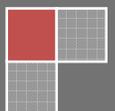


2012

# Tax Policy and Enterprise Development in South Asia

Integrated Research Proposal



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## **Project Overview**

**Title:** Tax Policy and Enterprise Development in South Asia

**Budget:** PKR 37,115,265 (CAD 450,000)

**Duration:** 3 years.

### **Objectives:**

**General Objective:** To advance technical knowledge on the relationship between tax policies, development of small enterprises, and inclusive growth in South Asia through collaborative time-bound research by the leading think-tanks of the region, and inform policy formulation in these areas by governments in Pakistan, India, Bangladesh, Sri Lanka, and Nepal.

**Specific Objective 1:** To develop three policy research studies that focus on the impacts of tax exemptions and concessions, Value-Added-Tax (VAT) reforms, and property tax (respectively) on the development of small enterprises in South Asia, with particular emphasis on those operating outside the tax net in the undocumented economy, as well as those owned/managed by women, focusing on the national and regional levels.

**Specific Objective 2:** To organize a Policy Engagement Workshop in each South Asian country to disseminate the findings of the research and advocate for policy recommendations emanating from this research among key government officials responsible for formulating and implementing policies on taxation and enterprise development in Pakistan, India, Bangladesh, Sri Lanka, and Nepal.

**Abstract:** Inclusive growth continues to remain a challenge for South Asian economies. Experts now agree that the missing link between growth and inclusivity is labor market outcomes that generate well-paying and productive jobs. Most non-agricultural employment in South Asia is concentrated in small enterprises characterized by very low productivity and wages. Research indicates that small enterprise development and employment generation is strongly linked to tax policy. First, tax exemptions and concessions are largely skewed to favor large enterprises. Second, small enterprise development is affected by taxes such as the Value Added Tax (VAT). Third, small enterprise development is affected by weak local property taxation. The gender dimension of small enterprise development in South Asia has been ignored in policy and research. These problems need to be researched through an integrated framework from the national and international perspectives. This research would fill research gaps, inform policy, and provide opportunities for shared learning outcomes at the regional level.

The proposed themes for this research were developed from discussions initiated at a Workshop held 8-9 August, 2010, inviting 15 leading think-tanks and research institutes across South Asia. These institutes have proposed to conduct collaborative, time-bound research on these themes focusing on South Asian experiences. This research will produce country studies on each theme which will then be processed at the regional level for meta-analysis. These studies will provide insights for more informed policies on inclusion and impacts on enterprise development, productive employment and inclusive growth at the national level, and promote transfers of learning experiences at the regional level. A Technical Advisory Board has been constituted to provide peer review services for research outputs and facilitate policy engagement. The Governance Institutes Network International

(GINI) will provide Secretariat services to this project. These themes constitute the research agenda for Year 1, after which a new Workplan will be developed and approved, prioritizing research on new policy challenges across South Asia.

## **Administrative Information**

**Project Leader:** The Governance Institutes Network International (GINI) will serve as Secretariat to the regional Network providing financial management, contract management, substantive support, and coordination services. Mr. Daniyal Aziz, Advisor, GINI will oversee Secretariat functions. His contact details are provided below:

Tel: ++92 51 285612  
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**Recipient Institution:** GINI will serve as the recipient institution in this case, and all funding will be channeled through GINI. The contact details of GINI are provided below:

Address: House # 23, Street # 30, Sector F-8/1, Islamabad, Pakistan.  
Tel: +92-51-2856509 / 2856512  
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### **Participating Institutions:**

- East-West Center, 1601 East-West Road Honolulu, Hawaii 96848 USA
- The World Bank Institute, Office of the Vice President, 1818 H Street, N.W. Washington, D.C. 20433
- Institute on Governance, 122 Clarence St. Ottawa, Ontario, Canada, K1N 5P6
- Beaconhouse National University (BNU), 3-C, Zafar Ali Road Gulberg – V, Lahore, Pakistan
- National Institute of Public Finance and Policy (NIPFP), New Delhi 18/2 Satsang Vihar Marg, Special Institutional Area, New Delhi-110067 (INDIA)
- Centre for Policy Dialogue (CPD), House#40/C, Road#11, Dhanmondi R/A, GPO Box 2129, Dhaka - 1205, Bangladesh
- Institute of Policy Studies of Sri Lanka, 99 St, Michael's Road, Colombo 03, Sri Lanka
- Institute for Integrated Development Studies (IIDS), Mandikhatar, Kathmandu, Nepal, P.O. Box 2254

**Supporting Administrative Documents:** A letter of formal request by Mr. Nasim Khan Raja, Company Secretary is attached.

## Problem and Justification

**Inclusive growth continues to remain a challenge for South Asian economies.** The recent growth spurt experienced by Pakistan, India, Bangladesh, Sri Lanka, and Nepal has been accompanied (to varying degrees) by rising inequality.<sup>1</sup> This fact is also reflected in the poor poverty reduction performance of these countries. Despite being one of the fastest growing regions in the world, South Asia still accounts for about a fifth of the world's poor, with higher poverty rates than any other region (43%), including Sub-Saharan Africa (39%).<sup>2</sup> **Experts now agree that the missing link between growth and inclusivity is labor market outcomes that generate well-paying and productive jobs.** This is exactly where South Asian economies have a poor track record. Even for economies such as India, which have recently posted some of the highest growth rates in the world, the transition of the labor force from employment characterized by low productivity and low wages to more productive and well-paid jobs has been slow and difficult.

**Most non-agricultural employment in South Asia is concentrated in small enterprises characterized by very low productivity and wages.**<sup>3</sup> The development of small and medium sized enterprises (SMEs) in these countries is arguably lagging, and with it their potential for creating productive jobs. While there is a large and growing body of research on entrepreneurship and enterprise performance, the role played by policy and institutional environment in influencing innovation, job creation, productivity increases, and market performance is not clearly understood. In particular, the role of tax policy needs to be explored in this regard.

**Research indicates that enterprise development and employment generation is strongly linked to tax policy.** Tax policies provide the incentive/disincentive structures that determine compliance with the taxation system.<sup>4</sup> Non-compliance places SMEs at a considerable disadvantage. First, SMEs not registered for taxation may not entirely escape taxation. In fact, they may bear an indirect tax burden that depends on the extent to which they purchase inputs from registered enterprises, and this may raise their marginal effective tax rates to exceptional levels.<sup>5</sup> Even with direct taxes, non-compliance may not be costless. In India for instance, non-filer compliance costs amount to 3.4% of non-corporate income tax collections. Around 75% of these costs are due to foregone consumption benefits, 30% due to income loss from distorted investment, and 5% from expected non-filing penalties.<sup>6</sup>

Second, the potential for growth is reduced for non-compliant SMEs. The need for advertising must be weighed with the need to maintain a low profile. Obtaining formal licenses, certificates, and permits from local and other government agencies becomes

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<sup>1</sup> Inclusive Growth: The Asian Experience, Hafiz A. Pash, 2007

<sup>2</sup> Website of CIVICUS. Link: <http://www.civicus.org/civicus-news/30-civicusnews/1029-south-asia-poverty-eradication-paradigms>

<sup>3</sup> Ibid. Small firms are defined differently in each country according to the unique size distribution of firms in that country.

<sup>4</sup> Schneider/Torgler, 2007; Schneider/Hametner, 2007; Naschekina/Timoshenkov, 2005. See also Thomas (1992); Lippert and Walker (1997); Schneider (1994, 1997, 1998, 2000); Johnson, Kaufmann, and Zoido-Lobaton (1998a,1998b); Tanzi (1999) and Giles (1999a). In addition, multiple country studies by the McKinsey Global Institute concur with these findings. **Non-compliance here is defined as lack of compliance with tax registration requirements with relevant government authorities. Non-compliant enterprises are understood to be working in the undocumented economy i.e. outside the tax net.**

<sup>5</sup> FIAS, Sector Study of the Effective Tax Burden – South Africa, 2006

<sup>6</sup> Das-Gupta, Tax Compliance Costs and Non-Filing Behaviour, 2002

difficult. They may also lose the government as a potential client, due to the requirements of tax clearance certificates, and also find it difficult to transact with formally registered enterprises. Formal sources of credit may also be barred to them, given the lack of tax certifications which is a common requirement. This may force borrowing at extortionate rates and conditions from informal sources.<sup>7</sup> Non-compliant SMEs operating in the undocumented economy outside the tax net, therefore, become trapped in a subscale, inefficient work dynamic which weighs down their productivity levels to half or even less than that of their formally registered counterparts.<sup>8</sup> Third, non-compliance with taxation may also distort competition by allowing inefficient enterprises to undercut the market share of more productive firms. Ultimately, this would hamper enterprise performance and entrepreneurship for the entire SME sector.

