

THE TAXATION OF THE INFORMAL SECTOR IN THE CAMEROONIAN CONTEXT: WHAT IS AT STAKE IN THE FORMALIZATION AND TRANSPARENCY OF INFORMAL SMES?

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Abstract

This study examines the impact of informal sector taxation on the formalization and transparency of informal small and medium-sized enterprises (SMEs) in Cameroon. It explores the perceptions of informal SME managers on the effects of this taxation in the Cameroonian context. The results show a mixed effect, with some managers fearing the negative repercussions on the survival of their businesses, while others see it as a means of formalizing and increasing transparency. The study highlights the need for public authorities to communicate more effectively on the benefits of taxation and to take account of the socio-economic context when implementing it.

1. INTRODUCTION

Taxing the informal sector is a major topic of debate in developing countries such as Cameroon, to formalize informal small and medium-sized enterprises (SMEs) and make them more transparent. This would involve registering these businesses with the government and subjecting

them to taxation (Gautier et al., 2001). Although the informal sector makes a significant contribution to the economy, it faces problems such as a lack of funding and inadequate recognition in the tax system (Omoloba & Bardot, 2023). The Cameroonian government has put in place various policies to formalize this sector, but their effectiveness remains debatable.

The informal SME sector poses significant challenges. These businesses do not pay taxes, limiting government tax revenues (Lopez-Castaño, 1987; Rubbers, 2007). Although the informal sector contributes significantly to the economy, its opaque nature creates problems (Omoloba & Bardot, 2023). Informal SMEs find it difficult to obtain bank finance due to their lack of transparency (Lekhal, 2013), which hampers their productivity and hiring capacity. It is therefore crucial to study how taxing the informal sector could promote the formalization and transparency of these businesses.

The informal sector plays an important role in the economy of developing countries such as Cameroon, but remains largely unregulated and untaxed, resulting in revenue losses for governments. The main challenge is the lack of formalisation and transparency of informal SMEs, which operate without legal documents (Etogo Nyaga, 2020; Kede Ndouna & Tsafack Nanfosso, 2023). This makes it difficult for governments to monitor them, collect taxes, and provide them with support, particularly in terms of access to financial services.

Based on a sample of 29 informal SMEs in 2024, this study examines managers' perceptions of the impact of taxation on their formalisation and transparency in order to promote their financial inclusion, performance, and sustainability.

2. LITERATURE REVIEW

According to Abate (2021), the informal sector is strategic in developing economies because it creates wealth and reduces youth unemployment. However, it leads to a shortfall in state tax revenues and opacity in transactions. There are mixed views on taxing this sector: it can improve the transparency, accountability, and tax compliance of informal SMEs through the use of electronic payment systems and compliance with legal tax requirements.

The promotion of electronic payments plays a key role in the formalization and transparency of informal SMEs. It increases the transparency of financial transactions, integrates informal SMEs into the formal economy (Gradeva, 2009), and reduces cash transactions (Lentz, 2010). This can lead to higher tax revenues and better financial regulation and supervision (Ngakosso, 2015). Technology, such as digital payment systems, makes it easier to track and monitor transactions (Lentz, 2010) while improving SMEs' access to finance and credit.

It provides a digital footprint that can be used to assess creditworthiness (Guérineau & Jacolin, 2014; Oudgou & Zeamari, 2018).

The taxation of the informal sector poses a challenge for the government, which is seeking to promote transparency and accountability in the tax system (Karimi, 2020). Among the measures envisaged are the non-deductibility of expenditure incurred with suppliers that are not registered with the tax authority, in order to encourage informal SMEs to register (Lekhail, 2013); the requirement that SMEs carry out transactions only with registered suppliers, thereby enabling better control of financial flows (Nohoua, 2016; Imad et al., 2022) and the non-deductibility of expenses justified by invoices outside the electronic invoicing system, encouraging SMEs to adopt this more transparent system (Gobert, 2001; Jay, 2015). These measures aim to encourage the formalization of informal SMEs and improve tax collection, thereby contributing to the country's economic growth (Barzi, 2011; Okombi, 2023).

Taxing informal SMEs can face several challenges, including high formalisation and business costs (Nohoua, 2016). Informal SMEs may find it difficult to comply with the regulatory requirements accompanying formalization (Kede Ndouna & Tsafack Nanfosso, 2023), due to a lack of capacity (Nohoua, 2016; Abate, 2017; Okombi, 2023). This could also lead to a reduction in the number of informal SMEs in the face of competition from formal businesses (Traore, 2021; Okombi, 2023).

