

Spring 2014

# Not Just A Formality: How Inefficient Bureaucracy and Government Distrust Fuel Nepal's Informal Economy

Anders Karl Lindgren  
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# Not Just a Formality: How Inefficient Bureaucracy and Government Distrust Fuel Nepal's Informal Economy

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Submitted in partial fulfillment of the requirements for Nepal: Development and Social Change, SIT Study Abroad

Spring 2014

## **Abstract**

Currently the Nepali government and the International Labour Organization (ILO) are involved in a campaign to increase rates of government registration among small businesses, which are technically illegal to operate unregistered. The program incentivizes and facilitates registration, attempting to change the cost-benefit analysis that shopkeepers make when deciding whether to register. Using interviews with small business owners in the Kathmandu area, this study provides qualitative data about what information these shopkeepers have, how they perceive the registration process, whether the government has traditionally followed through on its promises, and how all of these factors affect their registration cost-benefit analyses. Additionally, this study examines the perceptions, priorities, and methods of NGOs and government officials involved in directing initiatives which affect the informal economy. From the shopkeeper side we find that a confusing registration process as well as distrust in the government are the primary barriers to registration. From the government and NGO side we find that lack of information sharing and collaboration between various government ministries as well as between NGOs and the government are harmful to registration efforts.

Keywords: Economics, Government, Informal Economy

## **Dedication**

To my aamaa, who fed me, cared for me and taught me throughout this project

## **Acknowledgements**

Thank you first to all members of the SIT program faculty and staff for the support they've provided throughout our experience. To everybody who feeds us, teaches us, keeps us safe, and guides us through our time here, thank you. Thank you do Dr. Ram Chandra Dhakal who served as both a friend and advisor in my work on this project. Thank you to Shailendra Kumar Jha for taking an interest in my project and helping me understand the ILO's initiative. Thank you to everybody I interviewed, all of whom provided me with invaluable information for this project. And thank you most of all to the shopkeepers who were willing to discuss sensitive information with me, who were tolerant of my stumbling Nepali, and whose opinions and experiences are the keystone of my research.

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## **1) Introduction**

As one walks the streets of Kathmandu, small roadside shops are a bustling source of commercial activity. These small shops, generally owned and operated by a single individual or family, represent a significant portion of Nepal's overall employment, economic activity, and potential for growth. The only problem with this keystone of Nepali commerce is that many of these small shops are operating illegally. Although the vast majority of small shops do honest business selling entirely legal goods and services, many of them have not officially been registered with the government. This lack of government documentation makes these shops a part of Nepal's informal economy, a nebulous term which academics have yet to define by consensus. For the purposes of this paper we will use the definition from Ihrig and Moe (2004) to define informal enterprises as those which produce legal goods, but do not comply with government regulations. Specifically, this paper will focus on small retail or food shops. Using a broader definition of the informal economy which categorizes all unregistered activities, including those illegal by nature, as informal, Schneider (2002) estimates that informal activity may account for forty percent of Nepal's GDP. Other studies testify to the substantial nature of Nepal's informal economy, estimating that it employs more than 96% of Nepal's economically active population (Suwal & Pant, 2009) overall, with 70% of those working non-agricultural jobs involved in informal economic activity (Central Bureau of Statistics, 2008).

Currently, the International Labour Organization (ILO) is working with the Nepali government towards registering the informal sector through a mixture of incentives, informational campaigns, and bureaucratic changes. The programme, entitled “Way Out of Informality: Facilitating Formalization of Informal Economy in South Asia,” works closely with Nepal’s District Cottage and Small Industries Offices (DCSIO) in an attempt to centralize registration procedures and improve benefit distribution structures, which have previously been very difficult for shopkeepers to access. Mr. Shailendra Kumar Jha, the National Programme Coordinator for this project, makes it clear that forcing shopkeepers to register is not a viable strategy; rather, he says, the government and ILO together “must encourage and facilitate registration, highlighting the benefits to ensure that businesses choose to register” (Kumar Jha, 2014). The ILO is currently offering such incentives for registering as loans with the ILO’s partner – Megabank – and business management trainings. To better understand the cost-benefit analysis that shopkeepers make when deciding to register, my research draws upon interviews with individual shopkeepers who have been through the registration process, or decided to remain unregistered. Additionally, a series of interviews with government officials and experts in the field helps to explain the workings of Nepal’s current policy, as well as what efforts are currently in place to aid workers in the informal sector and encourage registration. My research will build upon a strong foundation of informal sector literature to provide a qualitative analysis of how political and economic factors contribute to the large quantity of illegally operating businesses in Nepal.

## **1.2) Informal Sector History**

Before the term “informal economy” was coined by a 1972 ILO study, very little academic work was devoted to understanding economic activity which was not registered with or regulated by the government. Soon afterwards, academics began to take the challenges presented by this portion of the economy much more seriously. Hart (1973) uses Ghana as a case study to conduct one of the earliest analyses of an informal economy. He hypothesizes a variety of causes for the informal economy, and notes that the emergence of this sector has complicated income and consumption patterns significantly. Thus, one of the first revelations about the informal economy was that it disrupted traditional western economic theories and prescriptions, thereby making the application of western economic and social policy in developing nations potentially disastrous (Hart, 1973).

