AN INVESTIGATION INTO FACTORS ASSOCIATED WITH TAX EVASION IN THE ZIMBABWE INFORMAL SECTOR: A SURVEY OF MBARE MAGABA INFORMAL TRADERS

BY

CUTHBERT MASARIRAMBI

A THESIS SUBMITTED IN FULFILLMENT OF THE REQUIREMENTS FOR THE DOCTOR OF PHILOSOPHY IN BUSINESS MANAGEMENT

TO

ZIMBABWE OPEN UNIVERSITY

SUPERVISOR: DR. T.P.Z. MPOFU

HARARE, 2013
ABSTRACT

African nations are taking the route of small to medium enterprises (MSMEs) and the contribution of micro enterprises to national development can no longer be ignored or taken for granted. The contribution of SMEs to national budgets has been curtailed by the phenomenon of tax evasion, yet little is known about factors associated with this phenomenon. This study was an investigation into factors associated with tax evasion in the Zimbabwe informal sector and it was a survey of Mbare Magaba Informal Traders. The study was carried out from November 2011 to October 2013 and a systematic sample of 150 informal traders working in makeshift shelters at Mbare Magaba was selected. Questionnaires were used to collect data and the methodology of the study was quantitative as it employed the survey research design.

The study established that the majority of the informal traders were young males aged less than 35 years. These were mainly individually/owner operated enterprises with the majority of them (51%) making profits of more than $500 per month while some (20%) were making more than $800 per month in profits. The major factors associated with tax evasion included low risk of non-compliance to tax laws, mismanagement of tax revenues by government, lack of trust in the government and most importantly that informal employment was mainly involuntary for most of the traders, hence, trying to survive even through tax evasion.

Major recommendations included that tax authorities should raise awareness and improve law enforcement especially through city councils. It was also recommended that programmes regarding sustainable livelihoods development (for poverty reduction) should mainly target the informal sector if they are to succeed and that government should make efforts to directly support the informal sector as they are part of MSMEs which government desires to support.
ACKNOWLEDGEMENTS

I would like to thank God the Almighty for the energy and zeal that remained inherent in my study.

First and foremost, the intellectual guidance provided by Higher Degrees Directorate, Professor Jameson Kurasha and Dr Adolph Chikasha the Director. is most appreciated along with staff in the Directorate, Zimbabwe Open University.

My work would not have been complete without the professional assistance of Dr. TPZ Mpofu who provided the necessary academic supervision.

The Zimbabwe Open University Library and Information Services, ZIMRA Head Office, Harare Metropolitan Police and a host of all other well-wishers who assisted are hereby acknowledged.
DEDICATION

This project is dedicated to my late father and mother who always stressed the importance of education from my early childhood into adult life.
# TABLE OF CONTENTS

ABSTRACT .................................................................................................................................................. II

ACKNOWLEDGEMENTS ............................................................................................................................ III

DEDICATION ............................................................................................................................................... IV

LIST OF TABLES ........................................................................................................................................ XI

LIST OF FIGURES ..................................................................................................................................... XII

ACRONYMS .............................................................................................................................................. XIII

1 CHAPTER ONE: INTRODUCTION ..................................................................................................... 1

1.1 BACKGROUND TO THE STUDY .................................................................................................... 1

1.1.1 The Informal Sector and tax compliance – General Overview ................................................ 4

1.1.2 South Africa ........................................................................................................................... 10

1.1.3 Zambia ................................................................................................................................... 11

1.1.4 Botswana ................................................................................................................................... 14

1.1.5 The Zimbabwean Case ......................................................................................................... 17

1.1.6 Presumptive tax system for the informal sector ................................................................. 21

1.1.7 Historical Revenue Head Percentage Contribution ....................................................... 24

1.1.8 Mbare Magaba Informal Market Place .................................................................................. 26

1.2 RATIONALE FOR THE STUDY ................................................................................................. 28

1.3 STATEMENT OF THE PROBLEM .............................................................................................. 29

1.4 AIMS OF THE STUDY .................................................................................................................... 30

1.5 OBJECTIVES OF THE STUDY ..................................................................................................... 31

1.6 RESEARCH QUESTIONS ............................................................................................................. 31

1.7 ASSUMPTIONS OF THE STUDY ................................................................................................. 32
1.8 SIGNIFICANCE OF THE STUDY ................................................................................................... 32
1.9 DELIMITATION OF THE STUDY ............................................................................................ 34
1.10 LIMITATIONS OF THE STUDY .............................................................................................. 34
1.11 ORGANIZATION OF THE STUDY ......................................................................................... 35
1.12 DEFINITION OF SPECIAL TERMS AND EXPRESSIONS ..................................................... 36
1.13 SUMMARY ............................................................................................................................... 37

2 CHAPTER TWO: REVIEW OF RELATED LITERATURE ................................................................ 38

2.1 INTRODUCTION ....................................................................................................................... 38
2.2 CONCEPTUAL FRAMEWORK .................................................................................................... 39
   2.2.1 The Dualist School ............................................................................................................. 40
   2.2.2 The Structuralist School ................................................................................................... 41
   2.2.3 The Legalist School ........................................................................................................... 41
   2.2.4 The Illegalist School ......................................................................................................... 42
2.3 UNDERSTANDING THE INFORMAL SECTOR ........................................................................ 42
   2.3.1 Causes and Consequences of Informality ........................................................................ 42
   2.3.2 Characterising the Informal Sector .................................................................................... 45
   2.3.3 Unreported income or tax evasion .................................................................................... 45
   2.3.4 Theories related to the informal sector ............................................................................. 46
   2.3.5 The Enterprise Characteristics of the Activities in the Informal Sector ......................... 50
   2.3.6 The behavioural perspective of the informal sector ......................................................... 54
   2.3.7 Reasons to become informal ............................................................................................. 55
2.4 INFORMAL BUSINESS PROGRESSION (FORMALISATION) .................................................... 83
   2.4.1 Formalisation Key Definitions .......................................................................................... 84
   2.4.2 Evolutionary approach .................................................................................................... 87
   2.4.3 Involutionary approach ................................................................................................... 87
   2.4.4 Residuary approach ......................................................................................................... 88
   2.4.5 The institutionalist perspective of informal sector .......................................................... 88
<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.4.6</td>
<td>Formalization Processes</td>
<td>89</td>
</tr>
<tr>
<td>2.4.7</td>
<td>Formalization Mechanisms</td>
<td>90</td>
</tr>
<tr>
<td>2.4.8</td>
<td>Formalization Progressions</td>
<td>91</td>
</tr>
<tr>
<td>2.4.9</td>
<td>Factors in the Enactment of Formalization Transactions</td>
<td>93</td>
</tr>
<tr>
<td>2.4.10</td>
<td>Formalisation choices</td>
<td>94</td>
</tr>
<tr>
<td>2.5</td>
<td>TAX EVASION</td>
<td>97</td>
</tr>
<tr>
<td>2.5.1</td>
<td>The framework for tax noncompliance in the informal sector</td>
<td>97</td>
</tr>
<tr>
<td>2.5.2</td>
<td>Measuring tax evasion</td>
<td>104</td>
</tr>
<tr>
<td>2.5.3</td>
<td>Reasons for tax evasion</td>
<td>104</td>
</tr>
<tr>
<td>2.6</td>
<td>STRATEGIES AGAINST TAX EVASION AND TAX AVOIDANCE</td>
<td>113</td>
</tr>
<tr>
<td>2.6.1</td>
<td>Measures improving tax compliance</td>
<td>114</td>
</tr>
<tr>
<td>2.6.2</td>
<td>Measures improving the ability to enforce tax laws</td>
<td>117</td>
</tr>
<tr>
<td>2.7</td>
<td>STRATEGIES FOR THE TAXATION OF INFORMAL ACTIVITIES</td>
<td>122</td>
</tr>
<tr>
<td>2.8</td>
<td>BARRIERS TO EFFICIENT TAX ADMINISTRATION</td>
<td>124</td>
</tr>
<tr>
<td>2.8.1</td>
<td>Lack of adequate resources</td>
<td>124</td>
</tr>
<tr>
<td>2.8.2</td>
<td>Financial constraints</td>
<td>125</td>
</tr>
<tr>
<td>2.8.3</td>
<td>Tax Administration and Data</td>
<td>126</td>
</tr>
<tr>
<td>2.8.4</td>
<td>Political and Social Factors</td>
<td>127</td>
</tr>
<tr>
<td>2.9</td>
<td>SUMMARY</td>
<td>129</td>
</tr>
</tbody>
</table>

3 CHAPTER THREE: RESEARCH METHODOLOGY AND DESIGN

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>INTRODUCTION</td>
<td>134</td>
</tr>
<tr>
<td>3.2</td>
<td>RESEARCH PARADIGM</td>
<td>135</td>
</tr>
<tr>
<td>3.2.1</td>
<td>Major Aim of the Study</td>
<td>135</td>
</tr>
<tr>
<td>3.2.2</td>
<td>Positivist Research Paradigm</td>
<td>136</td>
</tr>
<tr>
<td>3.2.3</td>
<td>Deductive Reasoning</td>
<td>139</td>
</tr>
<tr>
<td>3.3</td>
<td>RESEARCH DESIGN</td>
<td>141</td>
</tr>
<tr>
<td>3.3.1</td>
<td>Quantitative Research</td>
<td>141</td>
</tr>
</tbody>
</table>
CHAPTER FIVE: SUMMARY, FINDINGS, DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 THESIS SUMMARY ................................................................. 190

5.2 FINDINGS ............................................................................. 191
   5.2.1 Major characteristics of informal traders at Mbare Magaba Informal Market Place .......... 191
   5.2.2 Reasons to become informal..................................................... 193
   5.2.3 Perceptions of the informal traders on business progression ........................................... 193
   5.2.4 Factors accounting for high tax evasion in the informal sector .......................................... 194

5.3 DISCUSSION ......................................................................... 197
   5.3.1 Major characteristics of informal traders ......................................................... 197
   5.3.2 Tax compliance and evasion .............................................................................. 198
   5.3.3 Factors associated with tax evasion ....................................................................... 199

5.4 CONCLUSIONS ..................................................................... 200

5.5 RECOMMENDATIONS ............................................................ 201
   5.5.1 The informal sector has to be the route of sustainable poverty reduction initiatives ...... 201
   5.5.2 Government support programmes for the informal sector ........................................... 202
   5.5.3 Awareness .................................................................................. 203
   5.5.4 Capacity building programmes in record keeping ......................................................... 204
   5.5.5 Encourage grouping and associations and support informal sector formalisation ...... 205
   5.5.6 Enforcement ................................................................................ 205

5.6 AREAS FOR FURTHER STUDY ............................................. 206

REFERENCES .............................................................................. 207

BOOKS ...................................................................................... 207

JOURNALS .................................................................................. 211

NEWSPAPERS .......................................................................... 219

GOVERNMENT REPORTS ......................................................... 219
**LIST OF TABLES**

**TABLE 1.1**: HISTORICAL REVENUE HEAD PERCENTAGE CONTRIBUTION 2006 - 2011 ................................. 24

**TABLE 4.1**: GENERAL DEMOGRAPHICS OF RESPONDENTS........................................................................... 161

**TABLE 4.2**: HOUSEHOLD SIZE AND NUMBER OF EMPLOYEES ................................................................. 164

**TABLE 4.3**: CAUSES OF TAX EVASION .................................................................................................. 170

**TABLE 4.4**: CROSSTABULATION (VOLUNTARISM*TAX PAYMENT) ............................................................ 181

**TABLE 4.5**: CHI-SQUARE TEST (VOLUNTARISM*TAX PAYMENT) ............................................................. 182

**TABLE 4.6**: BUSINESS PROGRESSION PROSPECTS ............................................................................... 186

**TABLE 4.7**: CHI-SQUARE TEST (TAX EVASION*PROPENSITY TO GROW BUSINESS) .......................... 188
LIST OF FIGURES

FIGURE 1.1: THE IDEAL PRESumptive TAX CONTRIBUTION IN ZIMBABWE ................................................. 25
FIGURE 3.1: DEDUCTIVE AND INDUCTIVE THINKING .............................................................................. 140
FIGURE 4.1: MONTHLY PROFITS OF INFORMAL BUSINESSES AT MBARE MAGABA .................................... 165
FIGURE 4.2: TAX COMPLIANCE ............................................................................................................ 167
FIGURE 4.3: AWARENESS OF THE TAX REQUIREMENT OF THE BUSINESS VENTURE ......................... 168
FIGURE 4.4: AWARENESS CAMPAIGNS BY ZIMRA ON TAX ............................................................... 169
FIGURE 4.5: PERCEPTION ON TAX COMPLIANCE LEVEL OF FELLOW INFORMAL TRADERS ............... 172
FIGURE 4.6: LIKELIHOOD OF DETECTION IF EVADING TAX ............................................................... 173
FIGURE 4.7: AWARENESS OF PENALTIES FOR EVADING TAX ........................................................... 174
FIGURE 4.8: TYPE OF RECORD KEEPING COMMON AT MbARE MAGABA ........................................... 175
FIGURE 4.9: FINANCIAL CONTRIBUTION TO CHARITY AND/OR COMMUNITY .................................... 176
FIGURE 4.10: HISTORY OF FORMAL EMPLOYMENT .............................................................................. 177
FIGURE 4.11: REASONS FOR BECOMING INFORMAL ........................................................................... 178
FIGURE 4.12: PREFERENCE BETWEEN FORMAL AND INFORMAL EMPLOYMENT .................................. 180
FIGURE 4.13: PERCEPTION ABOUT BUSINESS GROWTH INTO LARGE SCALE ..................................... 183
FIGURE 4.14: PLANS TO FORMALIZE BUSINESS .................................................................................... 184
<table>
<thead>
<tr>
<th>ACRONYMS</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>AIDS</td>
<td>Acquired Immuno Deficiency Syndrome</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>GFI</td>
<td>Global Financial Integrity</td>
</tr>
<tr>
<td>GTZ</td>
<td>Gessellschaft fur Internationale Zusammenarbeit (German Technical Cooperation)</td>
</tr>
<tr>
<td>HIV</td>
<td>Human Immuno Deficiency Virus</td>
</tr>
<tr>
<td>IDA</td>
<td>Industrial Disputes Act</td>
</tr>
<tr>
<td>ILFS</td>
<td>Integrated Labour Force Survey</td>
</tr>
<tr>
<td>ILO</td>
<td>International Labour Organization</td>
</tr>
<tr>
<td>IPEA</td>
<td>Instituto de Pesquisa Economica Aplicada (Institute of Applied Economic Research)</td>
</tr>
<tr>
<td>ISSERG</td>
<td>The Institute of Statistical, Social and Economic Research of Ghana</td>
</tr>
<tr>
<td>LTO</td>
<td>Large Taxpayer Office</td>
</tr>
<tr>
<td>LTU</td>
<td>Large Taxpayer Unit</td>
</tr>
<tr>
<td>NUST</td>
<td>National University of Science and Technology</td>
</tr>
<tr>
<td>Acronym</td>
<td>Full Form</td>
</tr>
<tr>
<td>---------</td>
<td>-----------</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Cooperation and Development</td>
</tr>
<tr>
<td>OLS</td>
<td>Ontology Lookup Services</td>
</tr>
<tr>
<td>PRA</td>
<td>Peruvian Revenue Authority</td>
</tr>
<tr>
<td>SADC</td>
<td>Southern African Development Community</td>
</tr>
<tr>
<td>SBP</td>
<td>Strategic Business Partners</td>
</tr>
<tr>
<td>SME</td>
<td>Small to Medium Enterprise</td>
</tr>
<tr>
<td>TRA</td>
<td>Tanzania Revenue Authority</td>
</tr>
<tr>
<td>TShs</td>
<td>Tanzanian Shillings</td>
</tr>
<tr>
<td>VAT</td>
<td>Value-Added Tax</td>
</tr>
<tr>
<td>ZIMRA</td>
<td>Zimbabwe Revenue Authority</td>
</tr>
</tbody>
</table>
CHAPTER ONE: INTRODUCTION

1.1 BACKGROUND TO THE STUDY

The present chapter is an introduction to the study, taking the reader through a background of the study, rationale of the study, the statement of the problem, research objectives, research questions, aims of the study, delimitation and limitations of the study and assumptions of the study.

According to Matsebula (1996:p .4), whilst the urban informal sector is as old as the notion of industrialization, it did not receive close scrutiny in the context of development until the early 1970s. Keith Hart, a social anthropologist, was the first to bring the term ‘informal sector’ (in a Third World context) into the academic literature. His first publication was in 1973 but he had already used the term in 1971. Hart (1973 cited in Hart, 2006b) introduced the concept of the ‘informal sector’ as a part of the urban labour force, which takes place outside the formal labour market. He considered the ‘informal sector’ as almost synonymous with the categories of small self-employed. This was thereafter used to refer to ways of making a living outside the formal wage economy, either as an alternative to it, or as a means of supplementing income earned with it (Bromley and Gerry, 1979).

Worldwide, the economy of nations consists of formal and informal economy. Hart (2006a: p. 30-40) and Portes, Castells and Benton (1989) define formal economy as that economic zone that is legally sanctioned, regulated through state
intervention, and marked by regular work. In contrast, the informal economy is defined as irregular work, outside legal sanction and without state regulation of any sort. Since the concept came to limelight, Sindzingre (2006) argues that scholars have subjected the concept to highly heterogeneous phenomena, measurement methods and different definitional terminologies. For example, some of the early descriptions of the informal sector are the ‘bazaar-economy’ and the ‘firm-centered economy’ (Geertz, 1963); the ‘black market’ (Smithies, 1984); the ‘criminal underworld’ (Harding and Jenkins, 1989). Feige (1989: p. 989) introduces the term ‘underground economy’. What Feige calls the ‘underground economy’ is a mixture of activities. Different fields such as labour economics, sociology, finance, macroeconomics, statistics or criminology give it a different meaning. It appeared that no single definition of the informal economy could serve all these domains (Feige, 1989 cited in Sindzingre, 2006). In this study, the researcher defined the informal sector as a collection of organisations operating outside the formal labour market.

In Zimbabwe, the informal sector has been rapidly growing. Despite registering growth, the sector has remained hidden and uncontrolled and the government has not managed to collect much tax revenues from the sector. The Finance Minister, while presenting his Mid-Term Fiscal Policy Review (2011: p. 112) noted as a challenge (as in previous reviews) the mushrooming of informal traders and their minimal contribution to the fiscus. A survey conducted by the Finmark Trust, aided by the Ministry of Small to Medium Enterprises and Cooperative Development,
supported by the World Bank and the Zimbabwe Multi Donor Trust Fund shows that Zimbabwe has 3.5 million Small to Medium Enterprises with only 2% of all these paying taxes to ZIMRA (Bloch column in Zimbabwe Independent, 28 June 2013). Another study by Nyakuwa (2011: p. 30) showed that on average these informal traders were making at least $400 - $600 in profits which are above the minimum tax threshold of $250. This means 98% of these informal traders in Zimbabwe who are liable to tax laws do not pay taxes, depriving the government of millions of dollars in potential tax revenue. On the other hand, ZIMRA has made great strides in raising tax laws awareness to all Zimbabweans involved in business using popular television and radio channels as well as print media. Regardless of this, the informal sector contribution to tax revenue has remained minimal. This triggered the researcher’s interest to investigate why informal traders do not pay taxes and identify the factors associated with tax evasion behaviour with particular focus on the Mbare Magaba Informal Traders.

This study treats the informal sector as a significant and important sector that could contribute immensely to economic development and therefore it varies from other researchers who treat the sector as an unwanted black economy. With Africa going the route of small to medium enterprises (most of them operating in the informal sector), the relevance, importance and the capacity of the informal sector to contribute to national development cannot be overemphasized.
1.1.1 The Informal Sector and tax compliance – General Overview

Some major challenges confronting the governments of the third world in their frontal advance to socio-economic development is how to manage the phenomenon of the fledgling informal economy and maximization of revenue from that sector. This assertion was recognised by Anuradha and Ayee (2001), when they state that how to tax the informal sector remains a pressing question. Governments facing financial challenges that are undertaking financial reforms in a bid to increase their financial resource base. The informal sector is an obvious focus of attention as it forms a significant and growing proportion of the economy in the developing countries, yet pays little in the form of taxes (Anuradha and Ayee, 2002: p. 90). Earlier than Anuradha and Ayee this was also highlighted by Matsebula (1996:p.31) in his study of the informal sector in developing nations, particularly Botswana, Zambia and other Southern African Development Community (SADC) countries. Matsebula notes that developing countries face the challenge of regulating the informal sector yet the sector has the potential to contribute greatly to the national revenues.

Bagahwa and Naho (1995: p. 1387) state that public revenue remains weak in numerous Sub-Saharan African countries and the tax burden appears to be unevenly distributed. Two sectors are often considered as being undertaxed: the agricultural and the unrecorded urban sectors. Its (i.e. unrecorded sector) under-taxation results in considerable losses in tax revenue. What is worse, the development of unrecorded activities is threatening the official sector which plays a
crucial role in collecting government revenue (Matsebula, 1996p 87; Bagahwa and Naho, 1995: p. 1387). Following from this assertion, it is patently clear that under-
taxation of the informal sector is accounting for the imbalances in the tax system.

Historically the businesses engaged in the formal sector have suffered extremely high tax rates due to narrowness of the tax base resulting from most informal businesses operating outside the tax net.

Much of this unreported income of the informal sector is as a result of a deliberate attempt to evade taxes: indeed, in the literature, the non-reporting of income and tax evasion are almost synonymous (Gërxhani, 2003). The most recent studies (for example Schneider, 2000: p. 77-114) show that the informal sector in developing countries ranges in size from 20% to 70% of Gross Domestic Product (GDP). Additionally, there is empirical evidence that informal sectors worldwide have been growing in recent decades (Matsebula, 1996; Gerxhani, 2002 and 2003).

