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**Policy Brief**

# An Appraisal of Pakistan’s Informal Economy: Causes, Patterns, and Socioeconomic Footprints

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October 2025

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## Executive Summary

Informality remains a defining feature of Pakistan's economy. It acts as an employment shock absorber by providing livelihoods to a large segment of the workforce that cannot be absorbed by the formal sector. However, it constrains fiscal growth and productivity levels. This study examines the scale, pattern, size, and structural implications of Pakistan's informal economy. Based on data from the Pakistan Labour Force Survey and the Pakistan Economic Survey, the informal economy is estimated to constitute around 59 percent of GDP. Equivalent to Rs 67,668 billion in Fiscal Year 2024-25.

This study highlights that informality in Pakistan is shaped by two overlapping processes. In urban centres, it is driven by regulatory exclusion and sludges, limited industrial absorption, and the high cost of formal compliance. Likewise, in border regions, it arises from geographical isolation, weak institutional reach, and historical trade linkages.

The empirical findings show that the wholesale and retail trade sector with 45 percent share dominates informal employment, followed by manufacturing, construction, and repair activities. The informal economy has distortive effects on fiscal revenue and productivity. However, it continues to sustain millions of low-income households and absorbing excess labour excluded from the formal system.

Regionally, Pakistan's informal economy reiterates broader patterns across developing economies. India (50% of GDP and 62.4% employment), Turkey (35% of GDP), and Afghanistan and Iraq (over 70% of GDP) show that informality is both a structural and systemic feature of developing regions.

### Recommendations

The Government may:

- Follow an incentive-driven approach by launching a voluntary digital registration platform for the informal sector that instantly issues NTNs and integrates with mobile wallets as well as linked with CNICs and mobile numbers.
- Gazette a new "micro-enterprise class" within the tax system introducing simplified KYC procedures and defined turnover limits, complemented by a one-year fee holiday, VAT cash-back incentives, access to micro-loans, and a wallet-credited registration bonus to encourage formalisation and new business entry.
- Establish regulated border markets/zones along Pakistan's frontiers to formalise informal cross-border trade. These zones may provide essential infrastructure, on-site banking, and simplified one-window based customs and digital duty payment systems to formalise

existing flows. By converting survival economies into structured growth hubs, this approach can improve livelihoods in the border regions.

- Adopt a national model by-law for street vending with defined vending zones, capped fees, and digital permit draws. Provide micro-credit through MFBs using verified transaction history as collateral to replace informal moneylenders.
- Establish a Central Delivery Unit to operate monthly dashboards and quarterly KPI scorecards, linking national databases to monitor, analyse, and publish performance outcomes. Use these results to benchmark and publicly rank regional and municipal tax offices on indicators such as revenue collection and compliance growth. This may ensure healthy competition, higher performance standards, and stronger institutional credibility.
- Undertake a comprehensive mapping of informal product markets through a Border Commodity Reform Initiative targeting high-volume items such as Iranian fuel (11 million litres/day), consumer electronics, textiles, food staples, and vehicles & auto parts (45% of market turnover). This assessment should apply comparative advantage analysis, border-route mapping, and value chain diagnostics to quantify fiscal losses, trace supply chains, and pinpoint nodes for formalisation. By integrating PRAL-PSW-SBP data for real-time transaction matching and establishing regulated fuel depots and border trade zones with a 10% duty-rebate window, Pakistan can formalise over 60% of informal inflows.

## An Appraisal of Pakistan's Informal Economy:
## Causes, Patterns, and Socioeconomic Footprints

### Overview

Informal economy, however, it is defined, functions outside a country's formal economic frameworks. Globally, it shapes the everyday lives of nearly 60 percent of the world's employed population, engages around 2 billion workers, and remains central to global employment and income generation for millions excluded from formal economic structures.[1]

In Pakistan, likewise, the informal economy constitutes the everyday reality for nearly half of the population and forms a significant part of local trade and commerce. The country is grappling with constrained fiscal space and a narrowing tax base, as both federal and provincial authorities face persistent revenue shortfalls. However, in parallel, new digital rails such as NADRA, RAAST, and ongoing e-invoice pilots are creating new possibilities for informal economy integration and documentation. Provinces are also experimenting with municipal and vendor by-laws, while a border markets policy is being operationalised.

Together, these developments signal a moment of opportunity to address informality more systematically than ever before. However, research on Pakistan's informal economy remains limited, with persistent ambiguities surrounding its definitions, size, measurement methodologies, and sectoral composition.

