

# Pakistan's informal economy: the way forward

## Thesis Statement

Mature your thesis statement

Informal economy is not good. It should be formalised so that the formal economy would play a positive role in the economic situation of Pakistan.

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Irrelevant and unclear arguments

Arguments are vague

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Focus on proper deconstruction of the topic and add mature and relevant arguments

## Essay

International Labour Organization defines informal economy as, "The informal economy refers to all economic activities by workers and economic units that are - in law or in practice - not covered or insufficiently covered by formal arrangements."

Informal economy is not good. It should be formalised so that the formal economy play a positive role in the economic situation of Pakistan.

Many causes such as age of the people, delay system in institutions, lack of the tax registration system, etc. contribute to growth of the informal economy of Pakistan. The informal economy is not conducive for immense development of Pakistan.

Therefore, it should be removed from the economic system of Pakistan.

There are some way forwards such as expanding formal economy, giving quality education, eradicating public sector corruption, increasing threat of detection, developing tax morality, and digitalizing economy, etc. that can be used to formalise the economy of Pakistan. The formalisation of economy can bring prosperity in Pakistan.

The informal economy refers to economic activities that are not regulated by government or covered

by formal labour laws. It is that type of business through which the people earn money, as opposed to the formal economy. Most people emphasize working in informal economy in Pakistan because of neglect of the importance of the formal economy.

According to World Bank reports, the total size of the informal economy in Pakistan was around \$457 billion.

However, the estimates from SMEDA indicate that the informal economy has a market share of more than 40% of GDP.

Informal economy is not appropriate because it allows the individuals to do business in defiance of the state. They start informal activities without any registration.

Therefore, informal economy should be controlled in view of development of formal economy.

At individual levels, age of the people and over-population in the country are the causes which increase informal economy of Pakistan. According to a report published by USAID, 49% of the informal workers in Pakistan are young, belong to the age bracket of 25 to 35 years. Age of the people influences them to work in informal economy. According to the Pakistan Census data, total population of the country stands at 241.49 million.

includes that

Mature your choice of jargons

with an annual growth rate of 2.5 percent. In this situation, it is difficult for a government to check the economic activities of such a large population. In Pakistan with high population density and a youthful demographic, many individuals face challenges in securing stable jobs due to insufficient economic growth and limited access to education and skills training. This surplus labour often turns to informal work as a survival of means.

At institutional level, delay system of institutions and illegal activities are the causes to enhance informal economy. Whenever people go to institutions for any process regarding formalisation of economy, it is difficult for them to complete their task easily. In this scenario, people turn to illegal activities. People are discouraged and they are inclined more towards informal business. "Delay is the deadliest form of denial", said by C. Northcote Parkinson, British writer. When institutions are unable to provide timely services or enforce regulations effectively, people may resort to illegal activities or operate outside the law to meet their needs, leading to the proliferation of informal economy.

At the structural levels, lack of tax registration system and resistance towards government are the causes that increase informal economy. In Pakistan, there is severe lack of tax registration system. According to Federal Board of Revenue, the number of registered tax filers had 7.1 million out of which only 2.5 million were active tax filers in 2021. This is due to inefficiency at both ends i.e. government and people. The government is not showing positive results to collect appropriate taxes. On the other side, people are not willing to pay taxes because they show resistance towards government. They fear to lose time and money in government offices regarding tax registration system. So, they start their own business that is informal. The resistance towards government fosters a culture of informality, where economic activities are conducted without regulations and tax obligations.

At individual levels, expanding the formal economy is a way forward to formalize the informal economy. The government of Pakistan should take initiatives that can formalize the economy. Gary Becker, an American economist, proposed economy

as, "Economy is the art of making the most of life." It is need of small and medium level businesses run by government and private sector in order to attract more people towards formal economic activities. When people have option to work in formal sector of economy, they are inclined towards it rather than informal business. Expanding the formal economy can effectively mitigate the challenges posed by the informal economy by creating more job opportunities, enhancing regulatory frameworks and increasing access to social protections.

Education has nothing to do with formal or informal economy

The quality of education can formalise the economy of Pakistan in a good way. Education is a process through which intelligent and intellectual people are produced for the development of country. According to Pakistan Institute of Education, number of public institutes are 176184 (56%), private institutes are 137234 (49%), NGO-based schools are 2000 and madrassah are 43613 in Pakistan.

Maintaining quality education in these different modes of education makes people responsible who can understand the true meaning of formal economy. It can increase literacy rate among different strata of society. Hence,

this initiative empowers individuals to transition from informal work to formal ones, thereby increasing overall economic stability.

Inculcating technical education and vocational training can boost formal economy. It is required for people to gain technicality and vocational training to start a new business. As per National Vocational and Technical Training Commission, "Technical and Vocational Education and Training (TVET) institutions in Pakistan are 3634." Technical education and vocational training are key pathways to achieving successful outcomes in formal business ventures, as they provide individuals with valuable experience and skills. By providing individuals with practical skills that align with market demands, vocational training prepares them for stable jobs in the formal sector, thereby reducing their reliance on informal work.