There are two viewpoints with respect to the informal sector. The traditional view considers the informal sector as a source of income for the poor, and also associates it with unproductive and excluded workers (Matsebula, 1996; Tokman, 1978: p. 1065-1075). In this view, it then would mean that traders in the informal sector may not be able to pay tax based on low incomes and unproductive ventures. However, recent studies such as Gërxhani (2003), Schneider (2005) and Nyakuwa (2011: p. 30) have shown that the informal sector comprises of small businesses that are making more money for its individual owners than an average government employee, dismissing this view and bringing into discussion a more
recent view. The recent view is that the informal sector has the potential to achieve high levels of productivity through the dynamic, entrepreneurial character of the microenterprises which comprise this sector (Matsebula, 1996; Portes and Schauffler, 1992). Associated with this view are the studies that suggest that the informal sector is not just a survival mechanism for the poor, but a means by which educated and skilled individuals evade income taxes. For instance, in his examination of the informal sector in Poland, Bedi (1998) finds that workers in the public sector, who are highly educated, are more prone to participate in the informal sector. From this view, it then follows that the informal sector is able to pay tax. However, the reasons why the informal traders do not pay tax especially in a nation like Zimbabwe remain unknown and this is the focus of this study. This view combined with the extensive literature (partly referred to in the foregoing paragraphs) on the growth of the informal sector as well as its contribution to the Gross Domestic Product (GDP), it may be said that the informal sector is surely not just a survival mechanism for the poor but a sector that is capable of contributing immensely to the national tax revenues in developing countries. On the other hand, Government is at the centre of every nation’s activities and as such taxes must be paid by everyone.

1.1.1.1 Ghana

Developing countries continue to face challenges of tax evasion and non-compliance in the informal sector. In Ghana, an economy that is largely made up of individual and small-scale enterprises, for example, the government continues to
face this non-compliance challenge. The Institute of Statistical, Social and Economic Research of Ghana (ISSERG, 2003: p. 193) states that the main source of employment in Ghana is the informal sector, providing employment opportunities for at least 80% of the labour force. However, with a GDP contribution of about 22%, the sector remains hidden in tax revenue terms with very little contribution to tax revenue (ISSERG, 2003: p. 193). The first attempt in Ghana to tax the informal sector (i.e. small businesses and self-employed) was in 1963, when the Standard Assessments Act, 1963, Act 205 was enacted. This Act has gone through various amendments over the years and consolidated into the Internal Revenue Act, 592, 2000.

The standard assessment was a scheme in which a fixed lump-sum tax was levied on individuals and businesses on the basis of business activity in which they engaged. The levies correspond to some average income level presumed to be earned by members of a particular occupation or business grouping. The weak administrative capacity of the tax administration resulted in this system causing serious corruption and tax evasion by the informal sector players since the enforcement responsibility was given to other law enforcement agencies such as police and local councils who cashed in on the tax evaders who opted to pay smaller amounts to the police and local authority officers than paying the required taxes. The system also imposed the same tax liability on high and low income professionals such as doctors and lawyers. Hence, some low-income professionals were not encouraged to comply (World Bank, 2006).
The Standard Assessment system was reintroduced in a revised format in 1987 and was termed occupational grouping taxation. In this format, the occupational groupings were appointed as agents and commission ranging from 2% to 2.5% of their annual total collection was paid to them (World Bank, 2007). However, high levels of illiteracy and the low level of education among members of the associations or groupings resulted in poor record keeping by the associations making accounting and auditing procedures difficult, coupled with the deliberate avoidance and evasion of taxes in the informal sector (World Bank, 2006).

According to ISSERG (2003: p. 193) regardless of a GDP contribution of 22%, the informal sector contribution to tax revenue was as low as 3% showing a shortfall of at least 15% of tax revenue lost due to tax evasion. In value terms the organisation highlighted that this could translate to more than $500million of revenue lost due to tax evasion in the informal sector (ISSERG, 2003: p. 193).

1.1.1.2 Tanzania

The informal sector in Tanzania is among the most buoyant sectors. According to the Integrated Labour Force Survey (ILFS, 2006) the informal sector was the second main employing sector after agriculture by employing 10.1 percent of the employed persons, followed by other private sectors with 8.6 percent, where agriculture employed 75.1 percent. This may be explained by the fact that the main activity in rural areas is agriculture, which may not necessarily be defined as an informal sector activity in some cases.
A review of the informal sector for tax purposes by the Tanzania Revenue Authority (TRA, 2010) showed that the adopted Tanzanian presumptive income tax structure is good and simple compared to other African countries. Presumptive taxation involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts. The term "presumptive" is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method. According to Schneider (2003), presumptive taxation is principally used for classes of taxpayers which are ‘hard to tax’. Schneider adds that in most cases this is because the taxpayer does not have, or is not willing to make available, the financial records needed to prove what tax they owe. This is a common situation for enterprises in the informal sector, which do not have the skills needed to keep full, written accounts, and which may see avoidance of taxation as a key benefit of their informal status (Farrell, John and Fleming, 2000: p. 38).

According to TRA (2010) the rate in the 1st band for minimum turnover is 0 percent and 1 percent for maximum turnover of TShs 3 million. In the 2nd band the scheme imposes 3 percent on minimum sales of TShs 3 million and decreases to 1 percent on maximum sales of TShs 7 million. In the 3rd and 4th bands the situation is similar that the minimum sales suffer higher tax rates than the maximum sales of 4 percent, 2 percent and 3 percent respectively. The differential application of rates in this scheme made traders to object graduation from upper end to the next lower
band for fear to pay more tax. However, the system is regressive as non-record-keepers are more likely to lack the capacity to keep proper accounts (TRA, 2010).

In the TRA (2010) review, the total number of registered tax payers increased from 288,680 in year 2005/2006 to about 617,877 in year 2009/2010 and presumptive income tax payers increased from 199,448 in year 2005/2006 to about 376,673 in year 2009/2010. The total number of presumptive income tax payers as percent of total TRA tax payers increased from 69 percent in year 2005/2006 to about 75 percent in year 2006/07 and then starting to drop to about 61 percent in year 2009/2010.

According to TRA (2010), Tanzania is facing different forms of taxation problems related with tax avoidance and evasion. The study found that about 60.4 percent of those who were not paying tax argue that they do not pay tax because of small sizes of capital, turnover and profit generated from their operations. Not paying or negative taxes legally or subsidies are one of the best ways to increase business net worth faster and keep more of the wealth for the purpose of further investments. Negative taxes help small businesses to survive and grow and get ahead in life significantly (TRA, 2010).

1.1.2 South Africa

Unlike the advanced countries, the developing countries have a large informal sector that is difficult to tax. Developing countries face difficult challenges when they attempt to establish efficient tax systems given their weak direct and indirect
tax capacity. The tax revenue-GDP ratio is a good measure for direct taxation efficiency. This ratio is usually higher in developed countries than in poor countries (McLaren, 1998). South Africa is an interesting case study. The South African government has been particularly successful in collecting direct taxes - through a progressive tax system - in the form of corporate and personal income taxes. The tax represents, over the period 1997-2002, 25% of the South African GDP, the highest among middle-income countries for which the average ratio is 15%. However taxing the informal sector remains much less successful mainly because the cost of collections is too high. Thus there are still many South Africans who remain outside the tax net. According to the 2007 Labour Force Survey, 19.5% of employed workers operate in the informal sector in South Africa.

In countries where the labor market is characterized by the existence of a large informal sector and where governance quality is weak, the fiscal policy plays a significant role since it affects the individual's labor supply decision and sectoral choice.

1.1.3 Zambia
Zambia’s private sector development dialogue is inextricably linked to debates about its Informal Sector, which, according to most estimates, employs about 90% of its labor force. While some data on informal sector workers is available and has
been used to understand the nature of the informal labor force, little is known about enterprises that constitute the informal sector.

There are about 1.02 million informal micro and small enterprises (MSMEs) in Zambia, along with about 30,000 formal MSMEs. While this number seems strikingly high at first glance, and could imply enormous taxation potential, further examination shows that a vast majority of these “businesses” are very small: only 15% of firms have revenues greater than 1m kwacha per month; less than 8% have revenues more than 2 million kwacha. If one uses the 2m kwacha threshold for taxation eligibility; only about 80,000 businesses would qualify for taxation. Majority of these businesses (70%) are farming operations; others are mostly in the retail sector.

Data from the World Bank Enterprise Survey show that informal businesses in the urban areas of Lusaka and Copperbelt provinces are atypical of informal sector businesses as a whole, comprising only about 3% of the informal sector. However, they form the top tier of informal sector firms. Compared to an average, typically rural informal enterprise, informal businesses in the city centers resemble a typical formal MSME: they have more educated owners, greater access to public services and earn significantly higher revenues. Revenues of many firms in this urban segment overlap with those of firms in the formal sector.

Differences between formal MSMEs and informal sector operators lie along many dimensions. Registered firms have significantly higher labor costs and bureaucratic
burden compared to firms in the informal sector. However, these costs are offset by higher revenues and greater productivity. Managers with higher human and financial capital self-select themselves into the formal sector; firms in this sector are also much more likely to have access to basic infrastructure and financial services. There is a clear dichotomy in financial sector borrowing—almost without exception, only registered firms have access to overdrafts and loans.

Our results indicate that taxation potential is likely to be highest for urban, informal sector firms. These firms often have access to infrastructure services (mainly electricity and water) through their “society”, and enjoy the benefits of formalization, while circumventing registration costs, bureaucratic burden of tax compliance, and higher labor costs. Others—notably those in agriculture and service sector outside urban areas are unregistered because of low skills and productivity. These firms would benefit from interventions designed to augment productivity, including skills training, availability of infrastructure and microenterprise lending facilities. However, many of these firms are survivalist in nature, and should “disappear”, with policies geared towards structural transformation in agriculture, and growth of the formal large-firm private sector, which can shift informal workers and small-business employers as employees in its formal sector.

We see that more than 70% of MSMEs in Zambia are very small, with reported sales of less than 500,000 kwachas per month, equivalent to 6M kwachas a year, well below the 24M13 threshold for income taxes. Only 8% of MSMEs have sales greater than 2M kwachas a month; these constitute about 80,000 MSMEs.
We see that the largest share of MSMEs are in Agriculture off the line of rail. A vast majority of businesses have very low monthly revenues; if we were to consider a potential tax base to include firms with revenues of more than 2m kwacha per month, and those located along the line of rail, there are only about 23,000 businesses outside agriculture that meet this criteria.

Shar (2012)....It is important to note here that the minimum threshold was only recently raised (doubled) in the last budget. Previously, the cutoff was 12 m kwachas per year, which would almost double the tax base along the line of rail, and outside agriculture.

Urban Microenterprises: Examining the distribution of enterprise sales for this subset, we see that the median sales are considerably higher, at 4m kwachas per month, and the top quartile of firms have sales of more than 12m kwachas per month. Only 24% of urban micros have sales less than 2m kwachas per month, indicating a higher taxation potential for firms in this group. Further details are examined below

1.1.4 Botswana

The accurate size and magnitude of the informal sector in Botswana is not known partly because of the lack of conceptual clarity, ambiguous nature and definitional quagmire that besets the phenomenon. However, various surveys provide some estimates on the extent of the informal sector. Colclough and McCarthy (1980)
note that opportunities in the urban informal sector have grown rapidly from insignifiant proportions before independence. They note that the 1964 census had found "about 2,000 persons in non-agricultural self employment, most of whom were craft or other types of production workers". From the low pre-independence levels, the informal sector was clearly visible by the mid 1970s. A Central Statistics Office (1974) survey estimated that about 4,500 persons were engaged in the informal sector nationwide. Subsequently, a Labor Force Survey in 1984 showed that the informal sector grew by 17 percent during the period 1984-1987 (CSO, 1984). A most recent government sponsored study of the informal sector (1999/2000), shows that 13,400 (15.8%) of a total 84,833 surveyed households were identified to be engaged in some form of informal activity (CSO, 2001).

Available evidence on the informal sector in Botswana point to a gradual and steady increase in the size of informal activity especially in major urban centers. However, Botswana’s informal sector is relatively small, less vibrant and a recent phenomenon compared to other countries and regions in Africa especially West and East Africa. Aside the country’s small population size which limits the absolute size of the informal sector, the reasons underlying the country’s relatively small informal sector are historical and structural in nature. Unlike countries in West Africa, where Europeans and foreigners (Indians and Lebanese) had less success in penetrating parts of a remarkably well developed pre-colonial and colonial indigenous trade networks, Botswana experienced a more pervasive colonial impact on comparatively less developed indigenous trade networks. The advent of
colonialism and its associated restrictions and regulations (especially those regulating labor flows and urban settlement patterns) had the effect of restricting indigenous Batswana to particular economic activities⁴⁶.

structural transformation of a subsistence agrarian Tswana society through colonial taxation into an international migrant labor based wage economy for example had the effect of denying Batswana the ability to engage in entrepreneurship. Furthermore, colonial legislation on where Batswana could live, productive activities they could engage in and to what magnitudes, stipulations on where and how products could be sold all had the effect of undermining entrepreneurial development in colonial Botswana. Colonial policies therefore not only arrested the development of indigenous enterprises and entrepreneurship, but also restricted the participation of Batswana in commerce thus making it almost impossible for any new commercial ventures to emerge. An appreciation of this historical background of the informal sector is important because it sheds light on some of the contemporary problems of micro-enterprise development in Botswana.

The survey results based on systematic random sampling show that the informal sector is very varied and diversified and on the whole, the retail and service sub sectors dominate the informal landscape. These account for 52.6% and 33.7% respectively of all businesses surveyed. The manufacturing sub sector is the least populated; accounting for 13.7% of total enterprises. My survey results complements a 2001 national informal sector survey report in which retail trade accounted for 48 percent and manufacturing 16.5% of total enterprises surveyed
Likewise the survey results closely mimic national employment trends in which the retail sector is the second largest after agriculture which accounts for 30.9 percent of all employed (CSO 2006).

1.1.5 The Zimbabwean Case

Prior to Zimbabwe’s independence, indigenous Africans were regarded as temporary residents in urban areas (Luebker, 2008). Permanent urban settlement was for the white settlers. Africans who were destitute or had been made redundant in the formal sector were repatriated to their rural homes where they had a piece of land and relatives who could meet their social security needs.

Legislative measures such as the Vagrancy Act (1960), the Pass Laws, the provision of single accommodation for workers and the controlled lodger system implemented in 1955 effectively slowed down the rate of urbanization (Brand,
Gumbo and Mupedziswa, 1993). Municipalities also kept registers of all the new arrivals in town, and those looking for employment, in an attempt to weed out illegal immigrants (Luebker, 2008).

With the advent of independence the floodgates were opened as most of the restrictions to the migration of the indigenous people to urban areas were removed. According to Tibaijuka (2005), there was a massive movement of people from rural to urban areas. This was in an attempt to escape from rural poverty as the successive colonial regimes neglected the development of rural areas.

Urbanisation occurred at a very fast pace, far exceeding the rate of industrialisation. According to Tibaijuka (2005) urbanization occurred at 23% in 1982 to 30% by the early 1990s and 35% by the early 2000s resulting in overstretched infrastructure, straining of social services, unemployment and an acute shortage of housing. Retrenchment in both the public and private sector was also a major cause of socio-economic challenges in urban Zimbabwe. As a result, unemployment levels increased to as high as 80% in the late 2000s (Luebker, 2008). The rapid growth in the number of increasingly educated people unable to penetrate the formal sector inevitably meant that they had to fend for themselves. The Business Herald (1998) revealed that out of 300 000 school leavers churned out by the country’s education system, the formal sector only had room for 70 000. The remaining 230 000 thus had to find their own means of earning a living, most of which were informal.
With deregulation after independence and economic stagnation and decline, the informal sector share of employment grew to 20% by 1986/87, 27% by 1991 and an estimated 40% by 2004 (Tibaijuka, 2005). The informal economy had effectively become the mainstay for the majority of the Zimbabweans. The International Labour Organization (ILO) reported in June 2005 (ILO, 2005) that 3 to 4 million Zimbabweans earned their living through informal sector employment and supported another 5 million people, while the formal sector employed about 1.3 million people. Recent data from a survey conducted by the Finmark Trust, aided by the Ministry of Small to Medium Enterprises and Cooperative Development, supported by the World Bank and the Zimbabwe Multi Donor Trust Fund shows that Zimbabwe has 3.5 million Small to Medium Enterprises (SMEs) with an estimated turnover in 2012 of US$7.4 billion, with 2.8 million owners of the enterprises and 2.9 million employees excluding the owners (Bloch column in Zimbabwe Independent, 28 June 2013). This means the informal sector can no longer be ignored and treated as unwanted, since it has a potential to contribute to national revenue.

The term ‘informal sector or trade’ refers to employment and production that takes place in small and unregulated enterprises (ILO, 2002; Chant, 1999). The informal sector provides half or more of total employment in developing countries. Its contribution ranges from 48% in North Africa, 51% in Latin America, 65% in Asia and 72% in Sub-Saharan Africa (ILO, 2002).
According to Brand, Gumo and Mupedziswa (1993) the colonial regime attempted to control the spread of the informal sector in urban areas. They point out that the Town and Country Planning Act (1946), the Vagrancy Act (1960), the Urban Councils Act and the Vendors and Hawkers By-laws (1973) are some of the pieces of legislation that were enacted to frustrate the growth of informal sector activities. This did not reduce the growth of the informal sector but it had the effect of making it a "hidden" feature of the economy. To date, the informal sector has remained hidden and the government has not managed to control it or collect meaningful revenue from it.

From a tax administration point of view, rapid growth of informal sector signifies a large number of potential taxpayers. However, most of these small businesses either do not keep proper records, making it difficult for the government to collect revenue from them or they simply evade tax payment.

In 1994, the Income Tax Act (Chapter 24:06) was amended by the insertion of Section 36(f) and the Twenty-Sixth Schedule and introduced a simplified tax system for the informal sector. This move was expected to increase government revenues from the informal sector.

According to the Zimbabwe Revenue Authority (ZIMRA) annual report (2010), the system failed to capture all the individuals and small businesses in the informal sector. Actually the number of individuals and small businesses in the informal sector failing to comply with the tax laws and or pay appropriate taxes continues to
increase despite the introduction of this simplified tax system (ZIMRA annual report, 2010). Revenues from this sector are not improving as anticipated and this has become an area of concern for all stakeholders.

1.1.6 Presumptive tax system for the informal sector

Presumptive taxation involves the use of indirect means to ascertain tax liability, which differs from the usual rules based on the taxpayer's accounts. The term "presumptive" is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method. This presumption may or may not be rebuttable. According to ZIMRA (2010) the concept covers a wide variety of alternative means of determining the tax base, ranging from methods of reconstructing income based on administrative practice, which can be rebutted by the taxpayer, to true minimum taxes with tax bases specified in legislation.

Presumptive tax legislation was introduced to broaden the revenue base in view of the increase in informal business activities. Selected sectors of the economy were targeted to ensure the participation of informal businesses in tax payment in line with experiences of other developing countries.

Zimbabwe has a population size of roughly 14 million and the country is facing a massive problem of unemployment and underemployment estimated at 89% (ZIMRA, 2010).
With effect from 1\textsuperscript{st} January 2009 presumptive taxes became payable in foreign currency. ZIMRA stipulated that the following businesses should remit presumptive tax or risk the stated penalties. Most of the unemployed or the informally employed people in Zimbabwe have ventured into informal sector for sustenance. In this study only two forms of presumptive tax which apply to the study population are discussed:

1.1.6.1 Informal Traders’ Presumptive Tax

According to ZIMRA (online, accessed 22 January 2012), all persons in receipt of rental income from an informal trader in respect of residential accommodation, premises or a place on which trade is carried on are required to withhold an additional amount of Presumptive Tax equal to 10\% of the rental and remit to ZIMRA (ZIMRA online, accessed 22 January 2012). This includes local authorities.

The amount should be remitted within 30 days from the date the amount is recovered. Failure to recover or remit the Presumptive Tax renders the lessor personally liable for the payment of the Presumptive Tax and a penalty of 100\% of the amount due (ZIMRA online, accessed 22 January 2012). Failure or refusal on the part of the informal trader to pay the Presumptive Tax constitutes a breach of the lease and allows the lessor to terminate the lease without notice (ZIMRA online, accessed 22 January 2012). However, as shown in table 1.1 this has not worked as taxes from informal traders have been on a decline. There are also indications that there is lack of enforcement and follow through by the tax masters.
resulting in the system being compromised either by corruption or simply complacency of the informal traders to comply (ZIMRA online, accessed 22 January 2012).

Recent research by the Finmak Trust (cited in Bloch Column, 2013) has shown that only 2% of informal traders in Zimbabwe pay taxes with 98% not doing so raising questions about the reasons behind the high non tax compliance behaviour of the informal traders. Researchers such as the Bloch Column (2013) and Nyakuwa (2011: P. 30) have shown that informal traders have the capacity to pay taxes hence the aspect of affordability is out of question. Therefore there has to be reasons associated with tax evasion in the informal sector and this was the focus of this study.

1.1.6.2 Cottage Industry Operators

Every person who owns or is in charge of a cottage industry regardless of it being licensed or not is required to pay presumptive tax amounting to US$300 per quarter (ZIMRA online, accessed 22 January 2012). According to the ZIMRA website (accessed 22 January 2012) cottage industry operators include those in the furniture-making or upholstery trade, metal fabrication and any other cottage industry that the Minister may, by notice in a statutory instrument prescribe. Interest is chargeable where the amounts due are not paid by the due date. This has also not been successful as ZIMRA has not been getting these taxes from
cottage industries due to tax evasion as cited by Finmak Trust (cited in Bloch Column, 2013) and ZIMRA 2010.

