

Transition from Informal to Formal Sector: Issues, Challenges, and Opportunities



Submitted By

Muhammad Adnan

Supervised By

Dr. Muhammad Nasir

This dissertation is submitted to Pakistan Institute of Development Economics Islamabad in partial fulfillment of the requirement for the award of the degree of Master of Philosophy in Business Economics.

Department of Business Studies

**Pakistan Institute of Development Economics, Islamabad,
Pakistan.**

2018



Pakistan Institute of Development Economics

CERTIFICATE

This is to certify that this thesis entitled: **“Transition from informal to formal sector: Issues, challenges and opportunities”** submitted by Mr. Muhammad Adnan is accepted in its present form by the Department of Business Studies, Pakistan Institute of Development Economics (PIDE), Islamabad as satisfying the requirements for partial fulfillment of the degree of **Master of Philosophy in Business Economics**.

External Examiner:

Dr. Amanat Ali
Assistant Professor
QAU, Islamabad

Supervisor:

Dr. Muhammad Nasir
Senior Research Economist
PIDE, Islamabad

Head, Department of Business Studies:

Dr. Nadeem Ahmed Khan
Head
Department of Business Studies
PIDE, Islamabad

Dedication

I dedicate this thesis to Dr. Vaqar Ahmed, Joint Executive Director, Sustainable Development Policy Institute (SDPI). Without his encouragement and support I may not be able to not only obtain this degree but also the achievements I have accomplished in my life so far.

ACKNOWLEDGMENTS

First of all I would like to thank my thesis supervisor Dr. Muhammad Nasir. The door to his office was always open whenever I ran into a trouble spot or had a question about my research or writing. He consistently allowed this thesis to be my own work, but steered me in the right direction whenever he thought I needed it.

I would also wish to thank Prof. Dr. Usman Mustafa who was so kind enough to guide me throughout this research work and I am gratefully indebted to his very valuable comments on this thesis. He is very kind and supportive and likes to guide his students in research work.

I would also like to extend my profound gratitude to the respondents from Raja Bazar, Saddar, and Tench Bhatta Bazar of Rawalpindi city, who supported the field survey and provided important perspectives.

I also appreciate the inputs in this research work by Dr. Sajid Amin Javed, Syed Shujaat Ahmed, Muhammad Shahzad Afsar, and Imran Khan Bangash.

Finally, I must express my very profound gratitude to my parents and to my spouse for providing me with unfailing support and continuous encouragement throughout my years of study and through the process of researching and writing this thesis. This accomplishment would not have been possible without them.

Sincerely,

Muhammad Adnan

TABLE OF CONTENTS

ACKNOWLEDGMENTS	ii
LIST OF TABLES	v
LIST OF FIGURES	vi
ABSTRACT	vii
CHAPTER 1	1
INTRODUCTION	1
1.1 Statement of Problem	4
1.2 Research Question.....	5
1.3 Objectives.....	5
1.4 Significance of the Study	6
1.5 Organization of the Study	6
CHAPTER 2	7
INFORMAL SECTOR IN PAKISTAN	7
CHAPTER 3	13
LITERATURE REVIEW	13
3.1 Research Gap.....	18
CHAPTER 4	19
THEORATICAL FRAMEWORK	19
CHAPTER 5	22
METHODOLOGY	22
5.1 Study Area.....	22
5.2 Sample Size and Data Collection	22
5.3 Characteristics of Unit of Analysis	25
5.4 Econometric Specification of the Model.....	26

CHAPTER 6	29
RESULTS AND DISCUSSION	29
6.1 Profiles of the Business and Owners.....	29
6.1.1 Age of Business Owner	29
6.1.2 Education Level of Firm Owner	30
6.1.3 Business Type.....	31
6.1.4 Willingness to Register.....	32
6.1.5 Ownership of Land	34
6.2 Perceived Problems in Formal Sector	35
6.3 Perception about Tax Authorities.....	43
6.4 Descriptive Statistics	45
6.5 Regression Model.....	49
CHAPTER 7	52
CONCLUSION AND RECOMMENDATIONS	52
7.1 Conclusion.....	52
7.2 Policy Recommendations	55
REFERENCES	57
ANNEXURE – I	61
QUESTIONNAIRE	61

LIST OF TABLES

Table 5.1: Sampling Framework	24
Table 6.1: Descriptive Statistics.....	45
Table 6.2: Determinants for Willingness to Switch.....	50

LIST OF FIGURES

Figure 1: Age of Firm Owner	30
Figure 2: Education level of firm owner.....	31
Figure 3: Sector of informal businesses.....	32
Figure 4: Willingness to register with tax authorities	32
Figure 5: Choices for Willingness to register with tax authorities	33
Figure 6: Ownership of business land.....	34
Figure 7: Firm's profitability of informal sector.....	35
Figure 8: Issuance of receipts as a waste of time.....	37
Figure 9: Easier to expand as registered entity	38
Figure 10: Registered Businesses often subject to Audits and Inspections	38
Figure 11: Keeping Record for tax purposes is cumbersome and expensive	39
Figure 12: Professional Bookkeepers or Accountants are too expensive	40
Figure 13: Every business should pay taxes	41
Figure 14: Registration information easily available	41
Figure 15: Extent of informal payments to tax or other authorities.....	42
Figure 16: Competency of tax officers	43
Figure 17: Fairness of tax officers	44
Figure 18: Tax officers are underpaid.....	44
Figure 19: Taxes applied in Pakistan are fair.....	45

ABSTRACT

The informal sector in many developing countries that includes firms, workers, and production activities handled by firms which are not registered and also don't pay taxes, accounts for a substantial and increasing share of total economic activity. Informal sector plays a key role in developing countries like Pakistan. Informal sector is also untaxed and unregulated in Pakistan. The current research seeks the intention of the informal sector regarding transitioning towards formal sector. The dependent variable used in this research is 'willingness to switch' and the independent variables include, i) tax avoidance, ii) high tax rates, iii) complicated registration process, iv) tangible incentive. This research is conducted at three main commercial areas Raja Bazar, Saddar, and Tench Bhatta of Rawalpindi city, Punjab, Pakistan. Simple random sampling technique is used in this study with the sample size of 230. Primary data was collected through a structured questionnaire with both close and open ended questions. Linear probability model is used in this research for analysis of data. The results of the study show that 56% of the respondents are willing to register their enterprises; however they require some tangible benefits for registering their business. Furthermore, the results show that 78 percent think that people do not register because they want to avoid taxes. Another reason which 56 percent respondents think that is high tax rates. Seventy four percent respondents considers complications in the registration process restricting people to register their business, and 90 percent firm owners think that getting registered is not beneficial for them. The results of survey indicate that SECP and FBR need to step up its communications efforts in reaching out to the informal sector about the potential benefits of registering with the tax authorities. Formalization of businesses should be branded and incentivized. Furthermore awareness programmes are needed at a local level informing about initiatives such as the tax payers' facilitations unit and how to access these forums.

CHAPTER 1

INTRODUCTION

Informal sector is known by several names such as informal economy, unofficial economy, invisible sector, unorganized sector, parallel economy, hidden sector, irregular sector, unstructured sector, underground economy, and unobserved economy. The word informal sector was introduced by International Labour Organization (ILO) in its report “Employment, Incomes, and Inequality: A Strategy for Increasing Productive Employment in Kenya”. This report focuses on the importance as well activities performed in this sector. It says that “most of the employment in the informal sector, a long way from being just possibly productive, is economically resourceful and profit making, however little in scale and constrained by basic technologies, minimal capital and absence of connections with the other ('formal') sector. Inside the latter part of the informal sector are employed a various craftsmen, bricklayers, tailors and other tradesmen, and in addition cooks and cab drivers, offering virtually the full scope of essential abilities expected to provide goods and services to an extensive however often poor segment of the population” (ILO 1972).

Across the world the informal sector is neither taxed nor monitored by any form of government. Moreover, contrasting the formal sector, activities of the informal sector are not counted in the gross domestic product (GDP) as well as not in the gross national product of any country. Because of neither taxed, not monitored by any form of government this sector is called informal sector.

The informal sector in many developing countries that includes firms, workers, and production activities handled by firms which are not registered and also

don't pay taxes, accounts for a substantial and increasing share of total economic activity (La Porta and Shleifer, 2008).

Entrepreneurship in the informal sector is not some minor negligible aspect of the global economic landscape. ILO (2012) estimated that 17 percent (1 in 6) of the global non-agricultural workforce is involved in informal sector business activities as their main job. However, the share of non-agriculture labor force that is involved in informal businesses differs across the globe, ranges from 8.5 percent in Europe and Central Asia, 10 percent in South Asia, 11 percent in the Middle East and North Africa, 19 percent in East Asia and the Pacific, to 23 percent in Latin America and the Caribbean, and 26 percent in sub-Saharan Africa. Moreover, ILO (2015) reveals that almost half of the global workforce or approximately 2.5 billion people are involved in informal business activities.

Numerous researchers have explained the benefits of informal sector, the most important benefit the informal sector is providing the flexible employment for women who want to work close to their home (Alatas and Newhouse, 2010) and to low wage workers who could not find job in formal sector (Loayza and Rigolini, 2011), also the informal sector providing employment to most of the middle class group of any country (Van Klinken, 2009). Moreover, a substantial empirical literature argues that the share of informal sector is inversely linked with economic growth, public goods provision, tax revenues, and GDP per capita (La Porta and Shleifer, 2008).

On the other hand many studies show that there are some disadvantages of informal sector as the informal sector is marked by severe decent work deficits and a disproportionate share of the working poor. Plenty of empirical research has shown that workers in the informal sector face higher risks of poverty than those in the formal sector (ILO, 2002). As a result of these and other factors, there is a substantial,

but not complete, similarity between working informally and being poor and vulnerable. Most people involved in the informal sector have less regular and lower incomes than formal sector. They also face inadequate and unsafe working conditions with long working hours. The work in informal sector is excluded from the social security schemes, safety and health, maternity and other labour protection legislation.

Working informally is costly for businesses, workers, and the community. For example, for unprotected workers working in informal sector has more negative aspects of work than positive aspects. As they are not registered, protected under labour or social protection legislation, not even recognized properly, they are also not able to enjoy or defend their fundamental rights as a worker. That's also a reason of their little or no collective representation to employers' associations or public authorities (ILO, 2014).

Unregulated and unregistered businesses mostly do not pay taxes, neither give benefits nor any entitlements to their employees, which does not only negate the protection of workers, but also means that they compete unethically with other enterprises. Shortage in tax collection and contribution payments, which is sometimes very substantial, put an unfair weight on registered businesses (ILO, 2014).

In view of decent work shortfalls, social protection of workers and low tax to GDP ratio, the discussion regarding informal sector and possible approaches towards formalization of enterprises therefore attaining new momentum across the globe. Formalization of informal sector has been given push by the ILO's landmark transition from the informal to formal sector recommendation (ILO, 2015) that gives direction to expedite the conversion of workers and economic units from informal to formal sector.

Informal sector plays a key role in developing countries like Pakistan. This sector can be categorized as self-employed workers and wage workers performing different jobs from traders to small producers. Like other developing countries, most of the Pakistan's labor force for their livelihood is still depending on informal sector. The informal sector undoubtedly is playing a significant role in Pakistan economy. It is absorbing a vast proportion of workers who may otherwise be unemployed. It is also providing services at a cheaper cost to the public and produces goods and services.

Informal sector is also untaxed and unregulated in Pakistan. Much of the profits accumulated within the informal sector, therefore, go into the hands of the few, who are free to exploit poorer employees with no fear of labor inspections, no need to provide legal contracts of employment or to guarantee minimum wage.

Apart from agriculture, informal sector workers in urban and rural areas across the country work as mostly domestic servants. They produce glass bangles, garments, footwear, handicrafts, embroidery, sports goods, and surgical instruments, and they also work in leather tanneries, fisheries and mining. Currently, these informal workers are not only underpaid, but also working without health insurance and workplace safety. Moreover, they also do not have any access to social security benefits in Pakistan.

1.1 Statement of Problem

Almost 72.5 per cent non-agricultural work force is getting its livelihood through the informal sector (GoP, 2015). This sector is more or less evenly spread in rural and urban areas. According to the survey, the total civilian work force in Pakistan is 61.04 million, and among them 44.25 million employed work force is connected with the informal sector. The total number of tax payers in Pakistan is 1.4

million (FBR, 2018). The informal sector is not under the tax net of the country, and there is a dire need now to bring them under the tax net. Tax to GDP ratio is 11.2 percent (GoP, 2018). The country is facing huge budget deficit every year, and it fulfill its needs with internal and external borrowings. The debt level in Pakistan is increasing day by day and a huge amount of revenues are being use for debt servicing. If the government formalizes the huge informal sector and collects taxes from them, then its budget will not be in deficit and also it will not need internal as well as external borrowings. A number of social protection arrangements that are operating in the public as well as private sector covering a very small proportion of old-aged people of the country, whereas a major proportion of the old-aged people working in the informal sector remains generally unprotected by these social protection arrangements. The informal sector employees are ready to pay taxes but they need facilities like formal sector employees.

1.2 Research Question

The research question of the study is “why the informal sector is not transitioning towards formal sector in Rawalpindi City?”

1.3 Objectives

The current study aims to seek intensions of the informal sector enterprises regarding registration of their enterprises. The other specific objectives of the study are to:

- i) Identify issues and challenges faced by informal enterprises for registration in Rawalpindi City
- ii) Explore the complications in current procedures of registration of enterprises.