These findings are supported by business surveys carried out in developing countries. The World Bank's Paying Taxes Report finds that tax systems rank among the top 5 obstacles to the conduct of business in 90% of surveyed countries. Reasons include large number of taxes, complicated policy and administration, and high tax rates. The Report finds a direct relationship between inadequate taxation and the decision by enterprises to remain outside the formal tax net.<sup>9</sup> South Asia is a particularly poor performer in this regard, with one of the highest annual number of tax payments, time requirements for tax compliance, and tax rates as a percentage of firm's profits, worldwide. Sri Lanka for instance requires an annual 62 payments for an entrepreneur to pay taxes, as compared to 1 payment in Maldives. In Pakistan, firms must spend 560 hours per year preparing and filing returns and paying taxes, compared to 227 hours in East Asia and the Pacific. India levies taxes on entrepreneurs that constitute 65% of their profits, as compared to 32% in the Middle East and North Africa.<sup>10</sup> These factors raise compliance costs that may be regressive and put a disproportional burden on small businesses.<sup>11</sup> For instance, in Pakistan, 67% of SMEs term tax regulations as most problematic, while 28% feel that taxes in the country are too high. Smaller Pakistani firms find tax related issues more restrictive than larger firms; 69% of SMEs, whose size of assets was less than PKR 1 million face the greatest number of tax related problems. Many small firms claim it is not possible for them to maintain books as per law or hire a professional due to resource constraints.<sup>12</sup>

This may set in motion a vicious cycle where firms are pushed into non-compliance, forcing the government to collect more revenue from an ever-shrinking formally registered sector.<sup>13</sup> All stakeholders in this equation will potentially lose out. Compliant enterprises would be further disadvantaged as the competitive edge of non-compliant businesses is magnified. The pool of after-tax earnings that can be re-invested to enhance productivity may also dry up.<sup>14</sup> Enterprise performance and the productivity of entrepreneurial activity would thus be hampered. The government's capacity to fund adequate public services and social protection may be reduced.<sup>15</sup> Under fiscal pressure, governments may resort to inflationary borrowing

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<sup>7</sup> Designing a Tax System for Micro and Small Businesses: Guide for Practitioners, World Bank – DFID, 2007

<sup>8</sup> The hidden dangers of the informal economy, McKinsey Quarterly, August, 2004

<sup>9</sup> World Bank / Price Waterhouse Coopers (PWC) global report on Paying Taxes ([http://www.doingbusiness.org/documents/DB\\_Paying\\_Taxes.pdf](http://www.doingbusiness.org/documents/DB_Paying_Taxes.pdf))

<sup>10</sup> Doing Business 2010: South Asia, IFC-World Bank

<sup>11</sup> Designing a Tax System for Micro and Small Businesses: Guide for Practitioners, World Bank – DFID, 2007

<sup>12</sup> Developing SME Policy in Pakistan, Small and Medium Enterprise Development Authority, (SMEDA)

<sup>13</sup> World Bank (2004) Rising Informality, Vincent Palmade and Andrea Anayiotos, 2005

<sup>14</sup> The hidden dangers of the informal economy, McKinsey Quarterly, August, 2004

<sup>15</sup> Schneider, F., and D. H. Enste (2000) Shadow Economies: Size, Causes and Consequences. Journal of Economic Literature 38, 77–114.

and unsustainable debt. This may in turn necessitate money supply reduction and increased interest rates which will hamper credit creation and investment.<sup>16</sup> This would make it difficult for small enterprises to grow and create the productive and well-paying jobs that can make inclusive growth achievable. **Among the key taxation issues linked to the development of small enterprises and by extension the creation of productive, well-paying jobs in the South Asian context are: tax exemptions and concessions, Value Added Tax (VAT) reforms, and local property taxes.**

**First, tax exemptions and concessions are largely skewed to favor large enterprises.** The ILO reports: “*Supply-side support provided by the government [including] tax holidays... are normally biased in favour of larger industrial enterprises and may not only prevent smaller enterprises from developing their potential or gaining access to global markets, but may also lead to the displacement of informal operators and workers.*” Though officially designed to meet various policy goals, their efficacy becomes difficult to judge, as tax expenditures are not subject to the same scrutiny, political debate, or public attention as direct spending. This opacity creates the space for rent-seeking lobbies that serve the interests of large enterprises, at the expense of SMEs, especially those operating outside the tax net in the undocumented economy. This arguably impacts SME development, entrepreneurship, and reduces the opportunities for generating employment-intensive growth.

For instance, in Sri Lanka, tariff policies favoring the coir industry shifted the supply of coconut husks to mechanized units owned by men with access to credit, away from manual units owned by women lacking this access.<sup>17</sup> In Pakistan historical and current tax policy evidently purveys rents to large-scale manufacturers. Frequently changing SROs favor large firms over smaller ones. Export rebates and other concessions are largely inaccessible to small sub-contractors. Direct exporters are exempt from filing income tax returns, as banks will provide these services, whereas smaller sub-contractors must incur these costs, in most cases. Large firms located in special industrialized zones are waived customs duties and sales tax on import of inputs. Micro, small and medium enterprises are not afforded the same opportunities. There is even evidence of undue harassment of small firms regarding income tax assessment by tax authorities.<sup>18</sup> In India, small enterprises operating in the undocumented economy are provided a “*special*” rather than “*level*” playing field through the creation of Special Economic Zones that cater to large corporate entities.<sup>19</sup> These Zones feature comprehensive tax holidays of 5 years, 50% tax exemptions for the next 5 years, and 50% exemption on re-invested profits for the following 5 years.<sup>20</sup>

There is also evidence linking biased tax regimes to the emigration of entrepreneurs and skilled workers to friendlier tax climates. This may deplete the level of entrepreneurship with losses in productivity, reduce the potential for innovation, and the ability to create productive jobs associated with entrepreneurial activity. It may also amount to a ‘brain drain’ and deskilling of the labor supply in the country of origin, creating skill shortages, depressing productivity, and constraining market performance. In Pakistan, the emigration rate of individuals with a tertiary education to OECD countries is more than 7%. A recent Gallup

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<sup>16</sup> A fresh assessment of the underground economy and tax evasion in Pakistan: Causes, Consequences and Linkages with the Formal Economy, M Ali Kemal, PIDE, 2007

<sup>17</sup> Decent work and the informal economy, International Labor Conference, ILO, 2002

<sup>18</sup> Small and Medium Enterprise (SME) Development in Pakistan: Issues and Remedies, Khalid Aftab, 2005

<sup>19</sup> The Challenge of Employment in India: An Informal Economy Perspective, National Commission for Enterprise in the Unorganized Sector, 2009

<sup>20</sup> India to Continue Special Economic Zones Tax Benefits, India Briefing, Feb 2010

survey reveals that 38% of working adults (skilled and semi-skilled) would prefer to settle permanently outside Pakistan.<sup>21</sup> These figures do not take into account the growing outflow of skilled labor to the Middle East, particularly the UAE. Over 6000 Pakistani firms are now operating in this region.<sup>22</sup> Similarly, over 150 Indian companies are operating in Hong Kong and mainland China, attracted by friendlier taxation laws.<sup>23</sup>

International experience suggests that policy processes in their political dimensions are as important as policy outcomes. Yet, analysis of revenue systems from political economy perspectives remains sparse in South Asian countries. Without it narrow interest groups with political influence may continue to capture policy agendas. Research needs to be conducted, which provides a detailed, explicit stocktaking of how SME development is affected by tax exemptions and incentives, the roles of lobbies and interest groups in this regard, and to explore the ways in which the welfare impacts of tax expenditures can be maximized for the SME sector, allowing them to create productive jobs to make growth more inclusive.

**Second, enterprise development is affected by taxes such as the Value Added Tax (VAT).** However, research on the nature and magnitude of this impact is on the whole ambiguous. Mainstream policy advice to South Asian countries has advocated the introduction of VAT or raising VAT rates to compensate for the losses associated with liberalized trade regimes. However, research presents no straightforward endorsement of such reforms. Certain studies indicate that the introduction of indirect taxes (e.g. VAT, GST) pushes entrepreneurs toward non-compliance with the taxation system.<sup>24</sup> Small enterprises that are already operating in the undocumented economy will not be able to pass on the VAT to their consumers given that they cater to highly competitive and price sensitive markets. Research also finds that given the presence of a large undocumented economy, VAT reform reduces both welfare and revenue.<sup>25</sup> On the other hand, researchers argue that for non-compliant entrepreneurs, the VAT is in effect an import tariff, as they are not registered under VAT regulations, and so cannot claim input credits.<sup>26</sup> Others argue that input credits themselves may entice enterprises to formally register.<sup>27</sup> What may be reasonably concluded is that non-compliance would be reduced if the VAT reform is successful, as under a revenue neutral model, documentation of the economy would be necessary to generate more revenue.

But it is empirically unclear if tax compliance has been reduced or increased by VAT introduction in South Asian economies, which in turn raises questions concerning the success of VAT reforms. Pakistan is set to upgrade to a full-fledged VAT despite more than a decade of lack-luster performance under a quasi-VAT Sales Tax regime introduced in 1990.<sup>28</sup> Commentators have already predicted that the tax would potentially lower collection receipts and push more enterprises into non-compliance with the taxation system.<sup>29</sup> The VAT in Bangladesh is a strong earner but with evidently regressive distributional impacts.<sup>30</sup> In Sri Lanka, experts have noted that the strong role of the non-compliant enterprises and the large

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<sup>21</sup> Brain drain: causes and implications, Dawn, October, 2004

<sup>22</sup> Sourced from: [www.rasoulnews.com](http://www.rasoulnews.com)

<sup>23</sup> Sourced from: <http://info.hktdc.com/imm/06121903/markettrends156.htm>

<sup>24</sup> Spiro (1993)

<sup>25</sup> Price-Neutral Tax Reform With an Informal Economy, Emran & Stiglitz, 2003

<sup>26</sup> Keen, 2007

<sup>27</sup> Bird, 2008

<sup>28</sup> Pakistan Tax Policy Report, World Bank, Volumes I & II, July 2009

<sup>29</sup> Business and Finance Review, Dr. Noor Fatima, April, 2002

<sup>30</sup> The Equity Impact of the Value Added Tax in Bangladesh, Shahabuddin M. Hussain, 1995

number of undocumented transactions may have complicated VAT implementation.<sup>31</sup> After 8 years of operation, VAT revenue performance in the country remains sub-par in comparison to the taxes it replaced.<sup>32</sup> Experts have noted that in India, the large number of undocumented transactions implies that formally registered traders who invoice their sales may end up bearing the tax burden of the entire preceding informal value chain, under the VAT regime.<sup>33</sup> Thus far, the VAT has resulted in a loss of revenue for 10 states, and many manufacturers did not pass on the benefits of lower tax rates to consumers.<sup>34</sup> This heterogeneity of experience with essentially the same tax regime across the region raises various questions.