Following the ILO and Hart’s pioneering of informal sector research came a still unresolved struggle to define the informal economy. While Hart (1973) defined the informal economy as essentially synonymous with self-employment, ILO (1972) defined Kenya’s informal sector as a space unregulated and largely marginalized by the government. Since then, Hart has broadened his definition to include all economic activities that take place outside the framework of bureaucratic public and private sector establishments (Hart 2008). As previously discussed, this paper will define informal enterprises as those which produce legal goods, but do not comply with government regulations (Ihrig and Moe, 2004). Though some studies explore the informal sector in developed nations, largely the literature is focused on how developing or transitional countries are effected by their informal economy. Elgin and Oyvat, (2013: 7) note

that “the growth of the informal sector was observed all in Asian (Moser, 1978); African (Wuyts, 2001); and Latin American (de Janvry, 1981; Furtado, 1976) countries in their early phases of development.”

### **1.3) Informal Sector Causes**

As the study of informal economies became more common, many papers devoted themselves to understanding what caused these underground economic activities. Ultimately the debate largely breaks down into those researchers who attribute the growth of informal economies primarily to market factors, and those who attribute this growth primarily to political factors.

Hart (1973) began the discussion of market factors by positing that price inflation, low wages in the formal sector and surplus labor in the urban market were the primary causes of informality. Future studies reinforced the idea that labor surpluses and urbanization were among the main determinants of informality (Breman, 1980); (Elgin and Oyvat 2013). This line of thinking suggests that the informal sector is a natural offshoot of saturated labor markets and weak formal economies. The belief that market forces were the primary reason for informality created a conviction in the early stages of informal sector studies that economic growth would pull enterprises into the formal sector. Bangasser (2000:4) notes that before longitudinal data existed on the progress of informal economies “It was axiomatic that, as ‘take off’ was achieved and the development process gained momentum, the ‘modern sector’ would gradually absorb them.” When economic growth in developing countries showed no sign of decreasing informality – in some cases even increasing it – scholars began to give more thought to the political factors that contributed to informality.

In 1989, De Soto's radical work *The Other Path* hypothesized that the informal economy was a logical and efficient reaction to corruption, inefficient government bureaucracy and a formal sector made generally undesirable by government constraints. Following this seminal work, a series of studies reinforced that informal economies were in large part encouraged by corruption (Dutta et al, 2013), poor government systems (Levy, 2008), government-imposed barriers to entering the formal economy (Djankov et. al, 2002) as well as high degrees of bureaucratic discretion; low degrees of economic liberalization; high tax burdens; lack of credibility towards government; and macroeconomic instability (Kaufmann and Kaliberda, 1996). In one of the most comprehensive examinations of informal economies across the world, Schneider (2000:19) confidently states "In almost all studies, the increase of the tax and social security contribution burdens is one of the main causes for the increase of the shadow economy (Thomas, 1992), (Lippert and Walker, 1997), (Schneider, 1994, 1997, 1998), (Johnson, Kauffman and Zoido-Lobaton, 1998a, 1998b), (De Soto, 1989), (Zilberfarb, 1986), (Tanzi, 1999), and (Giles, 1999a)."

Only two years after De Soto's original publication, the ILO readily acknowledged that economic growth was not necessarily the cure for a large informal economy saying, "Contrary to earlier beliefs, the informal sector is not going to disappear spontaneously with economic growth. It is, on the contrary, likely to grow in the years to come, and with it the problems of urban poverty and congestion will also grow" (ILO, 1991: 63).

#### **1.4) Informal Sector Consequences**

Parallel to the debate concerning the many potential causes for informal economic activity runs an equally complex debate over a much simpler question: are informal economies good or bad? Though most academics agree that integrating informal economies into formal economies would be ideal in a perfect political atmosphere, much disagreement surrounds the role of informal economies in realistic scenarios. The essential question in this debate is whether informal economies exacerbate the problems of inefficient governments and disrupt formal markets, or whether they provide an avenue for productive economic activity despite the corruption and disorganized bureaucracy that often characterize these governments. The ILO's 1972 publication begins the debate by suggesting that Kenya's informal sector is a productive, positive development that suffers from governmental misunderstanding. The study hypothesizes that treating informal economies as a problem may create a vicious cycle in which governments suppress and discourage informal activity until it becomes marginalized and inefficient (ILO, 1972). Bangasser (2000:11) posits that despite this initial publication the ILO went on to hold "a pejorative official view that perpetuates debilitating conditions and creates a self-fulfilling prophecy of low productivity and poverty but (sic) ignores the creative potential and energies of the informal sector."

Much literature following the ILO publication either made arguments that the informal sector was harmful to the state, or implicitly assumed so. At the macro level, Frey (1989) argues that a large informal sector deprives the state of tax income, thereby decreasing the amount of state goods available to both formal and informal sector workers. From the micro perspective, Kauffman and

Kaliberda (1996) argue that the informal economy is a “survival sector” in which workers are merely trying to maintain subsistence, and often looking for other options. Thus they believe that investments will necessarily be low, and growth very slow. Though findings from Brazil indicate that most self-employed workers in the informal economy prefer to remain in this situation rather than participate in the formal economy (Maloney, 2004), the concept that informal employment is undesirable to its participants remains widespread. Under the implicit assumption that the informal economy cannot provide sustained growth for a country or productive employment for its laborers, some argue that the informal economy is destructive because it stifles growth which would otherwise be occurring in the formal sector (Portes, Castells, and Benton, 1989); (Gaddy and Ickes, 1998).

