



INSIGHTS INTO THE INFORMAL ECONOMY: HOUSEHOLD ENTERPRISES IN PAKISTAN

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Abstract

Household owned micro-enterprises play an important role in generating livelihoods in developing countries like Pakistan. This paper presents first of its kind estimates of household enterprises in Pakistan using data from the Household Integrated Economic Survey 2015-16, including businesses operating in a fixed location or in mobile form. The analysis shows a total of 7.35 million household establishments operating in the country during 2015-16, with a slightly higher share in rural areas (52 percent), while province-wise, the significant share is based in Punjab (72 percent). The sectoral distribution shows that more than half of all household enterprises (53 percent) are working in the wholesale and retail trade sector, followed by transport and storage (14.6 percent) and manufacturing (13 percent) sectors. These household owned businesses have been severely hit by the recent slowdown in economic activities brought about by the COVID-19 crisis and require urgent support from the government. However, as such businesses are not registered with any government agency, it would be difficult to identify and reach them with any assistance. This study presents a roadmap for bringing these businesses operating in unorganized sector into the formal economy.

Introduction

Like other developing countries, a large share of economic activities in Pakistan is carried out in the informal/ unorganized sector. The size of the informal economy in the country is estimated at 91 percent of GDP (Kemal and Qasim 2012), while total employment in the informal sector accounts for 72 percent of all non-agricultural employment (PBS 2018). Such activities carried out in different sectors of the economy remain off the radar of relevant government regulatory agencies, primarily to avoid taxes and other government levies and due to the small scale and at times subsistence level of operation of enterprises involved in such ventures. What sets enterprises involved in small scale productive or trading activities apart from their counterparts working in the formal sector is that these businesses do not have a separate legal identity distinguishing them from the household(s) owning and operating them. Such businesses are also characterized by the use of labour mainly from within the household in the form of unpaid family workers who are not directly paid any wages and usually work under the owner categorized as self-employed/ own account worker in labour force statistics.

There are presently no credible estimates available on the number of such household-owned micro enterprises working across various sectors of the economy and their contribution towards the total employment level in the country. The Economic Census 2005 provided estimates on number of household establishments at 184,000 (PBS 2005). However, these estimates only include the number of establishments working in fixed locations within the boundaries of the urban enumeration blocks or rural villages and do not cover mobile units, such as taxi, rickshaw, hawkers, street vendors and other small businesses without a permanent identifiable location. Anecdotal evidence suggests that such mobile forms of micro business form a significant share of household-owned enterprises, especially in large cities across the country.

Data Source

This paper makes use of a unique module of the Household Integrated Economic Survey (HIES) 2015-16 dataset to develop estimates of the total number of household owned establishments in Pakistan in the year 2015-16 (PBS 2016). Section 8-M of the HIES 2015-16 collects information on non-agricultural, non-financial establishments, businesses or shops (fixed or mobile) of which members of the enumerated households are proprietors or partners and which employ a maximum of 9 individuals on any day over a period of one year.

Data from this section, which has not been previously analysed, provides rich information on the household enterprises operating in the country in different sectors and geographical locations and has the added advantage of taking into account mobile businesses, such as hawkers, taxis and rickshaws, which are presently not captured in any enterprise level survey in the country.

Main Findings and Analysis

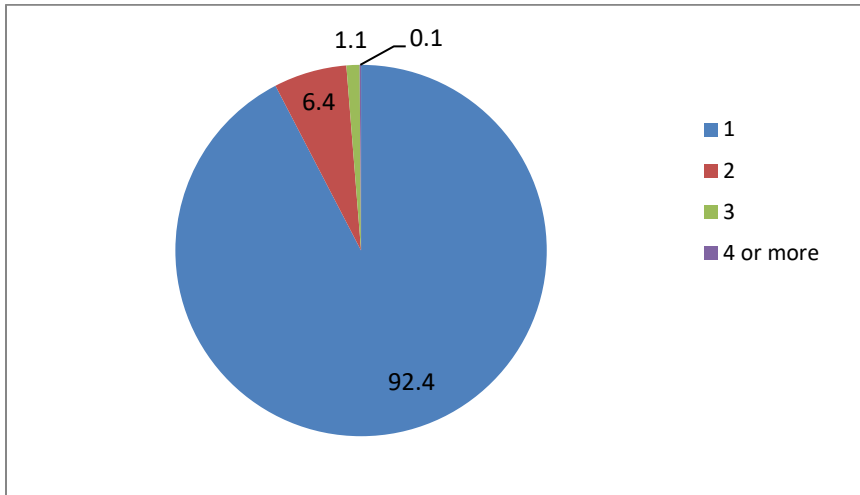
The analysis of data obtained from HIES 2015-16 reveals that there were a total of 7.35 million household establishments operating in the country in 2015-16 (Table 1). The regional disaggregation of these household enterprises shows that a slightly higher share of such activities are taking place in the rural areas (3.78 million – 51.5 percent) of the country in comparison to urban areas (3.57 million – 48.5 percent). The provincial break down indicates that the significant majority of household establishments (71.8 percent) are based in the province of Punjab at 5.28 million. This is followed by 1.12 million (15.3 percent) from the province of Sindh and 0.79 million (10.7 percent) from Khyber Pakhtunkhwa, while only 0.16 million (2.2 percent) household enterprises are working in Balochistan.