However, there is little in the way of detailed economic analysis by governments, think-tanks, or independent researchers on the impacts of such reforms on enterprise development and labor markets. Without this knowledge, it is difficult to assess prospects for improving the regulatory and policy framework, ascertain implications for parameters such as growth and inclusion, entrepreneurship and productivity, and the creation of productive jobs in South Asia. Given this shared experience of VAT, there is added value in collaborative research on this issue conducted by think tanks throughout the region. It will allow them to crystallize learning experiences, flag pitfalls for governments attempting new reforms, and share best practices on reform design, execution and sequencing.

**Third, enterprise development is affected by weak local property taxation.** Enterprises operating on informally developed land cannot access mortgage-backed finance. Informal land development itself can be reversed through effective property taxation in a number of ways. Levied on land value, property taxes can potentially pull the existing stock of serviced land to the market. Enterprises and workers excluded from social services and state attention would thus be brought into the formal sphere.<sup>35</sup> It may also bring down land prices through the capitalization effect, placing it within the affordability limits of entrepreneurs and SMEs.<sup>36</sup> Additionally, without effective property taxation to establish formal property rights, key opportunities to enhance employment intensive growth, which leads to more and productive jobs, become difficult to avail. For instance, the World Bank advocates the provision of access to housing finance to households in informal settlements as a key solution, which can trigger housing industry growth that may bring 3.2 million new jobs over the next decade. In India, such proposals are already in the pipeline with the potential to build houses for up to 28 million households.<sup>37</sup> However, without effective property taxation to establish formal property rights, housing finance will remain difficult to access. Research on the issue in the South Asian context is limited to a handful of studies on informal land and housing markets, despite the strong prevalence of these problems in South Asian countries.<sup>38</sup>

**The gender dimension of enterprise development in South Asia has been ignored in policy and research.** This is despite the significant statistical overlap between being a

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<sup>31</sup> Anomalies in the Taxation System in Sri Lanka: Need for Reform and Restructuring, Saman Kelegama, Executive Director, Institute of Policy Studies (IPS)

<sup>32</sup> Presentation by Dr. Saman Kelegama, at the GINI-IDRC Workshop for Collaborative Research on South Asia Tax Systems, 8-9 August, 2010

<sup>33</sup> VAT, or something like it, Dinkar Ayilavarapu, 2004

<sup>34</sup> 'Implementation of VAT in India: Lessons for transition to GST', CAG, July 2010

<sup>35</sup> Property Taxation and Informality: Challenges for Latin America, Smolka, Martim O. and Claudia M. De Cesare, 2006

<sup>36</sup> Bahl and Linn, 1992

<sup>37</sup> Housing Finance Needs to Reach South Asia's Poor: World Bank Report, Press Release, Oct 7, 2010

<sup>38</sup> Urban informality: transnational perspectives from the Middle East, Latin America, and South Asia, Ananya Roy, Nezar AlSayyad, 2004

woman, working in the undocumented economy, and being poor, in South Asia. The link between informal employment and poverty is stronger for women. Not only are women over-represented in the undocumented economy, they are over-represented in the lower-income segments of casual wage or home workers. In the higher-income segments of self-employment or employers, their involvement is concentrated in sub-scale operations with less growth potential than those performed by men.<sup>39</sup> Women entrepreneurs and workers are therefore relegated to unproductive, lower-paid employment options with inadequate legal recognition or protection, labor rights, social protection, and voice.<sup>40</sup> Inadequate taxation policies may either perpetuate these contrasts or further sharpen them. In addition to the biases that shut out SMEs from tax exemptions and concessions available to large enterprises, SMEs managed or owned by women, especially those operating in the undocumented economy, must face a host of other difficulties.

For instance, in Pakistan, most women entrepreneurs are trapped in household-based, low-return, unpredictable markets where growth prospects are limited. Enterprises managed by women are largely characterized by higher closure rates, and lack sufficient access to essential inputs such as finance, skills, and marketing channels.<sup>41</sup> A study conducted last year found that women in the undocumented economy did not figure largely (if at all) in tax policy and administration, and in budgeting and planning at the local, provincial and federal levels in Pakistan.<sup>42</sup> These women are far more likely to be unpaid family workers than own enterprises, when compared to men. They are also found, overall, to work longer hours for less pay, and are motivated by poverty.<sup>43</sup>

In India, women entrepreneurs grapple with similar issues. They lack sufficient access to credit, as the incentives open to other enterprises are more difficult for them to obtain.<sup>44</sup> They also lack formal operating spaces and most face harassment from local authorities.<sup>45</sup> Overall, their work continues to remain a legal offshoot of their households rather than an independent entity.<sup>46</sup> They must contend with a host of health and safety risks such as unsafe working environments and gender-based violence. And their productivity is limited by the non-availability of infrastructure, space and time.<sup>47</sup> Women entrepreneurs in Bangladesh, generally face harassment in dealings with the government, banks, lenders, and clients.<sup>48</sup> Cumbersome legal and regulatory requirements such as obtaining tax certificates and trade licenses, (among others) are more difficult to meet for women entrepreneurs, limiting their potential for growth.<sup>49</sup>

In Nepal's undocumented economy, only 17% of the female population owns productive assets, which makes institutional borrowing largely inaccessible and entrepreneurship

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<sup>39</sup> Women and Informality: A Global Picture, the Global Movement, Chen, Martha Alter, 2001

<sup>40</sup> Decent work and the informal economy, International Labor Conference, ILO, 2002

<sup>41</sup> Aftab, (1991); GCU (2004)

<sup>42</sup> Informal Economy Budget Analysis in Pakistan and Ravi Town, Lahore, Women in Informal Employment: Globalizing and Organizing (WIEGO), 2010

<sup>43</sup> Asad and Sohail (2001). See also: Farida Shaheed and Khawar Mumtaz, Invisible Workers: GOP. 1981; Shahanz Kazi and Zeba Sathar; Akmal Hussain et al, UNHDR Pakistan. 2003

<sup>44</sup> Schneider and Bajada 2003

<sup>45</sup> ILO 2002a, 2006a; Bhalotra 2002; Nelson 1997

<sup>46</sup> Chen et al. 1999, 2004; Bhatt 2006; Charmes 1998a,b

<sup>47</sup> Lund and Srinivas 2000; Chant 2007a,b; Gates 2002

<sup>48</sup> Legal Mechanisms to Empower Informal Businesses – Bangladesh Perspective, 2007

<sup>49</sup> A Comparative Study of Women Entrepreneurs in Formal and Informal Economy: A Study of Dhaka City, S.S.M. Sadrul Huda et al, Asian Journal of Business Management 1(1): 19-23, 2009

improbable. Women workers work 77 hours a week compared to 56% for men<sup>50</sup>, with marked contrasts in wages for similar work. Lack of child-care facilities, and discrimination in terms of opportunities for employment, training, promotion, and credit availability are commonly faced difficulties. They may also be exposed to sexual harassment, exploitation and trafficking. Overall, women in Nepal's undocumented economy lack access to education and information, markets, safe working conditions, and face the “*progressive loss of proprietorship*”.<sup>51</sup> In Bangladesh, women entrepreneurs are generally discriminated against at the family, market and community levels.<sup>52</sup> They are thus excluded from opportunities for entrepreneurship and productive work. These conditions may create entry barriers to entrepreneurship for women, and limit the development of women-led enterprises. In doing so, they may also constrict their potential for innovation, growth, and the creation of productive jobs.

**What is needed now is a collaborative effort by the leading think-tanks of the region, to conduct empirical research on tax policy and its relationship to enterprise development and inclusive growth, at the national and regional levels. This research would fill research gaps, inform policy, and provide opportunities for shared learning outcomes at the regional level.**

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<sup>50</sup> SAPPROS 2000

<sup>51</sup> Informal Economy and Workers in Nepal, ILO, 2004

<sup>52</sup> Social Initiatives Ltd., Women's Access to Markets: Vulnerabilities and Constraints – Study on the Social Vulnerability Analysis of Women to Assess their Market Access and Constraints from Selected Sites of BUILD, RMP an SHOW Project of CARE Bangladesh (2003)

## Objectives

**General Objective:** To advance technical knowledge on the relationship between tax policies, development of small enterprises, and inclusive growth in South Asia through collaborative time-bound research by the leading think-tanks of the region, and inform policy formulation in these areas by governments in Pakistan, India, Bangladesh, Sri Lanka, and Nepal.

**Specific Objective 1:** To develop three policy research studies that focus on the impacts of tax exemptions and concessions, Value-Added-Tax (VAT) reforms, and property tax (respectively) on the development of small enterprises in South Asia, with particular emphasis on those operating outside the tax net in the undocumented economy, as well as those owned/managed by women, focusing on the national and regional levels.

**Specific Objective 2:** To organize a Policy Engagement Workshop in each South Asian country to disseminate the findings of the research and advocate for policy recommendations emanating from this research among key government officials responsible for formulating and implementing policies on taxation and enterprise development in Pakistan, India, Bangladesh, Sri Lanka, and Nepal.