1.1.7 Historical Revenue Head Percentage Contribution

ZIMRA collects presumptive tax on its own but it can also appoint local authorities as agents for the collection and remittance of presumptive taxes. Tax collection trends from 2006 to 2011 are shown below.

Table 1.1: Historical Revenue Head Percentage Contribution 2006 - 2011

<table>
<thead>
<tr>
<th>Revenue Head</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>24%</td>
<td>32%</td>
<td>16%</td>
<td>15%</td>
<td>19%</td>
<td>21%</td>
</tr>
<tr>
<td>Companies</td>
<td>23%</td>
<td>17%</td>
<td>64%</td>
<td>5%</td>
<td>11%</td>
<td>22%</td>
</tr>
<tr>
<td>VAT</td>
<td>27%</td>
<td>24%</td>
<td>5%</td>
<td>38%</td>
<td>37%</td>
<td>31%</td>
</tr>
<tr>
<td>Customs Duty</td>
<td>10%</td>
<td>9%</td>
<td>0%</td>
<td>20%</td>
<td>16%</td>
<td>9%</td>
</tr>
<tr>
<td>Excise Duty</td>
<td>4%</td>
<td>3%</td>
<td>1%</td>
<td>8%</td>
<td>8%</td>
<td>10%</td>
</tr>
<tr>
<td>Other taxes including presumptive tax</td>
<td>12%</td>
<td>15%</td>
<td>14%</td>
<td>14%</td>
<td>9%</td>
<td>7%</td>
</tr>
</tbody>
</table>

Source: ZIMRA (2012)

The above table shows the historical revenue collected by ZIMRA over the period 2006 to 2011. Overall the percentage of presumptive tax contribution was extremely low considering the fact that the Zimbabwean economy is highly informalised and is supported by SMEs which contribute about 90% of the country’s workforce. According to Bloch (2013) the informal sector generated an estimated turnover of US$7.4 billion in 2012 and this is not a small figure against a national budget of US$2.74 billion in 2011 (Mid-Term Fiscal Policy Review, 2011)
and around US$5billion in 2012. This would have meant that presumptive tax should have been higher than the 7% contribution in 2011.

According to ZIMRA (2009) 50% of the GNP goes untaxed on account of informal economy, posing a very serious challenge for ZIMRA and a threat to the stability of the economy. Generation of untaxed income is by and large on the following accounts (ZIMRA, 2010):

A. Under reporting of income to avoid taxes.
B. Under invoicing of goods and services to avoid commodity taxes.
C. Real estate transfer at lower value to avoid taxes and to use black money earned elsewhere and
D. Tax evasion

The presence of a large informal economy in Zimbabwe results in loss of revenue to ZIMRA (50% of GNP in 2009 according to ZIMRA, 2009) as a consequence of tax evasion, loss of useful productive activity on account of non-utilization of black money in a useful economy, and the development of a plethora of problems on account of illegal economic activities. According to ZIMRA (2010), the contribution of presumptive tax in Zimbabwe should be looking like what is shown in Figure 1.1.

**Figure 1.1: The ideal presumptive tax contribution in Zimbabwe**
Because ZIMRA is unable to stop leakages of revenue collection, they impose more taxes on commodities and services to fulfil their revenue needs. The result is a regressive tax structure putting more pressure on honest taxpayers and promoting inequality in the society.

It is against this background that the study sought to investigate factors associated with the phenomenon of tax evasion in the informal sector of Zimbabwe with particular focus on the Mbare Magaba Informal Traders.

### 1.1.8 Mbare Magaba Informal Market Place

Mbare Magaba Informal Market place has been in existence way before 1981 when the first count and classification was made. Currently (based on a preliminary and familiarization enquiry made by the writer), informal activities include
manufacturing and retailing of plumbing materials, roofing materials, tyres, furniture, steelworks/metal fabrications, coffins and scotch-carts.

The Magaba Informal Marketplace stretches from the City-Mbare flyover to the Matapi Police Station and from the police station to the main road joining Mbare and Sunningdale. Traders include those selling their wares on sidewalks, retailers housed in the recently constructed Magaba Shops and those doing their work in makeshift wooden and plastic structures within fenced areas. Those trading their wares along sidewalks are normally harassed by police while those in shelters and fences are left to do their work. For the purposes of this study, the writer only focused on those who had designated places of work in the Magaba Informal Marketplace (those doing their work in makeshift wooden and plastic structures within fenced areas). These are registered under the Mbare Magaba cooperative grouping which has a secretariat and a chairman.

According to Nyakuwa (2011: P. 30) some operators in the Magaba Informal Marketplace are registered with the city council and municipality and have the required permits and licences from the city council while others engaging in the same activities do not. Nyakuwa argues that the informal marketplace has more than one thousand five hundred traders most of whom do not pay any taxes to government. The major reason given by Nyakuwa for the informal traders not paying taxes is lack of awareness as ZIMRA has not made enough efforts to collect revenue from the hidden economy citing lack of resources. However, based on the foregoing discussions, the researcher believes there is another side of this
explanation, tax evasion or non compliance due to other psychological reasons and tax evasion motivations. This was the focus of this study, digging deeper into the phenomenon of evasion of tax and finding the factors associated with the phenomenon.

1.2 RATIONALE FOR THE STUDY

This study aimed at developing a deeper understanding of the problem of tax evasion in developing countries. Against the background of growing interest by international development cooperation, governments of developing countries and international institutions in this topic, this study could contribute to the development of new knowledge. It becomes apparent that although there is a theoretical basis explaining tax evasion behaviour, little is known about the real causes of or factors associated with tax evasion in the regions of the world especially in Zimbabwe. A lot of focus has been placed by previous researchers on taxation of the informal sector and little has been done on understanding tax evasion in relation to the characteristic nature of informal trading. This study sought to cover this gap. However the major focus of the study was to provide a deeper understanding of the issues surrounding the informal sector and through this understanding, the researcher uncovered the underlying truths about tax evasion as well as the major issues causing this perennial problem. The study takes the reader into the world of informal trading by uncovering the perceptions, attitudes and characteristic
behaviours of informal traders and then links these truths to the phenomenon of tax evasion.

1.3 STATEMENT OF THE PROBLEM

According to the Finmark Trust (2012), 98% of informal traders in Zimbabwe were not paying taxes to the government. Nyakuwa (2011: P. 30) showed that informal traders in Zimbabwe earn a minimum of $400 - $600 on average per month as profits with some of them earning thousands of dollars in profits. This means that the informal traders’ incomes were above the taxable threshold of $250 and were therefore liable to tax. Nyakuwa (2011: P. 30) and the Finmark (2012) report showed that informal traders did not want to pay taxes in most cases which means they evaded taxes.

The reasons why the informal traders continue to evade taxes in Zimbabwe are not known and these vary from person to person. Therefore, to understand the informal trader’s behaviour in relation to tax evasion is crucial. Despite some studies done on the phenomenon of tax evasion, very little has been done to establish the factors associated with tax evasion especially in developing countries like Zimbabwe.

It is against this background that the researcher conducted an investigation into factors associated with tax evasion in the informal sector in Zimbabwe with focus on Mbare Magaba Informal Traders (registered with the Association of Mbare
Magaba Informal Traders under Harare City Council) from November 2011 to October 2013. This was therefore a survey of Mbare Magaba Informal Traders.

1.4 AIMS OF THE STUDY

Based on the previous discussions and theories, it is a fact that the informal sector exists in Zimbabwe and Africa in general. It is also understood that the tax evasion and non-compliance to tax phenomenon exists in the informal sector. This study was an investigation into factors associated with this phenomenon and sought to fully define it by looking at the characteristics of the informal sector and informal traders, the reasons to informalise as well as a look into the prospects of business progression. The study followed the dualist, legalist and illegalist schools of thought without ignoring the other schools.

In order to achieve the above mentioned aims and goals, the researcher chose to do a survey of informal traders working at the makeshift premises of Mbare Magaba Informal Trading Centre with focus on those registered under the Mbare Magaba cooperative grouping or Association. An investigation of factors associated with tax evasion was then conducted on these informal traders.
1.5 OBJECTIVES OF THE STUDY

The major aim of the study was to investigate factors associated with tax evasion in the informal sector of Zimbabwe with particular focus on Mbare Magaba Informal Traders. The specific objectives were to;

i. Establish the major characteristics of informal traders at Mbare Magaba Informal Market Place

ii. Ascertain the impact of voluntary or involuntary informal employment on tax evasion behaviour

iii. Determine whether the perceptions of the informal traders on the prospects of their micro or small business to progress into the formal sector (formalization) had any effect on their tax evasion behaviour

iv. Find out the factors accounting for high tax evasion in the informal sector

v. Provide some recommendations on the way forward in reducing tax evasion in the informal sector.

1.6 RESEARCH QUESTIONS

The writer sought to answer the following research questions;

i. Which major characteristics define informal traders and enterprises at Mbare Magaba Informal Market Place?

ii. How does voluntary or involuntary informal employment impact on tax evasion behaviour of informal traders?
iii. Do the perceptions of the informal traders about the prospects of their micro or small business progressing into formal enterprises have any effect on their tax evasion behaviour?

iv. Which factors account for high tax evasion in the informal sector?

v. How can tax evasion in the informal sector be reduced?

1.7 ASSUMPTIONS OF THE STUDY

The researcher made the following assumptions in the study:

- All respondents in the study gave accurate information and were honest in their responses, and
- The researcher maintained complete independence and did not affect the subject of the research

1.8 SIGNIFICANCE OF THE STUDY

There are many reasons why the focus on tax evasion in Zimbabwe’s Informal Sector is to be supported. Most importantly, dealing with tax evasion has the potential to increase tax revenues for the state. Since the principal source of a government’s revenue is taxation, making sure tax evasion is reduced would contribute immensely to national development. The findings and recommendations of this study would go a long way in informing policy makers in government and ZIMRA on how well they can reduce tax evasion and in turn increase tax revenues from the informal sector.
The informal sector, having thousands of small businesses, is considered to be rapidly growing. However, government pays little attention to the development of the sector since it remains hidden. This is mainly due to tax evasion and by reducing tax evasion, government and the informal sector can interact more often in developmental issues thereby paying more attention to the informal sector. The study also gave informal traders an opportunity to share their experiences and views towards the phenomenon of tax evasion.

This study would add to the existing body of knowledge and literature on the subject of tax evasion in the informal sector. The study pays much attention to the characteristic nature of the informal sector in its discussion of tax evasion, something that previous studies have overlooked. Previous studies have focused on taxation and how government can collect tax revenues from the sector with little attention on reducing tax evasion. Those that focused on reducing tax evasion did not fully define the phenomenon. This study sought to fully define the phenomenon by characterising the informal sector traders and enterprises, thereby closing the gap in literature.

This study could serve as a basis for future and further research and study in the area by other students and researchers. This study cannot be conclusive on the subject of tax evasion in the informal sector. As the social order changes and dynamics vary, further work could be carried out in the near future.
1.9 DELIMITATION OF THE STUDY

This study was an investigation into factors associated with tax evasion in the informal sector of Zimbabwe with particular focus on the Mbare Magaba Informal Trading Centre. It was a survey of cottage industry players and other informal traders at the Mbare Magaba Informal Trading Centre registered under the Mbare Magaba Cooperative Grouping. Areas covered include the major characteristics of informal traders and enterprises at Mbare Magaba Informal Market Place, voluntary/involuntary informal employment, business progression and the characteristic-factors accounting for high tax evasion in the informal sector. The study also sought to offer some recommendations on the way forward in reducing tax evasion in the informal sector. The study mainly focused on informal sector traders and players from the Mbare Magaba Informal Market Place. A population of 1500 informal traders at the Mbare Magaba Informal Market Place was used in the study and a representative systematic sample of 150 traders was drawn from it.

1.10 LIMITATIONS OF THE STUDY

Some of the targeted respondents were illiterate, making it difficult to let them complete questionnaires on their own. The researcher employed the self administration method of data collection in order to deal with this challenge.

In order to carry out a comprehensive study, the researcher had to have multiple visits to the research site and this proved to be costly. However, in order to cut
down these costs, no questionnaires were left behind. This means the researcher collected all the questionnaires administered on each day and left those which were not completed.

Information on tax evasion was considered confidential and threatening by the respondents such as their financial figures and whether they were paying taxes or not. This made the respondents think twice and hesitant to provide the required information. However, this challenge was dealt with by assuring confidentiality to the respondents.

1.11 ORGANIZATION OF THE STUDY

The study is organized in five chapters arranged in different sections of this thesis. The first chapter (current chapter) has presented an introduction to the study by providing background information, aims of the study, statement of the problem, study objectives and questions. The second chapter (Chapter two) presents and evaluates available literature related to tax evasion in developing countries. The third chapter (Chapter three) presents and discusses the methodology of the study including the research paradigm employed, research design, population of the study, sampling procedures, data collection procedures as well as data analysis and presentation techniques used. Chapter four presents, discusses and analyses the study results. The last chapter (Chapter five) presents a discussion of the, conclusions and recommendations from the study.
1.12 DEFINITION OF SPECIAL TERMS AND EXPRESSIONS

The subject of tax evasion and avoidance embraces many dimensions and problems. As there exists no clear-cut distinction between tax evasion and tax avoidance, one firstly needs to define which practices can be considered as violation or abuse of tax codes. To create a level playing field when discussing these issues, the following terms and definitions are helpful.

**Tax evasion** in general refers to illegal practices to escape from taxation. To this end, taxable income, profits liable to tax or other taxable activities are concealed, the amount and/or the source of income are misrepresented, or tax reducing factors such as deductions, exemptions or credits are deliberately overstated (see Alm and Vazquez, 2001 and Chiumya, 2006). Tax evasion can occur as an isolated incident within activities that are – in other aspects – legal. Or tax evasion occurs in the informal economy where the whole activity takes place in an informal manner – this means the business is not only evading tax payments but is also not registered as formal enterprise at all.

**Tax avoidance**, in contrast, takes place within the legal context of the tax system that is individuals or firms take advantage of the tax code and exploit “loopholes”, i.e. engage in activities that are legal but run counter to the purpose of the tax law. Usually, tax avoidance encompasses special activities with the sole purpose to reduce tax liabilities. An example for tax avoidance is strategic tax planning where financial affairs are arranged such in order to minimize tax liabilities by using tax deductions and taking advantage of tax credits.
Presumptive taxation involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts. The term "presumptive" is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method.

Informal sector or informal economy is that part of an economy that is not taxed, monitored by any form of government, or included in any gross national product (GNP), unlike the formal economy.

1.13 SUMMARY

The phenomenon of tax evasion has raised a lot of interest in developing countries. Research has shown that tax evasion is a major problem in developing and emerging countries where the informal sector's size is considered very large. This chapter has discussed all these aspects of the informal sector with particular focus on bringing out the tax evasion phenomenon.

In this chapter, the researcher has also presented and discussed the aims of the study, research objectives and questions, rationale of the study, limitations of the study, delimitation of the study, and structure of the study report. The following chapter presents an evaluation of the available literature on the subject of tax evasion.
CHAPTER TWO: REVIEW OF RELATED LITERATURE

2.1 INTRODUCTION

The issue of tax evasion and non compliance in the informal sector, whether intentional or not, has a significant impact on fiscal spending in Zimbabwe. Considering the growth of the informal sector in number of players and revenue, the loss of potential tax revenue is significant. In addition, Loayza (1996: P. 129-162) has found that in countries with disproportionate tax burdens combined with weak compliance structures, the increase in the size of the informal economy leads to a decline in overall economic growth. This is true for Zimbabwe based on the fact that the growth of the sector has not tallied with the contribution of the sector to tax revenues.

It is for this reason that the study of tax evasion is crucial and in this chapter, the researcher presents and discusses relevant literature on the subject matter. Gaps in the available literature are identified and it is these gaps that the current study sought to fill/close.
2.2 CONCEPTUAL FRAMEWORK

A number of authors and researchers have given their own working definition of the informal sector. Some definitions given in the past may be too narrow to meet the modern day informal sector as a result of constant changes in the form, activities and shape of that sector. A number of attempts have been made to define exactly what the informal sector is made up of. First, attempts to measure the informal sector faced the problem of definition (Schneider and Enste, 2000). One commonly used working definition is: all economic activities that contribute to the officially calculated (or observed) gross national product but are currently unregistered (Schneider and Enste, 2000).

There are also a number of theories propounded on the causes of the informal sector. These theories have been grouped into four schools of thought, as follows: the dualist school, the structuralist school, the legalist school and the illegalist school.
2.2.1 The Dualist School

This school was popularized by the International Labour Organization in the 1970s, and subscribes to the notion that the informal sector is comprised of marginal activities – distinct from and not related to the formal sector – that provide income for the poor and a safety net in times of crisis (Sethuraman, 1976: P. 69). The informal sector exists as an avenue for the lower class and the poor to be able to eke out a living. The informal sector acts as a buffer for those workers laid-off in times of economic recession.

According to this school, “the persistence of the informal sector activities is due largely to the fact that not enough modern job opportunities have been created to absorb surplus labour, due to a slow rate of economic growth and / or a faster rate of population growth” (ILO, 2005). Sethuraman (1976: P. 69-81) and Tokman (1976: P. 1065-1075), among others, have expounded this theory.

This approach has led to various debates regarding why some governments turn a blind eye to the enforcement of the tax laws on the informal sector. The explanation given has been that the sector is for the poor and provides a safety net for them, hence, taxing them would be unfair, and adding a bigger burden on the already poor, hence the best way would be increasing taxes on the formal sector (Sethuraman, 1976: P. 72).

The study makes use of this school of thought to find out if it still holds water. The argument is that the current trends have shown that national governments in
developing nations are taking the SMEs route and since most of the SMEs operate in the informal sector then there has to be a way to make these enterprises contribute to tax revenues for national development and one way to start is to establish the key factors associated with tax evasion.

2.2.2 The Structuralist School

Championed by Moser (1978) and Portes et al. (1989), in the late 1970s and 1980s, the structuralists hold it that the informal sector should be seen as subordinated economic units (micro-firms) and workers that serve to reduce input and labour costs and, thereby, increase competitiveness of large capitalist firms. In the structuralist model, in marked contrast to the dualist model, different modes and forms of production are seen not only to co-exist but also to be inextricably connected and interdependent (Moser, 1978; Portes et al., 1989). According to this school, the nature of capitalist development (rather than a lack of growth) accounts for the persistence and growth of informal production relationships.

2.2.3 The Legalist School

Hernando de Soto pioneered the legalist ideas in the late 1980s and early 1990s, subscribing to the notion that the informal sector is comprised of ‘plucky’ micro-entrepreneurs who choose to operate informally in order to avoid the cost, time and effort associated with formal business (de Soto, 1989).

According to de Soto (2000), micro-entrepreneurs will continue to produce informally so long as government procedures are cumbersome and costly. In his
view, unreasonable government rules and regulations are stifling formal private enterprise. By the legalist school of thought, the inordinate demand placed on businesses by the government’s enactment of numerous commercial laws and regulations is acting as a driving force for the participation in the informal sector. The simplification of rules and regulations for formalization process may reduce the rate of the informality by the entrepreneurs.

2.2.4 The Illegalist School

Popularized by neo-classical and neo-liberal economists, the illegalist school subscribes to the view that informal entrepreneurs deliberately seek to avoid regulations and taxation and, in some cases, to deal in illegal goods and services (Maloney, 2004: p. 1159-1178). This school is associated with the notion that the informal economy is an underground or black economy. According to this school of thought, informal entrepreneurs choose to operate illegally – or even criminally – in order to avoid taxation, commercial regulations, electricity and rental fees, and other costs of operating formally (Maloney, 2004).

2.3 UNDERSTANDING THE INFORMAL SECTOR

2.3.1 Causes and Consequences of Informality

There are both economic and non-economic reasons for participation in the informal sector. The economic motives relate to unemployment, an inflexible formal labour market and cost advantages in the informal production in terms of lower
capital prices. Greater flexibility and satisfaction on work, more leisure time and the benefit of utilizing more of one’s qualifications are examples of noneconomic motives to move to the informal sector (Gërxmlani, 2004). In a behavioural economics perspective, Renooy (1990) discusses two types of factors that are important in determining whether people choose to engage in informal activities, that is, structural and opportunity factors. The structural factors are financial pressure, socio-psychological factors and institutional constraints. The opportunity factors are made up from the individual skills, network and living situation; as well as the environment, social norms and tradition, values and standards. According to Renooy (1990) the opportunity factors explain why there exists informal economic activity. In this context the attitudes towards the government are particularly important, and together with the information set that individuals base their decisions on, people will decide on how they will comply with governmental taxes and regulations. In cases where the government has low credibility, the barriers to entering the informal sector is lowered to a large extent.

The increased (actual and perceived) burden of taxes and social security contributions are considered to be some of the most important causes of the development of the informal sector. Increasing direct and indirect taxes affect labour-leisure choices and the choice to take the plunge into the informal sector. The higher the difference between post-tax earnings and total labour cost in the formal labour market, the higher will the incentive become to evade the formal sector and earn a tax-free living in the informal sector. This difference depends
largely on the tax and social security system and is a key feature of the existence and prevalence of the informal sector (Schneider, 2005). An important aspect is the complexity of the tax system. The more complex the tax system is, the higher is the actual and perceived burden of the taxes. Furthermore, this makes it more difficult to determine the ones who are the winners and losers in the government redistribution scheme, making it more likely that most individuals feel that they are left out of the loop, creating an environment of distrust in the government. This may contribute to the individual’s choice to enter into informal activities (Schneider & Enste, 2000). This effect is related to the tax moral of the citizens and their inherent propensity to evade taxes and work illicitly, which also is seen as an important determinant to the development of the informal sector.