Table 1: Household enterprises in Pakistan by region and provinces

	No. of enterprises (millions)	Percentage (%)
Pakistan	7.35	100
Urban	3.78	48.5
Rural	3.57	51.5
Provincial breakup		
Punjab	5.28	71.8
Sindh	1.12	15.3
KP	0.79	10.7
Balochistan	0.16	2.2

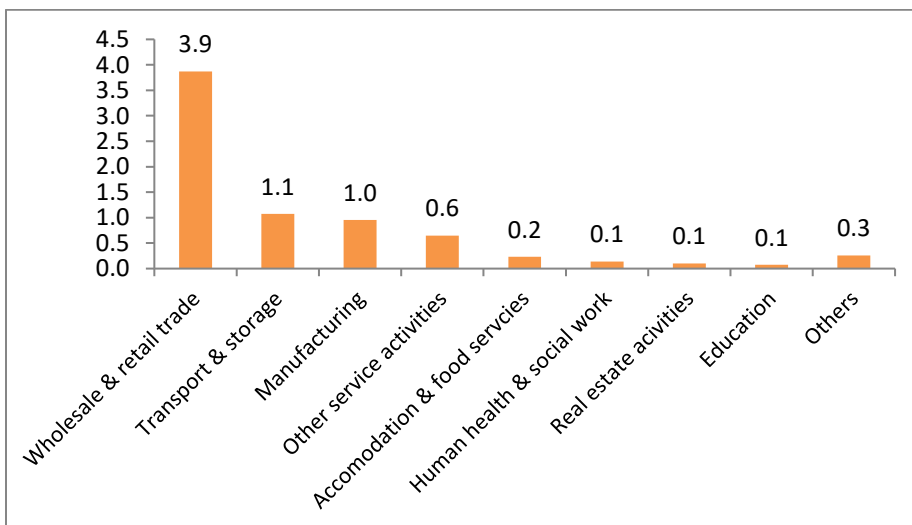
The percentage distribution of the households by the number of small businesses owned illustrated in Figure 1 shows that the overwhelming majority of households in the country report owning/operating only one enterprise (over 92 percent). Another 6.4 percent of the households indicate owning 2 enterprises, while 1.1 percent households are seen to own/operate 3 enterprises. A negligible share of households report owning 4 or more household enterprises at 0.1 percent. These shares are observed to be broadly similar across both the urban and rural areas of the country.

Figure 1: Percentage distribution of households by enterprise owned



The breakdown of the 7.35 million household enterprises by sector is shown in Figure 2. The analysis indicates that the highest number of such businesses representing more than half of all household enterprises (53 percent) is working in the wholesale and retail trade sector at 3.9 million. These businesses include small grocery shops and mobile hawkers and street vendors who are usually seen to be selling a variety of goods such as vegetables/ fruits, clothes, toys, small household items across both large and small cities in the country. Following this, the highest number of household enterprises is observed to be in the transport and storage sector, making up 1.1 million or 14.6 percent of all household establishments. This segment is likely to include mobile businesses, such as rickshaws and taxis that are owned and operated by households as well as services associated with transport activities, such as freight forwarding, travel agents and storage.

Figure 2: Household enterprises by sector (millions)



The third largest share of household establishments are seen to be working in the manufacturing sector, accounting for one million enterprises (13 percent of all household owned establishments). The establishments working in these three sectors of wholesale & retail trade, transport & storage

and manufacturing represent 80 percent of all such businesses. Following this, the household establishments are distributed across the remaining 14 non-agricultural sectors in small shares, with most notable ones being engaged in ‘other services activities’ (0.6 million), followed by accommodation and food services (0.23 million), health and social work (0.1 million), real estate activities (0.1 million), education (0.1 million) and professional, scientific and technical services (0.07 million).