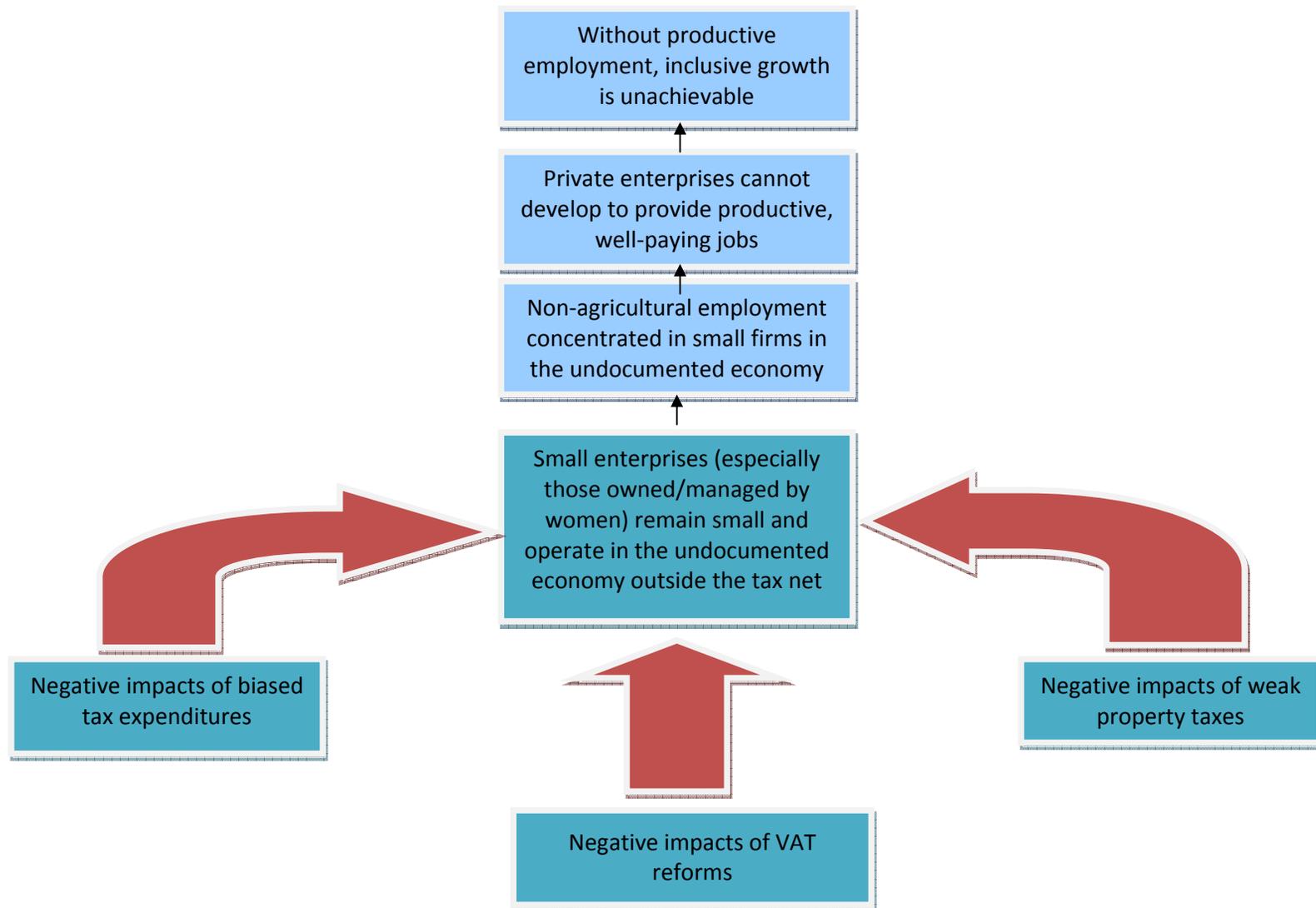
## **Methodology**

The programme duration will be 3 years, (36 months). It will also include an Annual Workplan which provides a detailed breakdown of work, assignment of tasks and responsibilities, budgetary outlays, and deadlines for completion and submission of research outputs under the 3 research themes described below. These outputs will go through 2 peer review cycles before being presented at Policy Engagement Workshops conducted by focal institutions in Pakistan, India, Sri Lanka, Bangladesh, and Nepal. The peer review will also invite inputs from the independent Technical Advisory Group (details provided in the following section). GINI will also develop a project web-site featuring:

- Internet database where research outcomes will be posted at various stages of completion
- Online forum for real-time communication amongst research partners
- ‘Progress’ page which will track and share details of programme activities to ensure all partners are kept abreast of latest developments, ensuring that momentum of work and partner cohesion are maintained throughout the programme cycle

The research themes identified constitute the research agenda for Year 1, 2, and 3. At the end of each Year, a new Annual Workplan will be developed by GINI to achieve the programme objectives throughout the year, through consultations with research partners and the approval of the Steering Committee.

*Conceptual and Theoretical Framework*



The above diagram depicts the conceptual framework for the research, and provides the basis for the following research themes and questions that the project will explore:

*Theme 1: The Impact of Tax Exemptions and Concessions on Enterprise Development*

- What is the extent to which small enterprises face biases in tax exemptions and incentives?
- What is the extent to which these biases disproportionately impact small enterprises operating in the undocumented economy and/or those owned/managed by women?
- What are the impacts of tax exemptions and concessions on entrepreneurs and SMEs in terms of enterprise performance and productivity, (including any disproportionate impacts on women informal entrepreneurs)?
- What are the impacts of biased tax regimes on emigration of entrepreneurs and skilled labor, the extent to which this contributes to ‘brain drain’ in South Asian countries?

*Theme 2: The Impact of the Value-Added-Tax (VAT) on Enterprise Development*

- What are the progressivity impacts of VAT burden on small enterprises and workers (particularly those operating in the undocumented economy), in terms of labor market outcomes, entrepreneurship and productivity at the bottom-income spectrum and in low value-added sectors?
- How are entrepreneurs (particularly those owning/managing small enterprises in the undocumented economy, especially women entrepreneurs) treated by VAT administration systems, against indicators of compliance costs and taxpayer friendliness?

*Theme 3: The Impact of Property Tax on Enterprise Development*

- What are the weaknesses in property tax systems that create and/or sustain informal land markets at the local levels, (including weaknesses in policy, administration, capacity and resources)?
- What is the nature and magnitude of impacts of land informality on entrepreneurs (owning/managing small enterprises) and workers (employed by small enterprises) operating in the undocumented economy (especially women)?

The regional scope of the project will allow the research to:

- Highlight similarities and differences in the institutions, regulatory and policy frameworks
- Identify and explain regional patterns and trends over time
- Evolve best practices for reform design, sequencing and implementation under adverse conditions

***User participation***

The users of the research results are envisaged as policymakers, policy analysts and advisors, as well as academics and researchers that are involved in focus areas ranging from economic planning and fiscal policy; fiscal decentralization and local public financial management; informal economy; entrepreneurship; gender equality and women’s economic participation; and labor economics, inspection and administration.

The research partner institutes constitute these target ‘users’ both at the policy and academic ends. For instance, Dr. Hafiz Pasha represents the Beaconhouse National University, which is a private center of academic research and learning. He is also a member of the Panel of

Economists, an independent advisory committee for the Pakistan government. He has also served as the Federal Minister for Finance and Economic Affairs, and Commerce Minister in three governments. Another example is Dr. Govinda Rao, who represents the National Institute of Public Finance and Policy which is an independent economic think-tank. Dr. Rao has also led or been part of Committees such as the Economic Advisory Council to the Prime Minister, Technical Experts Committee for the Introduction of State VAT in India, Expert Group on Taxation of Services, Expert Group Panchayat Raj, Tax Reforms Commission, Revenue Reforms Commission, State Finance Ministers' Committee on Sales Tax Reform.

These users have been involved at all stages of the planning cycle of the proposal, including the evolution of thematic focus, implementation modalities, institutional and financial arrangements, etc., as outlined in the 'Background of Proposal Development' section.

In addition, government officials in each country that are involved in formulating and/or implementing policies related to taxation and enterprise development will serve as Key Informants who will be interviewed to structure the policy problem and frame alternatives, at the data collection stage. They will also be invited to participate in Policy Engagement Workshops held in each country, (described below), where they will be presented with research findings and relevant policy recommendations.

### ***Data Collection & Analysis***

The methodology for collecting and analyzing data under each theme is provided below. In each case, the focal institute in each country shall nominate personnel, build and coordinate teams, and assign personnel roles and responsibilities. They shall also provide substantive guidance for the research as a whole. These focal institutes will monitor the progress of the research, ensure timely delivery of research outputs, provide human resources, as well as other resources which may be needed as in-kind contributions to the research.

Under each theme, research would cover all 5 countries in South Asia, given that these themes hold relevance across the region. Five country studies are proposed, for each theme (one focusing on each country), which could then be drawn together for meta-analysis highlighting the similarities, differences, learning outcomes, and cross-cutting recommendations at the regional level.

For each Country Study, the following methodology will be adopted.

First, a Literature Review will be conducted that will focus on (at the national and sub-national level):

- Enterprise surveys conducted by the World Bank, ILO, UNDP and other donors
- Previous research including reports by IFIs, think-tanks (including research partners) and government institutions (including annual reports, laws and regulations, etc.). These government institutes will include those mandated to promote the development of small enterprises in Pakistan (e.g. the Small and Medium Enterprise Development Authority), India (e.g. National Commission for Enterprises in the Unorganized Sector & National Institute of Micro, Small and Medium Enterprises), Sri Lanka (Ministry of Enterprise Development and Investment Promotion), and Bangladesh (SME Cell in the Ministry of Industries and the Small and Cottage Industries Corporation), and Nepal (Industrial Promotional Board).

- Manifestos of political parties, and programme documents of traders / farmers / transporters associations, Chambers of Commerce and other interest groups to map out the political economy factors at play
- Enterprise statistics for micro-economic data (such as value added for small enterprises, earnings information for self-employed workers, etc.) on informal and formal enterprises
- The constitutional, legal, and regulatory injunctions that govern taxation in each country
- Periodic Reports by revenue administration authorities such as the Federal Board of Revenue in Pakistan, the National Board of Revenue in Bangladesh and the Inland Revenue Department in Sri Lanka
- Consumption patterns and input-output tables from surveys and statistical data compilation authorities e.g. the Pakistan Living Standards Measurement Survey (PLSMS), Labor Force Survey, and the Federal Bureau of Statistics in Pakistan

Second, Key Informant Interviews will be conducted involving:

- Boundary analysis (a problem structuring technique) will be applied so that the number of ideas, opinions, and facts are exhausted
- Snowballing technique will be applied where each Key Informant will yield new contacts

These Interviews will target (at the national and sub-national levels)

- Serving and former civil servants (especially Customs & Excise and Income Tax Groups including personnel from revenue administration authorities, relevant Ministries, and enterprise development authorities including those mentioned above, trade and export control authorities, etc.)
- Elected officials (especially research partners of relevant parliamentary committees)
- Non-state actors including farmers /traders / professional associations, associations of home-based workers, Chambers of Commerce and Industry, Associations of Accountant Firms, NGOs active in this area, and scholars who have written on this issue.
- Representatives of the international donor community, including Programme Officers, Chief Technical Advisors, senior managers of the development assistance departments in relevant embassies, etc.
- Government officials involved in assessments and evaluations of tax bases, setting and revising of rates, and administering property taxes at the local (and/or higher) levels
- Government officials involved in land administration, governing aspects such as land registration and record-keeping, tenure, use, rights, markets, etc. at the local (and/or higher) levels
- Non-state stakeholders of land markets, including real-estate agencies, banks and lending institutions, NGOs advocating for land rights, etc.

