

# The informal economy of Pakistan: the way forward

## OUTLINE

### 1) INTRODUCTION

Thesis Statement: The informal economy in Pakistan poses severe threats to economy; however, the situation can be tackled by implementing certain measures which this essay is going to discuss.

### 2) Informal economy, a challenging task

### 3) Way forward:

- a. Corruption eradication measures
- b. Regular audit of bureaucrats and politicians
- c. Training of tax officers
- d. Broadening of tax net
- e. Introducing simple ways to filing a tax return
- f. Ban on amnesty schemes
- g. Documentation of economy
- h. Promotion of e-commerce
- i. Digital identity cards
- j. Labor market laws
- k. Tax awareness measures

### 4) CONCLUSION

"The informal economy is characterized by less job security, lower incomes, an absence of access to a range of social benefits and fewer possibilities to participate in formal education and training programmes— in short, the absence of key ingredients of decent work opportunities."

( Globalization and Informal Jobs  
in Developing Countries,  
Ekkehard Ernst )

Economic progress of a country largely depends on revenue generation through taxation. These taxes, in return, benefit the citizens in the form of infrastructure, security and human development. Economic systems all over the world contain informal economy. Volume of this informal economy is smaller in developed countries as compared to that of third world nations. Pakistan is among those poor nations where large volume of informal economy is of great concern. The informal economy entails economic activities that escape official records and taxation by government authorities. The informal sector encompasses various entities such as street vendors, domestic workers, small businesses and large portions of the real estate sector, frequently operating without formal registration. The informal economy in Pakistan poses severe threats to economy; however, the situation can be tackled by implementing certain measures which this essay is going to discuss.

The informal economy is a challenging task for Pakistan as it possesses a huge volume than formal economy. According to a World Bank report, in 2022, the total size of the informal economy in Pakistan was around \$457 billion. Within the informal sector,

disparities in compensation and benefits manifest, perpetuating a scenario where wages are markedly lower and employment perks are scant compared to formal sector. This makes income inequality worse, particularly for a large portion of the population working in these informal jobs. Nearly 75% of the total labour force in Pakistan is engaged in informal sector employment (Labour Force Survey 2020-21). The informal nature of this sector not only violates the labour rights of the individuals but also adds to the higher bigger problem of income inequality in society and inadequate access to a universal social protection system. Thus, informal economy is a challenging task requiring immediate solutions.

In order to overcome the issue of informal economy, government needs to take bold steps. First of all, government needs to take harsh measures to eradicate corruption. In this regard, filing of annual return and asset declaration form should be made mandatory for all politicians and bureaucrats. Along with that government should also conduct regular audit of officers. The regular audit of officers and other personnel would provide maximum restraint to corrupt and illicit activities. Moreover, the government should also increase salaries of tax officers so that they can work honestly without being involved in corruption. End of corruption can pave the way for the end of informal economy.

Thirdly, matters of taxation and tax laws are always technical in nature. Most of the tax officials and officers are incompetent as compared to chartered accountants of private firms. These chartered accountants know the tricks to evade tax. In this matter, government needs to conduct regular training of tax officers. Government can send

officers to get training from foreign countries to learn the tax mechanism of advanced countries. A competent tax officer will surely generate more revenue for the country.

Fourthly, government needs to improve the tax base. Pakistan has a notoriously narrow tax base. Most of the businesses which earn billions of rupees annually, such as transportation, real state, brokerage and commission, are still unregistered. Moreover, a large number of youngsters are earning on social sites and internet, which is a completely neglected sector in term of tax collection. Hence, government needs to <sup>take immediate measures to</sup> introduce simple methods of bringing these sectors into tax net.

Fifthly, a common man with small business but being less educated, cannot file tax return easily. In this regard, government needs to introduce simple methods of return filing. Mobile applications should be introduced in local and English languages so that a lay person can easily file tax return. Introducing simple ways will consequently generate more revenue.

Along with that, amnesty schemes should be banned for good. Amnesty schemes are against the very essence of democracy. Provision of amnesty to tax evaders means there is no rule of law in country. One who steals few rupees is sent to jail and one who steals billions of rupees is given a safe passage. It proves the adage: "Law catches flies but let hornets go free". In order to follow the true spirit of equality and democracy, government needs to end the tradition of amnesty schemes.

One of the main source of informality in Pakistan is cash transactions. Promotion of e-commerce can overcome this issue. Online sell and purchase of goods

requires payment through credit card or through banking channels. These online transactions can easily be documented. Government can trace out those people who <sup>make</sup> large transactions and bring them into tax net.

In this regard, government needs to introduce PayPal like online payment system through mobile phone. Promotion of e-commerce would not only enhance business activities but also reduce the informal activities. Therefore, overcoming cash transactions would be beneficial for revenue generation.

Moreover, in order to overcome the issue of informal economy government needs to introduce digital identity cards. Digital identity cards help gather information about various business activities. Pakistan can learn from India. India has introduced Aadhaar identity number. With digitalized identity cards and e-payments Pakistan can also solve the problem of informal economy.

Favourable outcomes can also be achieved by revising labor market laws and instilling a sense of responsibility in people's minds. The media can play a pivotal role in detecting unregistered economy operators, public consumption by individuals and groups, and exposing major tax evaders.

Last, Pakistan needs to promote awareness about the importance of tax and demerits of tax evasion. Pakistan is one of those countries where evasion of tax is not perceived as an illegal or immoral activity. In this regard, various campaigns on social media and public places can play a vital role. Along with that, government can also provide awareness to students by including lessons of benefits of tax.

To conclude, tax generation is necessary for the proper functioning of a government, which then paves

To way for the smooth working of economy.  
Unfortunately, this smooth working of economy in Pakistan is hindered by informal economy as the volume of informal economy is larger than the formal economy. Developed countries are dealing with this problem successfully, while the third world nations like Pakistan are still struggling with this. The informal economy is a challenging problem for the economy of Pakistan; nevertheless, there are solutions as well which can help the government prevent this problem.