The availability of these estimates on household/microenterprises is aptly timed given the current economic slowdown brought about by COVID-19. It is these micro-enterprises that have been severely hit by the crisis and require urgent support from the government to prevent loss of livelihoods. However, the support package announced by the State Bank of Pakistan to provide relief to the business sector does not seem to cover these microenterprises that usually get access to small scale financial services from microfinance banks and the non-bank microfinance providers regulated by the Securities and Exchange Commission of Pakistan.

Even if the Government wants to extend any kind of financial or other support to such small scale enterprises, it would be very difficult to accurately identify such businesses on the ground to channel any kind of assistance. This is due to the fact that these businesses are normally not registered with any government agency mainly to avoid paying taxes, other government levies as well as to avoid harassment from a multitude of government departments. However, it is pertinent to mention that under the existing labour laws of the country, the working conditions of persons employed in small scale businesses are regulated by the West Pakistan Shops and Establishment Ordinance 1969. This legislation which has been separately adopted by all four provinces in the country following the 18th Amendment to Pakistan’s Constitution makes it binding on all shops, commercial, industrial and other establishments, except a one man business (employing family members of the employer), operating in a province to register with the Deputy Chief Inspector of the provincial labour departments.

However, administrative data from the provincial labour departments shows only a small number of establishments registered under the Shops and Establishment Ordinance. In Punjab, a total of 150,000 establishments are registered across the province having a total of 900,000 employed workers. In case of Sindh, this number is reported at 37,000 establishments with a total workforce of 105,000 workers. In Khyber Pakhtunkhwa, 91,338 industrial and commercial establishments are registered under the Shops and Establishment Ordinance with total workers adding upto 132,186. In Balochistan, 38,000 operating establishments are registered under this law employing around 70,000 workers. In case of Islamabad Capital territory, a total of 46,500 commercial establishments are reported to be registered. These numbers of actual registered enterprises come nowhere near the estimated numbers shown in Table 1, with this gap being relatively lowest in Balochistan.

Bringing Micro-enterprises into the Fold of the Formal Economy: Way Forward

The present circumstances brought about by the COVID-19 crisis can serve as a unique window of opportunity for registering these household businesses and gradually bringing them into the formal economy. Following the three month lockdown in the country, there is growing realization among the employers and workers, especially in the small scale businesses about the need of being covered by some form of social protection scheme/ program to hedge/ mitigate the risks brought about by a sudden and unpredictable downturn in economic activities. Therefore, there is an urgent need to start a national dialogue on this issue with the relevant stakeholders to build further momentum for reform as well as ownership among the different interest groups that are likely to be affected by such reforms.

In order to fully convince the owners of small scale micro-enterprises to register with the relevant government departments, it would be essential for the government to clearly communicate the expected benefits from coming into the formal economy. Only when the perceived benefits of operating formally outweigh the costs of continuing to work through informal channels would the owners of such businesses come forward in support of these reforms. The possible benefits of working formally for such businesses can include access to finance, social protection floor, tax and other fiscal incentive packages to raise competitiveness, membership of trade associations, access to government subsidies and incentives, and rights to organize and bargain collectively.

In the present scenario of economic uncertainty brought about by the COVID-19 situation, access to some form of social protection mechanism may be one type of benefit that could be considered especially important for incentivizing the self-employed owners of household enterprises to register their small businesses.

In this regard, the Government can consider adopting the Monotax system, which has been successfully implemented in Brazil and other South American countries, like Argentina and Uruguay. The monotax regime (known as Simples Nacional) provides a single law and simplified procedures for own-account workers and micro and small enterprises on issues, such as business registration, taxation, social security, financial inclusion and government procurement (ILO 2018). Taxes and social security contributions under this scheme are lower than general taxes and micro-entrepreneurs who join are automatically entitled to the benefits of the contributory social security system. The scheme divides companies in three levels in terms of size, which includes the smallest individual micro company owners (*microempreendedor individual*, MEI), who pay a fixed monthly fee and can have one employee. Micro Companies (*microempresa*, ME) are the intermediate category, and Small Companies (*Empresa de Pequeno Porte*, EPP) are larger (salient features of the scheme for first two categories of businesses shown in Table 1). Each category of informal enterprise pays different contribution percentages to the Social Security Institute. During the period 2008-16, the number of total registered firms covered by the scheme increased from 3 million to around 12 million and it presently covers 75 per cent of all enterprises in Brazil.