Awareness is a way to achieve the target of formal economy. Raising awareness fosters responsibility in the individuals. When people are conscious, they know the real meaning of formal economy. Through awareness people differentiate the formal economy

from informal economy. They understand that the formal economy benefits not only the country but also supports their own positive growth. According to Nathaniel Branden, a Canadian-American author, "The first step towards change is awareness. The second step is acceptance." Awareness campaigns can also inform workers about the long-term impacts of informal work, including lack of benefits and vulnerability to exploitation. It can lead to formalise the economy.

At an institutional level, eradicating public sector corruption is a way forward to formalise the economy of Pakistan. When corruption is increasing in public sectors, the people are not inclined to formalise their business. They avoid to waste a large amount of money in public sectors regarding corruption, in turn, they like to begin an informal business. According to Transparency International, Pakistan has a score of 29 in corruption in 2023, meaning it ranks 133 out of 180 countries. In the presence of corruption, masses are not compromising the public sector. They do not believe on <sup>in</sup> public sector.

So, corruption should be controlled. Ultimately, a corruption-free environment not only strengthens public interest but also increases government revenue through taxation, which can be reinvested into services that support formal economic growth.

Increasing threat of detection is a way forward to formalize the economy. Threat of detection refers to the perception of fear of working in the informal economy. The people are free to take part in informal economy with the decreasing response of governments to curb the informal economy. They have no fear and threat to start an informal business. The reports, published by LUMS, reveals that a considerable majority (56%) of the informal workers perceived that running an informal business in Pakistan is not risky, followed by 34% of the informal workers who perceived that it is somewhat risky, while only 7% of the informal workers deemed that it is risky to run an informal business in this country. By enhancing surveillance, implementing robust reporting mechanisms and increasing penalties for non-compliance, governments can make the risks of remaining informal more apparent. So, increasing threat of detection leads to formalisation of

economy.

Reducing tax level is an initiative to formalise economy. The people are hesitating to pay taxes because it has a large amount of money. They choose to become part of informal economy. According to Trading Economics, personal income tax rate in Pakistan is 29% and sales tax rate is 18%. The high taxes are not satisfactory for Pakistan because people have not enough money or resources to pay high-level taxes. On the contrary, they like to work in an informal economic sector. Lower tax burdens can encourage informal operators to transition into the formal sector, as they perceive the costs of compliance as manageable. This shift not only helps integrate these businesses into the economy but also increases overall tax revenue through a broader tax base. Reducing tax level can promote formal economy.

At structural levels, developing tax morality is a motive to enhance formal economy. Morality is a framework of principles and values concerning behaviour of people. The people of Pakistan has less morality. Tax morality among people is also short, so they avoid to pay taxes.

appropriately. The research paper, published by Suleman Darwood School of Business, LUMS, shows that a significant portion of the informal business owners believe that it is either absolute or at least somewhat acceptable to run an informal business in Pakistan. People think that they lose their money by paying taxes. In contrast, they think it is a good source to earn money by informal economy without paying taxes. By promoting the benefits of taxation such as improved public services, infrastructure and social welfare, governments can encourage citizens and businesses to view tax contributions as a communal obligation rather than a burden. In this way, formal economy can be increased.

Digitalising economy is a step to increase formal economy. Digitalisation is the use of technology to transition towards a digital-oriented business approach. People can show interest to participate in the formal economy with the use of digital economy.

Digital transformation is a fundamental reality for businesses today, said by Warren Buffett, CEO of Berkshire Hathaway. In the presence of online data, people cannot feel risk to lose their money and time.

The digital economy show different things such as tax percentages, time required for registration, etc. that urge people to inculcate towards formal economy. Digital platforms enable seem-less transactions, record-keeping and tracking, making it more challenging for informal businesses to operate without detection. So, it can change the informal economy to formal economy.

Ensuring ease of doing business is a method to formalize economy. Ease of doing business refers to more business incentives. The people are more moving towards informal economic activities due to lack of ease of doing business. According to World Bank's "Doing Business" report, Pakistan is placed on the 110<sup>th</sup> position from among 189 countries. It is difficult to start a business in Pakistan because it requires a lot of approvals and hard registration process. In the long run, people prefer to work in informal business. Simplified regulations, and accessible financial services lower barriers to entry, encouraging businesses to register and comply with formal standards. So, formalise economy can be promoted through ensuring ease of doing business.

Enhancing accountability is a process way forward to formalise an informal economy. In Pakistan, there is shortage of accountability process. As per World Justice Project, perceptions of accountability in Pakistan is 21%. It allows the people to start a business that lies in the informal economy. The accountable citizens know that it is easy to initiate a formal activity, so they avoid informal business. Ultimately, a system that prioritizes accountability not only reduces the attractiveness of informal economy by ensuring a fair competition and protecting workers' rights, but also boost the formal economy.

Informal economy is increasing in Pakistan and it needs to be curbed with some way forwards. Informal economy hurts the formal economy of Pakistan because this economy is not effective to take part in the progress of Pakistan. Some factors such as over-population of Pakistan, resistance towards governments etc. are the causes to promote informal economy. Addressing the causes of informal economy of Pakistan is essential for fostering sustainable economic growth. The informal economy can be formalised

by using way forwards such as raising awareness, reducing tax levels, ensuring ease of doing business, and enhancing accountability, etc. Pakistan can become a developed country having strong economy by effectively managing the informal economy with suitable way forward.