Following years of general disregard for the ILO’s 1972 claim that the informal economy could offer a legitimate alternative to formal employment, De Soto (1989) provides the most substantial argument reiterating the productive potential of informal economies. Having stated that informal economies are largely caused by corruption and inefficient bureaucracy, De Soto goes on to posit that the informal sector is a necessary escape from governments which stifle economic growth. Ultimately De Soto advises that states make no effort to register the informal sector until they are capable of providing a productive business environment for all enterprises. ILO (1972), which was the first paper to view the informal economy in a positive light, recommended that the government respect the efficiency of the informal economy, but channel its productive potential into the formal economy by reforming outdated and

unnecessary licensing procedures. Similarly, Harding and Jenkins (1989) argue that if informal economic activities are supported they can become a strong source of economic growth for states. Levy (2008) posits that government inefficiencies contribute to the informal sector, and recommends that governments use incentive structures, as the ILO is doing, to formalize the informal sector. Essentially, this vein of the literature emphasizes the linkages between informal and formal enterprises, suggesting that the government allow businesses to grow informally without penalty or marginalization, but encourage them to enter the formal economy through reforming bureaucratic processes and offering incentives.

Though various theoretical and macro-level data exists debating the causes and consequences of the informal economy, very little examines how policy writers and shopkeepers perceive informality. Schneider (2000: 17) concludes a thorough macroeconomic survey of informal economies around the world by noting:

“Because macroeconomic approaches can often only show statistical correlation rather than causal relations, they cannot provide answers to questions like: Why do people choose to work in the shadow economy? What other factors (besides income motive) cause an increase in formal activities?... Because only individuals can choose, according to methodological individualism, it might be helpful to have a closer look at the individual decision process.”

### **1.5) The Individual Decision Process**

While much scholarship exists surrounding the informal economy, only recently have empirical studies begun to appear which more deeply investigate the process of registering informal enterprises. Woodruff (2013) uses a controlled study to measure the effectiveness of information and incentives in attempts to register informal businesses in Sri Lanka. The study finds that simply informing shopkeepers about the benefits of registering yields no results, while providing cash incentives along with this information can increase probability of registration by nearly fifty percent (Woodruff 2013). Additionally, Woodruff's follow-up finds that some businesses grew exponentially after registering, suggesting that they may have been intentionally hampering their own growth for fear of drawing government attention and being forced into the formal sector (Woodruff 2013). Though Woodruff's findings are an excellent starting point, his controlled research does not emulate realistic scenarios in which incentives consist of government programs rather than cash. Especially in cases like that of Nepal, where my research finds that shopkeepers have difficulty obtaining government-promised benefits, it is important to examine existing incentive structures as opposed to theoretical ones.

Cling et al. (2012) perform an analysis of informal sector registration in Vietnam which includes some qualitative information about the registration decision. Cling's analysis shows that poor information is a key determinant in the decision to remain unregistered (Cling 2012). This finding seems to imply that improving information should improve registration, a notion which Woodruff (2013) found untrue in Sri Lanka. Cling also finds that for those who

did choose to register, government benefits of formalization played a key role in their decision. Among the most important motivators were freedom from corruption and the ability to advertise (Cling, 2012). Thus, Cling makes an important contribution by confirming the effectiveness of structural incentives such as government benefits and providing a different perspective on the role of information.

These two works provide a solid, largely quantitative basis for research on the registration process, but lack an in-depth qualitative analysis of shopkeepers' cost-benefit analyses. Additionally, the seeming contradictions in Woodruff (2013) and Cling (2012) concerning the importance of information suggest that country-specific factors likely play a large role in determining the effectiveness of various informal economy registration efforts. My qualitative research complements these studies by providing an in-depth investigation into the decision making processes of Nepali shopkeepers who are considering registration as well as those who have already registered. This study's investigation of shopkeepers' cost-benefit analyses sheds light on the reasons shopkeepers choose to register or remain unregistered, thereby helping to explain some of the causes for Nepal's large informal economy. The addition of interviews with Nepali informal sector experts and government officials illuminates how many of the bureaucratic processes discussed actually function. I find that because information is disseminated so poorly, there often is a large gap between how shopkeepers perceive bureaucratic processes and how the government intends them to function.

As I speak to small unregistered shop owners about formalizing their enterprises, I find that two primary considerations often discourage them from registering with the government: the difficulty of the process itself, and their distrust of the Nepali government. Ultimately, it appears that such political factors as bureaucratic inefficiency, broken government promises, and inappropriate legislation are among the primary factors that contribute to Nepal's large informal sector. Though the ILO is working to facilitate the registration process and centralize distribution of benefits, I find that lack of collaboration and information sharing between various government ministries and NGOs is hampering the reform process.

## **2) Methodology**

To collect data concerning the informal economy in Nepal, I interviewed the owners of small shops, government officials, academics, and researchers. My many discussions with small shop owners accounts for the bulk of my interviews, as well as the most original and integral component of my research. I defined small shops for this research as those which are primarily owned and operated by an individual, family, or partnership, and do not employ laborers who are paid regular wages.

