old age pensions based on individual contributions, can opt to change their status, paying a 20% contribution rate and covering any other differences.

The monthly payment does not include pension contributions for the workers employed by the microentrepreneur. These contributions are set at 11% of the minimum wage, composed of a 3% employers’ contribution and an 8% workers’ contribution.

The implementation of the general law governing micro and small enterprises and the complementary law for individual microentrepreneurs has required major dissemination and capacity building efforts, including the training of municipal staff. Substantial efforts were made to ensure that the two laws would be effectively implemented countrywide within a relatively short period of time. In 2012, virtually all Brazilian municipalities were familiar with the procedures for the registration of microentrepreneurs, although the general law governing micro and small enterprises was not yet fully applied throughout the country. In this respect, it should be noted that the implementation of the two legal initiatives has not yet reached its full potential and that efforts to bring micro and small enterprises into the formal sector continue.

By 2014, four million individual microentrepreneurs had been formalized in Brazil. Between 2010 and 2013 alone, the INSS registered 2.6 million new taxpayers under these provisions.

**Figure 3: Registration of Individual Microentrepreneurs, 2010-2012 (thousands)**

Registered individual microentrepreneurs in 2012 included 54% men and 46% women, while an increase in women’s participation over recent years was observed. Since the vast majority of businesses operated by women classify as micro businesses, the MEI law has significantly improved their participation in the formal sector, thereby facilitating access of women entrepreneurs to new markets as well as to financial and non-financial services offered by public and private bodies.

In 2012, almost 60% of registered microentrepreneurs declared that their revenue had increased after they had formalized their operations. Just 3% reported a drop in income, while 41% reported no change.

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16 Sebrae, Regulamentação da Lei Geral Municipal, 2012.
18 Ibid.
It should be noted that in Brazil, neither the formalization of the business entity nor the formalization of employment in small businesses, mean that the people working in these firms lose access to benefits and subsidies provided by the different social protection programs. On the contrary, programs such as “Brazil without misery”, established in 2011, support their beneficiaries in establishing formal micro businesses. This program is directly linked to the MEI law and explicitly aims to promote the formalization of small enterprises created by low income people.

In 2011, of the 1.4 million individual microentrepreneurs registered, a significant number were beneficiaries of the conditional cash transfer program Bolsa Familia. In the southern region of Brazil, home to 14% of the individual microentrepreneurs registered in Brazil, 10% of them were registered with Bolsa Familia. In the northeastern region, which represents 22% of individual microentrepreneurs, 41% of them received benefits under Bolsa Familia.

The fact that a large number of individual microentrepreneurs receive benefits under these different social protection programs is the result of an explicit effort to ensure coherence between social policies and policies to promote the formalization of Brazil’s microentrepreneurs. Recognizing informality as an important obstacle to the alleviation of poverty and the reduction of inequality, the Brazilian Government considers that programs like Bolsa Familia and schemes to formalize micro and small enterprises, like Simples Nacional and the individual microentrepreneurs law (Lei MEI) need to go hand in hand.

Public acquisitions

A key component of Brazil’s policy framework for the formalization of micro and small enterprises are its initiatives to encourage MSE participation in public procurement. Several initiatives in this area have substantially contributed to the growth and development of small businesses.

The 2006 general law governing micro and small enterprises gives these firms sole access to public acquisitions of goods, services and works worth up to BRL80,000. The law also simplifies public tender procedures, permits subcontracting of micro and small enterprises within larger contracts and, in the event of a tie, guarantees their precedence over larger firms.

Decree 6204 promulgated in 2007 defines the details of the streamlined, differential treatment of micro and small enterprises in public procurement at the federal level, consolidating rules concerning MSE participation in public tendering. The effective inclusion of small businesses in federal, state and municipal tenders, however, has demanded and continues to require large efforts in terms of information dissemination and training of technical and managerial staff working in federal and municipal bodies.

One interesting initiative in terms of MSE participation in public procurement is the national school meals program (Programa Nacional de Alimentação Escolar, PNAE) run by the Ministry of Education. This initiative obliges municipalities to spend 30% of the resources received for school meals from the national education development fund (Fundo Nacional para o Desenvolvimento da Educação, FNDE) on products from family-based agriculture. Under Law 11947 (2009), public schools serve almost 50 million meals daily, meeting students’ alimentation needs and supporting local agricultural producers. The acquisition of products from local farms has also created more awareness of the benefits of consuming local healthy products.