- iii) Find out any local / national level policy measures for regulating informal sector

1.4 Significance of the Study

The study aims to investigate willingness of informal sector to become formal sector, it will highlight the issues, challenges and opportunities to the informal sector to become formal sector in the context of Rawalpindi city. This is very important for policy purposes as informal sector is not under the tax net and their activities are not accounted in GDP of the country. Moreover, this will help for policy makers to define a policy for proper regulation for informal sector employees to provide them benefits and incentives as applicable to formal sector employees.

1.5 Organization of the Study

The first section of the study is about introduction of the study, the second chapter discusses the state of informal sector in Pakistan, and third chapter is about review of existing literature related to subject. Theoretical framework is given at chapter four. Methodology of the study is explained in the fifth chapter. Results and discussion placed at sixth chapter and the last chapter provides the conclusion and policy recommendations.

CHAPTER 2

INFORMAL SECTOR IN PAKISTAN

The informal sector engages a massive proportion of workers who may otherwise be unemployed. The sector also provides goods and services at a cheaper cost to the public. It contributes a substantial part in the economy of developing countries like Pakistan. This sector can be categorized as self-employed labor and wage labor carrying different jobs from small producers to traders. In comparison to formal sector the informal sector has grown more quickly since the last four decades in Pakistan.

Informal activities are there in nearly all the sectors of Pakistan whether it is manufacturing, finance, transport, construction, services or agriculture. Informal sector laborers in urban and rural areas across Pakistan work as domestic servants, and they produce footwear, embroidery, garments, sports goods, surgical instruments, glass bangles etc., in addition, they also work in mining, leather tanneries and fisheries.

Through informal sector almost 72.5 per cent non-agricultural labor force is earning its livelihood. The sector is more or less evenly spread in urban and rural areas. Moreover, the total civilian labor force in Pakistan is 61.04 million, and among them 44.25 million employed labor is connected with the informal sector. Pakistan's informal sector exhibits a blended picture. Rural to urban movement rate is 29 percent that is lower for females (26 percent) and higher for males (33 percent). Employers in the formal sector constitute nearly 1.4 percent total employed and 2.4 percent in the informal sector. The remaining are wage labor and own account laborers in informal sector. Retail and wholesale trade, manufacturing and construction are the main

divisions for informal employed labor 27 percent, 25 percent and 13 percent employment opportunities to the informal laborers (GoP, 2015). The informal sector in Pakistan is growing rapidly and importantly more women are joining it, this sector emerging as the only work opportunity for low skilled workers in the non-agriculture sector of Pakistan.

There is absence of data on existing number of informal laborers and what are the reasons of their continuous growth in Pakistan. Sadly the most of the government documents like Labor Force Survey, Poverty Reduction Strategy Paper and Medium Term Development Framework have failed to respond to the problems of informal sector and also to the deficiencies of the informal sector, besides failing to equip some reasonably trustworthy information on the informal sector.

Most of the work that has been done about informal sector, centers around the negative impacts on the country and its deficiencies. Consequently, the typical policy suggestions followed by researchers in Pakistan are to constrain the size of informal sector as much as possible. In spite of the fact that 74 percent of the aggregate labour in the country is involved in the informal sector, there is a tremendous shortage of data about the "intentions" of individuals taking an interest in this broad circle of the economy. This absence of empirical data on the intentions of the informal sector is the thing that remains to be a major gap in the Pakistan literature (Shahid and Williams, 2017).

Haider *et al* (2010) describes the reasons of presence of informal sector in Pakistan. According to this study, the main causes/factors of informal sector in Pakistan include; cultural restraints, social imperatives, transfer of money through *hundi*, high proportion of per-capita income and most astounding currency denomination note, huge cost of doing business, low literacy rate, devaluation of

currency, low growth rate of public sector development expenditures it the correct way. Highly denominated currency notes are reckoned as one of the main reasons for the presence and extension of the informal sector in Pakistan. Inflation, tax avoidance, and corruption are not just causing an extension in the size of the sector yet in addition hampering the growth rate of informal sector, thus adding more to income inequality, poverty, and economic uncertainty.

In spite of the fact that most of the Pakistani literature on the theme of informal sector is fixated with estimating the size of such activity, some minor traces about the kind of informal work can be recognized in various studies. Kemal and Mahmood (1998), for instance, find that a vast greater part of the Pakistani businessmen are involved in the informal sector are well trained and highly educated. They also find that some of the informal sector businessmen are young and they may be searching for a better opportunity in the formal sector or transition towards formalizing their enterprises. However, a noteworthy part of these businessmen are more established in age too who most likely accept their position as a lasting activity, not aiming to enter the formal sector.

Likewise, Burqi and Afaqi (1996) assert that the clearly exploitative employee-employer of the informal sector is in reality an advantageous relationship, where the employer is normally observed as '*ustad* (educator)' instructing various skills to his '*shagirids* (workers)' established on a completely social contract between both of them. It is also observed that over 80 percent of these workers are trained inside the informal sector through this sort of relationship in Pakistan.

Informal sector is a changeless element of Pakistan's urban industrial sector. It developed over years and can no more be viewed as minimal. Informal sector laborers are confronting economic and social exclusion. These laborers face limited work

opportunities just because of low and poor quality of education, less skills, low wages, low availability of civic facilities, poverty and hard working conditions. Informal work seems to be the only opportunity for earning a livelihood by these workers that gives inadequate means to satisfy basic human needs (Nadia and Tahir, 2012).

It is hard to quantify the significant contribution of the informal sector in Pakistan. Various estimation approaches have been used indirectly on the basis of hours worked and employment to estimate the contribution of informal sector. For example, Kemal and Mehmood (1998) made the first effort to carry out a survey of urban informal enterprises in Pakistan. They find that no government intervention and tax exemption are the main reasons of growth of informal sector. Informal enterprises are observed to be escalated in unskilled labor. Rauf and Yasmin (2004) estimated the size of informal in 2002 as 29.9 percent of GDP. Kemal (2003) estimated it to be as huge as 64.3 percent of GDP in the same year. The results were not just differing across researches but even when the author within same research has tried to use different approach or assumption.

According to estimates of Idris (2008), the share of informal sector is 36.8 percent of GNP. Arby *et al* (2010) attempted to quantify the size of informal sector in Pakistan through monetary method. The findings of this study show that the size has decreased significantly.

Another study by Kemal and Qasim (2012) calculated the specific estimates of informal sector using the data for PSLM 2007-08 instead of PSLM 2010-11 because of unavailability of data. According to their estimates the size of informal sector was 91 percent of GDP in the year 2007-08. This indicates that Pakistan's formal GDP is nearly half of its actual GDP. This indicates that Pakistan's formal GDP is nearly half of its actual GDP. However, since the authors did not work out properly the

proportion of informal investment and they excluded some of private consumption transaction, therefore, it is still an under estimated number.

However, all these methods have number of issues among which first and major issue is that indicators of informal sector are indicating the size of this sector. Therefore, it does not provide the true estimates of informal sector instead it provides the trend estimates of it. The attempts to estimate the size of informal sector in Pakistan is greatly biased towards the use of indirect approaches through which proxy indicators were used to make quantifiable measures of the amount of informal sector activities, with having a lot of variance as explained above.

Informal sector laborers are as of now not only being working without regard to work place safety, access to any social security remunerations, health insurance or benefits, but also they are underpaid as well. The proprietors of informal factories and shops, and the employers of home based laborers have minimal advantage to register or regularize their production facilities. On the other hand, government is also itself struggling to guarantee conventional working conditions even to minority of laborers working in the formal sector. Furthermore, in Pakistan entry obstacles like extensive registration requirements, complex tax policy, licensing, and inspection requirement are the major reasons for businesses to remain in the informal sector in Pakistan.

And lastly, in Pakistan the labor laws don't give any social safety net for informal sector laborers. Given the weaker security of livelihood, earnings, and the absence of relevant legal cover, the working poor in the informal sector are in need of more noteworthy focus as they are ordinarily more vulnerable than those in the formal sector. This vulnerability is most unambiguous during the economic slowdown periods.

Small and medium informal enterprises are even more instable during the slowdown period. In the course of relative economic growth, there is an expansion in accessibility of work and open doors for informal enterprises, however not really the quality of work. Low levels of skills, low quality of education, less opportunities for skill improvement and high population growth rates are some of the elements that alleviate possible advantages of economic growth.

CHAPTER 3

LITERATURE REVIEW

The sector is characterized by small scale operations, labor intensive techniques, low-income families, private and local ownership of enterprises that are largely unprotected by government (Lawanson, 2011). Normally informal firms do not pay taxes, and this confine any government's ability to provide support for public goods (Levy, 2008).

The coexistence of informal and formal enterprises implies that enterprises contending in a similar industry could face various marginal production costs. As a result this could lead to unproductive allotment of resources in the country (Hsieh and Klenow, 2009). Likewise the informal sector is equipped for capital accumulation & growth and development and represents an advantage to the global economy (Maloney, 1998).

The cost advantage for informal sector firms prompts uncalled for rivalry with reputable formal-part firms, which could limit monetary development (Farrell, 2004). Informal businesses will be unable to legitimately acquire credit from formal budgetary sources, get to government projects, or fare items. As indicated by Maloney (2004), this could put informal enterprises a disadvantage comparative to other enterprises, restricting growth opportunities. The need to oblige and accommodate the informal sector has been greatly recognized.

Research led by the International Labor Organization (ILO) demonstrated that the informal sector had really been growing during the financial crisis (ILO, 2002). Formal sector is viewed as secure, well paid, educated and productive, and law abiding, whereas the informal sector is viewed as totally the opposite. In that capacity,

there isn't sufficient information or insights that identifies with the informal sector, which makes research into on this field rather troublesome (Portes *et al.*, 1991).

Informal labor is poor in light of the fact that their wages are low, they have low abilities, and there is no extensive government plan to safeguard the laborers and regulate informal sector employers (Charmes 2000). There is a need to regulate informal sector or they themselves make registration therefore the employees can avail the benefits like the formal sector laborers, furthermore government can also increase its tax revenue.

As per Haider *et al* (2010), with regard to free markets and globalization, the informal sector is enormously responsible for less value addition in the products traded in the international market, and in addition it is similarly responsible for limiting the capability of the country to produce great value added goods by limiting the shift of technology even in the formal sector through its forward and backward linkages with it. Therefore, the technological shift in formal sector of manufacturing sector is comparatively lower than that of Pakistan. It works in three different ways; first; as it results in low capital formation and low savings, second; low asset imperative in formal sector, third; puts limit requirement on work force and control the work force through efficiency through providing low salary, disguised employment, early age employment and through underemployment.

Lately, different theories have been made in the international literature to describe the thought processes of business people behind making part of or total of their business' dealings on informal basis (e.g. Valenzuela, 2001; Williams, 2006; Gurtoo, 2009). These theories include i) Structuralist, ii) Neo-liberal, and iii) Post-structuralist theory.

Structuralist theory sees the involvement of businessmen in informal sector as an immediate aftereffect of their automatic 'exclusion' from the conventional economy. The meaning of exclusion here is the inability of the laborers to work up to the "higher" standards of the formal labor market, and in this way cut out of the current economy to be left with no other option however to attempt informal sector work (Williams and Round, 2010). Numerous political economy analysts, while recognizing the development of the informal sector, have named it as a type of work common as an intrinsic segment of modern capitalism that is involving individuals in a horrible race to the bottommost (Williams, 2006).

Structuralists set forward as possible clarifications for this expanding involvement of businessmen in informal sector for two reasons. First, it is the rising pursuit of formal sector businesses to decrease their business costs by sub-contracting their business to informal sector firms under unfair work dealings (Espenshade, 2004). Second, it is the failure of the governments to give extensive welfare scheme and achieve full-employment level that has an immediate bearing on the rising dependence of people on informal activities (Hudson, 2005).

This perspective show that informal businessmen are thus unwilling and tragic pawns in an exploitative worldwide economics system, cast out into the informal sector on account of their less capability to search formal sector work (Gallin, 2001). Along these lines, informal entrepreneurship is a survival practice led out of need and a substitute of formal work sought after if all else fails only for economic reasons.

Rather than depict informal entrepreneurship as a survival practice led out of need by disregarded populations, a neo-liberal viewpoint has rather opposed that the growth of informal sector indicates how many are deciding to intentionally leave the formal sector. Here, informal businessmen are brave men refusing the bureaucratic

restraints of an over-controlled state (De Soto, 1989) and informal enterprises are an immediate reaction to the over-regulated of the market. Furthermore, such informal sector business is an indication of the well known resistance to over-regulation. It is a normal economic strategy intentionally sought after by businessmen muffled by state-forced imperatives (Maloney, 2004). This perspective shows that the contribution of entrepreneurs in the informal sector is a matter of choice that happens because of their "deliberate" exit from the over-regulated area of the formal sector. Nonetheless, similar to structuralist viewpoint, it also sees this engagement as essentially drive by economic benefits.

Those clarifying the perseverance and growth of informal sector entrepreneurship were for a few years restricted to a decision between either structuralist or neo-liberal theories, or structure versus agency. Lately, a third point of view has emerged. A free array of basic, post-colonial, post-structuralist, post-advancement and post-industrialist researchers has challenged the portrayal of informal sector businessmen as economic agents and rather represented them as them as principally social agents.