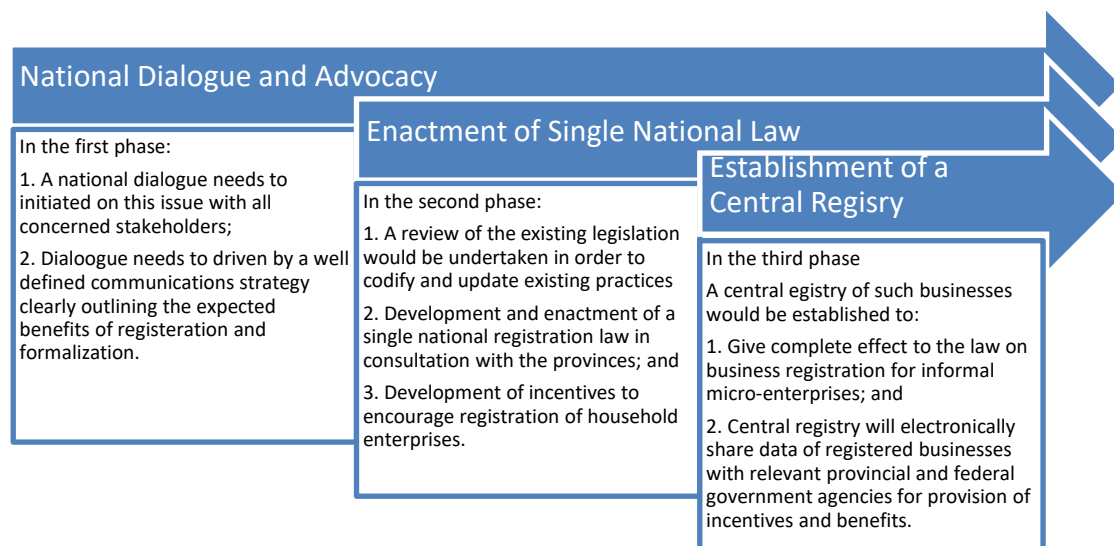
Table 2: Salient features of Monotax regime

	Monotax regime “Simples National”		Regular regime
Target Group	Own-account workers with up to one employee	Micro and small enterprises	Regime for enterprises that are not eligible, or not opting for monotax regime
Eligibility Criteria	Eligibility depends on the type of business (own-account worker), the number of employees, turnover threshold and type of economic activity ¹⁰ .	Eligibility depends on the turnover threshold, type of business and type of economic activity ¹¹ .	
Status	‘Individual Micro Entrepreneur’ statute	MSE statute	
Characteristics	Simplified tax return requirements, tax advantages, access to social protection, access to bank account with reduced rate, etc. ¹²	One single annual, simplified tax declaration, exemptions from paying additional social contributions and reduced fiscal obligations	
Type of taxation	Monthly lump-sum monotax ¹³	Monthly monotax with variables rates, based on gross turnover ¹⁴	Progressive tax regime
Filing requirements	Simplified filing requirements ¹⁵	Simplified filing requirements ¹⁶	Standard filing requirements

Source: Adapted from ILO 2019

The roadmap for Pakistan to move towards a simplified regime for formalizing micro-enterprises on the lines of the Monotax framework, is presented in Figure 3. The first step as already discussed above would be to initiate a national dialogue on this issue to develop consensus among all stakeholders on the need for reforms.

Figure 3: Roadmap for Reforms



In the second phase, work can be started for enactment of a single national law to define micro-enterprises and give them preferential treatment in terms of taxes, regulation of working conditions, mechanisms for provision of social protection and access to finance. However, under the present constitutional framework of the country, some of these functions are carried out by the provincial government, while some fall in the domain of the federal government. For instance, the registration of unincorporated forms of businesses & implementation of labour laws are provincial subjects, while income taxation is a federal subject. The enactment of such a single law across the country would not be possible without taking into confidence all provincial governments and having their buy-in and ownership. The forum of the Council of Common Interests can be used for persuading the federating units to harmonize the business registration and regulation laws and empowering the Federal Government for enacting a single national legislation. Article 144 of the Constitution empowers the Parliament to legislate on behalf of one or more provinces provided that the respective provincial assemblies pass resolution in this regard.

Once a single law is enacted, the next step would be development of a central registry to start registering all such small scale businesses, to operationalize the law. All businesses meeting the eligibility conditions under the law can be registered by issuing a unique identity number, which will serve as a certificate of special status of such businesses. Advancements in information and communication technologies can enable the central registry to electronically share details of each registered micro-enterprise with the relevant provincial and federal government agencies at the backend, so that the various benefits and incentives offered to such businesses can be provided in an easy and transparent manner.

The above roadmap for reforming the existing business registration system in the country for bringing the micro/ household enterprises into the formal and documented economy can be implemented over the next 2-3 years. However, key ingredients of successful implementation of such reforms would be national consensus and a strong political will to see through such a process.

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