

# Pakistan's Informal Economy: the way forward

## 1- Introduction

Thesis statement: The undocumented informal sector of Pakistan's economy has the potential to steer massive economic growth, but its transition to inclusive regulated economy requires concerted effort of all.

## 2- Overview of Pakistan's Informal Economy

### 3- Glance at the size of Pakistan's Informal Economy

a- Agricultural sector the largest undocumented sector of Pakistan

b- The burgeoning undocumented unproductive real estate sector.

c- Retailers in textile, sugarcane, wheat and construction industry

d- Transport, community and social personal services - a major chunk of informal economy

### 4- challenges to Pakistan informal economy

a- Low tax-GDP ratio

b- Absence of e-banking incentives

c- Lack of capacity building in Board of Revenue

d- over regulation and corruption

e- Hundi and Hawala endemic

### 5- Way forward to Pakistan's informal economy

a- Incentivize e-banking system

b- Improve taxation system by undertaking structural reforms

c- enhance capacity building in board of revenue

d- Document women participation in informal economy

e- Adopt policy of confidence-  
building measures

f- Provide more efficient and  
more reliable money transfer  
forums

g- Derugate statism in economy

h- Incentivize barter trade  
regionally

i- Targeted subsidy and  
improved direct taxation system

J- corruption eradication measure

6- conclusion

## 6 - Conclusion

“Supply creates its own demand.” Jean-Baptiste Say. The aforementioned quote explain the genesis of classical economics, which viewed that the supply of goods in the market lead to <sup>itself</sup> demand creation. Thus, not only in the formal economic institutions, but also in the informal economic institutions, as well. Similarly, in Pakistan the informal economy plays a pivotal role in generating mass-scale employment in sectors like Agriculture, textile, construction and transport etc. Moreover, its indirect contribution to GDP, growth and inflation shows its nexus with the economy. However, the challenges it poses to Pakistan economy like, <sup>6</sup> low-tax to GDP ratios, reluctance to shift toward ‘e-banking system’, lack of ‘capacity building’, coupled with ‘overregulation and wide spread corruption’, has exacerbated the pre-existing challenges. None the less, Pakistan has the potential to transform its <sup>undocumented</sup> informal economy into productive growth led sector. For instance, undertaking initiatives like digitizing e-banking system, doing structural reform in taxation system, and documenting women participation in informal economy.

while, deregulating statism in economy and executing corruption eradication measures could provide the market forces the incentive to play their role more effectively. Hence, it can be said that the undocumented informal sector of Pakistan's economy has the potential to steer massive economic growth, but its transition to inclusive regulated economy requires concerted effort of all.

As per, ILO, the term "informal economy" refers to all sorts of economic activities that are in law or in practice not covered by formal arrangement. This definition provides broad based understanding of what sort of ~~inf~~ activities fall under the ambit of informal economy. As this phenomena is widespread in developing countries, in particular Pakistan, where the size of informal economy is estimated to be 35.6% of GDP (Quarterly Informal economy survey/ world Economics London). This massive undocumented, untaxed circulation of money has hindered the growth prospect of Pakistan. Furthermore, its manifestation in vest <sup>and</sup> agricultural & real-estate practices has propelled informal economy to new height. Therefore, it can be said that Informal economy in Pakistan occupies the major chunk of undocumented wealth.

In Pakistan, agricultural sector is the largest undocumented sector. As this sector employs alone ~~em~~ 32% of Pakistan's Labour force, as per Labour force Survey/2021. Furthermore, it contribute to 21% of GDP, which is very much less as compared to its expected estimated potential. This low contribution to GDP is due to multifaceted structural

problems. For example, the entrenched feudalistic practices in sub-urban and rural areas coupled with inept practices of measuring yearly output flow and ineffective regulatory mechanism has rendered the agricultural growth prospects redundant in Pakistan. Thus, it can be deduced that informal agricultural output and its gain are being deliberately kept away from the Pakistan's formal sector of economy.