From this post-structuralist point of view, informal sector entrepreneurship is differently re-read as: performed as nearer social relations, for example, kinfolk, friends, neighbors, colleagues (Williams, 2004) sought after for social and redistributive causes instead of absolutely monetary gain an obstruction rehearse that is a reaction to the exploitation of laborer in the neo-liberal worldwide economic system and the bribes and corruption that can be a vital part of the formal sector (Whitson, 2007), or a substitute space in which members can change their work identity or potentially uncover their actual selves, for example, by building up informal lifestyle enterprises. (Snyder, 2004). Rather than depict informal

businessmen as unlucky pawns in an unfair worldwide economic system, or as deliberately leaving the formal domain as a result of over-regulation, post-structuralists in this manner again credit organization to informal entrepreneurship yet underline how it is an occupation hone chosen for redistributive, social, identity or resistance reasons (Biles, 2009).

In recent year, taxation issue of informal sector in transition and developing countries has received a greater attention. As per Farrell (2004) informal sector firms, bound to remain little in order to hide, hamper economic development and that their illicit cost advantage twists rivalry. Informal firms gain significant cost advantage by avoiding regulations and tax more than balances their low efficiency and small scale. Competition is in this manner thus twisted on the grounds that inefficient informal sector players remain in business and keep more profitable formal firms obtaining market share.

Any short term work advantages of informal sector are significantly out weighted by its long term negative effect on economic development and employment generation. A great part of the discussion over the expenses and advantages of taxing the informal sector has concentrated on direct revenue and equity implications. At first glance, tax collection from informal sector gives off an impression of being a possibly critical source of government income, as the informal sector involves a vast and, in numerous countries, increasing share of GDP (Schneider and Klinglmair, 2004). As indicated by Anuradha, Wilson, and Christopher (2014), taxing microenterprises can shape a culture of tax compliance, there is no systematic proof on the long-term influence of microenterprise taxation on behaviors towards taxation among those microenterprises.

The implications of increased tax collection for the growth of microenterprises are as imperative as prompt revenue generations. Many tax experts have the concern that high taxation of microenterprises may eventually ruin development, and that this cost may far exceed the revenue advantage. The reasoning is that microenterprises opt to remain in the informal sector precisely because they think that being informal will give benefits, given the burdens of being formal entity. Nonetheless, an increasing volume of research recommends that formalization – of which entrance into tax net is a central element – may, actually, have huge advantages for growth, may not hamper economic growth (Kenyon and Kapaz, 2005).

There is a few, albeit constrained, evidences that taxing the informal sector can lead to accountability and improved mobilization. Joshi and Ayee (2008) state that efforts to tax the informal sector microenterprises and medium firms results in some bargaining between state authorities and informal sector associations.

3.1 Research Gap

A lot of studies are available on informality and size of informal business in various countries including Pakistan. However, there is no proper study available on transition of informal sector to formal sector. In 2014 a conference by ILO was held in which it was discussed about how the transition of informal sector to formal sector can be made and based upon that conference in 2015 some recommendations were made for all countries about formalization of informal sector.

CHAPTER 4

THEORITICAL FRAMEWORK

In the economics literature, there are three distinctive broad classes of models clarifying why firms stay in the informal sector (La Porta and Shleifer, 2008). These models are I) exclusion model, ii) rational exit model, and dual economy model. In the exclusion model, government procedures exclude a bigger potential group of businesses (De Soto, 2000). Informal sector firms might be not able to get access to formal financial resources, undermining their capacity to secure loans to extend their enterprises, or they will most likely be unable to legitimately export their items, refuting them access to demand markets. In this view, informal sector firms are an undiscovered supply of entrepreneurial energy, which can be released by eliminating obstacles to entry, improving legal environment, and cutting the red tape system.

Rational exit model, the second model, is related with Levy (2008) and Maloney (2004), among others, sets that businesses leave the formal sector when the expenses of formal set up are more than its advantages. At the point when firms choose to formalize, they measure the advantages of formalization, for example, lessen risks of informal payments or gifts to government authorities, expanded access to banks loans, government contracts, courts, and cost of compliance with different business related rules and regulations, like labor laws. Firms take the decision to be formal like evaluating costs and benefits and investment decisions.

In the last model dual economy model, formal sector firms and informal sector firms are primarily different (La Porta and Shleifer, 2014). Informality is a result of poverty. Informal firms are generally inefficient and small, and kept running by less educated entrepreneurs. Generally, informal sector's productivity is too low to enable them to

survive in the formal sector. Along these lines, informal sector firms are to a great extent isolated from the formal sector. As the informal sector firms produce different items, using different labor, technological inputs, capital, and they serve diverse customers.

Informal firms generally don't pay official taxes, and this limits the government's capacity to give support for public goods and services, moreover, for not registering their businesses, they avoid to pay taxes as well (Levy, 2008). Norman Loayza (1996) finds the size of the informal is positively related with high tax rates, as well as labor market limitations and inefficient government organizations, and it is adversely related with the real per capita GDP. In addition, he claims that costs of corruption and bureaucracy, instead of official taxes, are the major factors for a presence of the informal sector. Furthermore, the complications in the registration as costs, time, and many efforts restrict informal firms owners to become formal and register their enterprise (Biles, 2009).

Because of less incentives of registering an enterprise or firm, some scholars like Cortellese (2015) claim that the relevant authorities i.e. firm registering bodies should offer tangible incentives to be formal and not only defend tax burden with general public services so if there are not appropriate incentives to be formal, it is more likely that microenterprise or medium enterprise owners would prefer to be completely informal. In this case, the informal sector is cause of a personal cost-benefit analysis for the government in short-medium term.

As we have to seek the intensions of informal business for registering their business therefore, our dependent variable will be “willingness to switch”. With the literature review and the theoretical framework above it seems to be the main four variables that can affect our dependent variable are:-

- i) Avoidance of taxes (Levy, 2008).
- ii) High tax rates (Norman Loayza, 1996).
- iii) Complicated registration process (Biles, 2009).
- iv) Tangible incentives (Cortellese, 2015).

CHAPTER 5

METHODOLOGY

5.1 Study Area

Rawalpindi City, usually recognized as '*Pindi*' is a city of Punjab province of Pakistan. Rawalpindi is neighboring to Islamabad, the capital city of Pakistan, and both the cities are jointly known as "twin cities" on account of healthy economic and social links between both cities. By population Rawalpindi is the fourth-largest city in Pakistan surpassing 3.2 million, whereas the bigger Rawalpindi-Islamabad metropolitan area is Pakistan's 3rd biggest metropolitan area. Economy of the city and the neighboring district has a diverse industrial base. The major industries of the city include gas processing, iron mills, oil refineries, brewery, tent factories, hosiery, pottery, sawmills, tent factories, leather goods production, transport, textile and tourism. As Rawalpindi is one of the main hubs of economic activities. It also has huge informal sector. Due to time and financial constraints, it is convenient for the author to collect data from Rawalpindi.

5.2 Sample Size and Data Collection

Simple random sampling technique is used in this study. This technique is used where we select a group of subjects (a sample) for study from a larger group (a population). Each individual is chosen totally by chance and each member of the population has an equal opportunity of being selected in the sample. Every possible sample of a given size has the same opportunity of selection. A huge amount of informal sector activities are performed in various areas of Rawalpindi city from a small street to larger commercial markets. Because of divergence it is not possible to collect data from all areas of Rawalpindi city as informal activities are performed

from a small street to bigger markets. Therefore, a micro-enterprise level survey in Rawalpindi city's three main commercial areas named, Raja Bazar, Saddar, and Tench Bhatta was conducted. Another reason of choosing these markets is time and resources constraint. These three markets are the main commercial markets which also constitute a representative sample for the types of businesses we are including in our study. The population (informal businesses) is heterogeneous and we were unable to select one type of business or a specific sector. There are two reasons for choosing more business types: (i) to increase sample size, and (ii) to increase diversification because different business owners may behave differently about switching to formal sector. This sampling frame generated data from heterogeneous types of micro-enterprises from various sectors in a wide range of localities who may possess very different rationales for participating in the informal sector. The intention in doing so was to prevent studying entrepreneurs only from a specific cohort who might have similar reasons for operating enterprises in the informal sector.

There is no data available anywhere about the informal firms in Rawalpindi City. As the population was unknown, so to determine the size of the population a market visit was conducted and primary information was gathered about the estimated population of all the markets. The estimated population was around 10,000 (Raja Bazar = 4000 + Saddar = 3500 + Tench Bhatta = 2500). Therefore, according to this population, the calculated sample size is 260 with 95 percent confidence interval with the help of following formula (CSR, 2018).

$$N = (p) * (1 - p) \frac{Z^2}{C^2}$$

Where:

Z = Confidence level (Usually it is assumed 95 percent confidence level, then value of Z is 1.96)

C = Confidence interval (tolerance for margin of error), usually is assumed 5 percent.

P = Response distribution or variance of the indicator to be measured

Further division of sample size of 260 according to areas is mentioned below.

Sampling framework is mentioned below in Table 5.1.

Table 5.1: Sampling Framework

Area	Estimated Population	Sample Size
Raja Bazar	4000	104
Saddar	3500	91
Tench Bhatta	2500	65
Total	10,000	260

However, because of low response rate of the respondents, we were able to interview only 230 informal businesses (Raja Bazar = 90, Saddar = 80, and Tench Bhatta = 60).

Primary data was collected through a structured questionnaire (Annexure - A) from informal firms of Rawalpindi city. Both the close ended and open ended questions were used in the questionnaire. The structured face-to-face interview schedule adopted a gradual approach to more sensitive questions, commencing with socio-demographic questions on age of firm owner, education level, marital status, household size, followed by second section on questions on the characteristics of the business, such as age of business, number of full and part time workers including the owner, sector in which the business is operating, and the ownership of land.

The third section then required data on registration issues, such as the reasons for not registering including avoidance of taxes, high tax rates, complicated taxation process and benefits as registered business, followed by a question on willingness to register with some choices. Next few questions were asked on perceptions of issues related to formal sector such as comparison of profitability between formal and informal sector, issuance of receipts a time waste, ease of registration process, easy expansion as formal entity, maintaining proper record for taxation, cost hiring professional bookkeepers and perception regarding business paying taxes. At the end few questions were asked about the perception of tax authorities in Pakistan such as competency, fairness and remuneration of tax officers along with question on fairness of tax applied in Pakistan. Secondary data is collected through available literature about the subject.

5.3 Characteristics of Unit of Analysis

The unit of the analysis in this research is small firm operating in the areas of Tench Bhatta, Raja Bazar and Saddar. The characteristics of the unit of analysis are mentioned below:-

- i. A small firm which is not registered with any government authority¹
- ii. A firm employed minimum of 3 workers and maximum of 9 workers.
- iii. The owner has been associated with the informal sector's economic activity for the past 12 months

¹ According to SMEDA (SME Policy 2017), the number of employment size is up to 250. There is no minimum size of the firm explained in the SMEDA documents. We are now using FBR standard definition of microenterprises which is less than 10 employees.

5.4 Econometric Specification of the Model

In order to seek information from informal sector regarding their willingness to switch to formal sector, we got the parameter estimates through the use of a linear probability model; it is a special case of a binomial regression model. The dependent variable for each observation takes values which are either 0 or 1, because the dependent variable in this case is binary in nature.

$$WTS = \beta_0 + \beta_1 AGE + \beta_2 EDU + \beta_3 MS + \beta_4 HHS + \beta_5 FS + \beta_6 BT + \beta_7 AB - \beta_8 AT - \beta_9 HTR - \beta_{10} CRP + \beta_{11} TI$$

All the variables used in the above model are explained below:-

Dependent Variable:

In the above model **WTS** is willingness to switch to formal sector by informal sector firms. This is a dummy variable, where we have measured the willingness by giving value of 1 for positive response (Yes), and 0 otherwise.

Independent Variables:

AGE: This shows the age of the firm owner. Age still matter a bit in the decision making about remaining in the informal sector or switching to the formal sector. Young firm owners or operators are more likely to manage totally informal business. This is also a categorical variable with four categories for those ages between 20-29, 30-39, 40-49, and 50 & above.

EDU: This is education level of firm owner, this indicates that education level of the firm owner have a strong bearing on the size of the informal sector, as less educated people find it difficult to adjust in the formal sector. As the education level of the firm owner increases the more likely they will go for registration of their business and become a formal entity. This is a categorical variable with seven categories including primary, middle, matric, intermediate, bachelors, masters, and diploma / other

courses. This is resulting from number of years in full time education received by firm owner in Pakistan.

MS: This is marital status of firm owner. This variable's impact on dependent variable is minimal, so we may expect that married firm owners are likely to go for registration. A value of 1 is assigned for married firm owners and 0 is assigned for unmarried firm owners.

HHS: This is the household size of firm owner. Also this variable's impact on dependent variable is minimal, and its expected that higher household size firm owners may likely to go for registering their businesses. This is an open ended question and we have not assigned any value for this variable.

FS: This is the firm size in terms of employed workers (full time and part time). A firm employed minimum of 3 workers and maximum of 9 workers. Numerical signs ranging from 3 to 9 were given to this variable. It is expected that the more the firm size, more likely the firm owners go for registering their business.

BT: This is business type, i.e which sector the business is operating and which sector is more likely to register with the tax authorities. It's a categorical variable with 9 categories including agriculture, manufacturing, construction, wholesale and retail trade, hotel & restaurants, property & real estate, communications & IT, transport & storage, and education.

AB: This is age of business, how many years since the business is operating, we have placed one condition that the business must be operating at least an year before. It is expected that the more the age of the business the more they willing to register their business.