Both the literature review and the Key Informant interviews will place particular emphasis on sub-national variations in both de facto and de jure policy regarding tax expenditures, VAT, and property taxes, as well as industrial composition and levels of informality, particularly in the 3 Country Studies on India and Pakistan, respectively.

Third, a survey of small compliant and non-compliant enterprises (and/or entrepreneurs) will be undertaken to assess key parameters of inquiry. They will include, employment, value added, fixed assets, wage bill, labor productivity, access to credit, expenditure on public goods and services, tax compliance costs, the knock-on effects of personal income tax levied on owners/managers, etc. The survey will employ an appropriate and workable sampling

methodology. Women owned/managed enterprises will be sampled to higher proportions to allow sufficient number of observations.

Once data collection is complete, each sub-theme will be analyzed as illustrated in the matrix below.

*Data Analysis Methodology for Theme 1: The Impact of Tax Exemptions and Concessions on Enterprise Development*

- First, for sub-sets of small compliant and non-compliant enterprises total tax expenditures will be calculated, covering exemptions, allowances, credits, rate relief, and deferrals. Tax expenditures will be identified for a comprehensive list of enterprise taxes, using a legal approach which takes current tax legislation as a basis for defining the benchmark tax from which deviations will constitute tax expenditures and be duly measured using the foregone revenue method, which measures the loss of revenue occurring after the introduction of the expenditure. This will be estimated using aggregate statistics obtained from national accounts.
- Second, the level of parity between the nature and magnitude of tax expenditures afforded to compliant and non-compliant enterprises will be determined.
- Third, econometric analysis will be conducted to determine the degree to which differences in the nature and magnitude of tax expenditures emerge as strong determinants of labor productivity, and the ability of small enterprises to grow and create productive jobs. The dependent variables in this case will be obtained from the survey carried out (described earlier). Women owned/managed enterprises will be separately analyzed in both sub-sets.
- Fourth, the same independent variables will be tested for significant correlation with emigration levels of entrepreneurs, with data on the latter obtained from relevant government authorities.
- Finally, policy recommendations will be made, considering the costs and benefits of these tax expenditures accruing to both compliant and non-compliant enterprises, especially those managed/owned by women.

*Data Analysis Methodology for Theme 2: The Impact of the Value-Added-Tax (VAT) on Enterprise Development*

- First, researchers will conduct a tax incidence analysis of VAT on small compliant and non-compliant enterprises. They will group consumption items into categories where tax receipts and consumption patterns of enterprise deciles is matched. Next, researchers will estimate the relative share of a consumption category for each enterprise quintile or decile. Finally, tax receipts for each consumption item category will be distributed based on the relative share of its consumption in each enterprise quintile or decile. Finally, this will allow the progressivity impacts of the VAT on small enterprises within and outside the tax net, to be determined. Two important assumptions will qualify the findings:
  - Final tax burden is borne down the supply chain to the consumer
  - Distribution of tax evasion among the population varies proportionally with consumption
- Second, researchers will conduct econometric analysis to test the degree to which indicators of taxpayer friendliness and compliance costs (including the second-order

costs related to personal income tax as measured from the survey conducted), are significant determinants of the ability of small enterprises to grow and create productive jobs

- Finally, policy implications and ensuing recommendations will be made for VAT design and administration to achieve greater equity and compliance, and to reduce disincentives for informal firms to join the regulated economy.

### *Data Analysis Methodology for Theme 3: The Impact of Property Tax on Enterprise Development*

Data gathered through Key Informant Interviews with relevant stakeholders will be analyzed to identify:

- Weaknesses in local property tax systems rising from areas such as inter-governmental fiscal relations; classification, valuation and assessment mechanisms; political factors; compliance culture; tax administration functions, especially record-keeping; exemptions and preferential treatments; among others.
- Anomalies in informal land markets rising from areas such as interest groups, formal land registration systems, recognition of informal transactions, and the ways in which informal transactions are carried out e.g. subdivision; renting and sub-renting; simple occupation, etc. The impacts of these anomalies on enterprises, especially enterprises owned/managed by women and those operating outside the tax net in the undocumented economy, will be focused on.
- Policy recommendations that address weaknesses in property tax systems which cause or worsen informal land development and the associated anomalies in informal land markets at the local levels.

The Themes demands expertise from public finance (specializing in tax policy), labor economics, local finance, land economics, and land administration backgrounds. In addition, experience conducting econometric analysis on microeconomic data is essential. Therefore, each Country Study should be developed by a 3-4 member team, composed of relevant qualifications and experience from each focal institute.

### ***Gender Considerations***

The proposed project includes research which specifically addresses gender considerations as an integral part of the problem being studied. Aside from this, gender concerns will be mainstreamed throughout the planning and execution phases of the project. These will include:

- Research Design and Methodology
  - Recognition of the importance of gender sensitive research at the conceptual level (as evident in this document).
  - Mainstreaming of gender considerations in research conducted on all proposed themes, as reflected by the formulated research questions.
  - Provisions for data collection methodologies that target specified samples of women among the population. This may involve disproportionate stratified sampling for women entrepreneurs, proprietors, managers, workers, etc. in the formal and informal sectors for surveys.
- Research Execution

- Equal opportunity policies which prioritize selection of women candidates for project staff in each country under study
- Provisions in scheduling and budgeting for the extra effort required to gain access to women respondents given constraints of background and culture in certain countries under study
- Data Processing and Analysis
  - Captured data will be disaggregated by gender (wherever possible)
  - Gender will form a key dimension for analysis in terms of roles, representation, voice and participation, access to rights, services and resources, etc.

### ***Ethical considerations***

The thematic focus and methodological arrangements of the project do not raise any exceptional ethical issues, as they do not involve health or other such dimensions. However, as a matter of policy, ethical dimensions of research, in terms of obtaining informed consent and securing confidentiality will be governed under the following guidelines:

- In dealings with government, information letters will be drafted and sent out to concerned offices prior to any meetings, that introduce the purpose, nature and background of the project. Wherever necessary, ‘no-objection’ letters or other documents acknowledging project activities and certifying granted permission will be obtained from concerned authorities prior to any exchange of information.
- All research instruments, including questionnaires, outlines of semi-structured interviews and FGDs, etc. will include Standard Operating Procedures (SOPs) that will require project personnel to gain informed consent from respondents prior to data collection, by establishing rapport, informing them of project purpose and background, providing assurances of confidentiality and (where applicable) anonymity, and briefing them on the nature of the exercise. These SOPs will form an integral component of any training or orientation imparted to research teams prior to data collection.
- Confidentiality will be ensured through organizational policies and controls in place at all collaborating institutes, that include limited physical access to documents, secure data entry, processing and storage protocols, secure transmission systems for sharing data among project staff, etc.

### ***Organizational matters***

Proposed research partners that participated in the planning Workshop (please refer to Annex: Background of Proposal Development for details), evolved a consensus on the following areas regarding organizational matters for this project:

- GINI will serve as Secretariat to the proposed project providing financial management, contract management, substantive support, and coordination services. All funding will be channeled through the Secretariat.
- The institutes in attendance will compose the Steering Committee (limited to those based in South Asia). The Steering Committee shall guide the research partners with its recommendations while ensuring that projects interests and needs are addressed and the resources supporting the project activities are effectively prioritized through an approved annual work plan.

1. The steering committee shall approve the annual work plan
  2. The steering committee shall monitor the progress of the annual work plan and Sub-Committees work through the GINI Secretariat and make attendant recommendations as required for the attainment of the objectives of the project
- The institutes attached to each research theme shall form a Sub-Committee which will formulate and agree on the summary of joint proposals to be submitted to GINI for development of the Proposal. The details will be worked out at the contracting stage following approval of the proposal.
  - Memoranda of Understanding (MoUs) between GINI and the research partners will serve as the organizing instrument. They will detail the obligations and commitments of research partners. Financial arrangements will be governed by legal contracts signed between GINI and research partners at the time of actually undertaking research activities after approval of the integrated proposal. These contracts will be approved by the Steering Committee and signed and managed by the GINI Secretariat.
  - The Institute on Governance, World Bank Representative, and the East-West Center representative will constitute a Technical Advisory Group that will provide peer review services for the research outputs produced by the Sub-Committees, and will also be invited to attend the Policy Engagement Workshops being held in each country, lending academic weight to the research and improving its chances for policy uptake. These institutes will not be part of the Steering Committee. This Group will be expanded to include other technical experts as and when needed and approved by the Steering Committee.
  - Detailed Terms of Reference (TORs) will be developed jointly by research partners and approved by the Steering Committee to govern the roles and responsibilities of these bodies. These will form part of a governance document developed by GINI and duly circulated amongst research partners for approval by the Steering Committee. It will also include draft MoUs and draft agreements with institutes and will be made available as an attachment to the Integrated Proposal.

## Results and Dissemination

The research outputs will be put through 2 peer review cycles before being published and communicated to the research partners, as well as made available for free-access downloading to any interested parties through the programme website.

