Pakistan's Informal Economy: The way Forward

1. Introduction

2. Weightage of Informal Economy of Pakistan and Challenges that pakistan is being facing from Informal Sector

   (a) Around 60% economy is informal according to IPRI report

   (b) Economic downfall owing to lower tax-to-GDP ratio that eventually loose the investor's moral

3. Way Forwards to Bring Informal Sector under Formal Economic system

3.1 Economic incentives based model at early stage to ensure more and more registration of informal entities (through providing subsidies, finan-cial incentives, and amnesty schemes to declare assets)

3.2 Digitalization and regulatory simplification to mitigate hectic registration process and use of government services
(India's digital UPI System)

3.3. Social protection and health & insurance services for workers and vendors to attract more entities toward formality
(Brazil's microemprededor Individual program 2009)

3.4 Market's infrastructure development and transform street vendors, hawkers into regulized business entities
(Malaysia, Penung street hawkers transformed into tourist attraction)
(Indonesia, Bendang markets regularity and development)

3.5 Effective service delivery and good governance to encourage informal sector toward formal economic model
(Chile's Comprehensive Social Protection and tax regime program that ensured unregistered user ~~from~~ fall from 40% in 2010 to 29% in 2018)

4. What Benefits all parties Can Avail in Formal Economy

4.1 Employee / workers Can get Social security services and Can avail health and insurance facilities

4.2 Investors or businesmans Can attract more customers through government contracts and Can avail bank loans easily for business growth

4.3 A Country Can boost economic growth by enhancing tax-to-GDP ratio that eventualy boost investor's moral and it Can ensure good governance and service delivery

Conclusion

The Essay

Informality is "People's spontaneus and creative response to the obstacles that state place in their way." Economist Hernodo De Soto said. This statement holds reality when developed countries have very minimal informal sector and on the other hand developing countries are stucked in informal economy. Being one amongst the developing countries, Pakistan is also struggling to mitigate this menace. one of the main reason of Pakistan's economic vulnerability is its informal sector that resist in economic growth. Economic growth and development is very hard to achieve, until and unless more and more entities can brought under formal economic model. More than half of Pakistan's economy is informal that manipulate the government policy making and regulatory process. It also affects the statistics of tax-to-GDP ratio that foreign investor notice earlier before investing in any country. Informality can be tranformed to formality as there are multiple examples from other countries that how this target can be achieved. Pakistan

Can also learn from those states and implement historically proven method to ensure maximum outcome. This can be achieved through: early focus on maximum registration and user growth rather than tax maximization; regularity simplification and digitalization of whole process; social protection, health, and insurance services delivery to workers and businesmans; infrastructure development and transformation of markets; and ensure effective service delivery and good governance. These are pragmatic measures advised by economists and professionals, if implied properly Pakistan can enhance its economic model. These suggestions are not only beneficials for state but also encourage that moral of businesman and workers and provide them remarkable benefits. Although Pakistan's economy is vulnerable to informal sector, but through effective and globally experienced policy implementation it can transform its informal economy into formal that ultimately results in prosperity of a country, its businesman and individual as well.

Before heading towards pathways to Counter informality, a brief overview of current economic situation can helps to understand it well. According to world Economic Report of 2024, pakistan's informal sector stands at 38%. However, local analysts and research of Islamabad Policy Research institute says that informal sector covers almost 60% of Pakistan's economy. This ratio illustrates the complexity of pakistan's economy. The country's current GDP stands at almost 410 billion dollars, However informal sector ratio is even more than that. This informal economy presents multiple challenges to the country. It directly manipulates the ratio of tax-to-GDP, ~~ratio~~ that trembles the whole economic outlook. government cannot make effective and transparent policies, investor hesitate to invest in a country whose tax-to-GDP is lower. Informal economy also bypass the tax collection that lower the tax collection and revenue generation. Pakistan revenue generation is mainly based on service sector and tax collection, but informal economy hinders to attain desired objectives.

In order to bring informal economy under formal economic system, government firstly focuses to bring more individuals into formal system as it can. To fulfill this target, government first introduces the incentive based registration process that focuse on maximum registration of individuals rather than tax collection. Primary focus must be to maximization of formal sector, then gradually these registered can be a source of tax collection and revenue generation. Registration subsidies, several incentives can encourage more and more individual to register themselves in government record. Moreover, to properly regulate the economic system, it is imperative that maximum stake holders must declare their assets and profits before government. For this objective, government can introduce amnesty schemes for businessmans and investors so that they can register themselves transparently.