AT: This shows the avoidance of taxes. We have assigned the value 1 as Yes (avoidance of taxes for registration) and 0 as No. This has an important role in

decision of firm owners regarding registration of their business. The more the people avoid the taxes the less the chances they will go for registration. It has significant negative impact on willingness to switch to formal by firm owners.

HTR: This indicates the high tax rates. We have assigned the values 1 to 5 for this variable where 1 being less high tax rates and 5 being too high tax rates. If the tax rates are too high than its more likely that firm owners will not go to registering their businesses, so it also has significant negative impact on willingness to switch to formal by firm owners.

CRP: This shows the complicated registration process. We have assigned the values 1 to 5 for this variable where 1 being less complicated and 5 being more complicated. This variable also has negative impact on willingness to switch to formal by firm owners because the more the complicated process, less the firm owners willing to register.

TI: This shows the tangible incentives. We also have assigned the values from 1 to 5 with 1 being less beneficial and 5 being most beneficial. This variable has significant positive relationship with dependent variable as the more beneficial is the registered business the more firm owners will go for registration of their business.

CHAPTER 6

RESULTS AND DISCUSSION

The results of regression model and the results from analysis of various questions related to the perception of the 230 respondents from commercial areas of Raja Bazar, Saddar, and Tench Bhatta of Rawalpindi city about registration as formal entity as well as taxation issues in Pakistan are presented in this chapter. For this purpose, we first examined the descriptive statistics of dependent and independent variables along with explanation of general results from survey questionnaire and after that we explained the regression model and its results.

6.1 Profiles of the Business and Owners

The profiles of the business and the business owner are explained below:-

6.1.1 Age of Business Owner

Age level still matter a bit in the decision making about remaining in the informal sector or switching to the formal sector. Young firm owners or operators are more likely to manage totally informal business. Some of the evidence is associating the age of the informal enterprise owner with his choice of working in the informal sector.

Few studies have found that the magnitude of informal sector is high when the group of informal sector owners is young (Pedersen, 2003). In the Pakistan context, very few studies have been conducted on this issue. Kemal and Mahmood (1998) looking at the age profile of the heads of informal sector businesses in Pakistan recommend that more than 60 percent of the owners of the informal sector fall in the

more young age and among 60 percent there are 49 percent of the owners of the businesses belong to the age bracket of 25 to 35 years.

Our survey results prove the same in the context of Rawalpindi city, 76 percent of the respondents are above the age of 20 and below 40. However, only 24 percent of the respondents are the above the age of 40. These findings suggest that informal sector contains comparatively youth following informal activities as mentioned in the figure – 1.

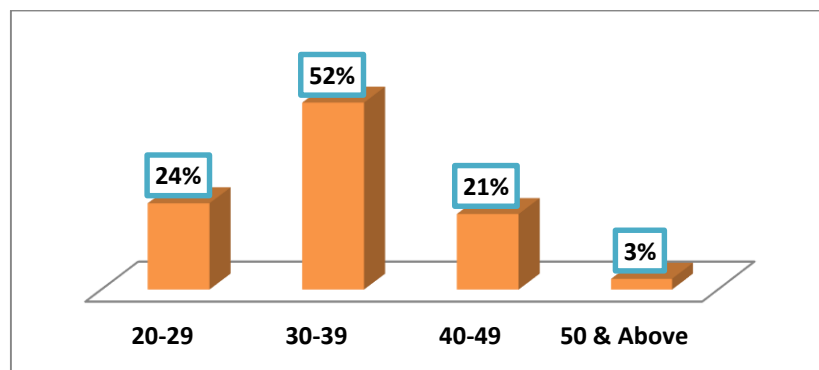


Figure – 1: Age of Firm Owner

6.1.2 Education Level of Firm Owner

Education level of the firm owner have a strong bearing on the size of the informal sector, as less educated people find it difficult to adjust in the formal sector. Therefore, the education level of the owner of the business of informal sector he is to operate informal business has a significant relationship. Connolly (1985) suggests that the amount of informal sector decreases with the increase in the education level of firm owners. In the context of Pakistan, Arby et al. (2010) emphasizes that lack of education of informal sector firm owners leads to decrease their choice of going into the formal sector.

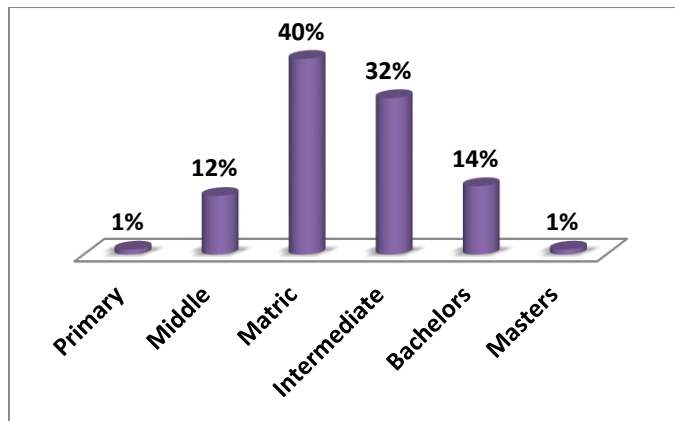


Figure – 2: Education level of firm owner

Our results show that not much owners of the informal sector in Rawalpindi city are mostly educated associated with the informal sector as only 14 percent have bachelors education and 1 percent with a master’s degree. However, a majority of the respondents around 72 percent were having education of matric and intermediate level. As the education level of the firm owner increases the more likely they will go for registration of their business and become a formal entity (figure – 2).

6.1.3 Business Type

Informal sector economic activities are performed in various sectors of the economy, In the commercial areas of Rawalpindi city most of the businesses operating in the wholesale and retail sector. In our survey 76 percent of the business operates in retail and wholesale sector, followed by 19 percent in communication and IT along with 5 percent in hotel and restaurants (figure – 3).

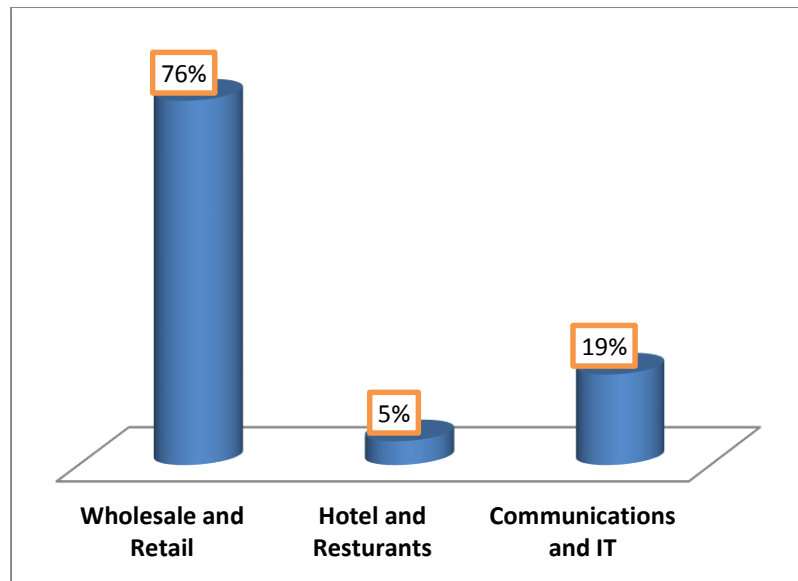


Figure – 3: Sector of informal businesses

6.1.4 Willingness to Register

A question was asked about willingness to register with tax authorities. Among the 230 respondents, there were 56 percent of the respondents were willing to register their enterprises in near future. However, 44 percent of the business owners were still reluctant to formalize their business as shown in the figure – 4.

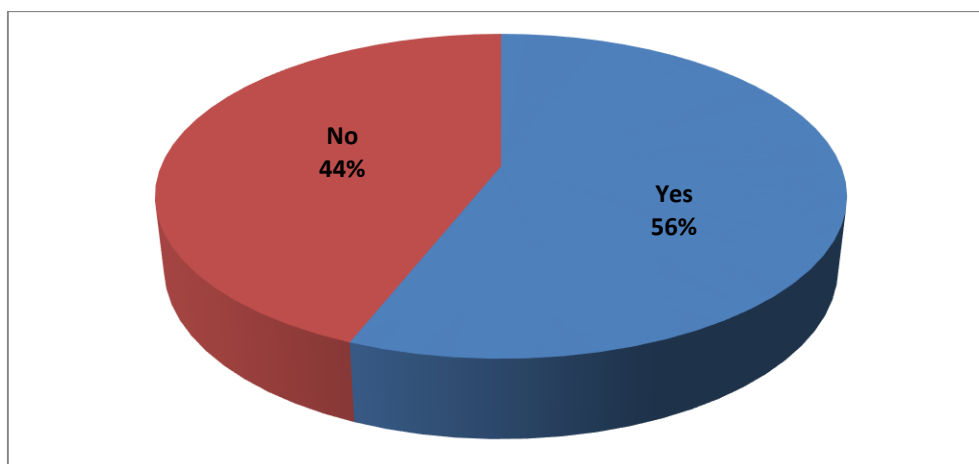


Figure - 4: Willingness to register with tax authorities

This implies that many of the business are still willing to register, however they require some tangible benefits for registering their business. Within this context next question asked to those who are willing to register their business and become the

part of formal entities. They were asked under which beneficial choices they would be willing to register. About 84 percent of the respondents were of the view that they will be willing to register and pay 10 percent tax if we are provided with any tangible benefits like compensation on education, health, and transportations etc. as shown in the figure – 5.

12 percent respondents would be willing to register if they have access to loan is easy from banks. And only 4 percent were of the view that they are willing to register with tax authorities if they have been asked to pay lump sum corporate tax at 15-20 percent of total revenues and amnesty for past years.

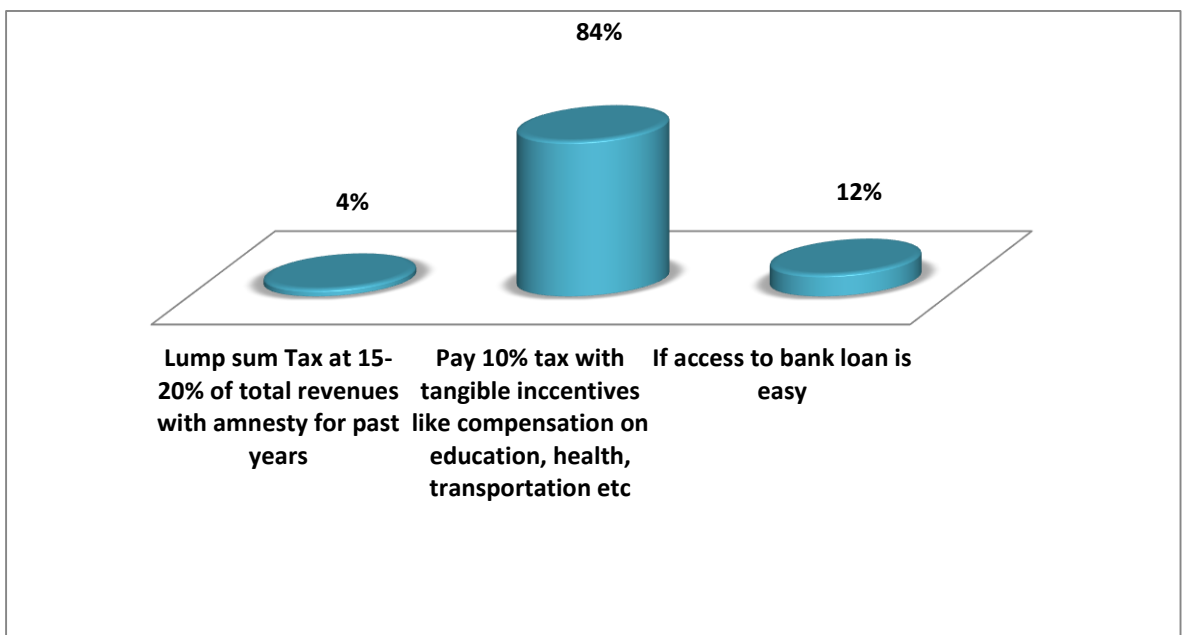


Figure - 5: Choices for Willingness to register with tax authorities

The informal workers have not such tangible benefits that's why most likely they do not register with any tax authorities in Pakistan. But if they are given with some tangible benefits as explained above like some relief in education of their children, health insurance for their family members and concession on traveling across the country they would be willing to pay 10 percent of their revenue as tax to government of Pakistan. They were of the view that with registered businesses they

are tax payers so they should also be provided with tangible incentives as mentioned above. So that they can feel they are tax payer responsible citizen of the country and having some benefits over those who are not registered and not paying any kind of taxes.

6.1.5 Ownership of Land

It is observed that the land prices in commercial areas of Rawalpindi city are very high and many of the small and medium enterprises in Pakistan can't afford to purchase land for their business activities, so they get a place on rent basis. The rents are also very high, the rents starts from 10,000 to 500,000 based on the square foot of the land.

So we have asked a question about ownership of land. The results show that only 10 percent of the respondents own the land of their business, however, 90 percent informal businesses are operating on rent basis (figure - 6). Because of high rents the prices of products are high and low profitability is observed in context of high rents in Rawalpindi city.