As I asked owners of small shops in each of my interviews whether their shop was registered or not (it would be illegal for them not to register) the most important aspect of my research was ensuring the safety of these shopkeepers. Almost all of these interviews were conducted in Nepali, as few shopkeepers spoke fluent English. In some interviews a relative of the shopkeeper who spoke good English would serve as a translation aid. To initiate an interview I would

introduce myself to a shopkeeper, explain that I was a student conducting research about small Nepali shops and the registration process, and show them a letter written in Nepali script which explained that I was completing an independent research project. After explaining the goals of my research and my reasons for doing it, I would ask them if they were willing to talk to me about their own shop, and its registration status. If they agreed I would go on to produce an informed consent form, which I would verbally explain in Nepali if they could not read English. After explaining that they could abstain from answering any questions, or withdraw from the interview at any time, I proceeded to give them an English pseudonym for protection, unless they specifically requested that their real name be used. To mark the interview, I wrote down only their pseudonym (or name, if requested), the town in which their shop was located, and the date and time. In cases where the type of shop was a very common one (cold stores, clothing shops, etc.) I would note the kind of shop; however, if the shop was unique enough to be identified by mentioning its wares, I would refrain from writing down this information. At the end of the interview I asked if the shopkeeper had any questions, and ensured that they felt comfortable with all of the information they had volunteered being used in my research. Because interview transcripts contain only a pseudonym and a very broad locational description, with any potentially identifying information omitted, I felt that this was appropriate protection for my interviewees.

At the start of my project I intended to interview shop keepers at random in various areas and neighborhoods, however I quickly found that this was an inefficient way of conducting my research. My primary problem was that most

shop owners were not willing to participate in an interview during business hours when customers could potentially need to be helped. Most shop owners were also unwilling to interview after the business day was over. Additionally, I found that even those who did have free time during the business day were sometimes very wary of my research and did not wish to participate in an interview for fear they would get in trouble. To solve these problems I ended up conducting many of my interviews through introductions to various shop owners. Shop owners tended to be much more willing to speak to me if a friend of theirs introduced me, explained my research, and vouched for me. Thus, many of my interviews were conducted through friends, friends of friends, and other distant contacts. This method of finding interviewees, coupled with the fact that some people refused to participate in interviews or withdrew from the interview, creates a very serious selection bias in my research. Because of this, it is important that my research be understood as a discussion of various perspectives on Nepal's informal economy and registration process, as opposed to a representative sample of shopkeeper's beliefs. Though a survey would have been helpful in achieving a more well-rounded consensus on certain issues, it was essentially impossible to administer given people's general unwillingness to answer questions concerning their shop's legal status without a proper introduction from a friend.

Interviews with government officials, academics and researchers were ethically simpler because I did not ask whether these people engaged in illegal activities. All of these interviews were conducted primarily in English. However, some government and NGO officials required permission from their superiors to sign a consent form, which was not always granted. They would

occasionally speak off the record, giving me general information about the informal economy and future leads, but requesting it not be credited to them or their organization. After interviews in which this was the case I would prepare a document with all the information I wished to attribute to the interviewee and allow them to redact or correct pieces of the information. After this process I was permitted to use the relevant information in my research.

### **3) Registration: A Confusing and Unrewarding Process**

#### **3.1) Time Constraints, Incentives, and Disincentives**

The World Bank's *Doing Business 2010* publication estimates that registering a business in Nepal requires seven distinct procedures and 31 days of the business owner's time, suggesting that Nepal's cumbersome registration process may be a main contributor to the size of the informal economy. The World Bank collects this data by using a case study of what they consider to be a "typical" company, which is of average size. I find that 15 days emerges as a consensus for the amount of days it takes to register a very small business, though 6-7 processes remains a relatively accurate estimate. Many registered participants in my research specifically remember a 15 day process, while some participants who had not registered independently produced the number as one they had heard through friends. Almost all unregistered participants in my research at some point cited the arduous process as one of their reasons for not registering. One woman, who asked to be identified only as Kamala, said plainly that if the process were made easier she would surely register (Kamala, 2014). Additionally, participants cited vastly different estimates of how much the entire

process cost them, or how much they expected to pay. One participant expressed confidence that the fees would amount to approximately 10,000 rupees (Austin, 2014) while another estimated 1,000 (John, 2014). Of those who had been through the process Kamal recalled 17,000 rupees in fees, while Kumar noted a 6,000 rupee a year cost to remain registered. The complete lack of consensus regarding registration fees suggests not only a lack of information about the process, but also the possibility of corruption and bribe-seeking within the system. The shopkeeper who asked to be identified as Austin mentioned that of the 10,000 rupees he expected to pay, only four to five thousand accounted for the actual registration fees, while the remainder would pay for a legal assistant to assure that he was not cheated during the process.