Another common determinant to the informal sector is the so-called intensity of regulations, often measured by the number of laws and regulations that exists in the formal sector. Excessive permit licensing, administrative procedures, red tape and bribes makes it difficult to establish an enterprise, and many are forced to work in or start up a small firm in the informal sector due to large entry costs. There may also be costly labour market regulations that make it more attractive to hire informal workers (both in formal and informal enterprises). As these costs may easily be transferred to the workers, additional incentives are created to work in the informal sector (Das-Gupta, 2003).
2.3.2 Characterising the Informal Sector

Although informal workers often operate outside the law, this is not because they chose to engage in illicit activities, but due to the law itself that does not recognize legitimate activities, some of which have been performed for centuries. Luebker (2008) argues that the lack of legal recognition should not be used as a pretext to criminalize the informal sector. As argued in the report on Decent Work and the informal economy submitted to the International Labour Conference in 2002, the majority of workers produce goods and services that are legal, although they are not regulated (ILO, 2002: 3).

2.3.3 Unreported income or tax evasion

Researchers, such as Ellingham and Sandmo (1972), the Internal Revenue Service (IRS, 1979), Feige (1981, 1990), Tanzi (1982, 1986) and Schneider and Enste (2003), specifically describe the informal economy as the sum of all taxable money left unreported with the intention to evade taxes. However, Bloch (2009) views tax evasion in the informal sector in Zimbabwe as attributable to lack of incentives for new entrants and smaller players who do not have start up capital.

Schneider and Enste (2003) suggested presumptive tax as the best for the informal sector. According to Schneider and Enste presumptive taxation involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts. The term "presumptive" is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method.
The aspect of presumptive tax could work in the informal sector considering the major challenge of lack of proper record keeping (Schneider and Enste, 2003). This lack of record keeping makes it difficult for the informal traders to qualify in the normal tax brackets.

In Zimbabwe, the Zimbabwe Revenue Authority (ZIMRA) is responsible for the collection of tax. ZIMRA became effective in January 2001 as a successor organisation to the then Department of Taxes and the Department of Customs and Excise following the promulgation of the Revenue Authority Act [Chapter 23:11] on February 11, 2000. ZIMRA was born out of Government’s realisation that an efficient revenue generating mechanism is central to the economic development of the Nation.

2.3.4 Theories related to the informal sector

Due to the diversity of focus and approaches, there has unfortunately not been developed a general theory of the informal sector. This is partly because most researchers do not approve of the simplistic notion of a dual economy, but also because there lacks a general agreement of what the informal sector or economy is. Furthermore, the literature is fraught with anecdotal evidence that is mostly based on studies in particular regions of the world. Thus it seems like “… almost every possible explanation has been given” as Gërrixhani (2004) put it. This thesis will however discuss some different attempts that have been made to explain informal economic activities in terms of their relationship with the formal economy and the motives people and enterprises have to enter the informal domain.
2.3.4.1 The dual economy approach

Originating from the notion of a dual economy in Boeke (1953) and others, models were developed to explain the dynamics between the rural agricultural sector and urban modern sector by Lewis (1954) and later by Ellingham and Sandmo (1972). These models did not discuss the informal sector at the outset (they were rather discussing rural-urban migration), but has later been expanded by e.g. Fields (1990) to include assumptions such that a majority of the urban unemployed are considered to be working in the urban informal sector. It is here theorized that all workers that are in the informal sector (and those that migrate from the rural sector) are trying to get a job in the modern sector, and that the informal sector works as a fallback option for those who fail to get a modern sector job. The informal sector is considered to offer subsistence to the urban poor in this setting. One important feature of this expanded model is to explain why there may be wage differences between the informal and modern sectors and why the rural population continues to migrate to the urban sector despite the slim chances of getting a job in the small modern sector. This approach has been criticized for its simplistic dual economy assumption; that there are informal workers in the urban sector only, and that all workers in the informal sector want to work in the modern sector (Thomas, 1999).

2.3.4.2 Tax evasion

Tax evasion is the most studied phenomenon in the economic literature on informality. The theoretical contributions to theories of tax evasion may roughly be
divided into two categories, depending on the assumptions made on the role that the government plays. The first assumes that the government is controlled by a benevolent dictator, a characteristic assumed in social welfare theories (among those are the optimal taxation theory developed by Allingham & Sandmo (1972) among others); the second assumes that government agents are rational utility maximizers, known from public choice theory.

Optimal taxation theory is about how the government chooses the optimal tax policy (in terms of tax and penalty rates) to maximize welfare by increasing the tax revenue or tax pool. Alternatively, one may define the problem to be how the government tries to minimize the total burden of taxation (Thomas, 1999). The only reason for people to pay taxes is to avoid being caught for tax fraud by government prosecution. Increasing the tax rate will increase the tax revenue but reduce the supply of labour, as some workers will avoid the increased taxes. This theory assumes that people avoid taxes in response to tax increases, not necessarily evade them. What optimal taxation theory fails to explain is that some people may choose to supply their labour hours in the informal sector instead of in the formal economy. Another problem with this theory is that it fails to take into account the impact of the quality of public goods that the government offers, a common characteristic of public choice theory. Attempts have been made to introduce the impact of public goods by Cowell (1990) and he finds that with decreasing absolute risk aversion and under-provision of public goods, tax evasion will increase in response to improved public goods provision financed by higher tax rates. This

48
general proposition has found little empirical support however. Most rather find that taxpayers take into account both the cost of higher taxes as well as the perceived improvement in public goods provision when deciding to evade taxes (Gërxhani, 2004).

One other weakness with models of optimal taxation is that the probability of being detected seems to be very low in most cases (as is the magnitude of penalties). This suggests that there must be other factors that constrain the behaviour of the taxpayer. De Soto (2000) includes the effect of individuals’ perception of fairness regarding their choice to evade taxes. If individuals believe that many others are evading taxes, then so will they. Thus the perceived fairness of tax policies induces individuals to evade. The result of such factors is that individuals may decide to comply with government taxes although it is in their best interest to evade taxes.

Maloney (2004) takes on a similar approach in his public choice model of tax evasion (assuming rational government agents). Arguing that individuals have the incentive to free-ride no matter how compliant all others are, he assumes a relation built on individuals’ trust in the government to deliver the promised public goods and in all taxpayers to pay taxes. If an individual does not fully trust the government to provide and fellow taxpayers to comply, his/her willingness to pay decreases. At the margin where the individual has zero willingness to pay, he/she will only pay according to the standard models of optimal taxation, i.e. maximize the expected income with respect to tax rates and detection rates (taking account of risk aversion). Thus Maloney (2004) predicts that we will see higher levels of tax
evasion in societies where the citizens’ trust in the government and each other are low. Without trust it is difficult for the government to predict what the citizens want, and in such a situation they are likely to provide less than optimal public goods provision. This is also the case if individuals have very diverse preferences (difficult to satisfy everybody’s preferences) or if the government is corrupt. In the end, it is the individuals’ surplus of income and public goods that determine the level of tax evasion, and the effect of increased taxes is that the propensity to evade taxes decreases if it increases the surplus of the citizen, assuming that public goods are under-provided initially (otherwise surplus would decrease).

2.3.5 The Enterprise Characteristics of the Activities in the Informal Sector

According to Matsebula (1996:p.13) the informal sector has a number of characteristics. He identifies 13 of them namely;

i. Ease of entry

ii. Self employment (at times assisted by unpaid family labour or very few hired workers and apprentices)

iii. NonEnumeration in official records

iv. Low division of labour

v. Low capital intensity

vi. Flexibility in hours of operation

vii. Low incomes (in particular, low value added per worker)

viii. Non-existent bookkeeping

ix. Non-seperation of business inputs from household inputs
x. Reliance on indigenous resources
xi. Usage of adapted technology
xii. Ubiquity
xiii. Informal acquisition of skills
xiv. Small-scale operations (measured variously by turnover, capital employed, number of employees, state of bookkeeping and official census)
 xv. Markets faced with competition from either informal or formal operations
xvi. Linkages to other sectors (including the formal sector)
xvii. Low usage of formal credit

Other researchers identify almost similar characteristics and these are explained below.

2.3.5.1 Unregulated and competitive markets

The fluidity and ubiquitous nature of the informal sector naturally renders local authorities and government paralyzed and unable to regulate this sector. It will be noted that an attempt to regulate the exercise can not be undertaken without huge financial expenditures. In fact the costs far exceed the financial benefit, a situation culminating in a "mission impossible" scenario as asserted by (Fleming, 200 p. 38).

Characteristic of the informal sector, many operates compete fiercely to gain the largest market share. A good example can be observed at the furniture
manufacturing sector in Mbare Magaba Informal Trading Centre. It is a survival of the fittest scenario.

2.3.5.2 Small scale operation with individual or family ownership

The usual informal sector business enterprise is run or operated by a sole proprietor and according to Yanksan (1989) “generally for less than five years”. In most cases the number of workers, trainees and members of the family employed plus “seed” money invested often determine the size of the enterprise. These enterprises usually employ an average of four depending on the type of business venture which may be individual ownership or sole trader, family business, corporatives and partnerships.

2.3.5.3 Ease of entry

Entry into the informal sector is with great ease such that at any given time any individual can simply decide to enter “the fray” start a small venture and compete in the informal sector. The intensity of start-up finance is low in the sector such that, “most of the entrepreneurs use labour intensive technology, with the biggest units having most fixed earnings per worker. (Yankson 1989).

2.3.5.4 Reliance on locally available resources

Informal sector businesses are quite small in size and lack capacity to do off-shore acquisition of resources - material, human and financial – for the running of the
business. Hence the informal sector businesses tend to rely more, if not solely, on the local resources. The resources are acquired from various sources, sometimes new or second-hand or self-constructed but very rarely imported. So also for their raw materials, informal sector entrepreneurs depend largely on the local resources, primarily from the formal sector units in the cities (Barwa, 1995).

2.3.5.5 Family ownership

Family ownership dominates the ownership of the informal sector businesses (Farrell and Fleming, 2000: p. 38). This is largely due to the fact that family provides cheap source of labour for the business. The lack of trust on the part of individuals does not promote formation of partnerships and joint ventures in the informal economy.

2.3.5.6 Labour intensive and adopted technology

In the Ghananian case, Yanksan, observed that technology in the informal sector was very low and in degraded state, usually equipment is home made or locally manufactured with subsequent modifications being made at the entrepreneur’s production point, Inventiveness has been displayed by the informal entrepreneur as the adapt and operate equipment manufactured in their own locale. Relying heavily on Labour intensive operations, operators in the informal sector have given up on the importation of advanced technology due to lack of sufficient funds. Production levels remain low.
2.3.6 The behavioural perspective of the informal sector

Antecedent literature indicates two principal research perspectives with regard to informal enterprises. According to Olomi (2001), the first is socio-economic and is concerned largely with defining and characterizing the informal sector, identifying the resources it attracts (capital, labour, technology) the markets it seeks to exploit, and the attributes of informal operators. This has already been discussed in the preceding sections.

A second perspective is behavioural, concerned with motives, decisions and the success of business strategies—success being variously defined in terms of survival and growth (Olomi, 2001; Mahemba and De Bruijn, 2003). In a multi-country study in sub-Saharan Africa by Frese (2000), links have been noted between entrepreneurial success and the personal action strategies of operators—proactive behaviour in planning and development being more likely to lead to success than reactive responses to unanticipated events.

In a Tanzanian study designed to understand the underlying causes of growth, an expected link between positive growth motivation and actual growth was detected, but the study failed to establish links between motivation and other descriptors of the operator-enterprise entity (Olomi, 2001), and the researcher concludes that other active factors must therefore be external influences. Also in Tanzania, a relationship has been established in some small-scale enterprises between growth and operators’ tendencies to innovate, also subject to external factors (Mahemba and De Bruijn, 2003).
These studies tend to reinforce the notion of institutional factors in enterprise development and issues to do with formalization of informal enterprises. Interest in entrepreneurship as a factor and/or process in business success falls into this behavioural perspective, but the wide heterogeneity of enterprises, the huge variety of enterprise contexts and situations, and the complexity of operator behaviour combine to make common principles of entrepreneurship as difficult to find in Africa (Spring and McDade 1998, pp. 1–34) as it is elsewhere, leading to the possible conclusion that it is the outcome of individual learning processes (Deakins, 1996).

2.3.7 Reasons to become informal

It is worth to note that outstanding contributions in the area of voluntary informal work emanate from Fields (1990) although the issue was looked into more closely about nine years by Malaney(1999 and 2004). Informal employment basically entails heterogeneity with two characteristic features, that is, “easy entry” and “upper tier” informal employment. Fields further asserts that “upper tier” informal employment is more favourable than formal sector employment and is “voluntary” (Fields pp50 and 66).

The “easy entry” conception to informal employment presents its own challenges. According to Maloney, the easy entry conception conflicts with ILOs “decent work”
definition. Malaney goes on to state that serious implications arise from the concept of “early entry” in terms of what are good or bad jobs taking into consideration unprotectedness and precariousness. According to the International Labour Organization, decent work may be defined as, “Jobs covered and protected by formal labour institutions (ILO 2004 p1159).

In contrast ILO (2002, pp 2-3) stressed on the heterogeneous nature of informal employment in a way that tallys with the concept of voluntary informal employment and gave and made the following observation quoted:

*Increasingly, “informal sector” has been found to be an inadequate, if not misleading, term to reflect these dynamic, heterogeneous and complex aspects of a phenomenon which is not, in fact, a “sector” in the sense of a specific industry group or economic activity […] There is no simple relationship between working informally and being poor, and working formally and escaping poverty (2002, pp. 2–3).*

This entails that informal workers employees are not poor whilst those in formal employment were actually poor when it came to disposable income. To this end, it is not surprising that workers in the formal sector opt for informal rather than formal
employment as the discussion goes. Issues at hand therefore is not about the existence of voluntary informal employment in developing nations but rather, the extent to which it is spread and variances at certain levels of development and for various employees whether man or woman. Within the policy issues at hand there carries out the need to articulate an increase in formal employment in tandem with improvement of informal workers conditions.

One of ILO’s primary objectives, the reduction of informal employment has continued to challenge economic development in developing countries on the backdrop of ILO’s labour regulation instruments as a defined policy. In contrast, popular views single out labour regulations as the root cause of informal employment which translates to say ILO’s stance are contradictory. A good example can be found in the volume “Informality Exit and Exclusion Pewy et, al 2007) provides empirical evidence supporting the view.

In contrast to the mentioned view, there is a notion that focuses unnecessarily on, negative unintended consequences and does not respect, the extent to which labour legislation’s objectives are fulfilled. Whilst it is noteworthy, makers of policy have to be aware of attendant negative consequences which may not have been the initial objective.
2.3.7.1 Voluntary informal employment

In the area of economics in developing countries, the issue of informal employment remains persistently outstanding. This notion is even aptly captured in an early seminar paper by Lewis in 1954, Kucera and Roncolate (2008) quoted:

*The phenomenon [of “disguised” unemployment] is not, however, by any means confined to the countryside. Another large sector to which it applies is the whole range of casual jobs – the workers on the docks, the young men who rush forward asking to carry your bags as you appear, the jobbing gardener … petty retail trading* (p. 141).

In the area of economics in developing countries, the issue of informal employment remains persistently outstanding. This notion is even aptly captured in an early seminar paper by Lewis in 1954, Kucera and Roncolate (2008) quoted.

A model of Labour market dualism was brought about by Harris and Todaro (1970). The model puts forward an explanation of why rural to urban migration might far exceed or outweigh available jobs in urban areas with the resultant effect of lack of employment in urban areas. Model depicts that start-up wages for employees were determined at political level above farm production and unrealized levels of market with the background Harris and Todaro (1970) as quoted by Kucera and Rocolato, 2008 pointed out “The distinguishing feature of this model is that migration proceeds in response to urban-rural differences.”

A foundation of theories on Informal employment was provided subsequent to revelations by the two authors, it would emerge. Later in 1975 a varied extension
to the Harris – Tonaro model was made incorporating an “urban informal sector” This sector regards “underemployment” as an alternative open unemployment for rural migrants unable to find work in the urban formal sector “Fields 1975.

Under employment, unemployment and informal authors are common factors arising from authors contributions with a final agreement that the undesirable conditions should be eliminated through policies of development. In recognition of the heterogeneous nature of the informal sector, Keith Hart (1973 p. 68 states, “in practice, informal activities encompass a wind ranging scale , from marginal operations to large enterprises “ In terms of typology of informal industries Hart(19673 p.69) demonstrates that its an illustration of the wide ranging opportunities to the city or town su-bproletariat.”

The dualism idea was a subsequently contributed by Fields in 1990 through research and own observations. He embraced the “upper tier” and “easy entry” concept within informal employment. Fields observed that a majority of upper-tier informal employees were actually in same skills and sufficient funds to start their own informal business. Fields further noted that although upper tier informal employment was predominantly voluntary, there were some elements of constraint in the voluntarism and further explains that, “given the constrained choices
available to them a great many of informal sector workers in the sector voluntarily” Fields (1990 p. 67)

In concurrence with Fields Maloney (2004) offers similar accounts of voluntary informal work however the two only differ in their degrees of emphasis of formal social protection being of a defined character and how individual entrepreneurs end up joining the informal sector for example, in a scenario in which an entire family is eligible for medical benefits as long as one member is formally employed, there is weaker incentive for additional members to be formally employed. This is based on the assumption that workers pay for these benefits in some form and that the formal and informal jobs in question are broadly comparable. Another scenario is that workers may shun compulsory pension contribution schemes for the reason that their apparent cost as related to doubtful return in future. According to (Saavedra and Tommasi, 2007). It is commonly accepted that, “the less efficient the delivery of formal social protection the weaker the incentive to participate.”

On the other hand Fields (1990) places voluntary informal employment in the realm of dualism within the informal urban labour market while Maloney (2004, p. 1159) adds that, “as a first approximation we should think of the informal sector as the unregulated, developing country analogue of the voluntary entrepreneurial small-firm sector found in advanced countries”. Instead, Maloney does not create an official model and so strict prudent assessments are not considered, thus rendering dubious how useful is such a “first approximation”. It appears to be
more prudential to pursue Fields’ line of inquiry and think of the relatedness prioritising of voluntary versus involuntary informal employment and the consequences and determining factors of the relatedness between the two.

Maloney (2004) has further asserted that, “The policy implications are of first importance. For instance, the higher the ratio of voluntary to involuntary informal employment:

1. The less meaningful is informal employment as an indicator of a decent work deficit and underdevelopment more generally.
2. The more meaningful is the open unemployment rate as an indicator of labour market slack, with attendant implications for macroeconomic policies.
3. The more contradictory may be policies aiming to increase formal employment while simultaneously improving conditions for informal workers.

There are also research and data implications. For instance, Fields (1990, p. 50) “argues that studies that do not account for such dualism within informal employment are “rendered dubious, if not downright invalid”. Fields (1990, p. 64) criticizes the ILO’s and other definitions of informal employment in this regard: “One is hard-pressed to see how these working definitions of the informal sector conform to earlier notions based on free-entry”. Yet measuring voluntary informal employment is intrinsically thorny, for it requires knowing not just the characteristics of the informal job in question (as per existing definitions), but the characteristics and availability of the formal jobs the worker is qualified for as well as the worker’s qualifications themselves (Jütting, Parlevliet and Xenogiani, 2007).
Much of the evidence on voluntary informal employment comes from Latin America; in Maloney’s case, from Argentina, Brazil and especially Mexico. These three countries have micro panel data, enabling one to trace the movement of workers between formal and informal employment. Yet these are among the most developed of developing countries, raising the question of how meaningful their findings are for poorer developing countries and regions like Zimbabwe. Fields (2005a) makes this point in reference to Maloney’s work: “Perhaps most informal entrepreneurs are in the upper-tier in Mexico, but I doubt this is the case in India, Bolivia and Kenya” (p. 25). Supporting this view, for example, are the findings of a study on Côte d’Ivoire, estimating that about twice as many urban workers want to work in formal employment than actually do, and that about three times as many urban workers are in the lower tier of informal employment than want to be (Günther and Launov, 2006).

Indeed there are several reasons to suspect that there might be a generally positive relationship between the ratio of voluntary to involuntary informal employment and levels of economic development. More developed countries generally have stronger unemployment insurance systems, and thus open unemployment can more readily provide an alternative to involuntary informal employment in the face of job loss.

Consider too that the share of informal employment is highest in the poorest developing regions, particularly in South Asia and sub-Saharan Africa (with informal employment approximated by self-employed and unpaid family workers in
urban and rural areas, for want of better regional estimates). In India, for example, the share of informal employment was 76.7 per cent in urban areas and 94.8 per cent in rural areas in 1999–2000 (Sakthivel and Joddar, 2006, p. 210). In South Asia and sub-Saharan Africa, there are lower propensities for a family member to be in formal employment and so more limited possibilities for other members to opt out of formal employment while receiving formal social protection (in cases of extension to family members). More fundamentally, voluntary informal employment implies a choice: that purportedly voluntary informal workers could work in formal employment if they so wished. Clearly the possibilities for this are exceedingly limited when the share of formal employment is very low (Günther and Launov, 2006).

Poorer developing countries and regions also have such high shares of informal employment and rates of poverty that there is necessarily much overlap between the two. In 2004, the two-dollar-a-day poverty ratio was 22.2 per cent in Latin America and the Caribbean, compared to 72.0 per cent in sub-Saharan Africa and 77.1 per cent in South Asia (World Bank, 2007). The researcher’s view is that informal workers in poverty cannot be voluntary in any meaningful sense of the word. From these considerations it follows that the concept of voluntary informal employment is least relevant where informal employment is most pervasive.

Regarding poverty, Maloney (2004, p. 1160 and 1164) takes a different view: “Arguing that workers are voluntarily informal does not, of course, imply that they are not living in poverty, only that they would not obviously be better off in the
formal jobs for which they are qualified … many are simply making the best choices they can given their low level of education”. This returns us to the issue of the “constrained voluntary nature” of purportedly voluntary informal employment.