The main challenges in taxing the informal sector are the difficulties in complying with government standards and accurately assessing the tax liability of informal SMEs (Benjamin & Mbaye, 2012; Mas-Montserrat et al., 2023). This leads to a situation where the burden of taxation falls disproportionately on businesses in the formal sector, exacerbating existing economic inequalities (Sani, 2009).

There are advantages to taxing the informal sector, including increased tax revenues and the formalization of the economy. However, the potential drawbacks need to be carefully considered so as not to disproportionately harm SMEs or exacerbate existing inequalities (Bellal, 2008). A nuanced approach, taking into account the specific needs and challenges of informal enterprises as well as the economic and social context, is needed to design appropriate policies (Houssein, 2008).

Therefore, based on the ideas developed, the following proposals are made for SMEs in the informal sector:

Proposal 1: The use of electronic payment systems by informal SMEs leads to their transparency in financial transactions.

Proposal 2: Informal SMEs that comply with legal tax requirements have easy access to bank financing.

Proposition 3: Informal SMEs that incur high formalization costs are likely to cease trading.

Proposition 4: The difficulties in complying with the requirements set by taxation are the reason why informal SMEs refuse to formalize.

The process of formalizing the informal sector can have divergent impacts on informal businesses. While some may benefit from the transition to the formal sector, others risk losing quality and competitiveness. Policymakers therefore need to consider these implications carefully and provide appropriate support to facilitate a smooth transition.

3. METHODOLOGY

This exploratory qualitative study was based on a case study (Hlady-Rispal, 2002) of 29 informal SMEs randomly selected in Cameroon’s capital cities. Open interviews were conducted with the managers of these SMEs in order to gather their perceptions of the effect of taxation of the informal sector on the formalization and transparency of their businesses. Thematic content analysis was used to identify recurring ideas and extract their meaning (Miles & Huberman, 2003). The aim was to draw up a representative portrait of business leaders’ views on the subject.

4. RESULTS

In this study, the opinions of the SME managers approached are mixed on the reform relating to the taxation of the informal sector, highlighting various perspectives on the issue of formalization and transparency of SMEs in the experimental area of the study. Indeed, some of the managers approached expressed their strong concern, which is reflected in various verbatims such as: “Taxing the informal sector is seen as a threat to our survival. Taxes are already high, and profit margins in the informal sector are particularly low. If additional tax burdens are imposed on us, we risk closing our businesses” (R2, personal communication, October 4, 2024). On the other hand, other SME managers see it as a guarantee of business transparency and put it this way: “Formalizing the informal sector is crucial. It would increase transparency in our transactions, which is essential for attracting financial partners. As SMEs, we need to be able to prove that we comply with standards, and this is difficult without a common basis of transparency across the sector” (R4, personal communication, October 4, 2024). The comments of some of the SME managers approached revealed a strong distrust of the tax authorities. “The problem is precisely that we do not trust the tax authorities. Many promoters fear that tax harmonization will lead to more corruption and extortion on the part of civil servants, rather than actually improving transparency” (R7, personal communication, October 10, 2024).

On the other hand, some of them nevertheless recognize that taxing the informal sector could be beneficial to them, but under certain conditions, as is clearly illustrated by various extracts from verbatims such as: “Taxation could be a good thing if it is accompanied by incentives such as tax reductions for businesses that formalize. This would encourage us to enter the formal sector while benefiting from certain legal protections” (R5, personal communication, October 10, 2024).

Some of the players approached expressed the need for support from the tax authorities as a major necessity if the reform is to be more effective. They put it this way: “For taxation of the informal sector to work, we need support. Training in tax and accounting management is needed so that SMEs like ours can comply with the new requirements without too much difficulty” (R3, personal communication, November 4, 2024).

5. CONCLUSION

The aim of this study was to examine the influence of the taxation of informal SMEs on their formalization and transparency.

The results obtained after content analysis of the respondents’ discourse offer a valuable contribution to understanding the issues involved in taxing informal SMEs and may guide policy decisions, business strategies, and future research in this area in Cameroon.

Despite this contribution, the study also has its limitations. It is based on a modest sample of informal SMEs and, above all, in a very specific context. Future research should take a more nuanced and multidisciplinary approach, taking account of the specific features of each context and integrating the social, environmental, and digital dimensions.

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