Another example is the national food acquisition program (Programa Nacional de Aquisição de Alimentos, PAA), which assists food insecure people through a network of popular restaurants, food banks, community kitchens, and food baskets distributed by the federal government. The program allows public sector organizations to purchase directly from small enterprises through open competitions and without the need for traditional tendering procedures, thereby supporting the growth and formalization of small rural production units. In 2012, more than 185,000 farming families supplied products to this program.

Eligible suppliers to the food acquisition program can be either small farms, indigenous or traditional communities. The program, that was launched in 2003, is financed with resources from the Ministry of Agricultural Development (Ministério do Desenvolvimento Agrário, MDA) and the Ministry for Social Development and Hunger Alleviation (Ministerio do Desenvolvimento Social e Combate à Fome), in conjunction with state and municipal governments, and the Brazilian National Supply Company (Companhia Nacional de Abastecimento, CONAB), as per Law 10,696 (2003).

In 2011, the Brazilian Government created a differential public procurement regime (Regime Diferenciado de Contratações Públicas, RDCP). This system promotes the participation of micro and small enterprises in government acquisitions for different international sport events, starting with the 2013 Brazil Confederations Cup, the 2014 FIFA World Cup and the 2016 Olympic Games. The regulations established under Law 12462 and Decree 7581 (2011) guarantee participation of small businesses in these tenders, be it directly or indirectly through subcontracting by large companies.

A more recent initiative to promote small business participation in public acquisitions is the Sustainable Public Procurement Program (Programa de Compras Sustentáveis), created in 2012. In this program, the federal government gives priority to small businesses specialized in

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20 Previdência Social, 2013.
environmentally, socially and economically responsible goods and services, underlining the importance of environmental preservation and responsible consumption.

Of the BLR40 million spent through sustainable tenders in 2012, 57% was secured by micro and small enterprises. In less than two years, the share of the total value of contracts supplied by micro and small enterprises rose 115%, from BLR6.6 million in 2010 to BLR22.4 million in 2012.

MSEs that want to participate in any of the public procurement programs described here, must be fully formalized. This way, policies to expand MSE access to public procurement have become a fundamental pillar of the national strategy to encourage formalization of small firms.

**Figure 6: Trends in Federal Government purchases from micro and small enterprises, 2003-2011**

![Graph showing trends in Federal Government purchases from MSEs and others, 2003-2011.](image)

Source: MPOG/SISG.
Note: deflator Ipca/IBGe.

**Credit-related policies**

An important benchmark in credit policies for micro and small enterprises was Law 10735 (2003), which requires that commercial banks, universal banks with commercial portfolios, and the **Caixa Econômica Federal** use 2% of demand deposits to finance loans to low-income individuals and microentrepreneurs. Banks have the possibility to either handle these operations themselves, transfer resources to other financial institutions with microcredit portfolios, or purchase transactions. According to the law, any unused funds must be deposited in the Central Bank, at no interest.

Law 10735, together with a set of improvements in the regulatory framework for financial service provision and a strong increase in the number of service points through banking agents, encouraged a rapid increase in credit to low income households and micro entrepreneurs over the past 10 years. The Brazilian network of banking agents presently includes 150,000 agents, who serve the public in stores, pharmacies and post offices, covering all municipalities.

In 2005, access to credit was further boosted when the Ministry of Labour and Employment launched its national oriented productive microcredit program (**Programa Nacional de Microcrédito Produtivo Orientado**, PNMPO) under Law 11110. This program, financed through the Workers Support Fund (**Fundo de Amparo ao Trabalhador**, FAT) and the compulsory allocation of 2% of demand deposits, provides access to credit to small enterprises. The main financial service providers involved are the **Banco Nacional Desenvolvimento Econômico e Social** (BNDES), NGOs, *Sebrae, Oportunidades para empresas de serviços terceirizáveis e empreendedores individuais. Brasilia: Sebrae, 2014.*

microfinance institutions, credit cooperatives, development agencies, and cooperative banks. Between 2005 and 2010, more than 6.7 million microcredit operations took place, injecting over BLR8.7 billion into small enterprises.

In 2011, national microcredit policies took further shape with the creation of the Crecer program, whose interest charges are set below inflation rates. Of the 3.4 million microcredit operations realized under this program in the period 2012-2013, around one-third went to the beneficiaries of the conditional cash transfer program Bolsa Familia.