In addition to the difficulty of the registration process, the ease with which penalties are avoided and the inaccessibility of government promised benefits make registering a business a very unappealing process. Austin, who notes he has many contacts within the government, is the only shopkeeper who expressed confidence in his ability to obtain government benefits. The combination of the sway his government friends have and the information they can give him regarding the process makes him confident that eventually he will receive the benefits the government promises. He admits, however, that for the majority of people who do not know government officials, it is extremely difficult to obtain loans, government-sanctioned electricity and phone connections to the business location, or any of the other benefits the government promises. Almost all shopkeepers agreed with Austin's assessment, expressing that they had either tried to get benefits from the government and been rebuffed,

or had been so discouraged by the experiences of their friends and neighbors that they did not even try. Further interviews showed that in addition to poorly dispersing incentives, the government is not effectively enforcing disincentives.

The unregistered shopkeepers to whom I spoke were almost universally not worried about the consequences of operating their businesses illegally. Though certainly this could be evidence of a self-selection problem in which those who were worried about the government opted out of talking to me, the shopkeepers' experiences with government figures are nonetheless revealing. Most unregistered shopkeepers said that when government workers came around they simply told the officials that the shop was very new and they were planning to register as soon as they had time. Because the registration process is so difficult it is nearly impossible to force shop owners through the steps of registration, and most government officials choose not to levy fines or penalties. Additionally, shopkeepers identified as John and Julie both relied heavily on imports for their unregistered businesses, even though importing without registration is illegal. Though both conceded that importing would be a simpler process with registration, neither feared that they would be punished by the government, or believed that illegally importing their goods was particularly difficult. Hector on the other hand, the owner of a legally registered clothing shop, felt frustrated that his imports were being heavily taxed while unregistered businesses so easily avoided these taxes.

### **2.3) Confusion and Under-registration**

With the benefits of registration difficult to obtain, shopkeepers often have little motivation to figure out the complex steps towards properly

registering a business. One of the most pressing problems with the registration process is that the lack of clarity and information availability make the process difficult to engage in, difficult to study, and difficult to fix. In studying the informal economy Akash Shrestha, an employee of Samriddhi: The Prosperity Foundation, found that 37.4% of survey respondents believed Nepal's registration process to be easy. Although this seems reasonable, upon following up with this contingent it was found that the vast majority were improperly registered and still operating illegally. To properly comply with all government regulations, a shop owner must register their business with their local governing body – a municipality office or Village Development Committee (VDC) – the Ministry of Commerce and Supplies, the central Ministry of Industry, and the Ministry of Finance (Akash Shrestha, 2014).

In a few cases, I did find shop owners who reported a very simple registration process taking only a few days, or who expected a simple process once they got around to registering. A shopkeeper who asked to be identified only as Kamal reported that registering his business was very simple, took him only three days, and required him to visit only two different places (Kamal, 2014). John, who plans to register in approximately two months, predicts a process of 3-4 days (John, 2014). Given the four ministries with which businesses are required to register, it is almost certain that John and Kamal are registering their shops incompletely.

This phenomenon of partial or incomplete registration makes it difficult to properly assess the degree to which the government is intentionally withholding benefits from small shop owners. In an interview Mr. Shrestha

stated that many shopkeepers are not receiving the benefits they were promised because they are improperly registered (Akash Shrestha, 2014). Thus, without conducting a thorough examination of a shopkeeper's registration process and the way they went about claiming their benefits, it is impossible to understand whether benefits were legally or illegally denied to them. With such a difficult process for both registering and claiming benefits, it is easy for government officials to deny wrongdoing, and very difficult to agitate for proper dispensation of benefits.

Mr. Krishna Man Shrestha heads the *Kirana Pasal Byaapaar Sangh*, an organization representing the interests of small food shops. Mr. Shrestha believes that a "one window policy" – one in which shopkeepers need only to register in one ministry and this ministry shares the shopkeeper's information with other government offices – is the most important step towards reform. He says it is imperative for small shops to register with the government, but that the difficulty of registration discourages people who otherwise would be willing to register (Krishna Man Shrestha, 2014). This policy would also ensure that no businesses are partially registered, thereby increasing the ease with which shopkeepers could claim benefits and government agencies who withheld benefits could be exposed.

In addition to being confused about the registration process, none of the shopkeepers I interviewed were aware of the specific incentives offered by the ILO's campaign. While many knew of the more longstanding government benefits such as being able to take out a loan, none knew that the ILO had partnered with Megabank to make taking out a loan easier, and few knew about

the business trainings offered by the ILO. Komal Bhatta works for the Employment Fund, a program of the Swiss NGO Helvetas which works directly with the ILO, and yet even he knew nothing about the benefits from the new campaign.

Mr. Bhatta runs a program for the Employment Fund which teaches marginalized youth vocational and business skills, ultimately culminating in each individual operating their own micro-enterprise. The program employs phased incentives, in which participants receive monetary grants after achieving certain goals, such as completing training, operating a business, and remaining employed for a certain time period after the training ends. Because the program works with the Nepali government, graduates of the program are supposed to formally register their businesses before they receive a payout. Mr. Bhatta, however, says that the program has changed the requirement for payout from registering a business to operating a business, because the registration process has been so frustrating for many micro-enterprise owners. He believes that forcing program graduates to register does nothing but create animosity towards the government when people inevitably run into bureaucratic hurdles. Instead, Mr. Bhatta says that allowing graduates to register when they are ready makes it more likely that they complete the process and maintain a positive attitude towards the government.