For voluntary informal employment to be a meaningful notion, it is important to consider the quality of this employment as well as formal employment alternatives in an absolute, not just a relative, sense – for there are good and bad jobs within the formal sector, dualism within both the formal and the informal sectors. Indeed, it was concern about the growth of marginal employment within formal establishments that motivated the ILO’s new definition of informal employment, adopted in 2003, which adds to employment in informal establishments (that is, employment in the informal sector) informal employment in formal establishments (Hussmanns, 2005).

The contingent nature of voluntary informal employment creates serious conceptual and measurement problems. Less-educated workers have more limited formal employment prospects, so consider what would happen if the level of educational attainment were to increase in a country. In such a case, more workers would be qualified for good jobs in the formal sector and so fewer would contentedly settle for informal employment. That is, the ratio of voluntary to involuntary informal employment would be lower, even though the ratio of good to bad jobs would remain the same. The then involuntary informal workers might now prefer to remain informal rather than seek formal employment. In this case, the ratio of voluntary to involuntary informal employment would be higher, even though
the ratio of good to bad jobs would be lower. In short, the ratio of voluntary to involuntary informal employment does not necessarily tell us anything about what we most want to know: the quality of jobs in an economy. Indeed these examples show how it can be downright misleading.

The notion of informal workers voluntarily opting out of formal social protection also raises concerns. This point is raised by Maloney (2004, p. 1167), who writes:

*What I am suggesting is that those contemplating opening their own firms may survey the array of available social protection mechanisms, both formal and informal and then, comparing the utility of the portfolio they can cobble together in the two sectors, make the decision to open an informal business and leave formal protections.*

Social protection policies can indeed have unintended negative consequences. For example, if workers’ and employers’ contributions to social protection schemes are too high, both parties have an incentive to keep their relationship off the books, whether within or outside of formal establishments. This provides a sense of the challenges of policy design, involving the extent to which social protection is financed from contributions versus government tax revenues.

Yet there are other fundamental issues at stake in considering formal and informal social protection as alternatives. Two forms of social protection that have received much attention are pensions and health care (e.g. Mesa-Lago, 1992). There can be informal alternatives to formal pensions, of which traditional family support has been most important historically. But there has been a breakdown of such support
in developing countries as a result of migration (internal and international) and the decline of the extended family household (Cassirer and Addati, 2007). And for formal health care, there are no viable informal alternatives. More generally, though it is true that poorer workers have less incentive to participate in formal social protection when service delivery is poor, this also applies to better-off workers. Poorer workers can less readily afford to waste or risk their money. Still, that poorer rather than better-off workers are more likely to forgo formal social protection seems more a reflection of constraints – of poverty itself – rather than a meaningful expression of choice.

Women are disproportionately represented in informal employment, and so debates on the quality of informal employment have particular bearing on them. Some studies of formal-informal employment dynamics evaluate men and women together (e.g. Calderón-Madrid, 2000, on Mexico), while others exclude women from the analysis altogether (e.g. Maloney, 1999, also on Mexico). However, studies that evaluate men and women separately find much less mobility between formal and informal employment for women, which their authors interpret as providing stronger evidence of labour market segmentation for women (Funkhouser, 1997, on El Salvador; Gong and van Soest, 2002, on Mexico).

Though Maloney’s emphasis is on men’s voluntary informal employment, he also discusses women’s informal employment, arguing that it too may be largely voluntary:
the explanation for the disproportionate representation of women in informal self employment may also again be found in certain desirable characteristics of the sector, particularly, flexibility ... Given the constraints that poor women face in balancing home responsibilities and the need to work, informal employment may be a relatively desirable alternative (Maloney, 2004, p. 1162–1163).

An alternative view is provided by Cassirer and Addati (2007), based on in-depth research on the childcare needs of informal workers in 13 developing countries. They find that the lack of childcare provision in developing countries leaves women with limited options in balancing work and family responsibilities.

The lack of support for unpaid family responsibilities may force many women, particularly poor women, to accept the low wages and poor working conditions typical of the informal economy, but as a survival strategy, such employment does not meet the broader aspirations of the working poor for economic security and freedom from poverty (Cassirer and Addati, 2007, p. 7).

These authors provide evidence that the challenge of balancing family responsibilities with paid work has become increasingly difficult as a result of the breakdown of traditional family support, the increased number of female-headed households, and a lack of public support for unpaid work. They also argue that the want of childcare provision contributes to the growth of informal employment in that it creates demand for domestic workers as childcare providers. Cassirer and Addati address not only childcare problems, but also childcare solutions, describing programmes directed toward informal women workers in several
developing countries. Indeed, if the question of whether women are voluntarily in informal employment is to be meaningful, one must endeavour to understand the constraints under which these women choose (Procter and Padfield, 1999).

2.3.7.2 Further discussion on voluntarism

Fields (1990) developed the idea of a dualistic informal sector, characterized by voluntary upper-tier and involuntary easy-entry components. The distinction is helpful in understanding the heterogeneity of informal employment and labour market dynamics in developing countries, such as voluntary movements of workers from formal to informal employment and that some rural-to-urban migrants seek informal rather than formal employment. More generally, the value of multi-sector labour market approaches is that they provide explanations of phenomena that are otherwise paradoxical (Fields, 2005a).

At the same time, the contingent nature of voluntary informal employment makes it difficult to measure. Moreover, current debates about voluntary informal employment are meant to be about job quality, about decent work. This calls for consideration of the quality of purportedly voluntary informal employment as well as formal employment alternatives in both relative and absolute senses.

There is also reason to think that voluntary informal employment may be the least prevalent where informal employment is itself the most prevalent, i.e. in the poorest developing regions. Further research on this hypothesis would be useful, if only to counter the tendency to project research findings from the most developed of
developing countries onto the developing world as a whole. Given the paucity of micro panel data on poor developing countries, such research would probably have to rely a good deal on worker surveys. To best inform policy, such research should be mindful of the constraints under which workers make choices, because understanding whether informal workers are meaningfully voluntary requires understanding their options. More generally, making sense of the debates on voluntary informal employment means contending with the possibility that policies can do what they are meant to do, and that is to expand options.

2.3.7.3 Formal labour regulations and informal employment

The World Bank’s *Informality: Exit and Exclusion* (Perry et al., 2007), though focusing on Latin America and the Caribbean, contains a fairly comprehensive survey of the empirical literature on labour regulations and informal employment and provides a useful point of comparison for our reading of this literature. Particularly relevant is the chapter by Maloney and Bosch (2007), “The informal labour market in motion: Dynamics, cycles and trends”.

We first provide a short theoretical overview, focusing on the literature deriving from models of labour market dualism and related to labour regulations. Among the issues addressed are trade unions, minimum wages, and hiring and firing costs. Taken together, these theories suggest that the effects of formal labour regulations on informal employment are ambiguous a priori.
2.3.7.3.1 Theory

Looking back over the period since the publication of his 1954 paper, Lewis (1979, p. 223) wrote that “urban wages in less developed countries have been rising faster than we would have predicted”. He attributes this to several factors: trade unions and their “strict control of entry”, “civil service unions raising government pay”, the “pressure of governments on foreign employers”, and minimum wage regulations (Lewis, 1979, p. 225 and 227). Consistent with his reliance on the neo-classical demand curve for labour (Lewis, 1954, p. 150), Lewis’s concern was that these factors give rise to less employment in the formal sector and more in the informal sector.

Harris and Todaro (1970) did not elaborate on how entry-level urban wages are “politically determined” above a hypothesized market-clearing level. Their model was extended in this regard by Calvo (1978), incorporating unions on the assumption that they are concerned with the difference between rural wages and union members’ urban wages. Calvo argued that this model was also relevant without unions, insofar as governments establish urban minimum wages. Quibria (1988) also extended the Harris-Todaro model, most relevantly by incorporating urban formal and informal sectors and unions on the assumption that they are concerned with the difference between wages in these two urban sectors. A key policy implication of the difference between these assumptions of union behaviour is that in Quibria’s model, government policies can eliminate urban unemployment and informal employment without having to resort to controls on rural-urban
migration. In this sense, the effects of unions on informal employment are benign. At this abstract level, the effects of unions are therefore ambiguous, and, more concretely, we know that unions’ attitudes and behaviours vary widely in developed and developing countries, from conflictual to cooperative.

Fields (2005b) uses the Harris-Todaro model to evaluate the effects of three labour market policies – “modern sector job creation”, “modern sector wage restraint” and “rural development” – on four labour outcomes, namely, unemployment, total labour earnings, inequality of labour earnings, and poverty. In this context, Fields’ finds that “modern sector wage restraint” can result in either higher or lower unemployment, depending on whether the demand for labour is sufficiently elastic or inelastic. “Modern sector job creation” results in higher unemployment. More generally, the effects of “modern sector wage restraint” and “modern sector job creation” have both negative and positive effects on the labour outcomes considered. Only “rural development” is found to be unambiguously beneficial.

Originally intended to explain unemployment, insider-outsider theory also provides an account of labour market segmentation, including segmentation between formal and informal workers (Lindbeck and Snower, 1986 and 2001; Solow et al., 1985). Central to this theory is a conflict of interests between higher-paid insiders and lower-paid (or unemployed) outsiders. In Lindbeck and Snower’s version of the theory, a key reason why firms do not replace insiders with outsiders lies in the associated hiring and firing costs, which can be influenced by labour regulations. The higher the hiring and firing costs, the higher insiders’ wages can reach above
a hypothesized market-clearing level and so the greater the potential extent of unemployment and informal employment. Unions can also come into play in insider-outsider theory insofar as insider status is associated with union membership. Unions can act to increase hiring and firing costs as well as strengthen insiders’ bargaining power.

There is a sizeable empirical literature on the effects of employment protection legislation on levels of employment. The theoretical effects are ambiguous, however. As Bertola, Boeri and Cazes (2007, p. 237) write, “Theoretical models show that employment protection does tend to have a constraining effect on both layoffs and hirings, job creation and destruction, unemployment inflows and outflows, with the extent to which one effect dominates the other depending on the values of the parameters”. In other words, employment protection legislation is expected to dampen the volatility of employment, but not necessarily affect the levels of employment. Employment protection legislation generally applies only to formal workers, so there is no clear expectation that employment protection legislation would affect the shares of formal and informal workers in an economy. Employment protection legislation could increase hiring and firing costs, though, returning us to the insider-outsider dynamic.

We have noted Fields’ (2005b) finding that the effects of modern-sector wage increases on unemployment are ambiguous. Another way of looking at this is to consider the macroeconomic effects of wage increases depending on whether a country is in a scenario of wage-led versus profit-led growth. This depends on a
country’s comparative savings rates out of profits versus wages, the strength of “accelerator effects”, and exposure to international competition (Blecker, 1996). In a wage-led growth scenario, formal-sector wage increases could result in formal sector employment increases.

Such a wage-led growth scenario is at odds with the neo-classical theory of unemployment that underlies the above models and the expectation that stronger formal labour regulations result in less formal and more informal employment. Job search theory is also an offshoot of the neo-classical theory of unemployment, for which the social wage – which includes unemployment insurance benefits – is argued to be the relevant determinant of unemployment. A useful overview of the neo-classical theory of unemployment and its offshoots is provided by Card and Krueger (1995), particularly as regards minimum wages and low-wage labour markets. Motivated by the empirical findings of their and other studies that the effect of minimum wage increases on employment is “centering on zero”, these authors argue that the predictions of the neo-classical theories of unemployment can be confounded when employers have a degree of discretion in wage-setting (Card and Krueger, 1995, p. 383).

The theoretical foundations of the neo-classical theory of unemployment-and, by implication, its various offshoots – have also been extensively critiqued, particularly regarding the derivation of the demand curve for labour (e.g. Garegnani, 1990; Felipe and McCombie, 2008). This calls into question the interpretation of observed inverse relationships between wages and employment and brings
another element of doubt into the expected effects of formal labour regulations on informal employment.

2.3.7.3.2 Evidence

Loayza and Rigolini’s (2006) conclusion of variance in self-employment is due to business flexibility. Maloney and Bosch support the above conclusion in their article in the World Bank’s Informality: Exit and Exclusion, they suggest that variations in business flexibility are responsible for 16 per cent of the variance in self-employment (2007, p. 121). The above study covering the period from the mid-1980s to 2004 used cross country panel data analysis to estimate the effects of “credit, labor and business” regulations on shares of self-employment (urban and rural) in developed and developing countries. From a sample of 42 countries, the study finds a 10 percent statistically significant relationship between stronger regulations and more self-employment. However, by separating developing countries only, the case of countries in Latin America and the Caribbean, this relationship is the opposite, although the relationship is weak. In the volume Law and Employment, edited by Heckman and Pagés (2004), which surveys and compiles a number of studies on the impact of labour regulations in Latin America and the Caribbean, Maloney and Bosch proves that a credible case can be built that labor legislation has a significant impact on the size of the formal sector” (2007, p. 121). The findings from this volume are significantly important since they rely on micro data and evaluate the effect of “job security costs” (cost of dismissing
a worker) on formal employment in Argentina, Barbados, Brazil, Chile, Jamaica, Peru, and Trinidad and Tobago.

Among these seven countries, statistically significant relationships between higher job security costs and less formal employment were found only in Argentina and Peru. The study confirms individual country differences on the implications of job security costs for informal employment, with the exception of Argentina with opposite findings due to the decreased urban informal employment in the 1990s. During this period, workers did not have adequate social security coverage. According to Saavedra and Torero, (2004) in the case of Peru in the 1990s it was proved that job security costs fell while formal employment increased, resulting in the rising of urban informal employment, meaning that falling job security costs coincided with a rising share of informal employment. The Peru case shows common trends in Latin America and all OECD countries of the relationship between changes in job security costs and shares of informal employment. Heckman and Pagés-Serra (2000) carried a study between 1990 and 1999 in Latin America, Caribbean and OECD countries which estimate the effects on shares of self-employment (non-agricultural) of job security costs, measured as the cost of dismissing a worker according to law, expressed in multiples of monthly wages. Despite the variations across countries there is a positive relationship between job security costs and shares of self-employment. In contrast, regressions driven by change over time (fixed effects) show the opposite, and such longitudinal evidence provides the better test of policy impact. In addition to that the
longitudinal evidence is stronger in terms of both the estimated strength and statistical significance of the relationship. As with Peru, changes in job security costs in Latin American, Caribbean and OECD countries are associated with opposite changes in shares of informal employment.

The study by Galli and Kucera (2004) provide more relevant findings which Maloney and Bosch (2007) ignored. The aspect of the effects of trade union rights on shares of formal and informal employment in a cross-country panel data analysis evaluating a sample of Latin American countries for the period 1990 to 1999. The findings of the study shows that countries with stronger “civic rights” for workers tend to have higher shares of formal employment.

Another study in Brazil between 1983 to 2002 by Bosch, Goni and Maloney (2007) critically examines the effects of “union power” on the share of urban formal employment, job creation and job destruction in a cross-industry panel data analysis (with time and industry fixed effects) with union power measured by union enrolment rate in each industry. Further the study examines the causes of the increase in the share of informal employment in the 1990s, particularly in the light of trade liberalization and the constitutional reform of 1988. The findings showed an increase in the share of urban informal employment of about ten percent from 1990 to 2002, with a slight decline from 2000 to 2002. The study further examined the effects of overtime costs and “firing costs”. Results from the authors’ “preferred specification” show that higher union enrolment is associated with higher shares of formal employment (Bosch, Goni and Maloney, 2007, p. 20). Moreover, there is a
smoothening effect in that the estimated positive and negative effects of union enrolment, overtime and firing costs on formal job creation and destruction cancel each other out over time.

However despite the above findings, the above authors write that “a small fraction of this rise in informality is driven by trade liberalization, and the remainder seems driven by rising labor costs and reduced flexibility arising from Constitutional reform […]. From this it is established that trade liberalization played a relatively small part in this increase [in shares of informal employment], but there is also suggestive evidence that several dimensions of Constitutional reform, in particular, regulations relating to firing costs, overtime, and union power, explain much more” (ibid., pp. 1 and 26). Data used show that hourly compensation costs in manufacturing (including non-wage labour costs) also declined markedly in Brazil during this period, as did aggregate real wages in both rural and urban areas after the mid-1990s (ILO, 2007c; IPEA, 2006). It is not evident how to match the authors’ conclusions with the sharp declines in these measures.

Besley and Burgess (2004) looked at Indian economic effects of labour regulations in India and reached their conclusions the authors by constructing an indicator, equal to plus or minus one, of changes in labour market regulations related to the Industrial Disputes Act (IDA) and used it in a cross-state panel data analysis for the period 1958–1992. They found that “pro-worker” amendments to the IDA resulted in lower output and employment in formal manufacturing and increased output in informal manufacturing. This study (and others using the Besley-Burgess indicator)
has been extensively critiqued by Bhattacharjea (2006). The indicator according to Bhattacharjea relate to “inappropriate classification of individual amendments, summary coding of incommensurable changes as either +1 or -1, and misleading cumulation over time”. the other weakness is that the indicator does not account for judicial interpretation of the IDA and that the IDA is only one of at least 45 acts addressing labour at the national level (ibid., p. 218) and therefore it can not be used as a standard barometer to make conclusions of any changes. Bhattacharjea further argues that their model specification in econometric analysis results in extremely fragile results (ibid., p. 212).

Maloney and Bosch (2007) did similar studies in Colombia evaluating the effects of labour regulations. A review of the work by Maloney and Nuñez Mendez (2003) and Arango and Pachón (2004) reveals that both made use of micro data and found that higher minimum wages are linked to less employment and more unemployment. Findings from these studies do not focus on the distinction between formal and informal employment, but estimate weaker effects on self-employment than other forms of employment, consistent with the view that minimum wage increases led to higher shares of self-employment. Kugler and Kugler (2003) carried similar studies to estimate the effects of higher payroll taxes on formal manufacturing employment in Colombia and the study used firm-level panel data from 1982 to 1996 and provides evidence that the substantial increase in payroll taxes during this period (not offset by a decrease in wages) led to declines in formal employment.
Colombian case study indicates a useful caution that badly designed and implemented labour regulations can have negative consequences as already alluded above. For example, Colombia’s minimum wage was already among the region’s highest when it was raised further in the midst of the deep recession of the late 1990s, during which the unemployment rate more than doubled to a historical high of 20 per cent, but the case of Colombia is not truly representative. The study on Brazil by Lemos (2007), proves that the minimum wages had the intended consequence of reducing the earnings disparity without the unintended consequence of reducing employment, neither for workers in general nor for vulnerable workers. This effect is of minimum wages on formal employment is noticeable and depends on a number of factors in addition to the state of the economy, including the difference between minimum and prevailing wages.

Maloney and Bosch (2007, p. 121) cite Djankov et al. (2002), along with Friedman et al. (2000) validate the size of the informal sector is determined largely by the regulatory distortions or corruption. Yet Djankov et al. (2002) provides a better study that shows the potentially negative repercussions of badly designed and implemented regulations rather than “regulatory distortions” as such. Djankov in a 1999 study of 85 developed and developing countries found a strong positive correlation between the number of procedures required to start a company and the size of the “unofficial economy”, measured as a share of GDP and a share of the labour force. However using procedures is an indication of the extent to which the state tries to regulate labour through firm entry, rather than either the overall
strength of labour regulations or de facto working conditions in a country. A good comparison is China and Canada where: Canada requires only two procedures to start a company – zero for labour and social security – while China requires 12 – five of which relate to labour and social security.

The main findings of Friedman et al.’s (2000) refer to corruption and taxes, in a study of 69 countries both developed and developing found out that higher tax rates are associated with less unofficial activity as a percentage of GDP but corruption is associated with more unofficial activity (p. 459). from the findings however there is room to interpret that higher taxes might be associated with stronger regulations. This is premised on the hypothesis that the associated costs of regulations are paid for from taxes thus, the stronger regulations, the less the unofficial activity.

2.3.7.3.3 Further evidence

Given what is at stake for workers in developing countries, the advocates of weakening labour regulations as a means of reducing informal employment ought to hold themselves to a high standard regarding the strength of empirical evidence. This standard has not been met. Some of the statistically strongest results in the literature show a positive relationship between the strength of labour regulations and shares of formal employment. We have noted, for example, the longitudinal results from Heckman and Pagés-Serra (2000). Most of the studies essentially show no relationship. In short, the empirical evidence does not support the view that weakening labour regulations is an effective policy for reducing informal
employment. Given the popularity of this view, we hope that this article will prove useful to policy-makers – for good policy-making is as much about what not to do as it is about what to do.

Loayza and Rigolini (2006) Stronger “credit, labour and business” regulations are associated with more self-employment (10 per cent statistical significance) for a sample of developed and developing countries, but not for samples of developing countries only, where the relevant coefficient estimates are of opposite sign (though statistically insignificant).

Heckman and Pagés (2004) Statistically significant relationships between higher job-security costs and less formal employment are found in only two of seven Latin American and Caribbean countries evaluated, Argentina and Peru. Yet these findings do not have clear-cut implications for informal employment. For Argentina in this period, the share of informal employment varied by different measures; for Peru, the share of informal employment increased by all measures, even though job-security costs fell.

Heckman and Pagés-Serra (2000), for samples of OECD, Latin American and Caribbean countries, OLS results (driven mainly by cross-country variation) show a positive relationship between job-security costs and shares of self-employment; fixed-effects results (driven by change over time) show a stronger negative relationship between job-security costs and shares of self-employment, consistent with the case of Peru noted above.
Galli and Kucera (2004) have pointed out that, “for a sample of Latin American countries, stronger “civic rights” for workers are associated with higher shares of formal employment. Bosch, Goni and Maloney (2007) on the other hand have pointed that the cause of the rising share of informal employment in Brazil in the 1990s is due to “rising labour costs” and “regulations relating to firing costs, overtime and union power”. Although this finding is not in concurrence with the study’s econometric analysis or supported by the patterns of declining union enrolment rates and labour costs. Besley and Burgess (2004) find that “pro-worker” amendments to India’s Industrial Disputes Act are associated with less formal manufacturing output and employment and more informal manufacturing output, but their indicators and analysis have been extensively critiqued by Bhattacharjea (2006) and others.