### Issue to be Analysed

This Brief aims to achieve the following objectives:

- Examine Informal economy definitional ambiguities.
- Identify the key determinants driving informal economic activities.
- Estimate the size of informal economy.

### Analysis

#### Definitional Ambiguities

The labels given to Informal vary across studies. It has been called "informal," "undocumented," "black," reflecting its embeddedness in social relations and daily economic life rather than formal regulatory systems. However, there is ambiguity and lack of a consistent informal economy definition. Making it difficult to fully conceptualize. An overview of the major definitions used for the informal economy is provided in Box 1.

#### Measurement of Pakistan's informal economy

The measurement of the informal economy presents significant challenges due to its transient undocumented, and unregulated nature. This study follows an indirect estimation approach

[1] International Labour Organization (2020). Women and Men in the Informal Economy: A Statistical Picture (Third Edition). Geneva: ILO.

using data from the Pakistan Labour Force Survey (LFS) 2021 the only official labour market dataset that provides disaggregated information on both formal and informal employment. The LFS includes detailed variables on employment status, enterprise registration, sectoral classification, and contractual arrangements. By distinguishing between formal and informal employment categories, the study infers the relative contribution of informal activities to aggregate economic output. The estimation methodology applies the sectoral contribution approach, whereby the proportion of informal employment within each sector is multiplied by that sector's share in GDP to approximate the total output of the informal economy. Mathematically:

| **Box 1: Informal economy vs Black economy** |
| --- |
| *Informal economy* refers to all economic activities not captured by official statistics or registration systems. It includes individuals and firms operating outside state regulation or registration. However, outside state regulation does not mean no regulation at all. It is often governed by nonstate mechanisms such as community norms, local networks, or customary rules.<br>Motivations for informality generally fall into two categories. Frist is avoiding complex bureaucratic procedures and high compliance costs to facilitate easier business operations. The second is concealing illicit or unethical practices such as tax evasion, product adulteration, or the sale of counterfeit goods.<br>*Black economy*, however, refers more specifically to income streams such as profits, interest, or rents that are deliberately concealed to evade taxes, regulations, or legal scrutiny. In other words, while all black-market activities are informal, not all informal activities are black. For instance, a consumer who purchases a product at its regular price without receiving a receipt participates in the informal economy. In contrast, a seller who withholds a receipt to evade tax obligations operates within the black economy<br>Estimates suggest that around 40 percent of total economic activity takes place within the black economy. Meanwhile 60% of the economy is informal. This shows a significant overlap between informality and black economy that weakens fiscal capacity and institutional credibility. |

$$\boldsymbol{IE} = \sum_{\boldsymbol{i=1}}^{\boldsymbol{N}} (\boldsymbol{Bi} \times \boldsymbol{Zi} \times \boldsymbol{Si})$$

In this approach, the informal economy is aggregated using broader sectors data. Since agriculture is largely informal by nature, its share is adjusted for household-level subsistence and smallholding activities not recorded in national accounts. Industrial and service sectors are analysed using enterprise-level data in the LFS. In the LFS, supplementary datasets such as the Pakistan Economic Survey, the Household Integrated Economic Survey (HIES), and national accounts statistics are also consulted to adjust for underreported output and income. Box 2 provides a comparative overview of informal economy estimation methods.

**Informal Economy Size**

Pakistan's GDP for FY25, at current market prices was Rs 114 trillion[2] and the estimated share

[2] PES (2025). Pakistan Economic Survey 2024-25. Ministry of Finance.

of informal economy is 59 percent (approx.)[3]. The estimated size of Pakistan's informal economy is Rs 67 trillion. This means that nearly three-fifths of Pakistan's total economic activity occurs outside the formal institutional framework unregistered/undocumented.

Khuong (2020)[4] also reports that, in 2020, the informal economy accounted for approximately 56% of Pakistan's gross domestic product (GDP).