In recent time, Real-Estate is becoming one of the largest informal economic sector in Pakistan. This sector is informal in the sense that there is no regulatory body which oversee it. Moreover, tax imposition on real estate is negligible. In addition to that, it is highly unproductive as money does not circulate in the economy. Hence, there is no nominal growth, production or value addition in the economy. As per, Pakistan Bureau of Statistics the market value of real estate in Pakistan is between 300-400 Billion Dollar, yet, its contribution to GDP is less than 2%. So, it can be viewed that real estate boom is burgeoning the informal growth in Pakistan.

In Pakistan, retailers' working in small-medium <sup>businesses</sup> industries such as textile, shops, construction, and manufacturing etc. are out of the Pakistan tax net. Though, it contribute to 40% of GDP indirectly, but every year a loss of 8% GDP is reported (Ipsos/tax evasion Report). In addition to that, this pattern of growth has

propelled expansionary and consumptionary attitude in the society in general. Which has led to more imports and has aggravated the balance of payment crisis. Moreover, the state neglect toward this sector has led to massive revenue losses, which could have improved the <sup>living</sup> standard of masses. Hence, retailers in informal sector are one of pillars who are leading the informal economy in Pakistan.

The <sup>domestic</sup> transport sector fall under the ambit of 'Grey economy'. As it provide 6% of nation total employment and contribute to 10% of nation's GDP. Moreover, this sector itself regulate <sup>fair</sup> prices ~~and~~ <sup>so</sup> the mechanism of imposing tax on this sector remains a distant idea. Similarly, in Pakistan community and social services project are free of tax. Thus, money received in the form of aid or donation is untaxed and its audit mechanism are absent. Furthermore, street vendors who makes major chunk from the informal economy donot give any sort of tax. Therefore, it can be said that transport sector and community driven project makes up the major informal economy chunk.

Pakistan Informal economy face myriad of issues among them 'Low tax to GDP ratio' is the most significant challenge. Currently, Pakistan tax to GDP ratio is 6.7% (Ministry of Finance (2022-23)). which is the lowest in the region. Life wise,

tax-GDP ratio in India is 11.1%, Bangladesh 7.64% and Sri Lanka 7.34%. So, it can be deduced that higher tax-GDP ratio shows strong taxation environment in the country. While, low tax-GDP ratio signifies weakening legitimacy of the state functionary. Therefore, it can be concluded that low-tax to GDP ratio is a major challenge to the economy of Pakistan.

The absence of profound 'digitization' and 'e-banking' incentives in the <sup>informal</sup> economy is keeping it at bay from integrating into the national economy. As it is away from GNP, which means that the money circulated is unaccounted, untaxed and can be used for fuelling consumption and inflation. Moreover, absence of aforementioned incentives leads to rampant 'money laundering' phenomena. ~~This~~ <sup>This</sup> not only damages the economy, but soft image of nations. For instance, in 2018, Pakistan was put into 'Grey list of FATF', which demanded tightening the banking laws and stringent regulatory policies. So, it can be said that lack of digitization and e-banking has exacerbated the challenge of integrating informal economy.

In Pakistan, the 'Board of Revenue' along with its subsidiary departments are tasked with the responsibility to <sup>levy and</sup> collect tax ~~and~~ money. Yet, Pakistan is <sup>electing</sup> ~~considered~~ the lowest tax-GDP ratio which is 6.7% in the region. This shows the lack of capacity building in board of revenue. As it is unable to directly impose

taxation on informal economy, which makes it to rely more on indirect taxation measures. Currently, Pakistan is employing 70% of indirect measure to collect tax, this directly hurts the vulnerable and impoverished segment of society. Thus it can be concurrently said that incapacity in board of revenue has added the challenge to inculcate informal economy into national economy.

In Pakistan the major challenge to inculcate informal economy into formal economy arises from the overregulation and bureaucratic hurdles. The phenomena of overregulation impedes the 'ease of doing business' environment. Moreover, rampant corruption in public and private sector has resulted in the flight of foreign capital. As per Transparency International Report Pakistan is ranked 140 in year 2022. This has enabled an environment not conducive for business activity. So, it clearly depicts how hard and troublesome it is to operate business in a formal setup. Hence, it can be said that overregulation coupled with corruption in public and private enterprises has made informal economy transition to formal economy difficult.