Maloney and Nuñez Mendez (2003) and Arango and Pachón (2004) argue that in the midst of the historically deep recession of the late 1990s, minimum wages in Colombia were increased; this was associated with more unemployment and less employment, with weaker effects on self-employment than on other forms of employment. Kugler and Kugler (2003) note that higher payroll taxes in Colombia are associated with less formal manufacturing employment. Lemos (2007) also notes that higher minimum wages in Brazil are associated with reduced earnings inequality but not with lower employment, either for workers in general or for vulnerable workers.
Giving an example of developed and developing nations, Djankov et al. (2002) noted that the higher number of processes required to start a business maybe closely linked with a larger “unofficial” economy, measured as a share of GDP and a share of the work force. Yet the number of processes is more revealing of the ways by which a country relies on regulations rather than the strength of legislation or existing conditions favourable or non favourable (e.g. while China requires five labour and social security-related procedures to start a company, Canada requires none).

Friedman et al. (2000), have pointed out that “for a sample of developed and developing countries, higher taxes and less corruption are associated with a smaller “unofficial” economy, measured as a share of GDP.” But stronger regulations may be may be related a smaller “unofficial” economy on the assumption that the related costs to regulate the economy are will be compensated for by taxpayer payments..

**2.4 INFORMAL BUSINESS PROGRESSION (FORMALISATION)**

‘Formalization’ or informal business progression means graduating from the informal to the formal sector, either directly or via semi-formal status. In Zimbabwe, the formal sector comprises enterprises registered with the state’s Business Registration and Licensing Authority (Registrar of Companies) as a business name or as a company.
According to Nelson and De Bruijn (2005), operators may use the informal sector as experimental space in which to make low-cost tests of the feasibility of their enterprise ideas, abandoning those that do not meet expectations or they may remain in the informal sector exploiting a series of ad hoc opportunities. In any case, the informal sector provides an operator with low-risk entrepreneurship learning space.

2.4.1 Formalisation Key Definitions

In order to maintain some degree of invisibility from regulatory authorities informal enterprises are generally of micro dimensions, a size band that includes a high proportion of enterprises. A small proportion of them are illicit, manufacturing or dealing in contraband substances, or engaged in other activities proscribed by law, as opposed to those that are licit but informal and for which there are formal counterparts. In Tanzania, small enterprises are able to obtain local authority operating licences, for which licensing procedures are simpler and the costs lower; this confers on them a semi-formal legal status without the necessity of registration with state authorities. As the minimum compliance with regulations, all enterprises are required to have at least a local authority operating licence. When informal enterprises 'choose' to comply they do so in the knowledge of penalties for non-compliance, which is deemed to be a 'quasi-voluntary' decision (Levi and Sherman, 1997). 'Formalization' means graduating from the informal to the formal sector, either directly or via semi-formal status. The formal sector comprises
enterprises registered with the state’s Business Registration and Licensing Authority as a business name or as a company. ‘Voluntary’ formalization is deemed to result from decisions taken without the pressure of government enforcement activities. ‘Non-voluntary’ formalization is defined as that which is coerced. ‘Involuntary’ formalization is instinctive, without conscious thought, as when operators act under a cultural compulsion to comply with the law.

Table 2.1: Key definitions and formalisation statuses

<table>
<thead>
<tr>
<th>Formal status</th>
<th>Legal form</th>
<th>Description and subcategories</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illicit</td>
<td>None</td>
<td>An enterprise is illicit when there is no legally permitted licensed or registered counterpart</td>
</tr>
<tr>
<td>Informal</td>
<td>None</td>
<td>An activity (for which there is a formal counterpart) that does not comply with requirements of the regulatory system regarding licences, permits, certificates, notification or registration of the activity is licit but informal.</td>
</tr>
<tr>
<td>Semi-formal</td>
<td>Local</td>
<td>An activity carried on by an operator</td>
</tr>
<tr>
<td>Authority licensed enterprise</td>
<td>who appears on a local authority list of licensed operators of enterprises but is not registered with the state registrar is semi-formal. For example, two forms exist in Tanzania: i. Hawkers licence, ii. Business licence</td>
<td></td>
</tr>
</tbody>
</table>

| Formal State-registered enterprise | Person(s) registered to conduct business activities under a registered business name; for example, enumerated on a state register as a sole ownership enterprise, a private limited company, or a joint stock company open to public subscription shareholdings |

Source: Nelson and De Bruijn (2005)

Perceptions about the intrinsic nature of business units in the urban informal sector in relation to those in the rest of the economy can be categorized into three principal approaches; namely evolutionary, involutionary and residuary. Another
approach which is not far from the three principal approaches is the institutionalist perspective and this will also be discussed.

2.4.2 Evolutionary approach

In terms of the basic evolutionary approach, the urban informal sector is visualized as some kind of hotbed for industrial expansion (Matsebula, 1990). The sector can play a role similar to that of cottage industries that eventually gave rise to industrial expansion in pre-industrial revolution Europe. As such, it can be visualized as containing embryonic business units that can grow over time into fully fledged mainstream production units. In this case there is a potential for business units to graduate from the informal into the formal sector.

2.4.3 Involutionary approach

In terms of the involutionary approach, the urban informal sector is visualized as largely independent of the rest of the economy. It is also static in the sense that business units entering it may grow in number, but the markets for disposing outputs may not grow in step. In the words of Sandbrook (1982: 63), “more people share stagnant markets among themselves”. A similar view is shared by ILO (1990a: p. 2) where it is stated that “the swelling of the number of units year after year has caused much concern among policy makers, not only because of its impact on the physical environment (increasing congestion and pollution), but it
has also raised fears of involutionary development in which a growing number of individuals share a limited and stagnant market, resulting in declining markets and productivity”. The crowding within the urban informal sector is a result of its separate, distinct and largely self-contained existence. The crowding is not relieved by progression of business units into the formal sector nor by any stimulus from elsewhere in the rest of the economy.

2.4.4 Residuary approach

In terms of the residuary approach, the urban formal sector is in a dominant position whereas the urban informal sector is in a dependant position (Matsebula, 1996). The approach is residuary in the sense that the urban informal sector ends up with whatever remains after the formal sector has taken what it wants and needs. In the words of Seturaman (1981, p. 38), the formal sector “not only retains the surplus generated within itself and creates fewer jobs by choosing capital intensive techniques, but it also appropriates the surplus generated in the informal sector by restricting access to modern input and product markets on the one hand and by flooding their own products on the informal sector participants on the other”.

2.4.5 The institutionalist perspective of informal sector

A third research perspective, which can be described as institutionalist, is concerned with the effect of the institutional environment on business operators—institutional constraints are a source of business transaction costs (North, 1990)
and government institutions (represented by legislation, regulations and administrative culture) tend to increase transaction costs (Ferrand, 1999). In Tanzania for example, the capacity of government to impose regulatory constraints on informal sector activity has been observed to be limited (Trip, 1997; Heilman, 1998) and the primary effect of government is to place legal status beyond the reach of large numbers of small-scale enterprises, thus confining them to the informal sector (This could also be the case for Zimbabwe).

Institutionalists have shown that whilst being a low-cost refuge, the informal sector denies operators the benefit of growth opportunities; formal institutions do not recognise the forms in which informal operators accumulate capital and may not even recognise their existence officially, thereby denying them access to factors such as capital, technology, training and opportunities (De Soto, 2000). As a result, those operators who enter the informal sector tend to be trapped there, if not by their personal lack of growth orientation or entrepreneurship then because of institutional barriers and the costs of leaving. Some do succeed in overcoming the barriers, but there is little if any antecedent research focused on them (Harrison, 2000, p. 139–148).

2.4.6 Formalization Processes

Informal, semi-formal and formal status under the law provides a basis for an unambiguous typology of enterprises and a ‘de jure’ process of formalization
(Table 1) proceeding in two main steps from informal to semi-formal and then to formal status. Additional steps are possible within both semi-formal and formal status bands. Each step takes the form of a bureaucratic event that changes the legal status of an enterprise. To each level of legal status there is attached a different package of obligations designed to protect consumers, employees and the environment, and to raise public revenue. The burden of obligations becomes heavier with higher legal status. According to Nelson and De Bruijn (2005), a second formalization progression can be observed as a continuum comprising many progressive acts of compliance with obligations to government and with the norms of doing business in the formal sector; the term used for this being ‘de facto’ formalization. Whereas de jure formalization is a change of legal form, de facto formalization frequently represents a change of substance concerning behaviour and systems. De jure graduation and the de facto continuum can be separate or parallel progressions.

2.4.7 Formalization Mechanisms

De jure change to a higher legal form is an acceptance of a government offer of formalization, implying an agreement of terms between the two parties (operator and government), in which the operator gains recognition, the right to operate freely and property rights in exchange for the payment of taxes and submission to government regulation. This perception of formalization as an exchange transaction places it within the context of the theory of new institutional economics
and raises to prominence the issue of the transaction costs, incentives and benefits. With co-operation and efficient coordination of their actions, the parties to a transaction can in principle maximize the aggregate benefits they realize from it (a win–win outcome). Conversely, by competing to maximize their self-interests, it is possible that they would minimize their aggregate benefits (a lose–lose outcome). The choice that each makes is dependent on the clarity and acceptability of the terms of the transaction, and whether there are mechanisms for reaching prior agreement on them. In the circumstances of a formalization transaction, there is ordinarily no mechanism that enables an operator to negotiate directly with government. Any such negotiation would be conducted by intermediaries, such as representative associations and advocates, bargaining on behalf of the collective membership, the bargaining mechanism being subject to the relative power of the parties (Knight, 2001). The asymmetrical distribution of power between the parties means that superior government power prevails at the cost of operators, leaving them to cope in their own ways with the consequences of their formalization.

2.4.8 Formalization Progressions

Operators may remain at any level of informal or formal status for widely differing periods of time, from one year to 29 years (Nelson and De Bruijn, 2005). An operator may progress via a semi-formal stage, or graduate directly from informal status to the registration of a business name or limited company (Knight, 2001).
There is no apparent correlation between the passage of time as a factor in the formalization process and the type of activity. Operators may use the informal sector as experimental space in which to make low-cost tests of the feasibility of their enterprise ideas, abandoning those that do not meet expectations or they may remain in the informal sector exploiting a series of ad hoc opportunities. In any case, the informal sector provides an operator with low-risk entrepreneurship learning space.

Of the formalization decisions shown, only one was taken under the threat of imminent enforcement; in respect of others, operators accepted government formalization offers voluntarily at a time and for a purpose advantageous for their business activities. For informal enterprises, legal status enables an operator to conduct business openly and therefore determines the ceiling on the amount of business activity in which he or she can safely engage or the location in which it can be conducted (Knight, 2001); for others, it confers a standing that may be demanded by other parties in business exchange transactions (Knight, 2001), and it may provide technical transactional advantages, as does registration in the system of value added tax (VAT). In general, the cases indicate that during the formalization process operators can make choices—whether to formalize or not, when to formalize, how to formalize and for what purpose—and each operator uses them in different combinations that constitute different strategies for enterprise development within the given institutional environment.
2.4.9 Factors in the Enactment of Formalization Transactions

In the cases examined, operators’ acceptances of the government offer of a formalization transaction generally coincide with a perceived opportunity to do business. Other incentives, such as property rights and legitimacy, are recognized (particularly by operators concerned with their family welfare and security in the longer term) but play the role of supporting factors, suggesting that the stimulation of an opportunity, if not the prime motive, is at least a necessary condition for voluntary formalization decisions and actions. Operators who decide to formalize find the enactment process to be lacking in cooperation from government officers and to be procedurally inefficient, having to address requirements set by different, poorly co-ordinated government bodies. Rather than being helpful in giving clear information and directions about how to comply with the preconditions for obtaining operating licences and certificates, some officers are (in the opinion of operators) deliberately unhelpful, obstructive and uncaring about the delays and costs resulting from their attitudes. The extreme example is when an operator must travel two or more days to reach the only available government office to submit an application, to be told the form is not correctly completed and to come back with it another day. Why not use the postal service? Because, say operators, the service is erratic and delivery is not guaranteed, government officials do not send out notification of receipt and, even if an application should reach its destination, officials are unlikely to respond; anecdotally, it is claimed they (the officials) prefer face-to-face situations that offer opportunities for personal benefit. Only the relevant Minister can approve a registration application, which is also a cause of
delays. An examination of the procedural process faced by investors in Tanzania revealed dozens of possible steps (Coopers and Lybrand, 1996; ILO, 2001), which portends considerable transaction cost. After being directed to different government offices and receiving no help and insufficient information, Milly Zukkia actually abandoned her first attempt to obtain a state export licence; later she succeeded in one afternoon through the influence of an established manufacturer. Alan Mungo breached a tax regulation because, he says, he was unaware of it— he subsequently hired the tax official who led the process against him as a part-time ‘consultant’. Taxation is a particular area of conflict in which government claims the right to raise revenue from private enterprise, and operators resist on the grounds of poor or non-existent government services in return.

2.4.10 Formalisation choices

Two observable dimensions of change during formalization are (1) de jure status— informal, semi-formal, formal and (2) de facto changes of behaviour or structure— which can include: establishment of an enterprise as a managed entity governed by internal rules and systems, acquisition of an established clientele, impersonal relationships with clients, operational standards (touching employment, product quality, and environment protection), reinvestment of operational surpluses, acceptance of liabilities, strategic planning, membership of associations, technology upgrade and negotiating forward supply linkages in business-to-
business activities. De facto formalization commonly takes the form of many small and imperceptible changes.

Having no a priori time limits or fixed relationships between phases of change, an operator enjoys considerable latitude for managing formalization progression. Nevertheless, a positive relationship emerges between the progressions of their experience, de jure events and de facto development. This was found when plotting the positions of nine enterprises in institutional space defined by de jure and de facto dimensions of formalization (Nelson, 2003).

Cases show that three basic considerations bear upon operators’ formalization decisions: Institutional Incentives (II), which are the legitimacy, rights and benefits conferred by legal status; Opportunity Cost (OC), which is the loss of potential gains suffered when an operator decides not to formalize; Formalization Cost (FC), which is the cost to an operator of enacting a formalization transaction with government. Formalization costs include all costs incurred as a result of formalizing, including the costs of preparing and submitting a licence application, licensing fees, taxes, and costs of complying with prior conditions and subsequent regulatory obligations, and the cost of time lost through bureaucracy and intangibles, such as stress. The balance of the values of these factors is presumed to represent the strength of a Stimulus (S) to formalize. The stimulus is the prospective value of finding an enhanced institutional environment in the formal sector. The institutional incentive comprises a number of factors, for example, legitimacy and the prospect of benefiting from new rights, to which operators must
assign personal values. Opportunity cost can in principle be calculated if it is related to a specific opportunity, such as an invitation to tender for a public sector procurement contract. The model is generalisable to different situations in which the factors may be active to a different degree.

Formalization costs fall into two categories; some of them, particularly de jure costs, are payable immediately as a condition of being granted legal status, whilst de facto costs are generally incurred later in the process of enacting a transaction. The distinction between immediate and delayed formalization costs is introduced into the model as follows:

Immediate formalization costs (IFC) would normally include all up-front costs—the preparation of a licence application, licence fee, and advance tax payments and the cost of satisfying pre-licensing condition. Deferred formalization cost (DFC) would normally comprise costs such as value added tax, direct income tax, employment taxes and compliance with any regulatory provisions that were not satisfied as pre-conditions of the transaction. Based on these perceptions, the following relations can be observed (Nelson, 2003):

a. The higher the opportunity cost (OC) and the greater the value assigned to the other incentives and benefits of formalization (II), then the stronger is the stimulus (S) to formalise.

b. When opportunity cost (OC) is an estimate, it is subject to variable optimistic or pessimistic evaluations by individual operators.
c. Institutional incentives that are non-money benefits, such as general property rights, or general borrowing potential, are given variable subjective evaluations by different operators.

d. The lower the combined formalization costs (FC), the stronger the stimulus (S).

e. The higher the proportion of deferred formalization cost (DFC), the more formalization cost can be subjectively discounted (S).

Due to unavoidable subjective elements in the decision-making model, decisions will be influenced by an operator’s personal characteristic traits, such as self-confidence, attitude to risk and, as mentioned above, optimism and pessimism at the time a decision is taken. The effect of subjective influences in decision-making is to reduce the predictability of operators' decisions.

2.5 TAX EVASION

Tax evasion and avoidance are both phenomena that are probably as old as taxation itself this is because individuals and firms always evade and/or develop innovative ways of avoiding them. With Globalization, this problem becomes more intense (for Authorities) mainly because there are more incentives to avoid tax and remain undetected.
Most developed countries are characterized by a broad base of direct and indirect taxes with tax liability covering the vast majority of citizens and firms. Developing countries, however, tend to be characterized by difficulties in establishing a robust finance system mainly resulting from the presence of a concomitant of social, political and administrative difficulties. This results in increased vulnerability to tax evasion and tax avoidance activities of individual taxpayers and corporations. This can be considered as one of the primary reasons for the disparities in the ability to mobilize own resources between developed and developing countries.

This is substantiated by statistics which shows that: tax revenues in OECD-countries amounted to almost 36 per cent of gross national income in 2007, the share in selected developing regions only came up to 23% in Africa in 2007 (OECD, 2010a) and 17.5% in Latin America in 2004 (OECD, 2008). Irrespective of this, trends show an upward movement of tax revenue over time in many low-income countries. This development is, however, not a result of an improved tax system or administration but rather the result of a widening tax collection base with its source being increased revenues from natural resource taxes, e.g. income from production sharing, royalties and corporate income tax on oil and mining companies.

Tax systems in many developing countries are characterized by tax structures which deviate from international standards. This is because of the absence of tax management policies, in addition there are low compliance levels and inappropriate capacities in tax administration. The difference in revenue mobilization also has its roots in the economic conditions (size of the informal sector) prevailing in a country. In fact,
most developing countries are characterized with indirect taxation. Many of them rely, to a greater extent, on indirect taxes such as value-added taxes (VAT) with indirect taxes amounting for more than 50 percent of total tax revenues.

In contrast, according to Global Financial Integrity (2008), in developing countries personal income taxes as a proportion of total tax revenue still play a minor role in contrast to OECD countries and although developing countries still realize some of their domestic revenues through international trade taxes and tariffs, they have declined over the last twenty years. Aside from these structural differences in the tax systems between developing and developed countries, it is important to recognize that tax losses that arise in the course of tax evasion and avoidance activities do largely contribute to the poor performance of state revenue mobilization in developing countries.

In the last couple of years, strengthening self-financing capacities of developing countries has become a topic of increased concern and interest. Domestic revenue mobilization as a central issue of the international development agenda has been emphasized in both the Monterrey Consensus and the Paris Declaration on Aid Effectiveness. This is due to a number of reasons.

Firstly, it is important to note that most developing countries possess congenital inadequate self-financing abilities meaning the only way self financing can be achieved is through tax revenue generation. This can not be overemphasized given that x revenue generation is the panacea for the achievement of National Goals which
incorporate the ensuring of sustainable development and the implementation of pro-poor policies.

Secondly, according to Kanniainen and Paakkonen (2004), fair and efficient tax systems can contribute to good governance, accountability of the state and democracy by establishing a bargaining process between the state and its citizens. This is because Governments that rely on broad based taxation are forced to take the demands of their taxpayers into account and also be transparent in how the money is spent. At the same time, the way in which a government levies taxes essentially affects the citizen's identification with the state and its agencies and this has the potential of increasing trust and compliance of its citizens and ultimately promoting political participation. Thus, besides generating public revenues, strengthening tax systems in developing countries is equally important for governance and national building.

Thirdly, Torgler and Schneider (2009) explains that revenue raising systems typically incorporate the entire population, thereby exhibiting a direct effect on the poor and their household income. Designing a tax system in a pro-poor way can be achieved by including a redistributive component. All in all, collecting a sufficient amount of revenues becomes essential for a country to fund pro-poor programs, build effective government institutions and strengthen democratic structures, stimulate sustainable economic growth and reach national and international development goals. To reach these goals Friedman et al. (2000) notes that it becomes essential that the tax system be implemented the way it was designed. Thus, counterproductive activities like tax
evasion and avoidance practices, that undermine the intentions of the system, have to be reduced

2.5.1 The framework for tax noncompliance in the informal sector

The invisibility to the Tax enforcement Agencies (ZIMRA in the case of Zimbabwe) is the driving force and a major incentive to taxpayers ignoring tax laws. Noncompliance arises not only by the actions and inactions of the taxpayers but also by the decisions of tax legislation makers. “Noncompliance could be said, therefore, to be a product of the decisions of rule makers as of the actions of the taxpayers” (Kidder and Craig, 2000). At any single point in time, compliance and noncompliance are a product of decisions of political, legal, and administrative actors and of the behaviour of taxpayers. This suggests that tax noncompliance cannot be blamed entirely on the taxpayers but also the actions and inactions of the authorities in charge of tax administration as a whole.

Tax noncompliance behavior studies of the informal sector entrepreneurs and businesses, the study favours looking at the “typology of noncompliance” as outlined by Kidder and Craig (2000).

Noncompliance type variables are hereby looked more closely into:

- **Procedural noncompliance** - It will be noted that failure to follow rules which outline how to file, when to file and which forms to file. These violations are not as a necessity resultant in understatement of tax liability but have a bearing the procedures by which the taxpayer declares
income and deductions. The extremely difficult process of complying with ZIMRA rules and regulations have resulted in only a few informal sector entrepreneurs being able to afford compliance, this only results in noncompliance.