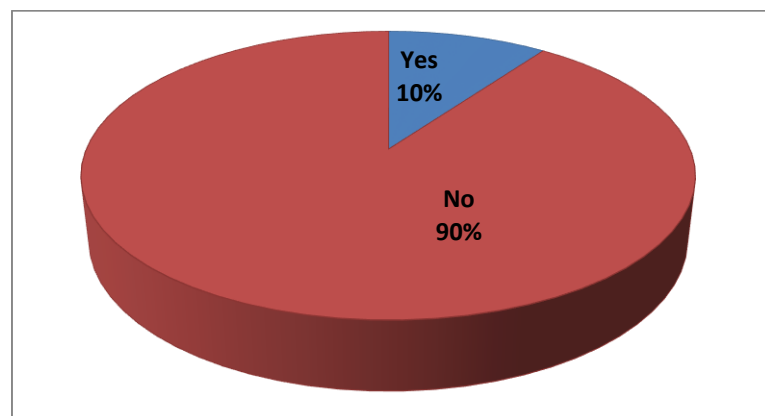


Figure – 6: Ownership of business land

6.2 Perceived Problems in Formal Sector

A question was asked about the perception of informal sector enterprises regarding problems of being a formal entity. The purpose of this question was to know their perception about formal sector issues. Likert scale was used to measure the perception with degrees of strongly disagree to strongly agree. 1 being the option of strongly disagree and 5 being the option of strongly agree with the middle value as don't know. Because of low responses on some options, therefore option 1 and 2 as strongly disagree and agree were merged as Disagree and option 4 and 5 strongly agree and agree are merged as Agree, however, the 3rd option 'Don't Know' kept as same. The first part of the question was 'informal sector is more profitable than formal sector'.

63 percent of the respondents agreed with statement and believed that informal sector still more profitable than formal sector as shown in the figure - 7.

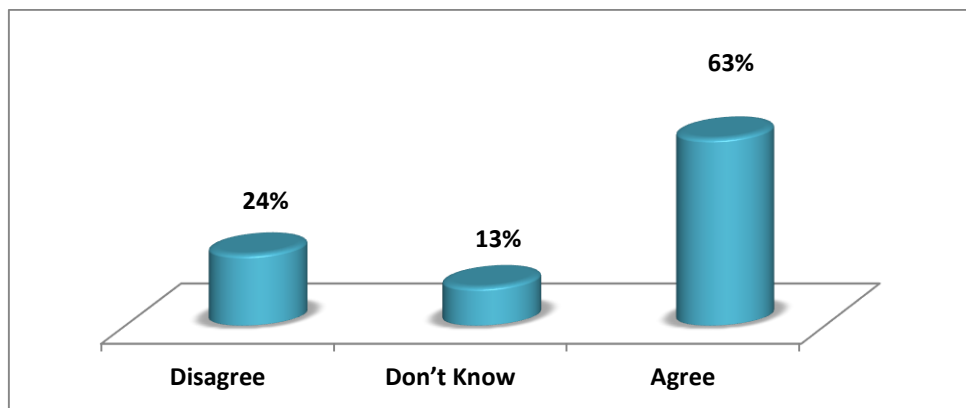


Figure – 7: Firm's profitability of informal sector

The main reason for their agreement was they think that they are not paying any kind of taxes, that's what whatever their profit is that is their own totally. 13 percent of the respondents think that because of unawareness about formal sector taxes and other relevant things, they don't know whether informal sector is more profitable or formal sector is more profitable. However, 24 percent of the respondents

still believe that formal sector is more profitable than informal sector. The main reason of their disagreement was they think that while being formal they can market their business without fear of any authority, they can place billboards, banners etc outside their shop and on road as well. So this will enhance their profit.

Issuance of receipts is very important in business transactions for the record of their business transactions for the tax and audit purposes. It is also responsibility of the buyers to always demand the receipt of their purchases. The practice is very usual in the formal sector to issue the receipts of every sale and purchase. However, it is observed that in some cases, for the ease of the buyer and selling of more products, sometimes they do not issue any receipts as the receipt is the evidence of some General Sales Tax (GST) deduction. So in this case the buyers gets the product at lower rates and the seller do not have to pay tax as well, this practice becomes informal sector practice. As we see informal sector firms not only pay taxes but also do not issue proper receipts. There is a difference between a proper receipt and general receipt as the proper receipt book contains of 2 copies of one receipt, they issue original receipt to the buyer and kept the carbon copy to themselves for tax and other records. However, the general receipt is a single copy of receipt which can not be kept as carbon copy. Sometimes the owners of the business specially the informal ones think that issuing a receipt is a waste of time, so in order to test this we asked our respondents that what they think that issuance of receipts is a waste of time.

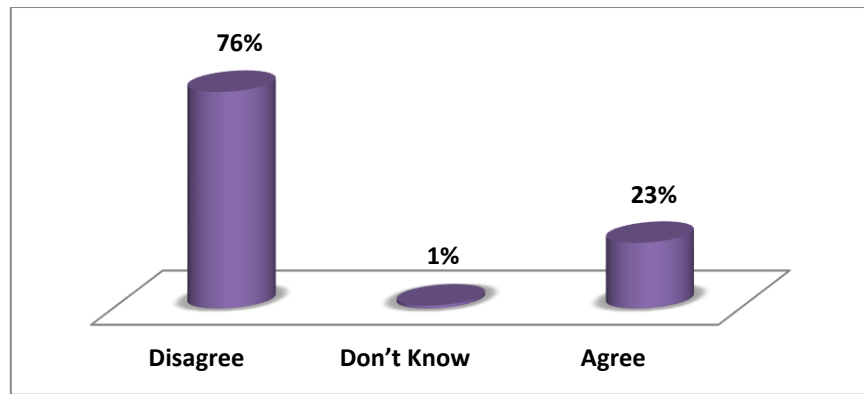


Figure – 8: Issuance of receipts as a waste of time

Only 23 percent of the respondents have agreed to the statement that issuance of receipt is a waste of time, however, a huge amount of respondents 76 percent think that issuance of receipt is very important and every business should issue the receipts of every transaction as shown in the figure - 8.

Every business firm owner whether formal or informal always look for more profit, and one source of earning more profit is expansion of business. sometimes its easy to expand and sometimes its difficult to expand for both formal and informal businesses. So we asked our respondents about their perception regarding easiness of expansion of business as registered entity. It was a mixed kind of response from all respondents, 29 percent think that its not easy to expand as registered entity because of complex registration and expansion procedures, however, 41 percent think that its easier to exaand as formal entity, because once you are legal you can easily expand the business. On the other hand 30 percent of the respondents in response said that they don't have any idea whether its easier or not easier to expand as registered entity as shown in the figure - 9.

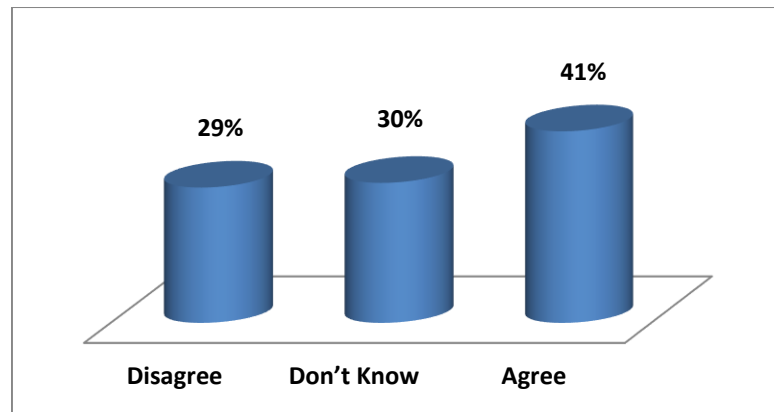


Figure – 9: Easier to expand as registered entity

Formal businesses are subject to audits and inspections, sometimes government auditors audit the firms and sometimes the firm owners hire 3rd party auditors in order to remain clean in their transactions. We asked about the perception of informal firms that they think firms who are registered face audits and inspections frequently or sometimes in a year.

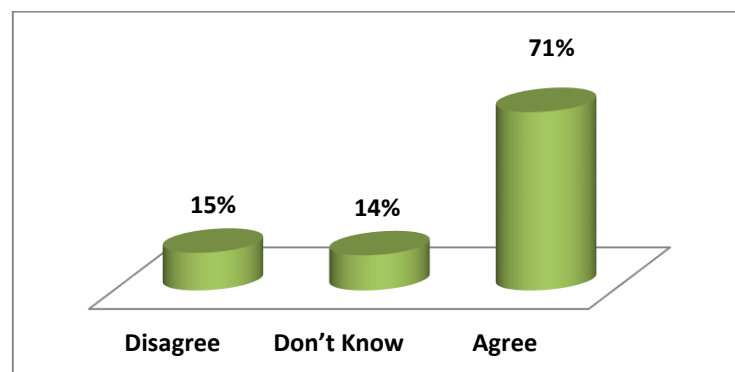


Figure – 10: Registered Businesses often subject to Audits and Inspections

15 percent of the respondents think that the formal sector firms do not face audits and inspections frequently, whereas 71 percent of respondents still think that formal businesses still face regular and frequent visits of audit and inspection teams. On the other hand, 14 percent of the respondents responded that they don't know about it whether the formal sector firms often face audits and inspections or not.

(figure – 10). This huge 71 percent response may be a reason of fear of not registering a business because of avoidance of this audit and inspection.

For audits and inspections all the formal firms have to keep all transaction records, sometimes the businesses make huge transactions and they kept a bulk of books of transaction records, although now there is somewhere placed computer system but still people rely on the manual system with hard copy receipts.

Our survey respondents were asked that ‘keeping the record for tax purposes is cumbersome and expensive’ among them 65 percent of the respondents think that its very expensive and cumbersome of keeping all the records, however, 29 percent of the respondents were still thinking that its not much expensive and cumbersome whereas only 6 percent of the respondents replied that they do not know about whether keeping the record for tax purposes is expensive or not as mentioned in the figure – 11.

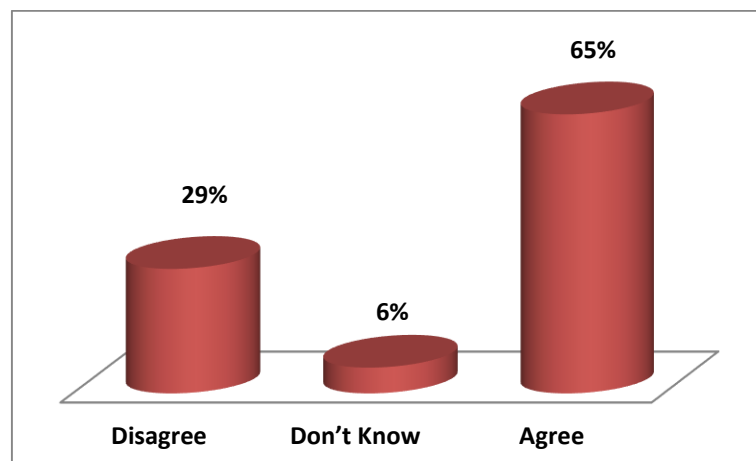


Figure – 11: Keeping Record for tax purposes is cumbersome and expensive

Formal business owners always can't file their tax returns and other related things personally; they have to dependent on professional bookkeepers and lawyers. These professionals sometimes too expensive and sometimes they charge normal

rates. We asked our respondents about their perception on hiring these professional bookkeepers and lawyers.

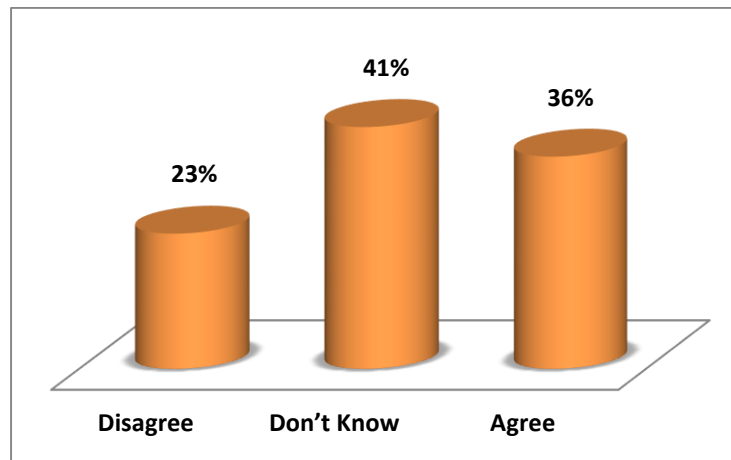


Figure – 12: Professional Bookkeepers or Accountants are too expensive

23 percent of the respondents are agreed with the statement that these professionals and lawyers are not much expensive and their charges are normal, however, 36 percent of the respondents still think that these are too expensive to bear their cost. On the other hand, 41 percent of the respondents has responded that they don't know about this as they have no idea because they have not got their services ever (figure – 12).

Here the FBR and SECP's role is important to let the businesses know and clear their perceptions about various aspects such as audits and inspection visits, ease of maintaining records for tax purposes and charges of professional bookkeepers and lawyers. A huge amount of business firm owners need some clarity about these issues, these are may be to some extent are the reasons of their remaining informal in Pakistan.

In Pakistan, people are ready to pay taxes but they need some benefits and assurance that their tax money is being spent on their welfare. We asked our respondents about paying taxes by business that businesses should pay taxes or not.