The results of the LFS-based analysis show that in Pakistan's informal economy the wholesale sector dominates with around 45 percent of informal workers engaged in retail trade services. The industrial sector contributes roughly 20 percent, mainly through small manufacturing, construction, and repair activities.[5]

**Box 2: Informal Economy Estimation Methods**

| Method | Approach | Assumptions | Limitations |
|---|---|---|---|
| Currency Demand based estimation | Excess Currency in circulation relative to formal transactions. | Informal transactions rely predominantly on cash. | Ignore non-cash informal economy determinants. |
| MIMIC Model estimation | Latent-variable modelling to infer informality from causal and indicator variables. | Stable causal relationships exist between determinants (e.g., taxation, regulation) and informality. | Based on assumed relationships and lacks robustness with limited and noisy data. |
| Labour Force Survey based estimation | Estimate informal output by combining sectoral employment with GDP. | Informal employment proportion is based on sectoral output contribution. | Based on official national datasets, however, assumes identical value added per worker. |

## Discussion

The size and impact of informal economy show that the informal economy in Pakistan is a significant activity and a principal mode of production and employment. However, the expansion of the informal economy produces structural consequences. The dominance of low-productivity/wage jobs in the informal sector suppresses overall labour productivity. Most informal workers lack access to credit, social protection, and training, trapping them in cycles of vulnerability. The widespread reliance on cash transactions limits financial inclusion and restricts the ability of the state to collect taxes.

[3] This figure represents an average of the informal non-agricultural share (45.3 percent) and the wider ILO-definition-based estimate of total non-agricultural employment (72.5 percent).

[4]. https://doi.org/10.1080/20430795.2020.1711501

[5] The present estimates assumes equal productivity between formal and informal workers within sectors. Future work should adjust for productivity. Moreover, any bias is limited in Pakistan's case. In Pakistan informal output broadly matches employment patterns, and productivity gaps between small formal and informal firms remain narrow. Thus, while minor over/or underestimation may occur across sectors, the overall results remain empirically consistent and credible.

Products in the informal economy are often of low-value and high-turnover goods. Iranian fuel, consumer electronics, vehicles, drugs, mobile accessories, and textiles form the backbone are major informal products at the borders. Garments, shoes, and household items produced in unregistered workshops feed city bazaars/markets. Informal trade in food staples such as tea, cooking oil, sugar, and wheat flour along with tobacco, betel nut, cigarettes and pharmaceuticals, sustains thousands of micro-retailers.

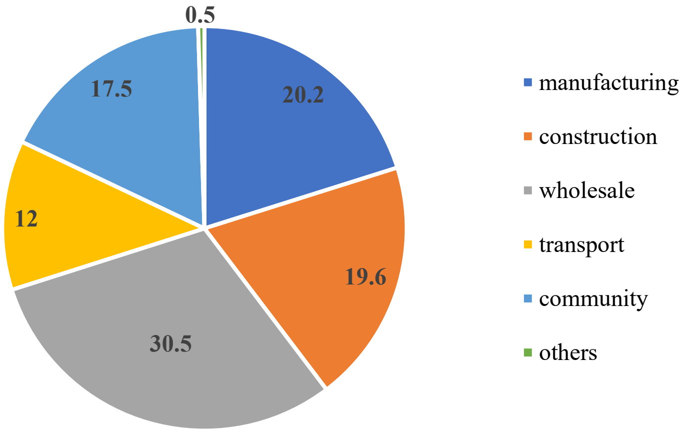


Figure 1: Informal Sector by Major Industry (in %) (LFS 2021, PBS)

Moreover, including the informal economy in GDP would make existing, unrecorded economic activity visible. This may increase Pakistan's official GDP size, improve the accuracy of growth and employment data, and strengthen fiscal capacity by expanding the tax base. The tax-to-GDP ratio, which stands near 10 percent, reflects the magnitude of untapped fiscal potential. Unregulated informal supply chains, informal price negotiations, and speculative stockpiling in food and fuel markets contribute to short-term inflationary pressures as well.

Despite these structural inefficiencies, the informal economy continues to perform crucial social functions. It reduces unemployment pressures, sustains low-income households, and compensates for the inadequacies of the state's welfare system. The literature [Slaman & Shah (2025) Zafran (2022)[6]] suggests that informal markets dominate employment/trade in bordering regions, while, in general, they remain the main channels for livelihoods and consumption across rural and semi-urban areas of Pakistan. This dual role as both a safety net and a distortionary force depicts the paradox grappling Pakistan's economic structure.

## Causes of Informality in Pakistan

- **Regulatory and Urban Informality**

Pakistan's regulatory environment continues to reinforce informality rather than reduce it. The World Bank's Regulatory Quality Index for Pakistan stands at -0.90. The Heritage Foundation's

[6] https://ipripak.org/wp-content/uploads/2025/06/Paper-Undocumented-Oil-Trade.pdf

Business Freedom Score is only 48 out of 100. This shows burdensome and inconsistent regulation. Combined with weak human capital, over-regulation, and limited institutional reach, these conditions push firms and workers to operate outside formal structures.