- **Unknowing noncompliance**- The underpayment of taxes through lack of knowledge of complicated, dubiously worded, constantly changed rules. Since the enactment of the presumptive tax regulations in 1996 there have not been any meaningful amendments to the regulations each year the government present the fiscal statement.

- **Lazy noncompliance**- Some individual informal players discover that they neglected documenting their business activities and also that they cannot record legitimate expenses for business or health costs or fail to maintain record of earnings from out sources for which there is no withholding. Truly speaking, deficiency in recording keeping is a common factor of the informal sector leading to the noncompliance.

- **Asocial noncompliance**- deliberate “innovative” ways of concealing gainful income accrued so as to escape the tax net of the ZIMRA officials. Several individual earners have managed to achieve this in several ways, common amongst them being through transacting cash in business and frequently changing business address so as to remain visible from the tax
man or ZIMRA. Informal sector business people in their large numbers are actively engaged in this form of noncompliance.

- **Symbolic noncompliance**- When a group of entrepreneurs collectively decide to act against some perceived unfairness and inequities in tax legislation. refuse to pay tax in protest against what the entrepreneurs see as unfair tax legislation and misuse of tax money by the senior civil service officials

- **Social noncompliance**- when fellow business people decide not to pay tax and social influence bears upon the taxpayer there is a tendency not to comply with the tax legislation. This occurs where networked individual business people jointly decline to pay tax in turn all those in the particular network will succumb to the peer pressure because of the situation obtaining.

- **Brokered noncompliance**- when an accountant, lawyer or bond dealer uses their expertise to advise a tax payer not to comply with the expected regulations by preparing but to gain an advantage from the cheating. The taxpayer is advised by the expert hired to prepare the accounts not to pay tax and so that the account may be paid for failing to honour its dues legally

- **Habitual noncompliance**- this is a situation arising from a tendency of failing to pay tax over a long stretch of time occasioned by the taxpayer
habitually getting used to either under-declaring or non-declaration of the correct figures arising from his income.

2.5.2 Measuring tax evasion

Literature and data concerning this topic are still insufficiently available although the topic of tax evasion and tax avoidance represents a problem for developed and developing countries. This is due in part to the fact that it is difficult to estimate as the phenomena are difficult to observe and precise data is, thus, lacking. Thus the absence of any empirical data on on the different kinds of tax evasion and avoidance. Rather, one needs to base any analysis on estimations. This makes the task of quantifying tax evasion and avoidance as well as identifying the underlying factors difficult especially in developing countries.

Fuest and Riedel (2009) provides an overview of the disagreements of different studies and their respective results concerning the range of tax evasion and avoidance. Due to the lack of data availability and the various estimation techniques, existing estimates on the tax gap resulting from tax evasion and avoidance are difficult to compare and often cover a wide spectrum. According to a calculation by Cobham (2005) based on estimates of the size of the domestic informal economy by Schneider (2005, 2007) developing countries lose a sum of US$285 billion per year because of tax evasion in the domestic informal economy. In addition there are varying estimates on tax revenue lost due to corporate income shifting with figures varying between US$35 billion and US$160

Global Financial Integrity (GFI) calculates that developing countries lose between $859 billion to $1.06 trillion a year through illicit financial flows (GFI, 2010). Illicit financial flows is defined as money that is illegally earned, transferred, or utilized. According to this definition of GFI this includes the transfer of money earned through illegal activities such as corruption, transactions involving contraband goods, criminal activities, and efforts to shelter wealth from a country’s tax authorities.

Empirical evidence about the extent of tax evasion and avoidance for different world regions is also very limited. A new study by GFI estimates that African countries lost a total of US$854 billion in cumulative capital flight over the period 1970-2008 (GFI, 2010).

The huge figures exhibited from these studies certainly reveal the importance of the issue and might even provide a rough indication of the size of the problem. However, it should be noted that the underlying definitions and assumptions used to come up with these estimates differ widely and thus the estimates are, therefore, neither comparable nor reliable.
2.5.3 Reasons for tax evasion

Tax remittance non-compliance is motivated by different reasons and for one to devise methods for curtailing tax evasion and avoidance it becomes imperative to understand the different reasons leading to such tendencies. These reasons can be filed in two categories. The first category comprises of factors that negatively affect taxpayers' compliance with tax legislation. These factors can be subsumed either contributing to a low willingness to pay taxes (low tax morale) or to high costs to comply with tax laws.

The second category contains reasons that are related with tax administration. Specifically, this connotes the low ability of tax administration and fiscal courts to enforce tax liabilities. These factors can be summarized as resulting from insufficiencies in the administration and collection of taxes as well as weak capacity in auditing and monitoring tax payments which limit the possibility to detect and prosecute violators. These facilitating factors are explained below.

2.5.3.1 Low tax morale

Taxpayers' willingness to pay taxes differs widely across the world. It cannot be viewed as simply depending on the tax burden. Rather, empirical research indicates that taxpayers throughout the world pay more taxes than can be explained by even the highest feasible levels of auditing, penalties and risk-aversion. Risk-averse individuals tend to pay more taxes attempting to avoid the risk of detection and punishment (Alm et al., 1992; Alm and Martinez-Vazquez,
These high levels of tax compliance result from the tax morale of society that fosters self-enforcement of tax compliance.

Tax morale is, however, not easy to establish. Especially countries without a deep-rooted 'culture' and habit of paying taxes find it difficult to establish tax morale (Cummings et al., 2005 and Torgler et al., 2007). This “willingness to pay” of the taxpayer is influenced by the following factors:

i. **Low quality of the service in return for taxes** - In general, citizens expect some kind of service or benefit in return for the taxes paid. If the government fails to provide basic public goods and services or provides them insufficiently, citizens may not be willing to pay taxes and tax evasion and avoidance will be the consequence (Pashev, 2005; Everest-Phillips, 2008; Lieberman, 2002; Brautigam et al., 2008).

ii. **Tax system and perception of fairness** - Some studies suggest that high tax rates foster evasion. The intuition is that high tax rates increase the tax burden and, hence, lower the disposable income of the taxpayer (Alligham and Sandmo, 1972; Chipeta, 2002). However, the level of the tax rate may not be the only factor influencing people’s decision about paying taxes. In fact, the structure of the overall tax system has an impact as well. If, for example, the tax rate on corporate profits is relatively low, but individuals are facing a high tax rate on their personal income, they may perceive their personal tax burden as unfair and choose to declare only a part of their
income. Similarly, large companies can often more easily take advantage of tax loopholes, thereby contributing to the perceived unfairness of the system. Tax rates and the overall structure of the tax system, therefore, have a significant effect on the disposition to evade and avoid taxes.

iii. **Low transparency and accountability of public institutions** - Lack of transparency and accountability in the use of public funds contributes to public distrust both with respect to the tax system as well as the government. This, in turn, increases the willingness to evade taxes (Kirchler et al., 2007).

iv. **High level of corruption** – Citizens are more likely to evade taxes if they perceive that high levels of corruption are existent within a country, in this regard citizens cannot be certain whether their paid taxes are used to finance public goods and services and their willingness to pay suffers. A taxpayer might consider evading taxes if the cost of bribing a tax auditor is lower than the potential benefit from tax evasion.

v. **Lack of rule of law and weak fiscal jurisdiction** - The absence of rule of law reduces transparency of public action and promote the development of distrust among citizens. As a result, citizens may not be willing to finance the state through taxes, and decide to evade these liabilities. The absence known norms and the general rule of law erodes transparency of public action and results in a deep rooted element of distrust amongst law abiding
citizens. Ultimately, a majority of citizenry may become reluctant to financially oblige the state through taxes, instead decide to evade the liabilities.

vi. **Psychological factors** – Abrie and Doussy (2006) posits that the attitude as well as the personality of an individual can explain his/her behavior towards tax payment. According to Alm and Martinez-Vazquez (in Abrie and Doussy, 2006 p 4), the social norms of an individual play a vital role in the decision to comply with the tax legislation. This attitude is also in part determined by the government. Once reminded of the benefits that they receive from government, citizens are more willing to pay taxes (Peters in Oberholzer, 2008a p 65). In a study by Oberholzer (2008a) most of the respondents felt that it is fair to pay taxes. However, the respondents unanimously agreed that in the event that corruption and careless spending by government is high, it becomes hard to justify paying taxes. According to Abrie and Doussy (2006) an individual’s church membership and/or history of contribution to charity or towards a need in the community or church could also be used as an indicator of the individual’s chances of complying with tax laws.

### 2.5.3.2 High compliance costs

A significant factor to tax evasion and compliance could be High compliance costs. Compliance costs are the costs the taxpayer has to bear to gather the necessary information, fill out tax forms etc. The World Bank’s 2008 World Development
Indicator for “time to prepare and pay taxes” shows huge differences between countries: this ranges from 210 hours on average in high income OECD countries, to 1080 hours in Bolivia and Vietnam and 2600 hours in Brazil. Similarly, Everest-Philips (2008) mapping of taxes in Yemen found over 1500 different taxes, licenses and fees covering various bases at different rates. This situation led businesses to worry more about the administrative burden than about the actual tax burden. In such a situation it can be concluded that compliance costs are very high and the probability of the taxpayer complying with such a great variety of taxes low.

Chief among the major “victims” of high compliance costs are medium sized enterprises (SME). SBP (2005) in a survey among South African firms on the regulatory costs of doing business, revealed that taxes, in particular VAT, are perceived as the most problematic set of regulations followed by labor regulation. On top of this is the paperwork that has to be mastered to comply with tax legislation which is deterring firms from paying their taxes appropriately. When asked on their strategy to cope with regulatory costs of running their business about 18 percent responded to simply try to avoid or evade taxation.

2.5.3.3 Weak enforcement of tax laws

According to the World Bank (2008) there exist several circumstances that restrain tax administrations from performing their functions properly thereby increasing the possibility of tax evasion. Shortfalls in tax collection procedures as well as weak capacities of tax administrations to detect and prosecute tax violators are both factors that contribute to a low enforcement of tax legislation (World Bank, 2008).
2.5.3.4 Insufficiencies in tax collection

Regarding tax collection, many developing countries face difficulties with respect to important premises for a well functioning tax administration, especially with respect to identifying and administering those citizens and firms that are liable to tax payments. Although there has been progress, tax administrations’ capacity to introduce and sustain e.g. well-functioning tax registers still pose severe difficulties in many developing countries. Problems of insufficient capacity may also occur due to the organizational set up of the tax administration and its relationship to the ministry of finance. In general, there are two approaches for the organizational set up of tax administration.

The first option is where the Ministry of Finance itself assumes the tax administration function and departments within the ministry of finance collect taxes. The second option is a semi-autonomous revenue authority where tax administration is moved out of the Ministry of Finance into a separate entity. Often, tax administration and collection by ministries of finance were considered inefficient and suffering from corruption and high compliance costs (Fjeldstad and Moore, 2009). Therefore the creation of semi autonomous revenue authorities has been pursued in many developing countries mostly as part of comprehensive tax administration reforms. Additionally, unclear responsibilities regarding the collection and administration of specific types of taxes by different institutions can lead to inefficiencies and tax losses and require a reorganization of the tax administration. Typically, an organizational approach according to the functions of
tax administrations is considered more efficient than one following different tax and revenue types.

Moreover, one has to bear in mind that tax administration and tax policy are intertwined spheres. Tax policy directly affects the costs and the organization of the tax administration. Additionally, the capacities of tax administration influence the way tax policy is implemented. Thus, both areas tax policy as well as tax administration have to be taken into consideration when designing successful tax reforms. Otherwise, the proper functioning of the overall system is affected. For this reason, the tax system should be aligned to the administrative and legal prerequisites of the respective country (Chiumya, 2006).

Qualified, well trained and motivated tax officials are crucial for the collection of taxes and the performance of tax administration bodies as a whole. In order to motivate tax officials to work in accordance with the interests of the government and to reduce their vulnerability to corruption, attention has to be given to wages and other incentives.

Finally, insufficiencies in tax collection result from the fact that economies of most developing countries are characterized by a large informal sector. Firms and individuals active in the informal sector usually do not pay direct taxes on personal or business income, and they do not charge consumption taxes or excises on their sales. The state loses these potential tax revenues and, as a consequence, lacks necessary funds to provide goods and service. Often, the reasons to be active in
the informal economy are not directly related to attempts to avoid taxation but rather to limited options or excessive administrative requirements to enter the formal economy or excessive costs of labour regulations. However, there are also cases where individuals and companies choose to be active in the informal sector with the intention to escape their tax liabilities. Nevertheless, tax evasion does not need to be the primary reason why firms remain or become informal.

2.6 STRATEGIES AGAINST TAX EVASION AND TAX AVOIDANCE

The previous sections have ambly demonstrated that, there are several causes and factors which contribute to a scenario where tax evasion and avoidance occur on a large scale. Tax evasion and avoidance may derive from low tax morale, high compliance costs or may result in the course of firms’ endeavours to maximize profits by reducing their tax liabilities. Hence, in the same way as there is not only one type of tax evasion and avoidance, there is “no one size fits all” (GTZ, 2006a, p. 12) solution to counter tax evasion and avoidance. The practicability and the size of the window of opportunity depend on the specific situation and the predominant type of tax evasion and avoidance in a country. An effective strategy needs to address the underlying causes and most importantly - in the context of developing countries - needs to be tailored to the specific country environment. Any imbalance between a country’s absorptive capacity and the complexity reforms can either induce a failure of reform or a wasted opportunity. If, for example, the absorptive capacity is low, reform strategies should either not be too ambitious or be accompanied by extensive capacity development initiatives. If, on
the other hand, the absorptive capacity is very high, simple reform strategies will likely be successful. Still, such a strategy would be unbalanced in the sense that more complex and more ambitious reforms could already be initiated.

Based on the preceding sections on the reasons and modes of tax evasion and avoidance, the present chapter describes potential ingredients of such an effective, country-specific strategy to fight specific causes and factors contributing to tax evasion and avoidance.

2.6.1 Measures improving tax compliance

Low tax compliance contributes to a large extent to insufficient revenue mobilization resulting from the evasion and avoidance of tax payments. It involves voluntary compliance of the single tax payer but also further aspects like taxpayer’s knowledge on tax procedures necessary for the fulfillment of her duties.

The improvement of citizens’ tax morale requires measures ensuring and visualizing that the state is acting in a transparent, accountable and efficient manner with the ultimate aim of providing services for its citizens. These measures go far beyond reforms of the tax system or administration by developing a sound state-society relationship and enhancing the legitimacy of the state requires taking into account the entire public system. Such broader strategies cover e.g. the quality of public services, the transparency and control of the public budget or the fight against corruption (Global Financial Integrity, 2008).
2.6.1.1 Taxpayer education and taxpayer service

The importance of taxes for the functioning of the state is not always apparent to the taxpayer. Similarly, individual tax liabilities as well as requirements to comply with the tax system such as filling out different tax forms might be unknown or difficult to understand. By means of taxpayer education and taxpayer service, citizens can be informed and educated about the tax system and be assisted in their attempts to comply with the tax system.

A key factor to strengthen voluntary tax compliance is sound education of (future) taxpayers in focal areas of taxation. Taxpayers need to understand the importance of contributing to the tax system. Further, they need to develop a deeper understanding of the tax system and the taxpaying procedures.

With the objective to change the public’s opinion of the revenue authority to a benevolent attitude and promote a “tax-paying citizen” culture, the Rwanda Revenue Authority has integrated its external environment into the capacity development process. This includes the organization of an annual “taxpayer’s week” with parades and the awarding of certificates and prizes. Additionally, opinion leaders and political figures are sensitized how to encourage compliance among constituents. Moreover, the Rwanda Revenue Authority is cooperating with partner organizations to reinforce their efforts to disseminate information about paying tax (Land, 2004). This emphasizes the importance of integrating a wide range of stakeholders into the education process. In addition to the typical efforts of politicians and tax officers, important tax payers, donors and NGOs can help to
improve the tax moral or function as a role model for a responsible and sensitive citizen.

The Peruvian Revenue Authority (PRA) educates citizens in the scope of taxation. PRA offers, among other services, E-learning, education programmes at schools and universities, education courses, video lessons, a virtual library and a range of publications. The aim is to educate both current and future taxpayers. The use of comics and videos can help to reach illiterates, children and in the end the majority of the citizens. The aim is to develop tax morale, tax culture and a deeper understanding of the tax system in the long run.

2.6.1.2 Addressing tax compliance costs and administrative costs

Apart from promoting voluntary tax compliance, governments in developing countries as well as development partners should concentrate on measures that reduce taxpayers’ costs of fulfilling their tax liabilities. In this regard, revenue authorities must be aware of the importance of acting service oriented and should therefore monitor customer satisfaction. Many revenue authorities shift towards a customer service orientation which reflects the growing awareness of the need to offer a quality service to the taxpaying public and to be responsive to public concerns. For instance, measures to simplify the taxpaying process and promoting service oriented tax administration include a reduction of the number of tax forms and officers assisting clients in filling out documents or the introduction of online services.
2.6.2 Measures improving the ability to enforce tax laws

Similarly to low tax morale, the ability to enforce taxes is influenced by a broad variety of factors. Not all of these can be tackled directly by reforms of the tax system or the tax administration. The following section identifies important measures related to taxation while broader strategies affecting the environment, e.g. formalization of the informal sector, will not be covered.

2.6.2.1 Addressing weak enforcement at the national level

Tax administration reforms are a crucial part of any effective strategy to strengthen enforcement of tax laws at the national level. Measures in this area include different approaches of organisational reform such as the creation of semi-autonomous revenue authorities, setting-up of Large Taxpayer Units as well as capacity development such as trainings and courses on selected topics, e.g. specialized courses in the area of detecting illegitimate profit shifting activities or tax fraud, but also restructuring of the wage schedule to offer sufficient incentives in order to attract and recruit capable staff and to minimize the risk of corruptive behaviour.

Reforms referring to the organization of the administration are a sensible step to enhance law enforcement. Often, the organizational setup of the tax administration is a reason for the extent and prevalence of inefficiencies. Therefore, public administration reforms should aim at simplifying the organizational body of tax
administrations and its working structure. For instance, countries could try to reduce the number of authorities dealing with tax issues and centralize the collection of tax revenues to one single authority.

Between and within different authorities, competences need to be divided and different departments within the institutions need to be mandated explicitly. Especially when it comes to exchanging information within the institution, simplification of the administrative organization might be a useful contribution. A common step in public administration reforms is the establishment of semi-autonomous revenue authorities.

A common measure in tax administration reforms in recent years has been the establishment of semi-autonomous revenue authorities. By setting up semi-autonomous revenue administrations many developing countries expected to enhance revenue mobilization, improve service orientation and staff quality, and fight tax related corruption and evasion. The semi-autonomous status enables revenue authorities to pay higher salaries than the public sector which enables them to recruit highly educated staff. It is also believed that higher salaries reduce corruption by lowering incentives to accept bribes. This leads to better work ethics as well as a proactive and professional administrative culture which ultimately contributes to improved law enforcement. Finally, semi-autonomous tax revenue authorities become de-politicized, promoting their acceptance in public by lowering the risk of being abused for interests of political elites (Mann, 2004).
Strategies to strengthen tax administration should also focus on reducing administrative costs inside the tax administration. For this purpose introducing unique taxpayer identification numbers are considered a useful instrument as they facilitate cross-checking of information between different types of taxes such as VAT and income tax. In addition, monitoring and auditing of tax payments and tax arrears are easier if a unique taxpayer identification number exist.

Along the same lines, the creation of a Large Taxpayer Unit (LTU) allows for specialization of tax auditors and thus increases efficiency. Additionally, LTUs help tax administration concentrate all available capacities to those firms that contribute considerable amounts to domestic revenues.

In developing countries, a small number of enterprises bear the lion’s share of the tax burden. Focusing on a small group of crucial taxpayers simplifies the enforcement of corporate tax laws and, hence, allows tax compliance at minimum costs, as the Kenyan experience reveals.

In 1998, the Kenyan revenue authority formed a Large Tax-payer Office (LTO) as a one-stop-service, substantially reducing costs of complying with the tax law. The LTO’s mandate covers the administration of income taxes, VAT, domestic excises and agency taxes. In 2006, the LTO covered 700 institutions which contributed about 75% of the domestic tax revenue. Ghana established a LTU in 2004 and was able to increase revenues by about 86% between 2003 and 2005 although the corporate tax rate was reduced (GTZ, 2006b).
The cases of Kenya and Ghana illustrate that the establishment of LTUs is particularly suitable to target limited administrative capacities in developing countries. However, despite of these advantages, one has to bear in mind that the creation of LTUs might slow down the process of integrating all citizens into the tax system in the long run. Including small and middle sized enterprises as well as natural persons into the tax system is essential to get society involved in public finance and to strengthen a state’s legitimacy and accountability. If citizens pay taxes they are more concerned about how the government spends their money. Taxing also small taxpayers leads to a critical monitoring of both the government and other, larger taxpayers by the public, thereby strengthening mutual accountability.

Complex and often changing tax laws cause confusion and uncertainty among tax officials and taxpayers. Addressing deficiencies in the tax system is therefore probably as important as process orientated reform actions that enhance the user-friendliness and transparency of the taxation procedure. Particularly small and medium size enterprises (SME) with only limited administrative capacities and private households do not only suffer from the bureaucratic burden of complicated tax procedures but also from the complexity of the tax system itself. Simplifying the (corporate) income tax structure by reducing the number of tax brackets and high statutory tax rates lowers the tax burden and may support voluntary compliance. A comprehensive reform of the tax law might be more advisable than reforming the
system step by step, thereby risking a complex financial law as is common in many (developing) countries today.