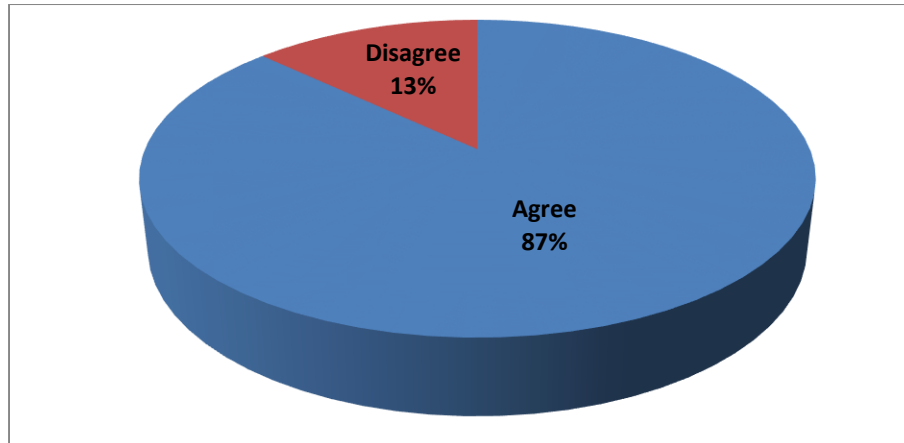


Figure – 13: Every business should pay taxes

As much as 87 percent huge amount of business owners thinks that every business should pay taxes, however, because of some miss trust there are 13 percent of the business owners disagree that businesses should pay taxes (figure – 13). The relevant authorities should work on the removing the perception of the people regarding paying of taxes.

Another important thing regarding registration of businesses with authorities in Pakistan is availability of information regarding registration. Although relevant authorities are making it very convenient though their website and other sources, however, still microenterprises think that the information for registration to them is not easily available. This might be the fact that many of them are not much using the technology for awareness about registration process.

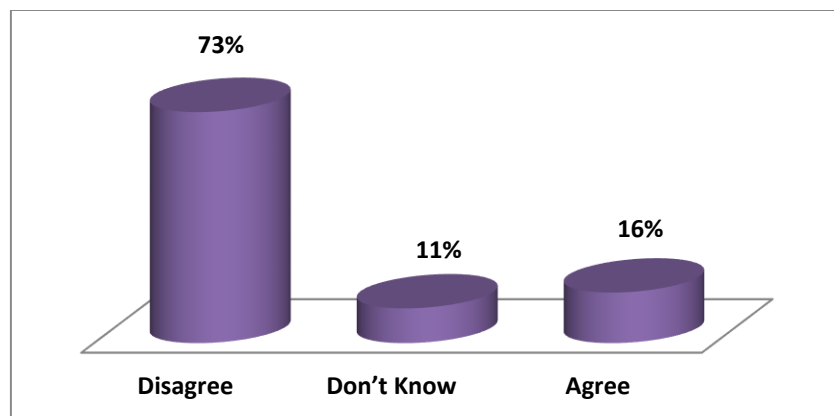


Figure – 14: Registration information easily available

As much as 73 percent of the respondents disagree that information regarding business registration is easily available, and only 16 percent think that registration information is easily available (figure – 14). Most of the respondents are less educated and the information is on website, so there is a need to star a proper campaign along with the other things mentioned above.

The respondents were asked if during the past 12 months they were expected to give any informal payments any of tax or other relevant department officials. There were 28 percent respondents who occasionally offer such payments. However, 1 percent respondents have paid during all of their engagements with the tax officials (Figure 15).

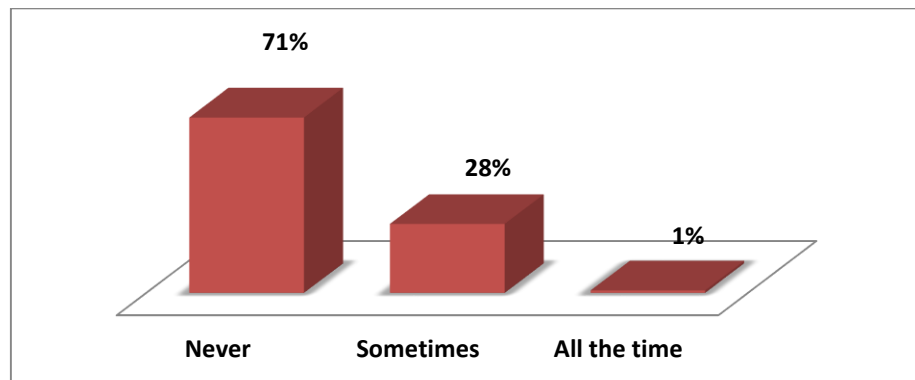


Figure – 15: Extent of informal payments to tax or other authorities

Such open acceptance of bribing the tax machinery came with a cynical view regarding the overall reform efforts. Those who are willingly giving these informal payments or gifts believe that the taxation machinery cannot be reformed easily and it is easier for them to safeguard from any future harassment by providing such bounties to the tax officials. Several of these respondents felt that the only solution to the problem was further reduction in human interaction during the entire process of tax compliance. There is some evidence to suggest that a reduction in human interaction

via increased technology adoption leads to reduced corruption. However this in no way warrants a permanent change in the behavior of officials.

6.3 Perception about Tax Authorities

Pakistan has the lowest levels of tax collection with respect to income levels in the world, even compared to countries with similar levels of per-capita income such as Bangladesh and India. This is low because of the mistrust of the people on tax authorities in Pakistan. We have asked our respondents about competency, fairness and their remuneration of tax officers in Pakistan. Upon a question on tax officers being competent, majority of the respondents around 62 percent have agreed (figure 16).

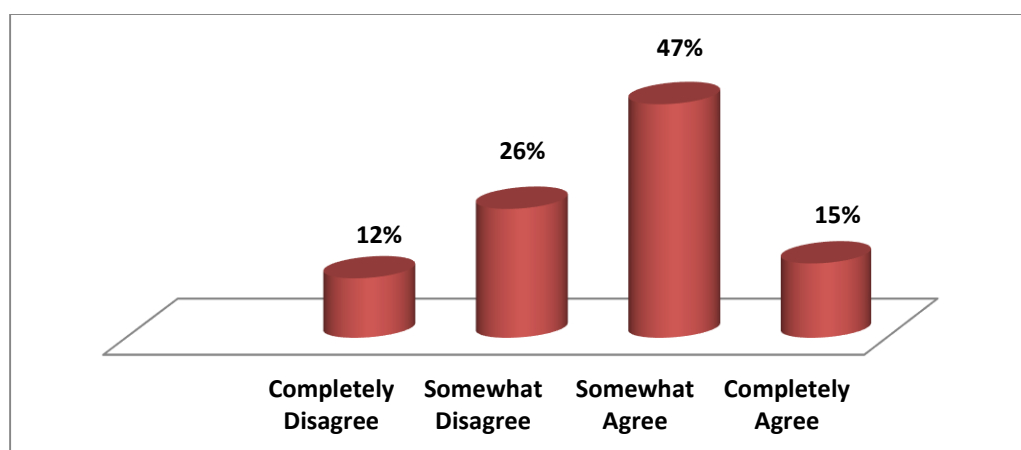


Figure – 16: Competency of tax officers

Next question was asked about the fairness of the tax officers in public dealing, one can imagine the trust deficit of business community over the tax officers in Pakistan that around 89 percent of the respondent think that tax officers are not fair. Only 11 percent people think that tax officers in Pakistan are fair (figure – 17).

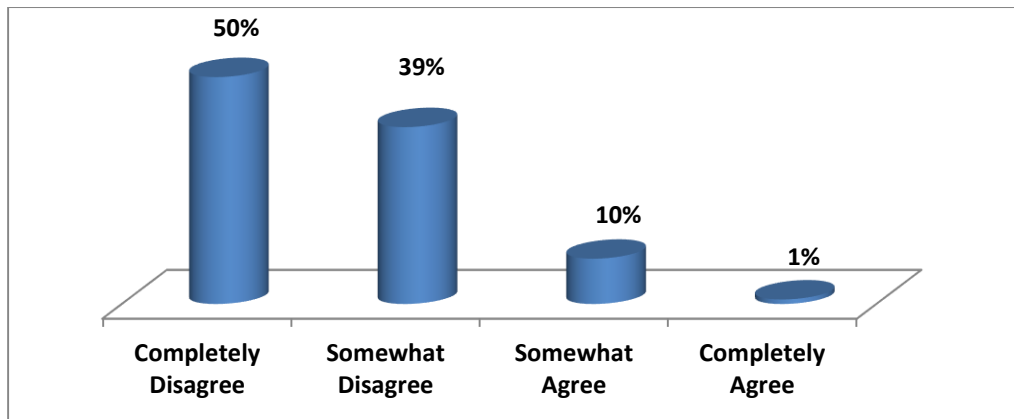


Figure – 17: Fairness of tax officers

Another question was asked about remuneration of the tax officers, as whether the tax officers in Pakistan are underpaid. Around 73 percent of the respondents totally disagree and somewhat disagree that tax officers in Pakistan are underpaid, however, only 27 percent respondents still think that tax officers in Pakistan are underpaid (Figure – 18).

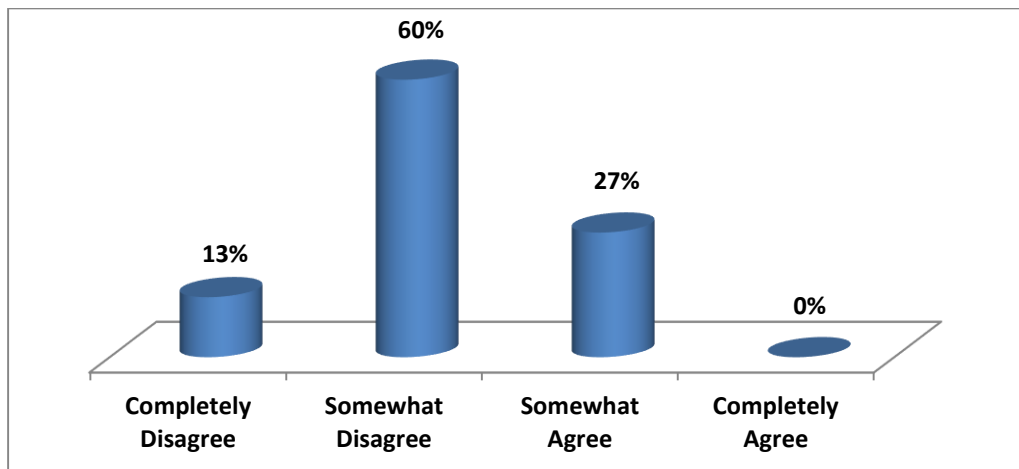


Figure – 18: Tax officers are underpaid

All taxes in Pakistan seems not to be fair, some hidden taxes are also present in utility bills such as extra tax, further tax. Nobody knows that what is extra tax and what is further tax but their rates are mentioned in the utility bills. We have asked our respondents about fairness of taxes applied in Pakistan. Its not much surprising with the results that 90 percent of the respondents completely and somewhat disagree that

taxes applied are fair (figure – 19), on the other hand 10 percent of respondents still think that taxes applied are fair.

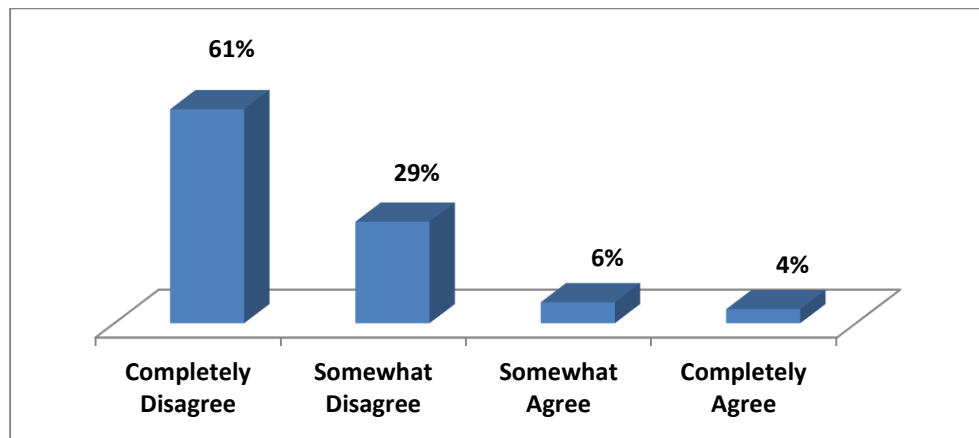


Figure – 19: Taxes applied in Pakistan are fair

There was a feeling that the tax machinery is heavily driven by rent-seeking motives of officials. Businesses in Pakistan remain reluctant to expand in the formal sector due to the fear of harassment by tax administration. The start-ups continue to remain informal for a substantial time period owing to similar reasons.

6.4 Descriptive Statistics

Before we move to regression analysis, it is important to discuss the descriptive statistics of the variables that are going to be used in the regression model. The descriptive statistics are reported in Table 6.1.

Table 6.1: Descriptive Statistics

VARIABLES	N	Mean	SD	Min	Max
Marital Status	230	0.813	0.397	0	1
Household Size	230	6.200	1.823	2	14
No of Workers	230	3.348	0.634	3	9
Tax Avoidance	230	0.778	0.416	0	1
Willingness to Register	230	0.552	0.498	0	1
High Tax	230	0.570	0.496	0	1
Complicated Registration Process	230	0.743	0.438	0	1
Less Beneficial	230	0.896	0.306	0	1
Age of Business	230	7.787	4.107	1	23

The descriptive statistics in the table show that just over 81 percent of the respondents are married and 19 percent of respondents were unmarried; we can conclude that most of the people engaged with informal sector in Pakistan are married. The average household size of firm owners of informal sector in our survey is 6.20. If we compare this household size with national level household size in Pakistan then according to Pakistan Census 2017, the average household size in Pakistan is 6.45. The maximum size of microenterprise in Pakistan is 9 or less, there is no proper data available in Pakistan regarding microenterprises' size of either formal or informal enterprises. However, in our survey the average size of informal firms is 3. The range of the firm size in our survey was 3 to 9. We have placed one condition that at least the firms who are operating in informal sector should be 1 year old. In our survey, the age of the businesses ranging from 1995 to 2017. By looking at the frequency table in the data, we can say that most of the businesses in informal sector started in 2010 (30 respondents).