In rural areas, the PRONAF program, mandated to support family-based agriculture (Programa Nacional de Fortalecimento da Agricultura Familiar) by providing finance to small farming projects either on an individual or collective basis, plays a significant role. In order to access PRONAF credit lines, farmers must open a bank account in a formal financial institution. During the 2012/2013 agricultural season, more than 2.2 million small farmers benefitted from low-cost microcredit operations worth a total BLR18 billion.

As a result of these different credit policies, the number of customers using financial services has augmented substantially. In 2010, the national credit registry counted 114 million individuals and 6.5 million businesses with active credit operations. In 2012, domestic credit to the private sector had risen to 53.3% of GDP, up from 25.5% in 2001. Public banks tripled their share of total domestic credit supply over the same period.

Through the abovementioned credit programs, the Brazilian Government envisaged to overcome one of the main barriers to micro and small enterprise development in the country. Without access to credit at affordable interest rates, small production units remain trapped in the informal sector, relying on subsistence strategies given their low productivity and profitability.

Notwithstanding these advances, significant challenges remain in terms of credit and financial service provision. The financial inclusion project developed by the Central Bank in 2009, therefore establishes three main goals: 1) ensuring that the supply of financial services is adapted to the population’s needs, with more emphasis on savings and insurance instruments, 2) promoting transparency in the supply of financial products and extending financial education, and 3) expanding people’s access to financial services.

Export policies

A public policy area worth mentioning, given its contribution to MSE development and formalization, is the promotion of an enabling environment for small firms to export their goods and services. In 1999, Brazil streamlined its procedures for low-value exports, introducing a simplified customs clearance procedure (Despacho Simplificado de Exportação, DSE) for exports worth up to US$50,000.

Twelve years later, in 2011, more than 3,400 enterprises or 26% of all exporting micro and small enterprises, used the simplified customs clearance procedure to realize almost BLR104 million in sales abroad. That same year, micro and small enterprises accounted for 62% of Brazil’s exporting firms and 1% of exports.

Promoting a solidarity-based economy

Another important contribution to formalization was the federal government’s decision to promote the social and solidarity economy as part of its national development agenda. As of the year 2000, the promotion of the social economy became an important and innovative strategy for local development and job creation through cooperatives, social enterprises, mutual societies and different kinds of non-profit institutions.

25 Ibid.
After several initiatives at the local level, the federal government has, since 2003, implemented a series of policies to encourage the development of the social and solidarity economy. With the creation of a specialized secretariat (Secretaria Nacional da Economia Solidária, SENAES) at the Ministry of Labour and Employment, the need to strengthen and support cooperatives and social enterprises has received increasing attention from public policymakers.

Specific measures taken to promote the social economy include programs to facilitate access to finance for cooperatives and social enterprises as well as technical assistance and training programs to increase knowledge and awareness on the role of the social economy in society. At the same time the government established a specific legal framework for the social economy and a publicly accessible database offering detailed information on social economy organizations and their support agencies nationwide.

Policies for innovation and technology transfer

Brazil’s policies and programs for innovation and technology transfer form an important part of the country’s formalization strategy as access to these programs serves as an important incentive for entrepreneurs to formalize their business. The Plan Brasil Maior (PBM), launched in 2011, defines federal government policies and initiatives in the area of innovation and competitiveness. The PBM replaces and provides continuity to the earlier policy framework for industrial development, technology and foreign trade (Política industrial, Tecnológica e de Comércio Exterior, PITCE), in effect from 2003-2007, and the private sector development policy (Política de Desenvolvimento Produtivo) of the period 2008-2010, both of which paid significant attention to micro and small enterprises.

With regards to micro and small enterprise development, Brasil Maior defines the need to improve access to credit both for working capital and investment projects. The document also highlights the need for local economic development strategies as a way to strengthen small companies.

As a result of measures implemented in the framework of Brasil Maior, small businesses have benefitted from export and investment exemptions, improved access to finance for technology transfers and innovation projects, improvements to the legal framework governing innovation, and expansion of fiscal incentives.

An important role here is played by FINEP (Financiadora de Estudos e Projetos, FINEP), a public corporation linked to the Ministry of Science and Technology, responsible for the financing of studies and projects. FINEP promotes innovation in firms, universities, technological institutes and other public or private institutions. Through specific programs and public calls for interest it provides grants and loans to public and private institutions working on innovation in the private sector.