Shailendra Kumar Jha of the ILO believes that poor information dissemination and lackluster collaboration among stakeholders are two of the most important problems to tackle in registering the informal economy. He says that the ILO is currently conducting an informational campaign to reach

shopkeepers, and working to centralize registration activities at the District Cottage and Small Industry Office. Because the registration process is currently scattered among various government industries, it is difficult for initiatives which should be working together to coordinate. Missed opportunities due to poor information are not uncommon. He believes that with registration activities centralized in one place, government ministries, NGOs, and other stakeholders will be better able to collaborate (Kumar Jha, 2014).

Professor Ram Chandra Dhakal, head of Tribhuvan University's Center for Economic Development and Administration (CEDA), believes that much of the distrust and confusion surrounding registration is the result of certain ministries prioritizing tax collection over other aspects of registration (Dhakal, 2014). To properly register a business the owner must first register with the District Cottage and Small Industry Office, after which they can register with the municipality office, tax office, and industry-specific office (Kumar Jha, 2014). However, certain ministries intentionally overlook incorrectly done registrations so long as their office is receiving taxes or fees. Thus, shopkeepers sometimes end up incompletely registered and ineligible to collect government benefits even though they are paying taxes.

#### **2.4) Post-Registration Difficulties**

Akash Shrestha warns that registering businesses too hastily could prove to be a problem for Nepal's economy. Given the largely inefficient bureaucracy, Mr. Shrestha worries that small shops, which are currently a strong source of income and employment for Nepali people, could suffer or even fail due to burdensome government regulations. Mr. Shrestha, who conducted many

interviews with shopkeepers for his own research, has sometimes found that shopkeepers who were doing good business before registration feel harassed by the government after they register. He tells a story of one man who began selling packages of rice, and saw his business grow. Though most stores carrying rice weigh out the rice depending on how much people want, this shop owner found that one and two kilogram orders were the most popular, so he began pre-packaging orders of this size. As people found they could save time by quickly grabbing a package instead of waiting for their rice to be weighed, his shop began to grow, and so he registered. After registration, the shop was visited by government officials who subjected the packages to harsh regulations, saying that packaged food needed to be inspected for cleanliness and needed to comply with a host of other requirements, even though the food he sold was in no way different from the unpackaged rice other stores offered. Rather than attempt to navigate the bureaucracy surrounding compliance with these regulations, the shopkeeper went back to weighing rice on demand and stopped selling the packages that had been driving his shop's growth (Akash Shrestha, 2014).

Many shopkeepers fear registration because it puts them on the government's radar, or simply because they cannot afford the time it takes to register. Kamala says that she feels unable to register because the difficult process would force her to close her shop for fifteen days, which she simply cannot afford to do. Anju, who has registered her shop, now feels trapped by the government. Every year she must re-register her shop, a process which, though simpler than the initial registration, she still finds difficult. Before voluntarily registering she had never been forced to pay a fine, but now that she is officially

in the government's books she faces steep penalties if she fails to re-register every year. She says that the time she must take away from tending to her business to register every year is harmful. Because many shopkeepers do not trust the government, or find the bureaucracy to be inefficient, they simply fear being monitored by the government. Though most say that the taxes they would pay if registered are practically negligible, they fear that the government could change tax structure or regulations in the future. Anju, frustrated by how registration has affected her shop, says that the benefit she wants most from the government is "laws like those in other countries<sup>1</sup>" (Anju, 2014).

#### **4) Relationships With the Government**

##### **4.1) Negative Views and Mindset Changes**

Though the literature surrounding registration focuses on the role of individual incentives, participants in my research generally disregarded individual benefits when considering registration, instead focusing on the government's overall performance. When asked why they chose to operate their shops illegally, almost all unregistered shopkeepers I interviewed responded that the government's inability to provide good roads, water systems, and electricity made them feel as though the government did not have a right to tax and regulate them. David, whose shop has been operating for over twenty years, describes the government as "the biggest thieves<sup>2</sup>" and does not plan to register. Though when asked about benefits to his shop he replies that only big businesses are able to get

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<sup>1</sup> Quote translated from Nepali

<sup>2</sup> Quote translated from Nepali

benefits, he makes it clear that he is much more concerned about the larger infrastructural failures of Nepal's government (David, 2014).

Not all have such drastic views as David, but even those participants who are not particularly angry at the government see its failures as a rational reason for avoiding taxes. Jay, who said his business has been bad this year, plans to register when he sees sales picking up. Until then, he feels that he has a right to remain unregistered given how poorly the government is responding to the needs of its citizens. Although Jay eventually wants to operate his business legally, he feels that because the government uses his taxes so poorly, he has no responsibility to pay them until he sees positive developments in the government (Jay, 2014). Kamala states simply that if the government improves, she will surely go register (Kamala, 2014). Many participants in my research who registered despite negative views of the government said that they registered merely because it was compulsory. These participants mostly reported having not given registration much thought, though some later regret having registered without having considered the costs and the benefits.