An evidence from literature show that the informal sector enterprises do not register their businesses because they want to avoid taxes. This evidence also support our results that one of the reasons of not registering businesses because they don't want to pay any taxes. Our results show that 78 percent firm owners have the same perception; however, only 22 percent think that is not just the reason of not registering their businesses. Informal businesses also avoid becoming the formal enterprises because they think that tax rates are too high and with low profitability they cannot afford to pay high taxes. We asked on a scale 1 to 5 how high the tax rates are with 1 being less high and 5 being too high. We have merged option 1 – 3 as less high and gave it a value 0, and option 4 – 5 merged as too high tax rates with value 1. The results show that 57 percent of the respondents think that tax rates are too high

whereas 43 percent respondents think that tax rate are high but not too much high, they are less high. In Pakistan there are various studies which distinguish high tax rate to be a vital determinant influencing the magnitude of the Informal sector. Increase in the taxation rate is often highlighted as one of the most critical elements that adequately define the augmentation in the size of informal sector. Usually it is asserted by researchers that imposition of high tax rates lead to expansion in the size of informal sector (Kemal, 2003; Arby et al,2010). Higher tax rates induce micro-enterprises firm owners to remain in the informal sector in an offer to avoid taxes and increase profits.

Another reason of not registering their businesses by informal sector firm owners is the complications in registration process in Pakistan. Before discussing further lets have a short look on the registration process of firms in Pakistan. Every business in Pakistan has to register with Securities and Exchange Commission of Pakistan, none of the other organization has the power to register the business in Pakistan. All the procedures of registration are according to Companies Ordinance Act 1984².

There are six steps involved in a registration process. These steps are:-

- i. Name your firm and get it approved by SECP

The name should neither closely resemble with any other firm nor should be identical to any other firm. One should also abide by the criteria given by SECP for naming any firm.

- ii. Paying the due fee for registration

Before paying the fee, one should also need to have name availability form by SECP for file processing after paying the due fee. The

² Source: SECP website

required fee should be paid using any bank *challans* at assigned Muslim Commercial Banks (MCB) branches.

iii. Take Digital Signature and Prepare a Firm Seal

Through SECP E-Services one can get digital signature from National Institutional Facilitation Technologies (NIFT) which the only institute grants digital signatures. After getting signatures, one has to prepare a firm seal and present to SECP along with certificate of incorporation.

iv. Registration for Professional Taxes, Income and Sales

For professional taxes one need to register with Excise and Taxation (ET) of relevant District. For sales and income tax one need to register with Regional Tax Officer (RTO) of Federal Board of Revenue (FBR) to get Sales Tax Number (STN). For income tax one has to apply for National Taxation Number (NTN). There are various documents required for getting NTN i.e i) NTN form, ii) proof of registration, iii) bank account number, iv) memorandum of articles of association, v) copies of CNICs of board of directors, and vi) an attestation of business address.

v. Registration with EOBI and ESSI

After all these steps one has then need to register with provincial Employee Social Security Institution (ESSI) and Employees Old Age Benefit Institute (EOBI). Every commercial business entity having 5 or more employees has to be register with EOBI.

vi. Registration with District Labor Department

The last step of registration process is getting registered with district labor department for the safety and implementation of labor laws with

those firms who have 2 or more employees. One also requires submitting a form along with prescribed fee.

Following all the steps assured one's business entity is registered in Pakistan. One can clearly see that how complicated is the registration process in Pakistan. Just like the previous variable this variable is also constructed as dummy variable we have clubbed the option 1 – 3 as less complication with the value 0 and clubbed option 4 and 5 as most complicated with the value 1. The results show that 74 percent of the respondents think that registration process is most complicated while 26 percent of the respondents think its not very much complicated. The results prove that the registration process is very much complicated and SECP along with other relevant authorities need to make it convenient to people.

6.5 Regression Model

In order to analyze the willingness of informal business owners regarding switching to formal sector, we have estimated the effects of variables i) tax avoidance, ii) high tax rates, iii) complicated registration process, and iv) less beneficial on willingness to switch to formal sector. Moreover, we have treated the other variables like age of firm owner, education level, marital status, household size, age of business, firm size, and business type as control variables. Two variables less beneficial and complicated registration process are highly significant whereas the other two variables are not significant. The details are mentioned in Table 6.2.

Table 6.2: Determinants for Willingness to Switch

VARIABLES	Model 1	Model 2	Model 3	Model 4
Complicated Registration Process	-0.285*** (0.070)	-0.268*** (0.069)	-0.268*** (0.070)	-0.273*** (0.070)
Less Beneficial		-0.371*** (0.080)	-0.369*** (0.080)	-0.360*** (0.082)
High Tax Rates			-0.010 (0.066)	-0.004 (0.067)
Tax Avoidance				-0.053 (0.076)
Constant	1.309*** (0.409)	1.547*** (0.378)	1.552*** (0.379)	1.583*** (0.372)
Observations	230	230	230	230
R-squared	0.141	0.185	0.185	0.187
Controls	YES	YES	YES	YES

Note: Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1: The controls included age of firm owner, education level, marital status, household size, age of business, firm size, and business type.

Model 4 has been used for interpreting the results, as this model is having all variables including controls. The respondents who consider the registration process to more complicated are 27 percent less likely willing to register their firms compared to those who believed that the process is not complicated. The respondents who believe that it is less beneficial to become a formal sector firm are 36 percent less likely to register compare to those who believe otherwise. These all independent variables in the literature have significant effects, however, in our case the two main reasons of not registering their enterprises and these includes i) complicated registration process and, ii) they don't see it much beneficial.

The other two variables avoidance of taxes and high tax rates are not significant however, these two variables are not much issue for our respondents as they have not faced yet any taxes, and they have to pay taxes after being a registered entity. This is justifiable as one who did not face anything yet it can't be an issue for him at the moment. Furthermore, if we conduct a survey from formal sector enterprises and they are paying the taxes, then they can properly explain that tax rates are very high, therefore, as the informal sector firms who have not registered yet and have not faced any taxes yet, rates of taxes are not matter concern for them. On the other hand about avoidance of taxes, one should know that these are not registered firms, they do not want to avoid taxes and in other question regarding paying taxes by business 87 percent of the respondents were of the view that businesses should pay taxes. Therefore, if these two variables are not significant in our case but these are justified insignificant variables.

CHAPTER 7

CONCLUSION AND RECOMMENDATIONS

7.1 Conclusion

The starting point of this research was to seek intentions of informal sector microenterprises regarding transitioning from informal to formal sector. For doing so, a microenterprise level survey was conducted from 230 informal sector firm owners operating businesses at commercial areas of Raja Bazar, Saddar and Tench Bhatta of Rawalpindi city.

The findings of the survey show that 56 percent of the respondents are willing to register their business and become a part of formal sector of Pakistan. But these willing firm owners also demanded some additional benefits like health insurance, compensation on children education, transportation, concession on other public services, and easy access to loan etc. Currently, they do not see registering their business is much beneficial for them. There are some benefits for registered businesses in Pakistan but it is not as much beneficial as it should be for small and medium enterprises. Around 90 percent of the respondents were of the view that it is less beneficial.

Moreover, they are also willing to pay taxes but they also require a balanced tax system for them. Currently, there is imbalance of tax system in Pakistan, a lot of taxes and other charges are not fair, as if one can see a commercial utility bill, he would be surprised to note that there are some 'extra tax', 'further tax' mentioned in the bill with some charges. Moreover, one also sees the television fee in the utility bill, where most of the microenterprises are not having any television in their shops. In this context, 90 percent of our respondents were of the view that taxes applied in

Pakistan are not fair. In addition to this, tax rates are also high for registered businesses and 57 percent of the respondents think that tax rates are too high. In Pakistan there are various studies which distinguish high tax rate to be a vital determinant influencing the magnitude of the Informal sector. Increase in the taxation rate is often highlighted as one of the most critical elements that adequately define the augmentation in the size of informal sector. Usually it is asserted by researchers that imposition of high tax rates lead to expansion in the size of informal sector (Kemal, 2003; Arby et al, 2010). Higher tax rates induce micro-enterprises firm owners to remain in the informal sector in an offer to avoid taxes and increase profits.

Not only the taxes and their rates applied in Pakistan are fair but the tax officers are not fair the country. 89 percent of the respondents considered tax officers in Pakistan are unfair. They also take bribes from microenterprises, as informal sector firms sometimes do not follow proper rules and regulations and for not paying the heavy fines, they pay small amount to tax officers. 28 percent of the respondents admitted that they have paid informal payments to tax officers. Those who are willingly giving these informal payments or gifts believe that the taxation machinery cannot be reformed easily and it is easier for them to safeguard from any future harassment by providing such bounties to the tax officials. Because of this there is mistrust between people and tax authorities and then the people sometimes do not any kind of taxes. In the survey, 80 percent of the respondents were not paying any taxes. Majority views about the taxation system for formal firms are provided below:-

- Registering a business with government authorities is not easy (75 percent)
- Businesses registered with tax authorities are subject to frequent audits (76 percent)

- Keeping transaction records for taxation purposes is cumbersome, time consuming and expensive (65 percent)
- Engaging accountants and lawyers to help file taxes is expensive (83 percent)
- Information on tax compliance is not easily available (73 percent)

The other major reason of not registering their businesses with tax authorities in Pakistan is the complicated registration process. 74 percent of the respondents think that registration process is most complicated. Regardless of the efforts by SECP and FBR to reduce the time and cost involved in registering a business, the informal sector firms still consider business registration a hard process.

Age and education level are also matter a lot of the firm owners. Few studies have found that the magnitude of informal sector is high when the group of informal sector owners is young (Pedersen, 2003). In our survey 76 percent of the respondents are above the age of 20 and below 40. However, only 24 percent of the respondents are the above the age of 40. These findings suggest that informal sector contains comparatively youth following informal activities.

Education level of the firm owner have a strong bearing on the size of the informal sector, as less educated people find it difficult to adjust in the formal sector. Therefore, the education level of the owner of the business of informal sector he is to operate informal business has a significant relationship. The amount of informal sector decreases with the increase in the education level of firm owners. Our results show that not much owners of the informal sector in Rawalpindi city are mostly educated associated with the informal sector as only 14 percent have bachelors education and 1 percent with a master's degree. However, a majority of the respondents around 72 percent were having education of matric and intermediate level.

There is not any policy or measures found for formalizing the informal sector in Rawalpindi city. There is no mechanism in place at the city for registering or even making proper campaigns at the district level for formalizing this huge informal sector.

In terms of theoretical advances, this paper is first of its kind, such an extensive work on perception on registration of informal sector enterprises have not done in Pakistan before. This will be a great addition in the literature on registration of firms in Pakistan. Moreover, this will help for policy makers to define a policy for proper regulation for informal sector employees to provide them benefits and incentives in order to gain more taxes.

7.2 Policy Recommendations

It's time now for Pakistan to tackle the informal sector, and to address the issue of inequity. Despite obstacles still it's a doable task. The formalization process should be in phases, a process of context-specific, integrated procedures taken to decrease informal sector in a specified sector. The huge 72.5 percent work force (44.25 million) is getting its livelihood through informal sector. The total number of tax payers in Pakistan is 1.4 million and tax to GDP ratio is 11.2 percent. The informal sector is not under the tax net of the country, and there is a dire need now to bring them under the tax net. If the government formalizes the huge informal sector and collects taxes from them, then its budget will not be in deficit and also it will not need internal as well as external borrowings.

The results of our survey clearly indicate that SECP and FBR need to step up its communications efforts in reaching out to the informal sector about the potential benefits of registering with the tax authorities. Formalization of businesses should be branded and incentivized. Furthermore awareness programmes are needed at a local

level informing about initiatives such as the tax payers' facilitations unit and how to access these forums.

Both SECP and FBR should conduct a survey to estimate a proper size of informal sector in Pakistan and also their income or revenue levels. The tax rates should be aligned with the profitability and size of the microenterprises, every microenterprise should not be treated on a same rate. The respondents were of the view that the role of professional bookkeepers and lawyers should be eliminated, the process should be as easy as a common man can easily file his returns. Moreover, many of the informal sector firm owners do not know the actual benefits and advantages of being registered entity. Therefore, it is suggested that a proper registration campaigns should be advertised through print, electronic or even through social media. There is a lack of awareness about the real benefits of being a registered business.