The immediate users of research results will be the research partners (as discussed earlier), while the intermediate users will include:

- Government officials in South Asia responsible for policy areas of taxation and enterprise development, as well as peripheral policy areas which have a bearing on these issues, including labor, women's empowerment, trade, business regulation, financial credit markets, human capital building, etc.
- Academic community conducting research, involved in advocacy, and/or capacity building related to the programme themes in South Asia
- Members of the international donor community sponsoring reforms in areas including public finance, labor, innovation, entrepreneurship, enterprise development, women's rights, etc.
- Governments and donors in other developing regions, such as Latin America, Middle East, and Africa for whom enterprise development and inclusive growth remain elusive
- Civil society groups at the national and regional levels, focusing on the delivery of rights and services to workers and entrepreneurs

GINI will undertake measures to strengthen policy uptake of research by immediate and intermediate users. First, GINI will organize a Policy Engagement Workshop in each country, which will invite these immediate and intermediate users. In particular, government officials will include those who are enrolled in mandatory training courses at government institutes such as the National School of Public Policy in Pakistan and the Administrative Staff College in India, to target individuals who are less involved with their professional routines and so more receptive for engagement and advocacy. At these events, collaborating institutes will present research, solicit feedback and generate debate and discussion with attending stakeholders on the policy recommendations tabled. Non-Asian institutes will also be invited to add academic weight and credibility to research findings, and advocate on key policy positions with government stakeholders.

A Workshop Report will be developed after each event to document the proceedings, highlighting key points of consensus and/or contention, and the issues and questions raised by participants. These Reports will be widely disseminated amongst the users, as well as uploaded on GINI's website. These Workshops are also intended to be widely covered by the national media in each country, which will give the research added visibility, generate public debate on research areas, and create additional pressure for key policy recommendations emanating from research findings to be given state attention.

Secondly, as part of the MoUs signed with partner institutes, GINI will include roles and responsibilities focusing on advocacy based on research findings as and when they emerge. This will be facilitated by the fact that policymakers in key decision-making positions will be among the Key Informants targeted for Interviews, as part of the data collection. Substantive involvement in the research process itself will create ownership of recommendations derived from its findings. These advocacy activities will take the shape determined most relevant and feasible by the partner institutes themselves. GINI will encourage the incorporation of these

advocacy activities to be built in to existing activities where partner institutes engage relevant policymakers as part of their own institutional plans and agendas.

For example, GINI is currently undertaking a project with the Planning Commission of Pakistan, involving the development of an economic growth framework that will guide fiscal policy over the next 5 years. NIPFP, India, in collaboration with OECD organized a Symposium titled: "Towards Balanced Development and Inclusive Growth: The Indian Experience" which was timed to coincide with the release of the 2nd OECD Economic Survey of India, 14 June 2011. The event invited representatives from the Ministry of Finance, Reserve Bank of India, National Stock Exchange, Planning Commission, Economic Advisory Council to the Prime Minister, etc. IPS, Sri Lanka, organized an International Conference On Taxation & Development, 03 -04 November 2011, in collaboration with the Inland Revenue Department, Sri Lanka Institute of Taxation, and Institute of Chartered Accountants of Sri Lanka. These examples represent opportunities to engage target end-users through events with immediate relevance to the proposed project.

These measures will facilitate policy uptake and allow the expected impacts of research results to come about. These expected impacts of research results can be viewed in the following perspectives<sup>53</sup>.

*Contribution to scientific and technical knowledge* – While the knowledge area of enterprise development has received great attention recently, given the emerging consensus surrounding the importance of making growth more inclusive, research has:

- Focused more on the determinants of size, which is equivocated with the ability to generate productive employment, rather than compliance with taxation systems
- Focused on policy areas such as trade and labor, not taxation which has strong empirical linkages to small enterprise development and the quantity and quality of jobs they are able to produce
- Not focused on the statistically significant gender dimension of small enterprise development and labor market outcomes
- Not focused on the South Asian region, which is unique in terms of economic socio-economic development and structure, policies and institutions, and experiences with enterprise development and inclusive growth, which presents opportunities for new insights to be gleaned from comparative analysis
- Generally not employed the level of sophistication in data analysis that this project proposes, to draw conclusions that are as statistically valid and reliable as possible

In sum, the proposed project will make new and valuable contributions to scientific and technical knowledge on the subject.

*Policy formulation and implementation* – The research will make explicit, concrete, and realistic policy recommendations based on the findings for all South Asian economies, relating to the following policy areas:

- Small enterprise development policy, will benefit from empirical evidence of the extent and nature of contrasts between enterprises operating within the formal tax net and those operating in the undocumented economy (where most SMEs operate) and what policy alternatives can be adopted to help them grow and create productive jobs

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<sup>53</sup> These perspectives are adapted from "Guidelines for Writing a Project Proposal", IDRC website: [http://www.idrc.ca/cp/ev-57070-201-1-DO\\_TOPIC.html](http://www.idrc.ca/cp/ev-57070-201-1-DO_TOPIC.html)

- Labor policy will be better informed of trends in concentration and productivity of labor, as well as the policy alternatives that when exercised will allow the creation of more productive, well-paying and secure jobs, particularly with regard to the neglected undocumented economy
- Taxation policy will benefit from:
  - An objective analysis of tax expenditures (weak and/or opaque in most South Asian countries), and the differential treatment of small enterprises in this regard
  - An assessment of the impacts of VAT policy and administration on small enterprises and their development and productivity
  - An exploration of the link between weak local property taxes and land informality and how it affects entrepreneurs (owning/managing small enterprises) and workers
- Women's empowerment policy will benefit from data on women's economic participation as workers and entrepreneurs (owning/managing small enterprises) in the informal economy and factors in the policy/institutional environment that limit their growth and productivity
- Trade policy, particularly with regard to export promotion will benefit from an appreciation of the difficulties faced by small enterprises who are excluded from the incentives available to other firms for accessing international markets to improve growth and productivity
- Business regulation policy will benefit from an identification of bottle-necks at the policy and administration level, that discourage entrepreneurship, encourage small enterprises to exit the tax net and remain outside it, and limit the potential for innovation, growth and job-creation for enterprises within the tax net
- Financial credit policy, particularly with regard to financial services at the micro-level will benefit from an indication of the ways in which access to small firms could be expanded, as well as ideas for new financial products which enhance productivity and growth for these firms
- Education and human capital policy would benefit from an assessment of the demand for technical and professional/vocational skills among small enterprises, and the policies that would help supply them

*Potential use in other settings* – As mentioned earlier, governments and donors in other developing regions, such as Latin America, Middle East, and Africa would also benefit from this research as these economies are relatively comparable with South Asia in terms of:

- Growth inclusivity
- Economic structure and composition, particularly with regard to the undocumented economy and non-agricultural employment
- Structural issues of economic governance

The following indicators are proposed to objectively verify progress against programme objectives:

- Number of research outputs accessed/downloaded/shared from the programme website
- Number of new research papers published in domestic/international journals related to taxation and enterprise development in South Asia
- Number of news items and articles in national publications concerning taxation and enterprise development in South Asia
- Number of key institutions and actors registered as research partners
- Level of activity in online forums and discussion boards on the programme website

- Level of attendance at project meetings both in absolute numbers and in representation of all stakeholder groups

The following risks and assumptions may make the achievement of project objectives difficult:

- *There may be possible coordination and logistical constraints associated with collaborative research at the international level, for instance with travel and visa issues, communications, and meetings, particularly when dealing with India.* GINI will bring to bear its extensive international coordination experience to bear for mitigating such risks. First, for international travel, GINI will assist all travelers with visa arrangements in preparation of required documentation. For travel to Pakistan, GINI will liaise with relevant government institutions such as the Ministry of Foreign Affairs and Pakistani embassies in origin countries for facilitating speedy delivery of visas. In any case, if serious issues arise, neutral venues in third countries can be arranged. For example, the initial Workshop, held in August, 2010 was organized by GINI in Singapore, which was attended by 4 Indian delegates without any problems. Second, for meetings/workshops, GINI will plan for availability of participants, venue arrangements, flight itineraries, and accommodation details well in advance. Third, for communications GINI will manage time zone issues and coordinate meetings through online videoconferencing. GINI will also use online forums and blogs to help research teams to stay connected. GINI has used all these measures to manage international coordination risks successfully in the past.
- *Policymaking processes may not be receptive to research and analysis.* As explained earlier, GINI will conduct highly publicized Policy Engagement Workshops to enhance policy uptake of research, encourage partner institutes (through MoUs) to use their institutional proximity to governments for advocacy of research findings within their own spheres of influence.
- *Security conditions in Pakistan and elsewhere may make research environments unsafe.* GINI is currently conducting 2 research projects funded by the USAID (focusing on women's land rights), and the US Institute of Peace (focusing on radicalization) in Northern Pakistan, including the volatile FATA region. GINI has successfully managed security issues by working in partnership with local authorities, employing locally based research teams, and following local customs in data collection protocols. The same methodologies will be used to overcome security constraints for the proposed project. In any case, the themes of the proposed project are assessed as far less controversial as compared to the projects mentioned above, and so the level of risk associated with the former are marginal.
- *Data, particularly financial data is assumed to be obtainable.* GINI has successfully obtained sensitive data from government agencies for past research projects, including data on corruption. The links established with these agencies will be used to overcome problems in this regard. Also, most partner institutes already have institutional linkages with the government for information sharing. Finally, for data sources GINI has identified not only government but also international donors, which could be used if data from government is unavailable.
- *Biases of respondents may skew findings.* GINI will ensure that the reliability of instruments used is up to international standards through thorough pre-testing, and that experienced data collectors are employed.
- *Lack of sufficient time, manpower or resources may force research design to use non-probabilistic methodologies, or under-sample population to reduce validity and/or reliability of findings.* GINI will review all research designs to ensure that they are feasible in terms of resource requirements, before any research is initiated on ground.

- *Media may not find programme activities newsworthy.* The immediate and intermediate users of the research are highly recognizable and prominent opinion-formers experts in their respective fields. This will enhance the newsworthiness of project activities where they are involved. In addition, GINI will actively seek to involve media through press releases and invitation to project events to secure media attention.