Some believe that justifying tax evasion based on poor government performance inevitably creates vicious cycles of low tax revenues, under-funded governments, poor infrastructure, and further tax evasion. Komal Bhatta of the Employment Fund believes that a mindset change among shopkeepers is necessary to break this negative feedback loop. Though Mr. Bhatta has repeatedly seen firsthand the frustrations of registration, he still feels that the Nepali people should feel a duty to register their businesses and pay their taxes. He believes that "responsible citizen" thinking is emerging in the Nepali people,

and when this kind of thinking becomes widespread it will help to break the vicious cycle of poor infrastructure, lack of faith in government, and tax evasion. Even so, Mr. Bhatta admits that the government has largely crafted policies which favor big enterprises over small shops, and that the government has a part to play in breaking this cycle (Bhatta, 2014).

Krishna Man Shrestha of the *Kirana Byaapaari Sangh*, however, believes that a mindset change can also be instrumental in combating policies which are unfavorable for small businesses. Mr. Shrestha believes that ultimately registration will greatly improve the growth potential of Nepal's micro-enterprises. Currently, Mr. Shrestha believes that a major problem with informality is the government's lack of information concerning the economic activities that occur in the informal sector. Without access to this information Mr. Shrestha believes the government is incapable of making policy which is conducive to economic growth and increased employment in small businesses. A tendency for government policy to favor large enterprises, which shopkeepers I interviewed largely believed to be a deliberate attempt to ignore them, may instead be the result of a lack of information. Thus, Mr. Shrestha recommends a mindset change among shopkeepers in which they recognize the collective benefits of registration and provide the government the information it needs to make informed policies (Krishna Man Shrestha, 2014).

While belief in a "mindset change" method of solving Nepal's micro-enterprise problems accurately identifies what the Nepali government needs, it cannot make predictions about what the government will do. It is true that without an adequate tax base the Nepali government cannot fund infrastructural

projects, and that without collecting information on micro-enterprises the Nepali government cannot write informed policy. This does not mean, however, that with adequate tax revenue and information the government would effectively fix Nepal's infrastructural problems and rewrite policy to favor small businesses. The idea that mindset change is necessary places the entire burden of Nepal's problems squarely on the shoulders of poor Nepali citizens, asking them to trust that the government will fulfill its role after they have fulfilled theirs. Shopkeepers such as David and Jay, who have not seen government promises fulfilled in the past, or tax dollars put to good use, prefer to wait for signs of improvement in the government before they change their mindset and register their businesses.

The performance of the current government, in fact, suggests that tax evasion may not be hurting the government as much as some claim. The Himalayan Times reports that in the 2013 fiscal year the government was only able to spend about half of its budget (The Himalayan Times, 2013). In 2014 The Himalayan Times credits a poor planning process and ad hoc decision making as the government again fails to spend even half of its fiscal year budget (The Himalayan Times, 2014). The government's inability to spend its budget despite Nepal's glaring infrastructure problems suggests that greater tax flows are unlikely to fix the problems that shopkeepers complain about. Thus, it seems that tax evasion is not likely to be related to Nepal's infrastructural failures.

#### **4.2) I Want to Pay Taxes**

However much certain shopkeepers may distrust the government, the idea of mindset change is far from a pipe dream. When asked what the primary

benefits of registration were, shopkeepers Kumar and Kamal both cited the ability to pay their taxes as one of the most important aspects of operating their businesses legally. When I used a more specific question, asking what the government had directly done for their shops since registration, but Kumar and Kamal replied that the government does not provide benefits to small shops. And yet despite the fact that the government has done nothing for them directly, both shopkeepers feel happy to register their shops and pay their taxes.

The key to Kumar and Kamal's willingness to operate their businesses legally seems to lie in how they perceive their current and future governments. Kamal has faith in the current Nepali government, saying that he feels his taxes go towards important development projects. Though Kumar does not express such optimism concerning the current Nepali government, he does believe that in the future the government will stabilize. He says that he expects the government to begin fulfilling the promises it has made to small registered shops within a year of stabilization.

## **5) Discussion/Analysis**

Dr. Ram Chandra Dhakal of Tribhuvan University identifies two keys to registering Nepal's informal economy: improving the registration process and having the government follow through on its promises to shopkeepers (Dhakal, 2014). My research supports these views, showing that to the shopkeepers whom I interviewed the difficulties of registration and their level of trust in the government tended to be the primary factors in their decision about whether to register.

My findings also strengthen a trend in the informal sector literature which indicates that political factors may be even more important than market factors in determining the size of a country's informal economy. Professor Dhakal agrees, stating that many used to believe Nepal's economic growth would eradicate informal activities, but people have now begun to understand the importance of political factors. Though certainly Professor Dhakal sees nothing wrong with the ILO's campaign or NGO initiatives, he believes that such efforts play a minor part in addressing the problems of the informal economy compared to rectifying the larger issues of poor policy and political instability (Dhakal, 2014).

Certainly the most important finding of this study is that the Nepali government has the most important role to play in encouraging registration of the informal economy, and yet these findings can also inform the actions of both government and non-government initiatives. It is important to note that a lack of information sharing and communication accounts for many of the problems discussed in this paper. The difficulty of the business registration process stems largely from the unwillingness of various ministries to share information and collaborate. Similarly, NGOs miss many important opportunities when they fail to communicate with the government and one another. By working with the Employment Fund, the ILO could be disseminating information about the incentives it offers for registration to many new small business owners, and yet even Mr. Bhatta who runs the skill and business training program knows nothing about the ILO's campaign. My findings suggest that individuals or NGOs working with the informal sector – or perhaps any sector – in Nepal should strive to combat the inefficiencies that arise when information sharing and

collaboration are not practiced. Essentially, the process of registering the informal economy is one that will be defined by the government's actions in the coming years as well as NGOs' willingness to support the government as opposed to spearheading isolated initiatives.