REFERENCES

- Alatas, V., and Newhouse, D. (2010), Indonesia jobs report: Toward better jobs and security for all. Washington, DC: Main Report, World Bank.
- Arby, M. F., M. J. Malik and M. N. Hanif (2010), “The Size of Informal Economy in Pakistan”, SBP Working Paper Series, 33, May.
- Biles, J. (2009), Informal work in Latin America: Competing perspectives and recent debates. *Geography Compass*, 3(1), 214-36.
- Burki, A. A., and Afaqi, U. (1996). Pakistan's Informal Sector: Review of Evidence and Policy Issues. *Pakistan Journal of Applied Economics*, 12(1), 1-30.
- Cortellese, F. (2015), Definition of informal economy and estimation of tax evasion for European countries, PhD Thesis, Autonomous University of Madrid, XXII Meeting of Public Economy Santander, February 5 and 6, 2015.
- CRS (2018), The Survey System, Creative Research Systems, viewed on August 3, 2018 at <https://www.surveysystem.com/sscalc.htm>
- De Soto, H. (1989), *The Other Path: The Economic Answer to Terrorism*. London: Harper and Row.
- De Soto, H. (2000), *The mystery of capital: Why capitalism triumphs in the west and fails everywhere else*. New York: Basic Books.
- Espenshade, J. (2004), *Monitoring Sweatshops: Workers, Consumers and the Global Apparel Industry*, Philadelphia: Temple University Press.
- Farrell, D. (2004), The hidden dangers of the informal economy. *Mckinsey Quarterly*, 3, 27–37.
- Gallin, D. (2001), Propositions on trade unions and informal employment in time of globalization, *Antipode*, 19(4), 531–549.
- GoP (2015), *Labor Force Survey – 2014-15*, Bureau of Statistics, Government of Pakistan.
- GoP (2018), *Pakistan Economic Survey – 2017-18*, Finance Division, Government of Pakistan.
- Gurtoo, A. (2009), Policy support for informal sector entrepreneurship: Micro-enterprises in India. *Journal of Developmental Entrepreneurship*, 14(2), 181-94.
- Haider N, et al (2010), What is Hidden, in the Hidden Economy of Pakistan? Size, Causes, Issues, and Implications, *The Pakistan Development Review*, Vol. 49:4 Part II (Winter 2010) pp. 665–704, Islamabad, Pakistan.

- Hsieh, C. T., & Klenow, P. J. (2009), Misallocation and manufacturing TFP in China and India. *Quarterly Journal of Economics*, 124, 1403–1448.
- Hudson, R. (2005), *Economic geographies: Circuits, flows and spaces*. London, Sage.
- Idris, I. (2008). *Legal Empowerment in Pakistan*. United Nations Development Programme, Pakistan
- ILO (1972), *Employment, Incomes and Equality: A Strategy for Increasing Productive Employment in Kenya*. Geneva: ILO.
- ILO (2002), *Decent Work and the Informal Economy; Report of the Director-General; International Labour Conference, 90th Session; Report VI*; ILO, Geneva.
- ILO (2012), *Statistical Update on Employment in the Informal Economy*. Geneva: International Labour Organization.
- ILO (2014), *Transitioning from the informal to formal economy, Report V (I)*, International Labour Conference, 103rd Session, Geneva.
- ILO (2015), *Transition from the Informal to the Formal Economy Recommendation, 2015 (No. 204) - Workers' Guide*
- Joshi A., Prichard W., and Heady C., (2014), *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research*, *The Journal of Development Studies*, Volume 50, Issue 10.
- Kemal, A. and Z. Mahmood (1998), *The urban informal sector of Pakistan: Some stylized facts*, Pakistan Institute of Development Economics.
- Kemal, M. A. (2003), “*Underground Economy and Tax Evasion in Pakistan: A Critical Evaluation*”, PIDE Research Report, 184.
- Kemal, M. A., and Qasim, A. W., (2012), “*Precise Estimates of the Informal Economy*”. Pakistan Institute of Development Economics (PIDE), Islamabad.
- Kenyon, T., and Kapaz, E. (2005), *The informality trap: Tax evasion, finance and productivity in Brazil*. Public Policy for the Private Sector Note Number 301, Washington, DC: World Bank.
- La Porta, R., & Shleifer, A. (2008). *The unofficial economy and economic development*. *Brookings Papers on Economic Activity*, 275.
- La Porta, R., & Shleifer, A. (2014), *Informality and development*. *Journal of Economic Perspectives*, 28, 109–126.
- Lawanson (2011), *Assessment of home-based economic enterprises in residential areas of Lagos metropolis*. An unpublished PhD Thesis, Federal University of Technology, Akure

- Levy, S. (2008), *Good Intentions, bad outcomes: social policy, informality, and economic growth in Mexico*. Washington, DC: Brookings Institution Press.
- Loayza, N.V. (1996), *The Economics of the Informal Sector: A Simple Model and Some Empirical Evidence from Latin America*, Carnegie-Rochester Conference Series on Public Policy, 129-162.
- Loayza, N.V., & Rigolini, J. (2011), *Informal employment: Safety net or growth engine?* *World Development*, 39, 1503–1515.
- Maloney, W.F. (2004), ‘*Informality Revisited*’, *World Development*, 32(7): 1159–1178.
- Maloney, William F. (1998), *Are Labor Markets in Developing Countries Dualistic?* The World Bank: Policy Research Working Paper 1941.
- Pedersen, S., (2003), *The Shadow Economy in Germany, Great Britain and Scandinavia: A measurement based on questionnaire surveys*, Copenhagen: The Rockwool Foundation Research Unit.
- Portes, A., Manuel C. and Lauren A. B. (1991), *Introduction in The Informal Economy, Studies in Advanced and Less Developed Countries* (ed) Alejandro Portes, Manuel Castells and Lauren A. Benton, Baltimore: The Johns Hopkins University Press.
- Rauf, H., and Yasmin, B. (2004), “*Measuring the Underground Economy and its Impact on the Economy of Pakistan*”, *The Lahore Journal of Economics*, 9(2), 93 – 106
- Schneider, F., and Klinglmair, R. (2004), *Shadow economies around the world: What do we know?* Working Paper, Department of Economics, No. 0403, Linz: Johannes Kepler University.
- Shahid M.S., and Williams C.C., (2017), *Evaluating the motives for informal entrepreneurship in Pakistan: a result of exit or exclusion?* *Review of Social Economy*, Volume 75, 2017 - Issue 4.
- Snyder, K.A. (2004), ‘*Routes to the informal economy in New York’s East village: crisis, economics and identity*’, *Sociological Perspectives*, 47(2), 215–240.
- Tahir N., and Tahir P., (2012), ‘*Is Informal Sector Employment Marginal to Formal Sector Growth?*’ *The Pakistan Development Review*, vol. 51, issue 4, 543-564
- Tribune (2011), *Informal sector grows faster than formal economy*, *Express Tribune*, Pakistan, < <https://tribune.com.pk/story/285820/informal-sector-grows-faster-than-formal-economy/>> viewed on 15-05-2018.
- Valenzuela, A. (2001), *Day labourers as entrepreneurs*. *Journal of Ethnic and Migration Studies*, 27(2), 335-52.
- Van Klinken, G. (2009), *Decolonization and the making of middle Indonesia*. *Urban Geography*, 30, 879–897.

- Whitson, R (2007), Hidden struggles: Spaces of power and resistance in informal work in urban Argentina. *Environment and Planning A*, 39(10), 2916-34.
- Williams, C.C. (2006), *The Hidden Enterprise Culture: Entrepreneurship in the Underground Economy*, Cheltenham: Edward Elgar.
- Williams, C.C. (2007), Entrepreneurs operating in the informal economy: Necessity or opportunity driven? *Journal of Small Business and Entrepreneurship*, 20(3), 309-20.
- Williams, C.C., and J Round (2010), Spatial variations in the character of off-the-books entrepreneurship: Lessons from a study of contrasting districts in Moscow. *International Journal of Entrepreneurship and Small Business*, 10(2), 287–301.
- Williams, C.C., Shahid, M. and Martinez, A. (2015), Determinants of the level of informality of informal micro-enterprises: some evidence from the city of Lahore, Pakistan. *World Development*. ISSN 1873-5991
- Williams, CC (2004), *Cash-in-Hand Work: The Underground Sector and the Hidden Economy of Favours*. Basingstoke: Palgrave Macmillan.

QUESTIONNAIRE

PAKISTAN INSTITUTE OF DEVELOPMENT ECONOMICS,
ISLAMABAD

A firm level survey on

TRANSITION FROM INFORMAL TO FORMAL SECTOR: ISSUES,
CHALLENGES AND OPPORTUNITIES

This research is conducted to know about the perception of the informal sector firms about moving from informal to formal sector in Rawalpindi city. The main objectives of this study are to i) identify issues and challenges faced by informal enterprises for registration in Rawalpindi city, and ii) explore the complications in current procedures of registration of enterprises. This research is only for academic purpose and the responses given will be kept confidential. It will be very helpful if you cooperate with us and give your time to answer a set of questions in this questionnaire.

Characteristics:

1. A small firm which is not registered with any government authority
2. A firm employed minimum of 3 workers and maximum of 9 workers.
3. The owner has been associated with informal sector's business for the past 12 months.

Sr No _____

Date of Interview _____

Area _____

Contact No (Optional) _____

Section 1: Firm Owner Details

1. Age of the firm owner
 - a. 20 - 29
 - b. 30 - 39
 - c. 40 - 49
 - d. 50 & Above
2. Education level of firm owner
 - a. Primary
 - b. Middle
 - c. Matric
 - d. Intermediate
 - e. Bachelors
 - f. Masters
 - g. Diploma/Courses
 - h. Any other _____
3. Marital Status of firm owner
 - a. Married
 - b. Unmarried
 - c. Any other _____
4. Household Size _____

Section 2: Business Details

5. In which year did this business start operations? _____
 6. Including yourself how many?

- a. Number of Full time workers are employed _____
 b. Number of Part-time workers are employed _____

Note: A worker is considered full time employee if he or she works 40 hours a week or more.

7. In which sector do you or your business operate in?

Options	Please tick the single appropriate choice
Agriculture	1
Manufacturing	2
Construction	3
Wholesale and retail trade	4
Hotel, restaurants, tourism, cultural services	5
Property and real estate	6
Communications and IT	7
Transport and Storage	8
Education	9
Others (Specify _____)	10

8. Is the land used in this business your own?

Options	Please tick appropriate choice
Yes	1
No	0

Section 3: Business Registration Details

9. Do you think businesses like you, are not registering their business because they want to avoid taxes?

Options	Please tick appropriate choice
Yes	1
No	0

10. On a scale of 1 to 5 with 5 being the too high and 1 being the low high, how high the tax rates for business are stopping them for registering their business? Please tick appropriate choice.

1	2	3	4	5
---	---	---	---	---

11. On a scale of 1 to 5 with 5 being the most complicated and 1 being the less complicated, what do you think how complicated the registration process is? Please tick appropriate choice

1	2	3	4	5
---	---	---	---	---

12. On a scale of 1 to 5 with 5 being the most beneficial and 1 being less beneficial, what do you think how beneficial it is to register a business? Please tick appropriate choice

1	2	3	4	5
---	---	---	---	---

13. Are you willing to register your business with tax authorities at any time in future?

Options	Please tick appropriate choice
Yes	1
No	0

14. If Yes, then under which of the following choices will you choose to register?

Options	Please tick (single) appropriate choice
Lump sum corporate tax at 15-20 percent of total revenues and amnesty for past years	1
Will be willing to register for GST and amnesty for past years	2
Will be willing to register for both GST and income/corporate tax if amnesty for past years	3
Will be willing to register and pay 10 percent tax if we are provided with any tangible benefits like compensation on education, health, and transportations etc.	4
If access to bank loans is easy	5
Others (Specify_____)	6

15. What is your stance on the following business related issues?

	1 Completely Disagree	2 Disagree	3 Don't Know	4 Agree	5 Completely Agree
Informal sector is more profitable than formal sector in Pakistan					
Businesses see issuing of receipts for each transaction as a waste of time					

Registering a business with government authorities is very easy					
It is easier to expand if you operate as a registered business					
There are many benefits for businesses that pay taxes					
Businesses registered for tax are often subjected to audits and inspections					
Keeping records for tax purposes is cumbersome and expensive					
Professional bookkeepers or accountants are too expensive					
Every business should pay taxes					
Information about getting registered with tax authorities is easily available					

16. Please mention below if during the past 12 months you were expected to give any informal payments or gifts to tax department officials in your local area.

	1 Never	2 Sometime	3 All the time
Extent of Informal Payments			
Extent of in-kind gifts			

17. What do you think are the main reasons business has to give gifts or informal payments?

	1 Main Reason	2 Second Reason	3 Third Reason
To prevent closure			
To prevent prosecution			
To stop Tax Authority officers' harassment			
To reduce time and money spent on various regulations related to for example labour, property and banking laws			
Others (Specify _____)			

18. What do you think about the taxation authorities in Pakistan?

	1 Completely Disagree	2 Somewhat Disagree	3 Somewhat Agree	4 Completely Agree
Tax officers are competent				
Tax officers are fair				
Tax officers are underpaid				
Taxes applied in Pakistan are fair				

19. Did you ever register any of your grievances with any of the government departments include tax department?

Options	Please tick appropriate choice
Yes	1
No	0

20. If yes, please indicate your level of satisfaction from the service provided by government authorities? (Please select only a single appropriate choice)

Options	Please tick (single) appropriate choice
Very satisfied	1
Quite satisfied	2
Not very satisfied	3
Not at all satisfied	4

21. How many different types of taxes do you pay?

Options	Tick multiple choice if applicable
General Sales Tax	1
Federal Excise Duty	2
Customs Duty	3
Property Tax	4
Agricultural Taxation (any form)	5
Services Tax (provincial)	6
Provincial Excise duties	7
Stamp duties	8
Income tax	9
Others (Specify _____)	10
Nil	11

-----Thank You-----