- **Peripheral and Border Informality**

In Pakistan's border regions, informality stems from geographic isolation, limited state presence, and entrenched informal trade networks. The country's 6,774-kilometre land border with India, Afghanistan, Iran, and China runs through sparsely governed and underdeveloped areas such as Balochistan and Khyber Pakhtunkhwa. Here, informal cross-border trade is common and often acts as the primary source of income and survival. Familial/kinship networks in the borderlands, weak institutional oversight and limited economic alternatives sustain these networks, embedding informality as a structural feature of local economies.[7]

**Regional/Global Context**

The informal economy is not specific to Pakistan. It is a structural characteristic of many developing economies. Across countries such as Pakistan, Iraq, Afghanistan, and Turkey, limited formal employment opportunities, weak institutional oversight, and complex regulatory systems have driven a significant share of the labour force into informal activity (Katz, 2023). In 2022, nearly 60 percent of global employment is informal. Around 2 billion workers were engaged in informal employment globally (ILO, 2022)[8]. In Turkey, the informal economy was estimated at 31.0 % of GDP in 2020. Similarly, in 2020. in India 62.4 percent of India's employed population works in the informal sector, representing around 109.6 million workers. Despite recent efforts toward formalisation through digitalisation, labour reforms, and the Goods and Services Tax (GST) framework, India continues to host one of the world's largest informal economies. Empirical evidence shows that the informal economy accounts for approximately 50 percent of India's GDP in 2023[9][10].

In Pakistan, over the years, successive governments have pursued policy measures to draw capital out of the black economy and channel it into productive, taxable activity. However, such policy shifts (often under the banner of deregulation and liberalisation) have paradoxically facilitated capital flight by easing restrictions on financial movement. Meanwhile, the closure of certain legal loopholes and incentives to repatriate offshore wealth have occasionally produced artificial surges in growth rates, largely reflecting the formal reporting of previously

[7] https://openknowledge.worldbank.org/bitstreams/b02052ec-b06f-4dbf-b362-066941586a3a/download
[8] https://ilostat.ilo.org/data/
[9] https://www.outlookindia.com/national/the-shrinking-informal-sector-in-india-trends-and-statistical-insights
[10] https://www.wiego.org/wp-content/uploads/2020/10/WIEGO_Statistical_Brief_N24_India.pdf

undeclared production rather than genuine economic expansion.

Over time, tax authorities often increase the tax rate on the existing taxpayers that often result in reduce economic activity due to the tax burdens. Moreover, bureaucratic bottlenecks such as an ample number of NOCs for registering a single business entity makes registration difficult. A practical pathway may simplify business entry and licensing, rationalise overlapping regulations, and reduce compliance costs through unified registration and tax portals. Strengthen local institutions to provide small enterprises with predictable access to infrastructure, credit, and basic services. By sequencing reform through enabling, digitising, and enforcing, Pakistan can transform informality from a survival strategy into a foundation for inclusive, documented, and sustainable economic growth.

However, any enforcement may follow and enable reforms, not precede them. The government may first ensure data-sharing between federal and provincial authorities as well as place viable digital and regulatory systems, later then it may strengthen enforcement capacity to deter tax evasion and curb illicit flows. Based on the above discussion the following recommendations are provided hereunder:

**Recommendations**

The Government may:

- Follow an incentive-driven approach by launching a voluntary digital registration platform for the informal sector linked to CNICs and mobile numbers that instantly issues NTNs and integrates with mobile wallets.
- Gazette a new "micro-enterprise class" within the tax system introducing simplified KYC procedures and defined turnover limits, complemented by a one-year fee holiday, VAT cash-back incentives, access to micro-loans, and a wallet-credited registration bonus to encourage formalisation and new business entry.
- Establish regulated border markets/zones along Pakistan's frontiers to formalise informal cross-border trade. These zones may provide essential infrastructure, on-site banking, and simplified one-window based customs and digital duty payment systems to formalise existing flows. By converting survival economies into structured growth hubs, this approach can improve livelihoods in the border regions.
- Adopt a national model by-law for street vending with defined vending zones, capped fees, and digital permit draws. Provide micro-credit through MFBs using verified transaction history as collateral to replace informal moneylenders.