Another important implication of this research is that government agencies and NGOs working to register the informal sector should tread carefully; a short-term rise in the number of registered businesses does not necessarily indicate success. Firstly, the initiatives must take into account whether businesses can survive the registration process and post-registration difficulties. If businesses are unable to sustain themselves because of time taken off for registration, or crumble under new regulations and suffocating bureaucracy, then registration can hardly be called a success. As De Soto argues in *The Other Path* and Akash Shrestha notes in the Nepali context, governments should create a business environment and bureaucracy conducive to growth, employment, and prosperity before they focus their efforts on eradicating informal enterprises (De Soto, 1989)(Shrestha, 2014). The government should especially take into account that because they have not been collecting information about informal economic activities, their current policy may not be appropriate for regulating the kinds of businesses that are currently unregistered. As such, if the government expects such business to enter the formal economy, they must be alert for signs of inappropriate policies and be willing to adjust and rewrite accordingly.

Secondly, all initiatives must consider that, in the long run, trust in the government appears to be of utmost importance for convincing businesses to

operate legally. This means that any gains in registration caused by offering incentives is likely to be offset by future decreases in registration if the government does not follow through on its promises. Given the registration cost-benefit analysis described by participants in my research, it seems that building strong relationships between shopkeepers and the government should be prioritized over any short-term strategy to increase registration. The government, and any other agencies involved in registration, should ensure that they are able to follow through with any promises they make.

While it is important for ministries and NGOs involved in registration to practice information sharing, collaboration, and flexible policy, we must keep in mind that political instability on a greater scale also contributes to Nepal's large informal economy. Lack of proper infrastructure and distrust of the government as a whole are problems which have profound implications for Nepal's informal economy. Despite any future improvements to registration made by the ILO, various ministries, or NGOs, it seems that many shopkeepers will continue to operate illegally until Nepal's government stabilizes.

Though the opinions of those who participated in my research can certainly help inform future decisions surrounding registration, my findings must be understood as what they are: a non-random collection of shopkeeper opinions rather than a representative sample, or a quantitative analysis of people's beliefs. The shopkeepers I interviewed almost all had some social connection to me, were all willing to talk about their registration status, and were mostly concentrated within a similar geographic area. In short, there is undoubtedly selection bias in the series of opinions expressed in these pages. Additionally, there is no way of

ensuring that opinions expressed to me were truly felt by the interviewees, as opposed to being expressed in order to sound patriotic, or for fear of being found by the government. Indeed, there is no way even to completely ensure that those who claimed to be registered indeed were.

Despite these limitations, this research gives shopkeepers a platform to express what matters to them. Future research should work to address these limitations, and either strengthen or challenge my conclusions so that good policy recommendations can be made. If researchers can overcome the barrier of fear that exists when discussing illegal activities, a quantitatively rigorous survey analysis of shopkeepers' registration statuses and opinions would provide more substantial evidence on which to inform the government's actions. Additionally, expanding the interviewee base to sectors beyond small retail shops would help to give a more balanced perspective on Nepal's informal sector. According to the ILO, tourist services, agricultural activities, and construction companies are among the other sectors in Nepal which are disproportionately informal. Before writing policy that would affect all informal enterprises, more research must be done on how other sections of Nepal's informal economy feel about the registration process. Lastly, future research should investigate the effects of bureaucratic inefficiencies, distrust of government, and lack of information sharing on other initiatives in Nepal. Clearly these three problems have posed numerous difficulties to Nepal's informal sector and the government's attempts to register it, and there is no reason to believe these same problems do not have wide-ranging effects across Nepal.

## 6) Conclusion

My research contributes to the largely macro-level discussion of informal economies by providing qualitative information directly from shopkeepers participating in the informal economy, NGOs studying and serving the informal economy, and government figures running initiatives which affect the informal economy. Additionally, this study adds to the Nepali-specific informal economy literature which, given the many state-specific aspects of the informal economy, is critical for forming policy recommendations. Based on the opinions of those I interviewed it seems that the persistence of Nepal's informal sector is largely driven by a difficult and confusing registration process, poor information sharing and collaboration among various government ministries, as well as NGOs, and a general distrust of the government.

It seems that to productively integrate the informal economy into the formal, the government must focus on building trust among Nepali citizens, encouraging collaboration among ministries to centralize the registration process, and writing flexible policy concerning the informal economy. NGOs involved with the informal economy should recognize that the government has the largest role to play in registering the informal economy, and thus should actively pursue collaboration with the government. Though some believe that a mindset change among Nepali citizens is the first step towards breaking the vicious cycles described in this research, I find that shopkeepers often have good reason for being skeptical of the government. It seems more likely that the government can break these cycles by building trust among shopkeepers than that Nepali citizens

will spontaneously develop “responsible citizen thinking” without impetus from the government.

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