The another <sup>hurdle in the way</sup> challenge to inculcate informal economy into formal economy is deepening <sup>ed by</sup> <sup>prevalent</sup> the hundi endemic in Pakistan. As hundi leads to loss of capital through illegal channels which not only bleak economic prospects but also lead to loss of



nation's global standing. For instance, during the present economic crisis the nation's financial reserve have fallen to \$3.814 Billion mainly because substantial flow of dollar to Afghanistan was taking place through smuggling and hundi means. Moreover, it has developed a thriving informal economy for money exchangers which could be used for terror financing as stated by FATF in its Oct. 2022 submit. Therefore, it can be inferred that endemic of Hundi is a major challenge for informal economy in Pakistan.

To make informal economy more appealing and inclusive to masses, the state must incentivize 'e-banking system'. As this intervention will lead to documentation of the economy. Moreover, it will make business run more smoothly, efficiently and will enable them to function as per modern banking standards. In this regard, the state of Pakistan has developed various e-banking platforms like Rast, <sup>E-paisa</sup> ~~and~~ etc. ~~and~~ more initiative and policy should be developed for bitcoin, Forex and blockchain emerging technology. Though, it can be said that incentivizing e-banking sector will lead to a gradual flux from informal to formal economy in Pakistan.

The overhaul structural reforms in the taxation system of Pakistan is the need of hour. As Pakistan has the lowest tax-GDP ratio in the region and it <sup>over</sup> reliance on indirect tax <sup>measure</sup> ~~has~~ rendered imposition of proportional direct taxation

In this regard measure redundant. For instance, the state should increase corporate-gain tax, as the prices of real estate is skyrocketing. Moreover, imposition of retailer tax and legal loopholes by which tax is evaded must be patched with stringent <sup>regulatory</sup> measures. Thus, it can be said that structural reforms can not only improve the existing taxation system but can pave the way for better <sup>vibrant</sup> informal economic environment.

To betterly document the informal economy, it is utmost necessary to enhance capacity building in the Board of Revenue department. As the board of revenue is still operating on out-dated procedural manuals. For example, it is still operating on Land Acquisition Act, 1894, while the world has moved onto digital, modern and sophisticated measures to collect revenue from land. Similarly, tax officers must undergo an a yearly training programs on how to effectively implement tax policies. Moreover, to make it function better "Key performance indicator target" must be set in place. <sup>From</sup> ~~Through~~ the aforementioned measures, <sup>implementations</sup> it can be said that performance of the board of revenue would improve.

The documentation of women participation in the informal economy is pivotal for growth and development. Generally in Pakistan women participating in informal sectors are not included in the National GDP and GNP. For example, women working in agricultural field, house-chores labor, textile, salons and beauticians contribution are not

accounted in the GDP. Moreover, they are more prone to work in inequivalent conditions ~~like~~ <sup>and</sup> they are lowly paid. While, nations like China by documenting women who are working in informal enterprises has not only ensured better working environment and equal wages for women, but has tapped women potential effectively and efficiently. As said by Mao Zedong <sup>66</sup> "Women hold half the sky." <sup>99</sup> Thus, it can be said that documentation of women role in informal economy can harness untapped women <sup>potential</sup> participation in Pakistan.

To inculcate informal economy into formal economy, it is important that the state adopt and implement Policy of confidence building measures. <sup>AS</sup> CBM means raising tax awareness campaigns and explaining the needs and benefits <sup>of inculcating</sup> ~~associated~~ into the formal economy. Furthermore, such measures will lead to tax reforms which would lead to inclusive growth, income and redistribution of wealth. Moreover, it is important to ~~keep~~ <sup>add</sup> in mind the principle of <sup>66</sup> "fairness, certainty, convenience and efficiency." <sup>99</sup> ~~is keep~~ in the policy of CBM. By adopting such measures, the informal sector will be obliged to get the fruitful benefits of the formal sector. So, it can be conclusively said that CBM can play its proactive role in making informal sector vibrant <sup>inclusive</sup> growth led economy.