Secondly, Digitalization and simplification in regulatory process is imperative. one of the reason that businesses and small and medium enterprizes hesitate to register themselves is hectic and long procedure of registration and further activities. Government must introduce digital platforms or appli-cations that must be easy and user friendly so that a common vendor can also access that. Regulatory model simplification holds significance because many informal individuals are less educated and some of them are illeterate and because of simple and easy to use services they can directly participate in it. India has introduced unified payment interface few year back and it has achieved remarkable success. This digital UPI system is linked with Adhaar Card and provide all governance and economic services at single place. Pakistan can also learn from this model and no doubt digital pakistan initiative would provide positive result.

Thirdly, maximum individuals participation in formal economy demands social protection, health and insurance based outcomes in response. Individuals are hard to be attracted untill they will be given these services. This would encourage informal sector to register theirselves in regularized model. Brazil had implemented microempreder individual program in 2009 and this made registration possible of more than 15 million individuals. This MEI program is based on services delivery of social protection. The government charges minimum and easy to afford fee from every individual and in response to it they would be provided health and insurance services. Individuals also get late age benefits in similars to pensions that proves to be a most effective policy of this program. This program gives social and end of service benefits to end participant and in response individuals willingly came under government regularized economic model. This program, if implied in Pakistan, will surely be beneficial for economic formality.

Fourthly, street vendors and daily hawkers should also be brought under economic model through providing them well maintained markets and better service service delivery. Government should focus on market's infrastructure development and provide dignified platform to street hawkers. In Penang, the city of Malaysia, government transformed street hawkers into tourist attraction. This step not only served the street hawkers but also enhanced the country's tourist services. On the other side, in Bandung of Indonesia, government regularized the vendors and provide the better infrastrucure in markets. The government has delivered developed markets and well structured streets that have encouraged moral of businessman that government is delivering its best, we must deliver our best. Pakistan should also learn from these models and attract more individuals whether they are street hawkers or an industrialist or small enterprizes' owner.

Fifthly, untill effective services and governance is provided in return to individual participation, the desired outcome will hard to achieve. Developed nations have less informal sector ration, merely because their citizens gives good governance and better services in return. As famous economist said, " Pakistan's informal sector is not only because of mass dishonesty but because of its egregious policies and hectic governance model. This fits true here, that indeed pakistani's are unwilling to come under formal sector because they face multiple taxes and multiplied taxes as well, they fears hectic process of tax submission, above all they face threats from regularity bodies that involved in the activities beyond their jurisdiction. These challenges should be overcomed in order to encourage more participation from more individuals. Chile's unified social protection and tax regime model is one of the betters example. This model acquired remarkable success where Chile's unregistered and informal sector ratio fell from 40% in 2010 to mere 29% in 2019. Current ration is more better. pakistan should also focus on its transparency, good governance, and effective service delivery to end user.

These are the well proven and experienced policies around the world to ensure formal economy, now take a look upon that what benefits can actually an individual, an investor, or a country can get in formal economy.

At worker's end, it can get social services from government and its employer as Brazil's individual model has proved this. Social security and legal protection is a thing that an employee or worker can not be able to avail in informal sector and face discrimination and strict behaviour from senior. More on this health and security ser-vices would also be provided to a registered worker. There are multiple example around the world that those countries which informal sector ratio is less, there are more socially protected and well structured laws exist. Workers safety and social services are as important as the country economic growth, because at the end these individuals can lead the country towards prosperity.

On the vendor or investor's side, they can also acquired benefi-cial services. If they register their business or enterprize they can grow their businesses by getting easy loan from government or any bank. Moreover, they can also avail more Customers and ~~Custo~~ participation by getting government sector Contracts. Government collaboration with any business entity can bring customers from every level, whether they are from government sector, public sector, or private sector.

A state can also ensure maximum benefit from formal economy. The country, Pakistan, can first of all enhance its tax-to-GDP growth. Tax-to-GDP ratio plays pivotal role in the country's economic growth. Many local and public sector, domestic and international level activities are bound to tax-to-GDP growth. Specifically foreign direct investment demands good tax-to-GDP growth. Pakistan's growth is at 9% whereas IMF issued ideal growth rate should be between 15 to 20%. Moreover, many other activities demands formal sector inclusivity; good governance, service delivery, and regulatory process. A Good revenue generation can make sure the good services from government end.

To summarize all the discussion, there is no doubt that Pakistan's economy is squeezed owing to informal sector. However by taking pragmatic measure, as other countries have took, Pakistan can also ensure formality in economic domain. As discussed that this is beneficial for individual, investor, and a country as well. These are actually, government policies and service delivery trajectory that shape the economic model. Developed countries, with effective service service delivery and good governance, has proved that these policies ensures formal economy. whereas developing countries that have bad governance and insufficient policies, have more economy informal. Pakistan can also learn from these developed and economically succesful countries in order to acquire more effective, tranparent, and people centric policies. It is high time to decide, whether the country would remain vulnerable to informal economy or it could transform informality into formality through efficient and good policies and their implementation.