The project will produce the following outputs:

- Project website (as described in the Methodology Section, Page 14)
- Annual Workplans (as described in the Methodology Section, Page 14)
- Interim and Final Country Reports and Regional Reports for the 3 research themes as described throughout the Methodology Section, beginning on Page 14)
- Workshop Reports for the 5 Policy Engagement Workshops (one in each country in South Asia, as described on Page 23)

## Institutions and Personnel

<i>Institutes</i>	<i>Institutional Background</i>	<i>Personnel</i>	<i>Qualifications &amp; Experience</i>
Governance Institutes Network International (GINI), Pakistan House 21, Street 56, F-6/4, Islamabad	Governance Institutions Network International (GINI) is an NGO based in Islamabad, Pakistan, specializing in policy research, analysis, advocacy, resource mobilization, capacity building and innovative IT solutions for governance reform at the national and local levels. It has previously conducted IDRC supported research under the Fiscal Policy and Accountability theme.	Mr. Daniyal Aziz, Advisor Email: <a href="mailto:dax100@hotmail.com">dax100@hotmail.com</a>	He holds over 17 years of experience in governance, institutional reform and economic development, with a career spanning involvement in national and local politics, civil society leadership, and international networking. He has been a member of the National Assembly, as well as Chairman, National Reconstruction Bureau (NRB), was elected Chairman of the Forum on Ministers of Social Development in Asia, and currently heads various donor-led governance reform initiatives including the Devolution Trust for Community Empowerment (DTCE).
		Mr. Usama Bakhtiar Ahmed, Research Manager Email: <a href="mailto:usamab@gmail.com">usamab@gmail.com</a>	He holds over 5 years of experience with the UNDP conducting policy research, analysis, advocacy and program evaluation. He has worked for governance reform at the regional level throughout the Asia Pacific, and within Pakistan in support of devolution. This experience includes designing and managing several national level survey research projects. He has also provided substantive and administrative support for research conducted by GINI. His academic qualifications include a Masters degree in Public Policy and Management from Carnegie Mellon University, USA.
East-West Center, 1601 East-West Road Honolulu, Hawaii 96848 USA	The East-West Center was established by the U.S. Congress in 1960, and serves as a resource for information and analysis on critical issues of common	Dr. Shabbir Cheema, Director Asia-Pacific, Governance and Democracy Initiative Email: <a href="mailto:cheemas@eastwestcenter.org">cheemas@eastwestcenter.org</a>	Dr. Shabbir Cheema was previously the Director of the Governance Division of UNDP. His current work focuses on governance in Asia and the Pacific including decentralization, civil society engagement, electoral and parliamentary processes and civil service

	<p>concern, bringing people together to exchange views, build expertise, and develop policy options. The Center is an independent, public, nonprofit organization with funding from the U.S. government, and additional support provided by private agencies, individuals, foundations, corporations, and governments in the region.</p>		<p>reform. He is the contributor and co-editor of <i>Decentralizing Governance: Emerging Concepts and Practices</i> (Brookings and Harvard 2007).</p>
<p>World Bank Institute, Washington, USA</p>	<p>The World Bank Institute (WBI) is the Bank Group's principal provider of learning activities. It has delivered training courses and seminars since the 1950s, mostly for government officials in developing countries on such topics as macroeconomic policy, poverty reduction, health, education, and policy reform in other economic sectors.</p>	<p>Dr. Anwar Shah, Economist and Program Leader, Governance Program Email: <a href="mailto:ashah@worldbank.org">ashah@worldbank.org</a></p>	<p>Dr. Anwar Shah has previously served the Ministry of Finance, Government of Canada and Government of Alberta, Canada and held responsibilities for federal-provincial and provincial-local fiscal relations respectively. He has advised multiple governments on fiscal federalism.</p>
<p>Institute on Governance in Ottawa, Canada</p>	<p>Founded in 1990, the Institute On Governance (IOG) is an independent, Canada-based, not-for-profit public interest institution with its head office in Ottawa and an office in Toronto. Their mission is 'advancing better governance in the public interest,' which they accomplish by exploring, developing and</p>	<p>Ms. Maryantonett Flumian President Email: <a href="mailto:mflumian@iog.ca">mflumian@iog.ca</a></p>	<p>She is a seasoned senior executive at the Deputy Minister level in the Canadian federal Public Service with more than 20 years of large-scale operational experience in the economic, social and federal/provincial domains. She is internationally recognized for her work as a transformational leader across many complex areas of public policy and administration such as labour markets, firearms, fisheries, and environmental issues. She was the first Deputy Minister of Service Canada. Her current</p>

	promoting the principles, standards and practices which underlie good governance in the public sphere, both in Canada and abroad.		research focuses on leadership, collaboration, governance, and the transformational potential of technology primarily in the area of citizen-centered services.
		Ms. Laura Edgar Vice President Email: <a href="mailto:ledgar@iog.ca">ledgar@iog.ca</a>	Laura Edgar leads the Institute’s international work, including building and managing modernizing government, organizational governance, indigenous governance, health and innovation and partnership initiatives and projects around the world. Laura also leads the Institute’s work on the governance of partnerships, including PPPs and civil society – government relations. Additionally, she has over ten years experience working with boards of directors of public purpose organizations. She has worked in West Africa, Japan, South-East Asia and Losotho.
Beaconhouse National University (BNU), Pakistan 3-C, Zafar Ali Road Gulberg – V, Lahore Tel: 92-42-5718260-3 Email: <a href="mailto:info@bnu.edu.pk">info@bnu.edu.pk</a>	BNU is the first Liberal Arts University of Pakistan. Chartered by the Government of Punjab, the BNU, was established in 2003 for the purpose of imparting education with a modern and rational course content while ensuring that the history and culture of Pakistani society are respected. BNU is planned as a non-profit, private university disseminating learning and encouraging research in diverse areas where the essential focus of the programs offered has been	Dr. Aisha Ghaus Pasha, Director of Research, Beaconhouse National University (BNU) Cell: 0306-4543693 Email: <a href="mailto:aishagp@aol.com">aishagp@aol.com</a>	Dr. Aisha has 23 year of experience in teaching, undertaking research and consulting assignments in social policy and development, governance, public finance and urban and regional economics and in advocacy work on social and economic issues.
		Dr. Hafiz A. Pasha, Dean, School of Social Sciences, BNU Ext: 889 Email: <a href="mailto:hafiz.pasha@gmail.com">hafiz.pasha@gmail.com</a>	Dr. Hafiz Pasha is a member of the Panel of Economists an independent advisory committee for the Pakistan government. He has served as the Federal Minister for Finance and Economic Affairs, and Commerce Minister in three governments. He has also served as a United Nations Assistant Secretary General and United Nations Development Program Assistant Administrator and as director of the Regional Bureau for Asia and the Pacific.

	determined by the type of the work force identified for the future economic, business, academic, cultural and technological advancement of the country.	Dr. Sartaj Aziz, Vice Chancellor, BNU Ext (PA): 821 Email: <a href="mailto:sartajaziz@hotmail.com">sartajaziz@hotmail.com</a>	He is a recognized development economist, having served as Minister of State for Food, Agriculture and Cooperatives, Minister for Finance Planning and Economic Affairs and as Senator for the Pakistan government where he is a member of the Standing Committee on Finance and Economic Affairs. He has held senior positions in the UN, FAO, World Food Council, and International Fund for Agricultural Development. He has also played a key role in the North-South dialogue and South-South cooperation.
National Institute of Public Finance and Policy (NIPFP), New Delhi 18/2 Satsang Vihar Marg, Special Institutional Area, New Delhi-110067 (INDIA) Tel.: 91-11 26563688, 26569780, 26569784, 26963421, Fax: 91-11-26852548	The National Institute of Public Finance and Policy (NIPFP) is a centre for applied research in public finance and public policy. Established in 1976 as an autonomous society under the Societies Registration Act XXI of 1860, the main aim of NIPFP is to contribute to policy-making in spheres relating to public economics. Its research work focuses on tax policy and administration, public expenditure and control, public debt and its management, intergovernmental fiscal relations, economics and pricing of public and industrial enterprises and such other aspects of public finance as may relate to broader economic and fiscal	Dr. Govinda Rao Marapalli, Director Office: F-11, First Floor Email: <a href="mailto:mgr@nipfp.org.in">mgr@nipfp.org.in</a> Phone: 91-011-26857274 Fax: 91-011-26512703	He has led or been part of Committees such as Economic Advisory Council to the Prime Minister, Technical Experts Committee for the Introduction of State VAT in India, Expert Group on Taxation of Services, Expert Group Panchayat Raj, Tax Reforms Commission, Revenue Reforms Commission, State Finance Ministers' Committee on Sales Tax Reform. He has also been actively involved as Consultant/adviser on public policy to various international bodies such as World bank , Asian development bank, UNDP, ESCAP-United Nations.

	policies.		
Centre for Policy Dialogue (CPD) House#40/C, Road#11 Dhanmondi R/A GPO Box 2129 Dhaka - 1205, Bangladesh	The Centre for Policy Dialogue (CPD), established in 1993 by Professor Rehman Sobhan with support from leading civil society institutions in Bangladesh, is mandated by its <i>Deed of Trust</i> to service the growing demand that originates from the emerging civil society of Bangladesh for a more participatory and accountable development process. CPD focuses on frontier issues which are critical to the development process of Bangladesh in the present context, and which are expected to shape and influence the country's development prospect in the mid-term. CPD's current programme portfolio includes research activities, holding of dialogues, publication and dissemination as well as networking related initiatives.	Dr. Mustafizur Rahman, Executive Director Email: <a href="mailto:mustafiz@cpd.org.bd">mustafiz@cpd.org.bd</a> Telephone: 880 2 9141655 Fax: 880 2 8130951	He is serving as Member of Bangladesh Economic Association (BEA) as well as the Working Group on WTO, Ministry of Commerce. He specializes in Trade sector performance, backward and forward linkages, trade policy analysis, export competitiveness issues including technology, exchange rates and incentives, regionalization and regional economic cooperation in South Asia, foreign aid, globalization and its multidimensional implications for Bangladesh's external sector performance.