Of the wide range of existing programs in the area of innovation and technology transfer, it is worth mentioning the National Support Program for Business Incubators (Programa Nacional de Apoio às Incubadoras de Empresas), which has been particularly effective in strengthening the capacity of incubators and technological parks to expand and optimize resources available for the creation and consolidation of innovative micro and small enterprises.

Another significant program is the FINEP/SEBRAE initiative, which finances innovation projects jointly developed by micro and small enterprises and institutions involved in science and technology. This program has permitted the implementation of innovation projects of interest to MSEs and promoted cooperation between technological institutions and small businesses.

SEBRAE also implements a local innovation agents program, a model intended to foster innovation in small firms through specialized local agents. At the same time the SEBRAETEC program, which offers subsidized access to technology transfer and innovation, in the year 2011 assisted 22,200 micro and small enterprises countrywide.
In general terms, SEBRAE plays an important role in Brazil’s system for technology transfer and development, connecting resources, instruments and services offered by a range of public and private institutions specialized in technology and innovation, thus encouraging more technological development in small and micro enterprises.

**REDESIM**

The Brazilian Government’s efforts to formalize companies also led to the creation of a national network for the simplification of business registration and legalization, known as REDESIM (Rede Nacional para a Simplificação do Registro e da Legalização de Empresas e Negócios), under the supervision of the Ministry of Development, Industry and Foreign Trade (MDIC). Its purpose, as defined in complementary law 123 (2006), is to streamline and integrate into a single system all registration and licensing procedures related to the start-up, operation and closure of companies, regardless of their size.

Decree 6884 (2009) made the REDESIM executive committee responsible for developing an operational model for the network and defining its internal regulations. The network will be led by the federal government with the active participation of state and municipal bodies from the different states committed to integrating and streamlining the different systems and procedures currently in place.

The REDESIM network is supposed to integrate the procedures and services of trade boards with the administrative procedures and processes presently administered by different federal, state and municipal bodies. Uniform electronic systems for data management will make it possible to integrate processes undertaken by the different institutions involved in business registration and formalization. REDESIM is also expected to establish business service centres to guide and support companies with the different procedures related to business formalization.

The central task of the REDESIM network to create a single window for registration, licensing and closure of enterprises is still work in process. With the creation by the federal government of a Secretariat for Micro and Small Enterprises in 2013, an automatic licensing system is presently at the design stage. This system would combine automatic licensing with ex post verification by the competent bodies, thereby significantly streamlining the formalization of small firms.

Bringing together the three levels of government to design a new system with a one-stop service for business owners, is a major coordination effort that requires time. But it has been considered fundamental to systematically involve from the beginning all actors that presently have a role in business registration and licensing processes.

**3. Results**

Progress in Brazil in terms of formalizing the informal economy is directly and indirectly related to a series of public policies applied in the country as of the first decade of the 21st century, that go well beyond small enterprise development policies alone. Different macro and microeconomic measures complemented each other, bringing about positive results at the level of the economy and specifically in the segment of small and micro enterprises. Positive results, therefore should not be attached to any individual policy, but rather to the combination of a broad set of government measures.

Comparing data from the 1990s and the 2000s reveals a significant shift toward formalization of the working population in Brazil, measured as the percentage of wage workers (employees) covered by social security.
Figure 7: Formalization rate* employees aged 16-59 years, 1992-2012 (%)

![Graph showing formalization rate in % from 1992 to 2012](image)

* Measured as contribution to social security.

**Source:** Authors, based on data from IBGE/PNADs.

The average annual increase in the number of employees covered by social security contributions was 2.6 million between 2003 and 2013, as compared to an annual increase of 1.4 million people over the period 1996-2003.

Figure 8: Trends in number of employees paying into social security, 1996-2012 (millions)

![Graph showing trends in number of employees paying into social security](image)

**Source:** Authors, based on data from MPS.

At the same time, considering total employment, between 2001 and 2012, the formalization rate increased by 32.2%. Among employers, formalization rose by 12.4%, among employees by 12.6%, among own-account workers by 55.4%, and among contributing family workers it increased 3.5 times. The overall formalization rate presented here is defined as the number of persons that contribute to the Brazilian social security system (including wage workers, domestic workers, the military, public sector workers, own-account workers, contributing family workers and employers) as compared to total employment, which is the definition used by the ILO Office in Brazil.