To ensure inclusivity, the state must provide alternative money

transfer forums? which should conform with the present efficient global monetary setup. Similarly, it should adopt stringent regulatory policies to discourage hundi and hawala practices. Moreover, to make it user-friendly it should establish <sup>more</sup> e-mobile apps to facilitate payment and transaction of money globally. For instance, initiatives like Jazz-cash, easy-paisa, cash-app has revolutionize the modern system while, the world has ~~gone~~ <sup>transpassed</sup> the Q-R same technology, Pakistan is now adopting it. Therefore, it can deduced that efficient and reliable money transfer form will help in dismantling the informal sector in Pakistan.

The <sup>Liberal</sup> ideas that state should not interwine in the market and let the market decide on its own hold merit. As overregulation in the market by state lead to stagnation and loss of productivity (Why Nation Fail / 2013). Likewise, in Pakistan the situation is no different as state sway vast hold over economic activity and many of its SOE are yearly accumulating billions of Rupees losses. Take for example, PIA, Pakistan Railway and steel mills which added debt of 1.74 trillion Rupees in year of 2022 (Economic survey / 21-22). So, deregulating such SOEs and giving the informal <sup>economic</sup> sector a level playing can make the <sup>economic</sup> sector more productive, competitive and in the end will generate gigantic profit dividend for the nation.

The notion of trade

through 'barter system' among regional states, has the potential to bring prosperity and wealth for all. As barter trade system is an ancient <sup>system</sup> and its efficacy cannot be ignored for Pakistan. In many parts of Pakistan like Balochistan, where Iranian oil is being smuggled through barter trade. Similarly, Pakistan can do barter trade agreement with Iran, where Pakistan <sup>can</sup> ~~will~~ export <sup>Iran</sup> ~~them~~ wheat and vegetable, while Iran can export cheap gas and energy to Pakistan. This will help save dollar and will provide alternative way of payment to both nations. Thus, it can be inferred that business-business barter trade can transform the informal economy of the region.

To tap the potential of informal economy targeted subsidy and direct taxation measures can put the whole economy on growth trajectory path. As targeted subsidy to marginalized groups especially women, laborers and workers working in informal setup will be empowered to contribute efficiently in the economy. For instance, interest free loans can help them contribute better in nation's building. Moreover, the imposition of direct taxation measure could help in redistributing the resources and would help state adopt welfare policies, which could foster growth and ensure well-being of the vulnerable segment of society. Hence, it can be deduced that aforementioned tool can pave the way for growth and prosperity.

It is generally believed that corruption in the informal sector is rampant, as there is least regulated implementation mechanism set in place. As a result Pakistan is ranked 140/180 by Transparency International in its year 2022 Report. In addition to that, tax evasion in the form of Amnesty policies announced by various governments have made corruption eradication <sup>measures</sup> difficult. Therefore, it is imperative to adopt stringent corruption eradication measures, which can ensure level playing field for all actors in the informal setup. Similarly, various watchdogs must revamp their system of investigation and <sup>modes</sup> control to effectively control this menace. Thus, it can concurrently said that corruption eradication measure can make the informal sector effective vibrant and inclusive to today economic need.

In conclusion, it can be conclusively said that Informal economy of Pakistan is still <sup>an</sup> untapped resource. As its various sectors like agriculture, real-estate, retailers and transport sector <sup>still</sup> sway large control over it, as discussed in the aforementioned sections in detail. Similarly rising challenge like low-tax GDP ratio, absence of e-banking incentive and Hawala and Hundi endemic are adding burgeoning challenges to the fragile economy. But, aforementioned policy reforms like doing

cannot be ignored  
parts of Pakistan like D.A.  
Iranian (14)

Structural reform in Pakistan taxation system, incentivizing e-banking system, policy of CBD, deregulating economy and corruption eradication measure can <sup>tap</sup> the informal economy resource potential to its fullest. Hence, it can be said without an iota of doubt that the undocumented informal sector of Pakistan's economy has the potential to steer massive economic growth, but its transition to inclusive regulated economy requires concerted effort of all.