<p>Institute of Policy Studies of Sri Lanka 99 St, Michael's Road Colombo 03 Sri Lanka</p>	<p>IPS is an autonomous, not for profit, civil society organization, dedicated to promoting policy-oriented research. IPS provides a forum for informed discussion and dialogue on national and international issues. The contributions spanning over about thirty years and the overall impact signifies the importance of pragmatic research on policy issues. The Institute highlights the role of think-tanks in modern democratic polity. IPS has defined Pakistan Affairs, International Relations and Faith and Society as its major areas of research and has developed an effective system of coordination of research activities by local and foreign scholars through a dedicated team of research coordinators.</p>	<p>Dr. Saman Kelegama, Executive Director Email: <a href="mailto:ed@ips.lk">ed@ips.lk</a> Telephone: 00 94 11 2431368 Facsimile: 00 94 11 2431395</p>	<p>He is a trade policy economist who also works on industrial economics, public enterprise reform, and macroeconomics. He is a Fellow of the National Academy of Sciences of Sri Lanka. He was a Visiting Fellow at the Australia South Asia Research Centre, Australian National University, Canberra, Australia (1998); Government of India Distinguished Visiting Scholar (1998); Salzburg Fellow (1997); USIS International Visitor (1993); and Visiting Fellow, Institute of Social Studies, The Hague, The Netherlands (1992/3). He has served as a consultant to the World Bank, ADB, UNDP, UNIDO, ILO, UN-ESCAP, Commonwealth Secretariat, among other organizations.</p>
		<p>Dr. Dushni Weerakoon, Deputy Director &amp; Head of Macroeconomic Policy Research Email: <a href="mailto:dushni@ips.lk">dushni@ips.lk</a></p>	<p>Since joining the IPS in 1994, her research and publications have covered areas related to regional trade integration, macroeconomic policy and international economics. She has extensive experience working in policy development committees and official delegations of the Government of Sri Lanka including as a member of the Macro and Trade Policy Steering Committee of the Ministry of Policy Development and Implementation and as an official delegate to the Committee of Experts to negotiate the South Asian Free Trade Agreement. She currently serves on the Trade and Tariff Committee of the National Council for Economic Development (NCED) of the Ministry of Finance, Sri Lanka.</p>

<p>Institute for Integrated Development Studies (IIDS), Mandikhatar, Kathmandu, Nepal  P.O. Box 2254  Tel: 977-1-4378831 / 4371006</p> <p>Fax: 977-1-4378809</p> <p>Email: <a href="mailto:iids@wlink.com.np">iids@wlink.com.np</a>  Website: <a href="http://www.iids.org.np">www.iids.org.np</a></p>	<p>Founded in 1990 after the promulgation of the multi party democracy as a successor of the Integrated Development system (IDS), the Institute of Integrated Development Studies (IIDS) is a leading non-governmental, non-profit organization research institute of Nepal registered under the Societies Registration Act 1977. It conducts research on various disciplines including economics, aquiculture, rural development, poverty, public administration, gender, political development and natural resources.</p>	<p>Dr. Bishnu Pant,  Executive Director  Email: <a href="mailto:bishnu.pant@gmail.com">bishnu.pant@gmail.com</a>  <a href="mailto:bdpant@iids.wlink.com.np">bdpant@iids.wlink.com.np</a></p>	<p>Dr. Pant worked in the Asian Development Bank (ADB), Manila in different capacities for more than 12 years since April 1996, and was mostly responsible in assisting the ADB developing member countries improve their statistical systems. His contribution in successfully completing the 2005 round of ICP Asia Pacific has been highly commendable. He also worked in the United Nations Economic and Social Commission for Asia and the Pacific (UN-ESCAP), Bangkok as Chief of the Statistical Information Services Section from April 1986 to March 1996. His major areas of expertise include statistics and national accounts.</p>
		<p>Dr. Mahesh Baskota,  Treasurer  Email: <a href="mailto:mbanskota@ku.edu.np">mbanskota@ku.edu.np</a></p>	<p>Dr. Mahesh Baskota, is also currently serving as the Dean, School of Arts, Kathmandu University. He has formerly served as Country Representatives at The World Conservation Union (IUCN), Nepal Country Office; Deputy Director of ICIMOD and Programme Director of Nepal Staff College; as well as Associate Professor of Centre for Economic Development and Administration (CEDA).</p>

## Timetable and Budget

The following timetable provides the tentative schedule for Years 1, 2, and 3. The timetables may be revised based on Annual Workplans developed by GINI and approved by the Steering Committee.

<i>Months</i>	<i>Outputs Produced</i>
Month 1-3	<ul style="list-style-type: none"> <li>• Research Design Document</li> <li>• Annual Workplan</li> <li>• MoUs with research partners signed</li> <li>• Contracts signed with institutes undertaking research on each theme</li> </ul>
Month 5-12	1 <sup>st</sup> batch of Interim Deliverables received for research outputs for Themes 1 ,2 & 3 for peer review and dissemination
Month 13-24	2 <sup>nd</sup> batch of Interim Deliverables received for all research outputs for Themes 1, 2 & 3 for peer review and dissemination
Month 25-33	Final Research Deliverables for Themes 1, 2 & 3 prepared and disseminated to all project stakeholders
Month 33-36	Policy Engagement Workshops conducted in each country to present research and advocate on key policy recommendations

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>IDRC Share</b>
<b>Personnel</b>	<b>3,960,000</b>	<b>2,640,000</b>	<b>2,640,000</b>	<b>9,240,000</b>
Project Leader	3,600,000	2,280,000	2,280,000	8,160,000
Research Manager	360,000	360,000	360,000	1,080,000
<b>Travel (Staff) / Voyages (personnel)</b>	<b>1,033,355</b>	<b>1,033,355</b>	<b>1,033,355</b>	<b>3,100,065</b>
GINI Coordination visits to network country teams - airfare	780,000	780,000	780,000	2,340,000
GINI Coordination visits to network country teams - Per Diems	253,355	253,355	253,355	760,065
<b>Research Expenses / Frais de recherches</b>	<b>6,656,400</b>	<b>6,656,400</b>	<b>7,196,400</b>	<b>20,509,200</b>
Research and Dissemination Expenses	6,656,400	6,656,400	7,196,400	20,509,200
<b>Indirect Costs / Frais indirects</b>	<b>1,422,000</b>	<b>1,422,000</b>	<b>1,422,000</b>	<b>4,266,000</b>
Rent for premises used in research activities	1,020,000	1,020,000	1,020,000	3,060,000
Company Secretary	222,000	222,000	222,000	666,000
IT Manager	180,000	180,000	180,000	540,000
<b>Total (RAP/PAB) in reporting currency</b>	<b>13,071,755</b>	<b>11,751,755</b>	<b>12,291,755</b>	<b>37,115,265</b>
<b>Total (RP/PAB) in CAD (for IDRC) and USD for Other Donors and GINI</b>	<b>158,500</b>	<b>142,500</b>	<b>149,000</b>	<b>450,000</b>

Exchange rates used are: 1 CAD=82.4810 PKR (as specified by IDRC) and 1 USD=88.25 PKR as obtained from [www.xe.com](http://www.xe.com) at 12:41 UTC, 2011-11-29.

## **Annex: Background of Proposal Development**

The Governance Institutes Network International (GINI) took the initiative for bringing together South Asian think-tanks and research institutes which would undertake collaborative research on South Asian Tax Systems, with the support of the International Development Research Centre (IDRC), Canada. GINI worked in close collaboration with IDRC to develop the conceptual and methodological framework for this project, which was articulated in a detailed proposal.

Prospective partners were then identified in consultation with IDRC, based on each institution's expertise and research experience in the relevant economic areas. In May, 2010 GINI established contact with select institutes in Pakistan, India, Nepal, Sri Lanka, Bangladesh, USA and Canada to introduce the organization and agenda, assess willingness to participate in the project, and confirm availability for attending an initial planning Workshop in Singapore. GINI also circulated a draft Workshop Document which laid out the agenda for the planned Workshop, provided background on the proposed research themes, and indicated the proposed responsibilities of all participants in terms of pre-Workshop preparation. All institutes were encouraged to propose amendments or additions to the proposed research themes according to their national experiences. The responses forthcoming from all contacted institutes were unanimously positive. According to the feedback received from all participants, GINI revised the thematic focus of the Workshop document, and initiated logistical arrangements for the Workshop.

The 2-day Workshop on South Asia Tax systems was held from 8-9 August, 2010, in Furama City Centre, Singapore. It brought together representatives of the 15 leading economic think-tanks and research institutes from India, Pakistan, Bangladesh, Sri Lanka, Nepal, USA and Canada.

Participants discussed at length the successes, failures and difficulties faced by their governments in reversing the growth of the informal economy in their countries through effective tax regimes. They concluded that: *“despite growth, entrepreneurship and innovation in South Asia, the region faced poverty and lack of human development.”* One of the key causes was the limited *“coverage”* of tax regimes and the fact that *“efforts to document the informal economy”* and *“bring the informal sector into the tax net”* have met with limited success.<sup>54</sup>

They agreed on the need to undertake collaborative research on these issues in South Asia. They also identified key research themes that reflected the highest degree of policy relevance as well as the greatest potential to add significantly to the extant body of academic literature on the informal economy in South Asia, and the tax regimes that determined its size and shape. These were also themes that afforded the most valuable opportunities for collaborative research and sharing of learning experiences through comparative analyses at the regional level. Institutes based in South Asia elected themselves into research groups that would undertake research under these themes based on their interests and capacities. Following subsequent discussions between GINI and IDRC, these themes presented in this proposal were finalized for the project.

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<sup>54</sup> Workshop Report, GINI, 2010