- Establish a Central Delivery Unit to operate monthly dashboards and quarterly KPI scorecards, linking national databases to monitor, analyse, and publish performance outcomes. Use these results to benchmark and publicly rank regional and municipal tax offices on indicators such as revenue collection and compliance growth. This may ensure healthy competition, higher performance standards, and stronger institutional credibility.
- Undertake a comprehensive mapping of informal product markets through a Border Commodity Reform Initiative targeting high-volume items such as Iranian fuel (11 million litres/day), consumer electronics, textiles, food staples, and vehicles & auto parts (45% of market turnover). This assessment should apply comparative advantage analysis, border-route mapping, and value chain diagnostics to quantify fiscal losses, trace supply chains, and pinpoint nodes for formalisation. By integrating PRAL-PSW-SBP data for real-time transaction matching and establishing regulated fuel depots and border trade zones with a 10% duty-rebate window, Pakistan can formalise over 60% of informal inflows.

## Conclusion

This study highlights that an estimated 59 percent (around Rs 67,668 billion) of the economy is informal in Pakistan. The wholesale and retail sector dominates informality, absorbing nearly 45 percent of informal workers in trade-related services.

The study moreover reports that Pakistan's informal economy functions as a lifeline for millions, offering livelihoods where formal institutions fall short. Its scale and opacity undermine fiscal capacity, distort market competition, and weaken institutional trust. The overlap between informal and illicit financial activities compounds governance challenges by exploiting the same unregulated networks.

Given administrative and fiscal limitations, rapid nationwide formalisation remains unrealistic, especially in low-density and economically peripheral regions like Balochistan. A phased, incentive-driven strategy is therefore essential one that strengthens income generation, job creation, and social protection while promoting gradual documentation.

In sum, Pakistan's informal economy is both a symptom of underdevelopment and a reservoir of resilience. Transforming it from a survival mechanism into a springboard for inclusive growth will depend on embedding informality into taxation, finance, and social protection frameworks turning hidden productivity into measurable national progress.

**Action Matrix**

| Pillar | Timeframe (Months) | Action | Regulatory/Policy Step | Incentive/Finance | Lead Agency | Key Performance Indicators |
|---|---|---|---|---|---|---|
| **Make Entry Cheap & Instant** | 0-6 | CNIC-linked mobile registration, instant NTN, default mobile wallet | Gazette micro-enterprise class (≤ PKR 1 million turnover/year) with simplified KYC | 12-month fee holiday, PKR 5000 registration bonus (wallet) | FBR, SECP, SBP | 1.0m new registrations; median time-to-ID <10 mins |
| **Digitise Sales & Reward Compliance** | 3-12 | Roll out QR/e-invoice for retail & services | Tiered turnover regime; safe-harbour year | POS rebate (cash-back) from VAT uplift | FBR, SBP | 25-30% e-invoice penetration. 0.5% VAT Collection-efficiency |
| **Protect Workers to Pull Them In** | 6-18 | Opt-in micro-pension (3% of sales) & health cover | CNIC-based portability; nationwide claims app | Gov't match first PKR N in contributions | MoFEPT, EOBI, Provinces | 500k active contributors. Claim TAT <7 days |
| **Formalise Street Economy** | 0-12 | Model vending by-laws; permits via e-draw | Municipal regulations with vending zones & fee caps | Micro-credit via MFBs; collateral = transaction history | Provinces, MoFEPT, SMEDA | 100k permits issued. Vending evictions reduce 60% |
| **Border Markets to Value Chains** | 3-18 | Establish sustenance border markets with digital customs | Simplified customs regime, AML/KYC via CNIC | Trade-for-development grants (storage, cold chain) | MoC, FBR-Customs | 30% shift from informal to documented flows; seizures reduction 40% |
| **Governance & M&E** | Ongoing | Monthly dashboard, quarterly KPI scorecards | Inter-agency coordination framework | Delivery Unit under MoFEPT | MoFEPT, PBS | Quarterly reporting; KPI publication compliance |
| **Border Commodity Reform Initiative** | 3–18 | Mapping of informal products/markets such as oil, betel nuts, consumer goods, tea | Comparative analysis, and value-chain diagnostics and identification integrate PRAL-PSW-SBP | 10% duty-rebate window; establishment of regulated fuel depots and border trade zones | FBR, MoC, SBP, PBS | 60% of informal inflows formalised. ~Rs. 400 billion recovered annually |

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