Small firms were the ones that contributed most to employment formalization in recent years. The formalization of micro and small enterprises through the Simples Nacional and Microempreendedor Individual programs significantly boosted formalization rates in the country. In 2012, for example, there were 7.1 million formalized establishments, of which 2.7 million were registered as IMEs and 4.4 million as micro and small enterprises. Over a period of only five years (2007-2012), a total of 4.9 million micro and small enterprises were formalized.
Results in terms of the formalization of employment in small businesses were substantial. Between 2006 and 2011, for example, the percentage of formal wage earners in firms with up to 10 staff on average increased by 3.1% annually, as compared to an average annual increase of 0.8% in companies with more than 10 workers.

Figure 10: Formalization Rates* of Workers in Businesses by Size, 1996-2006-2012 (%)
covered by at least one social security contribution in 2012, more than 7.1 million were persons registered with Simples Nacional.

4. Conclusions

Brazil’s recent efforts to formalize micro and small enterprises form an important part of the county’s endeavors to reduce inequality and poverty. Measures such as the general law governing micro and small enterprises and the law on individual microentrepreneurs, fit seamlessly into a broader strategy to improve people’s access to employment and income.

Consistent with the observation that small companies are responsible for the majority of jobs in Brazil, the country has implemented a set of public policies to encourage their growth and formalization. These policies are rooted in the 1988 Federal Constitution, which recognizes the central role of micro and small enterprises in the economy and establishes differential treatment for this segment of companies.

With the coming into force of the General Law for Micro and Small Enterprises (2006), the general stipulations regarding differential and favourable treatment for micro and small enterprises established in the federal constitution were put into practice. Subsequent adjustments to the regulatory framework governing small firms, combined with efforts to disseminate policies nationwide and train state and municipal staff, helped to create a favourable environment for MSE formalization.

Although Simples Nacional is usually singled out as the key policy that led to a substantial increase in the formalization of micro and small enterprises, this focus note reveals that achievements were actually the result of an integrated set of policies that combine enterprise development promotion with access to credit and a more favourable regulatory environment. The effectiveness of efforts to formalize the informal economy in recent years cannot be attributed to any single policy initiative, but rather to their interconnectedness and to synergies created with other policy areas.

Progress observed in Brazil in terms of the formalization of employment in micro and small enterprises firms leaves no doubt as to the success of the strategies applied during the first ten years of the 2000s. The significant rise in formal employment observed during these years was not led by large companies, as occurred in the past, but by small and micro enterprises.

Continued efforts to bring informal micro enterprises into the formal economy, however, remain crucial, particularly in a country with an enormous legacy of inequality and poverty. More investment in informational campaigns and direct support to businesses is important, particularly in the case of individual microenterprises in remote areas. At the same time, efforts to promote the use of information and communication technologies are vital if the country wants to move towards a situation where micro and small enterprises handle their administrative obligations via internet.

While Simples Nacional significantly simplified procedures for starting and running a micro or small enterprise with gross revenues under BRL2.4 million, creating a limited liability company in Brazil still requires 13 different steps and takes at least 120 days.27 The cost of starting a limited liability company, moreover, is calculated at 34.4% of per capita income. Closing an insolvent firm on average takes four years. These figures demonstrate the importance of the REDESIM project, which seeks to integrate all business regulations and procedures in a single, low-cost system. Until this system is in place, the regulatory burden presently placed on larger firms discourages enterprise growth and development.

In terms of financial inclusion, the country still has a long way to go to ensure that micro and small enterprises have access to financial services that really help to reduce vulnerability and

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improve productivity in the long term. Without this qualitative leap in financial service provision and without the extension of much needed financial education countrywide, indebtedness and its cost may discourage formalization.

The Brazilian experience demonstrates that whether policies for the formalization of MSEs bring about the desired results or not, greatly depends on the general economic context in which these policies are implemented. The economic context characterized by economic growth and greater income distribution that enabled formalization policies to flourish in Brazil during the period 2000-2010, required public policy formulation and coordination in multiple spheres, including macroeconomic development, trade, credit, education, science and technology.

It is the context of this broader policy framework that Brazil’s efforts to create an enabling environment for the growth and formalization of micro and small enterprises, brought about the results in terms of formalization presented in this focus note. The success of Simples Nacional and of the provisions for individual microentrepreneurs should be seen in the light of public policies applied at the macro, meso, and micro level.