Furthermore, the possibility to detect and prosecute tax violators depends crucially on data availability and data quality. Hence, actions taken against tax evasion and avoidance relate to an improvement of the data quality available to tax officers. The (inter-)institutional exchange of high quality information requires different steps. On the one hand, it is important to ensure the collection of adequate data. Therefore, one needs to ensure a sufficient endowment with technical equipment and the establishment of good performing statistic divisions with competent staff members to collect data and keep records. On the other hand, good technical equipment and technically educated staff are also a prerequisite for a well functioning information exchange. Along these lines, automation of tax collection procedures e.g. through online tax assessment, payment and monitoring opportunities may serve as an efficient way to reduce the scope for tax evasion and avoidance. Stiglitz (1986) and Golob (1996) argue that a flat corporate income tax would benefit small businesses the most, not least because of lower compliance costs.

In fact, the Tanzanian Revenue Authority successfully implemented a computerized tax administration system (iTAX) which simplifies tax compliance and contributes to enhanced efficiency of tax collection as well as auditing processes (GTZ, 2010).
Tax fraud and avoidance are also a result of a weak judiciary. Addressing revenue shortfalls needs to go hand in hand with legislative reforms strengthening the rule of law. This includes insufficient punishment and prosecution of violators which can only be tackled when detected tax criminals face stricter penalties that are effectively executed by courts. As shown by Fishlow and Friedman (1994), higher penalties act as a deterrent and help to improve tax compliance. To achieve this goal governments have to strengthen the rule of law and develop capacities of investigation authorities. Moreover, investigators as well as courts and judges should receive greater support by politicians in order to emphasize the importance of this issue.

2.7 STRATEGIES FOR THE TAXATION OF INFORMAL ACTIVITIES

Subjecting informal activities to a direct tax appears important for two main reasons. First, taxpayers are far more aware of direct taxes than of indirect taxes. As a result, direct taxes can give the taxpayer the feeling of belonging to a community and therefore might encourage him to demand more efficient public expenditures. Second, a direct tax on informal activities can constitute a significant resource for local public finance (Bulotoglu, 1995).

In the past, small firms in francophone Africa were subject to a complex tax system (the “forfei”) system). The amount of different presumptive taxes included in the “forfei” system (profit tax, VAT or turnover tax and business tax) were calculated in relation to an estimated turnover, whereas small firms carried out no book-keeping (Bulotoglu, 1995). Due to the lack of reliable book keeping, the reference to
turnover in order to determine the tax base of this business tax still remains a source of uncertainty and complications (Bulotoglu, 1995).

According to Loayza (1996) the taxation system for small activities could therefore be greatly improved by adopting a simplified unified business tax. Loayza added that the scale of this tax would be determined according to objective indicators of contributory capacity such as average or minimum income per type of business, with no reference to turnover. Hence, book-keeping and return filing would not be necessary. The scale of the unified tax should naturally take into account any advance payment on profit tax, as well as the VAT incidence on intermediate consumptions (Loayza, 1996).

The extreme simplicity of this unified business tax would facilitate its understanding and acceptance by the taxpayers. It would also allow a reduction in monitoring costs by avoiding an excessive number of complex taxes with regard to these small taxpayers (Loayza, 1996). Toye and Moore (1998) argued that for an efficient collection of the unified tax, it would be necessary to favour a spontaneous payment procedure based on periodic payments (most often a quarterly periodicity would be adequate). Collection visits in the field would aim at registering the informal taxpayers, checking the effective tax payments and collecting the tax from defaulters (Loayza, 1996). According to Toye and Moore (1998) the simplification introduced by a calculation of the unified business tax based on specific indicators would also allow the collection of this tax to be entrusted to the decentralized authorities: the unified business tax has a clear local application.
2.8 BARRIERS TO EFFICIENT TAX ADMINISTRATION

Everest-Phillips (2008) points out that while tax laws impose obligations on taxpayers to contribute to government revenues, the actual amount of revenues flowing into the hands of any government depends on the effectiveness of its revenue administration. Weakness in revenue collections leads to inadequate tax collections. For a number of reasons, efficient tax administration is a major problem in developing countries. Not only do developing governments face an uphill battle in bringing individuals and small businesses into the taxation process, but governments face insufficient administrative staff with no skills, high levels of illiteracy among taxpayers and tax collectors, lack of sufficient computer equipment and facilities, and lack of reliable statistical data.

2.8.1 Lack of adequate resources

A major constraint in tax administration is the lack of adequate resources to sustain and facilitate the operation of tax authorities (Easson, 2004). Resources to administer a tax can generally be divided into two categories: human resources and physical resources. Human resources include not only the number of tax officials but also the quality of tax officials. Physical resources cover a wider dimension, ranging from office buildings and office equipment to vehicles and communication systems. These are the resources required by the human resources in order to ensure compliance with tax laws.
The Zimbabwe Revenue Authority (ZIMRA) is undergoing major investment in computerized systems to enhance its risk management function. This investment in equipment such as scanners is aimed at increasing detection and deterrence of criminal activities like fraud and smuggling at all ports of entry. Strides have so far been made in embracing information and communication technology as part of the Authority’s efforts to modernise Tax and Customs operations. The introduction of ASYCUDA World and scanners at some stations to expedite Customs clearance is a case in point. ZIMRA now has a fully functional in-house training centre whose goal is to impart skills to its officers. In conjunction with the National University of Science and Technology (NUST), ZIMRA set up a Bachelor of Commerce degree in Fiscal Studies and the first batch of graduates is expected before the end of 2012. Despite these developments, ZIMRA has not put enough effort to develop strategies for collecting revenue from the informal sector. All these developments seem to be targeted at the formal sector. In fact, the company seems to place a blind eye on the sector.

2.8.2 Financial constraints

Due to financial constraints, many tax officials who are hired lack understanding of the tax laws they are administering, and the concepts of accounting that are essential to analyzing returns. According to Everest-Phillips (2008) lack of modern technology, especially computers, to facilitate the taxation process is another impediment to effective tax administration. Until recently, Uganda, like most developing countries, had to rely on manually entering taxpayer data into record
books, and keeping a voluminous amount of tax information in print. Even with the advent of modern technology, the lack of resources to purchase equipment means that a number of tax offices still use highly ineffective manual systems of recording tax information.

2.8.3 Tax Administration and Data

A challenge facing tax policy in developing countries is the lack of efficient tax administration (Land, 2004). Administrations face major problems: a large proportion of the economy is at a subsistence level; many taxpayers do not keep records, and even where records are kept, they are not necessarily reliable. Taxpayer cooperation is also low because of chronic shortages of trained officials, traditions of corruption, and lack of visible improvements in government services. As a consequence, countries often develop tax systems that exploit whatever obvious revenue-generating options they have rather than develop modern and efficient tax systems that create wide tax bases from which to draw revenue. Hence many developing countries often end up with too many small tax sources, with heavy reliance on foreign trade taxes, and a relatively small use of personal income taxes. This is visible in Zimbabwe where pressure is put on the few formal sector large businesses and at ports. Because ZIMRA is unable to increase the number of taxpayers especially from the informal sector, they impose more taxes on commodities and services to fulfill the country’s revenue needs. The result is a regressive tax structure putting more pressure on honest taxpayers and promoting inequality in the society.
The Global Financial Integrity (2010) concluded that effective tax administration depends on the existence of these factors:

- The existence of a predominantly money economy;

- A high standard of literacy; although literacy is not a necessary condition for taxation, the lack of a literate population reduces the options for policymakers;

- Prevalence of honest and reliable accounting; lack of reliable accounting constrains the types of taxes that can be effectively employed;

- A large degree of voluntary compliance on the part of taxpayers; modern taxation involving self-assessment depends heavily on voluntary cooperation by taxpayers;

- A political system not dominated by wealthy groups acting arbitrarily in their own self-interest.

2.8.4 Political and Social Factors

According to Everest-Phillips (2008) political and social factors create additional challenges in devising tax policies for developing countries. Lack of political will to support tax reforms in developing countries has oftentimes led to unsuccessful reforms. Lessons learned from successful reform programmes suggest that the key factor is strong political will, demonstrated by a commitment from leaders at all
levels of government. Additionally, most developing countries suffer from military dictatorships, corruption, civil wars, underdevelopment, deep poverty, disease, and famine. All these challenges have inevitably led to low tax revenue yields in developing countries.

Another developmental challenge facing the world and particularly Africa is the HIV/AIDS epidemic. The epidemic has become much more than a health problem as it encompasses economic, social, political, psychological, and cultural dimensions. Sub-Saharan Africa continues to be the most severely affected by HIV/AIDS. In 2006, it was reported that almost two-thirds (63%) of all persons infected with HIV are living in Sub-Saharan Africa -- approximately 24.7 million people in total. An estimated 2.8 million adults and children in Sub-Saharan Africa became infected with HIV in 2006 -- more than in the rest of the world combined. The scale of the epidemic’s impact greatly varies from place to place. In countries with high levels of HIV/AIDS, the epidemic is having a serious impact on public services. At the same time that productivity and tax bases are being constrained by the deaths of adults in their productive prime, AIDS is placing increasing demands on public sector services, such as health and education, and on public administration. Thus AIDS has started to reverse the economic gains that had been achieved by many developing countries (Baker, 2005).
2.9 SUMMARY

The available knowledge on the subject of evasion of tax payment has been outlined in this chapter in order to highlight problems of developing third world nations. Information and sufficient literature on the topic of tax evasion may seemingly be available but physically the sources for this data are actually hard to come by. In actual fact the crux of the whole issue lies in the situation where the tax demographic and geographic spread of tax evaders has remained a phenomenon hard to quantify as there is no processed data to the effect.

Empirical findings giving a clear picture of the extent of tax evasion remain very few. Several ways of tax evasion and avoidance are employed in the informal sector yet these have gone unnoticed.

There are various reasons which give way to tax evasion with some indirectly facilitating the practice. Early researchers put factors facilitating tax evasion into categories to cover aspects that affect tax payers compliance in a negative way and on the other hand reasons that account for weak enforcement by the authorities in fiscal courts to deal with non compliance by tax evaders. In order to
combat and understand tax evasion and tax avoidance it is felt more important to get a deeper insight into factors underlying the problem of tax evasion and avoidance. The researcher also strived to give a deeper conceptual perception into the root causes of voluntarily entering the informal sector and how some perceive the prospects of their business growth. These aspects have not been highlighted by previous researches on the topic whilst this study made it clear that these aspects are inseparable in the academic discourse. which propounds that the informal sector, “is comprised of plucky micro entrepreneurs who … (desoto) with government procedures being long and dumbsome, (desoto) goes on to say, small and medium operators will continue to find ways and means of avoiding the costs of time and efforts that go with operating a small to medium enterprise. (Desoto, 1989 and 2000). According to the legalist school of thought, the long, numerous pieces of legislation governing entry and operations of a micro enterprise are one major reason pulling entrepreneurs into the informal economy.

The Dualist School of thought have touched on the mentioned aspects much as it does not mention or fails to relate the known aspects of tax evasion phenomenon. This school was based on the assumption that the informal sector provides income for the poor and a safety valve to those “ in times of crisis and that it exists as an avenue for the lower class and the poor to be able to eke out a living.” According to ILO (2005), this school elaborates that the persistence of the informal sector activities is due largely to the fact that not enough modern job opportunities have been created to absorb surplus labour, due to a slow rate of economic growth and /
or a faster rate of population growth. Although this school could be true in the Zimbabwean case, no connection is made to one of the most pressing problem of the informal sector (tax evasion).

Another school that has been discussed in this chapter is the Legalist School subscribing to the notion that the informal sector is comprised of ‘plucky’ micro-entrepreneurs who choose to operate informally in order to avoid the cost, time and effort associated with formal business (de Soto, 1989 and 2000). According to de Soto (2000), micro-entrepreneurs will continue to produce informally so long as government procedures are cumbersome and costly. By the legalist school of thought, the inordinate demand placed on businesses by the government’s enactment of numerous commercial laws and regulations is acting as a driving force for the participation in the informal sector. Assuming that this school of thought is applicable in developing countries such as Zimbabwe, it would mean that the simplification of rules and regulations for formalization process may reduce the rate of the informality by the entrepreneurs, thereby increasing the likelihood of one complying with tax laws. However, the challenge with this school is that this may not be the case in developing nations especially Sub-Saharan African countries where government rules and regulations have not been cited as major factors contributing to informality and tax evasion. Other schools of thought such as the illegalist still do not give a clear indication of what could be the major underlying cause of tax evasion in Zimbabwe and other Sub-Saharan African nations.
This study looked further than the usual suspected factors associated with tax evasion such as government rules and regulations. The researcher also looked into voluntarism. Although previous studies have looked at these aspects, they did not try to relate these aspects of voluntarism to tax evasion and the researcher believes there should be a connection. Indeed there are several reasons to suspect that there might be a generally positive relationship between the ratio of voluntary to involuntary informal employment and levels of tax evasion. More developed countries generally have stronger unemployment insurance systems, and thus open unemployment can more readily provide an alternative to involuntary informal employment in the face of job loss. Considering too that the share of informal employment is highest in the poorest developing regions, particularly in South Asia and sub-Saharan Africa (with informal employment approximated by self-employed and unpaid family workers in urban and rural areas, for want of better regional estimates). This could be an indication that there could be other factors associated with tax evasion other than the usual and this study sought to investigate these other factors along with trying to see if the usual factors are applicable to the Zimbabwe case. Other aspects looked at included the perceptions that informal traders had on the prospects of their businesses progressing into the formal sector among others.

All these gaps prompted the researcher to look deeper into factors associated with tax evasion, thereby resulting in the undertaking of this study.
This study sought to test the already existing theories about tax evasion in the informal sector and see if they were applicable to the Zimbabwean case. Research sought to investigate the major underlying factor or factors resulting in the usually suspected factors as those discussed in this chapter such as government rules and regulations and tax administration inefficiencies among others. This came about after realizing that these usually suspected or identified factors failed to clearly explain why informal traders evade taxes.
CHAPTER THREE: RESEARCH METHODOLOGY AND DESIGN

3.1 INTRODUCTION

In this chapter, the researcher presents and discusses the methodology and design of the study. The topics covered under this chapter include research paradigm, research design, research process, data collection instruments and procedures, data presentation analysis and interpretation procedures, validity and reliability and ethical issues. The methodology and methods used in this study sought to create new knowledge in the phenomenon of tax evasion in the informal sector as the study itself looked at factors associated with tax evasion in the informal sector of Zimbabwe, with focus on the Mbare Magaba Informal Trading Centre or Market Place. In other words, the study asked the question “Why is there tax evasion in the informal sector at such high levels of 98% as cited by the Finmark Trust?” and went further to also look into the characteristics of the informal sector in relation to tax evasion. This way the study sought to add more knowledge to the existing body of knowledge about tax evasion.
3.2 RESEARCH PARADIGM

3.2.1 Major Aim of the Study

As discussed in the first chapter, this study was both investigative and descriptive as it looked at the factors associated with the phenomenon of tax evasion in the informal sector with focus on the Mbare Magaba Informal Trading Centre in Harare. According to Dane (1990), descriptive research involves examining a phenomenon to more fully define it or describe it. In this case, the phenomenon of tax evasion has been defined by previous studies and this study sought to bring more knowledge about it by investigating the factors associated with it. According to O’Leary (2005) descriptive research, also known as statistical research, describes data and characteristics about the population or phenomenon being studied. This was exactly what the researcher aimed to do.

The act of a business enterprise attempting to escape payment of tax or engaging in unlawful activities to avoid tax payment defines tax evasion in simple terms. This includes concealing taxable income of the business, profits liable to taxation and/or other taxable activities, misrepresentation of the amount and/or the source of income, or overstating tax reducing factors such as deductions, exemptions or credits (Alm and Vazquez, 2001 and Chiumya, 2006). Tax evasion can occur either in the formal sector where it happens within activities that are – in other aspects – legal or it occurs in the informal sector where the whole activity takes place in a hidden manner and in most cases, this means the enterprise is both evading tax payments and is also unregistered as a formal business.
The researcher takes the view of the informal sector tax evasion since the focus of the study was on tax evasion in the informal sector. The general belief is that the characteristics of the informal sector themselves promote tax evasion and by choosing to enter the informal sector, the chances of one evading tax are high. Hence, the focus of the study was not to prove whether tax evasion existed in the informal sector but it focused on factors associated with tax evasion, including voluntarism at the startup stage.

Previous studies have defined tax evasion in general terms and those that looked at the causes of tax evasion took a general perspective and looked at tax evasion as a whole, combining both tax evasion in the formal sector perspective and that of the informal sector perspective. This study focused on tax evasion from an informal sector perspective and sought to define fully the factors associated with tax evasion and then characterising the informal traders and examining how each of the major characteristics of informal traders was related to tax evasion behaviour.

The above discussion means that the study was scientific in nature and therefore made use of scientific methods which are explained in this chapter.

3.2.2 Positivist Research Paradigm

Research philosophy or paradigm is the researcher’s interpretation of the world that impacts on his/her approach to a given problem. According to O’Leary (2005), it is the orientation that the researcher adopts in addressing a given problem.
According to Saunders *et al.* (1997), the positivist paradigm was originally developed in the natural sciences working with an observable social reality and the same writer explained that the characteristic product of successful scientific research is knowledge which is possible and indeed actual. In this regard, this study sought to contribute to the existing body of knowledge by bringing more knowledge to the phenomenon of tax evasion.

According to Pope and Mays (2000), the positivist holds that experimental investigation and observations are the only source of substantial knowledge. For this reason, the study relied on observable data which were collected in a scientific manner in which reliability and validity were both important. The traditional assumption is that in science the researcher must maintain complete independence and should not affect or should not be affected by the subject of the research, if there is to be any validity in the results produced (Saunders *et al.*, 1997). This is explained in later sections of this chapter.

Based on collection and analysis of data, it is possible to predict the phenomenon with the starting point of what was known already (Pope and Mays, 2000). In this study, the researcher started off with the known phenomenon of tax evasion and developed it further by attempting to investigate and identify factors associated with tax evasion as well as the characteristics of the research respondents. Focus was placed on descriptives in order to develop the phenomenon of tax evasion.
The following are some of the reasons why the researcher chose the positivist paradigm:

- **Objective** - the world is external and objective where the observer is independent (Denscombe 2004: 106). This made observations possible and the researcher was an independent observer in the research while data were derived from the informal traders. Objectivity was also harnessed through the use of scientific methods of data collection and analysis such as systematic sampling and chi-square tests of association.

- **Scientific** – Measures were systematically created before data collection and were standardised as far as possible. This means that the study also made use of other existing theories rather than only relying on itself. Scientific methods were also used in sampling (systematic sampling) as well as in data analysis and presentation.

- **Quantitative** - Concepts were in the form of numbers from precise measurement. Measurement was very important in the study. This means quantitative techniques had to be used and the positivist paradigm was considered the best approach suitable to achieve this goal. The main positivist related designs consist of observations, experiments and survey techniques and in this case the survey design was employed (explained later in section 3.3.2). Further, the positivist paradigm often involves complicated statistical analysis in order to generate the findings and to test...
hypotheses empirically and tries to break complex matters into simple forms for easy understanding (Jankowitz, 2005). This was found to be very useful in this study, hence the choice of the paradigm.

3.2.3 Deductive Reasoning

The researcher employed deductive reasoning in this study. According to Hussey and Hussey (1997:13) deductive research is a process in which the researcher moves from theory to observation and starts with what is already known about a phenomenon and goes on to test the theory to come up with a confirmation. This is different from the inductive method in which theory is “developed from the observation of empirical reality (Hussey, 1997). The following figure shows the distinction between deductive and inductive thinking.
Figure 3.1 shows that inductive reasoning moves from an observation to identify a pattern and ends with a generalization or theory. In this study, inductive thinking was not employed. This was mainly because the researcher made use of the positivist paradigm which was the opposite of inductive reasoning. Further this study was quantitative and since inductive methods are more compatible with qualitative research, the researcher chose to employ deductive reasoning.

Keogh (1999) makes a distinction between deductive and inductive approaches to research. Inductive reasoning starts with an observation and then goes on to identify patterns in the observed data which results in coming up with a theory.
(Keogh, 1999). This was not the goal of this study since tax evasion is a known phenomenon with existing theories which needed to be tested in the Zimbabwean context. According to Jankowitz (2005) inductive reasoning is mainly useful in studies of new phenomenon, that is when there is no evidence about a certain phenomenon which the researcher studies to establish the phenomenon.

Deductive reasoning is an interpretive approach where one interprets what is on the ground starting with a theory and then testing it after which he/she comes up with an observation and a confirmation (Keogh, 1999). In this study the researcher started with theories discussed in chapter two regarding factors associated with tax evasion and went on to test these theories. A good example is the testing of voluntarism, that is, whether one’s voluntary or involuntary venturing into informal employment has an impact on his/her tax evasion behaviour. Tax evasion has been studied before. However, there is a lack of focus on the factors associated with the phenomenon. These factors were therefore the focus of this study.

### 3.3 RESEARCH DESIGN

#### 3.3.1 Quantitative Research

In this study, the researcher made use of a quantitative research design. According to Saunders et al. (1997), research designs can be classified as qualitative or quantitative. As a rule, information is considered qualitative in nature if it cannot be analysed by means of mathematical techniques. According to O’Leary (2005),
quantitative research, on the other hand, generally involves the collection of primary data from large numbers of individual units, frequently with the objective of projecting the results to a wider population.

According to White (2000) the quantitative research design has its origin in science and is sometimes referred to as the ‘scientific method’. It is based on the collection of facts and observable phenomena and scientists use these to deduce laws or generalizations and establish relationships between variables. According to the same writer, quantitative research describes, explains and tests relationships. This was one of the reasons for the choice of the quantitative research design mainly because the aim of the study was descriptive. Descriptive statistics were the cornerstone of this study; hence, quantitative methods (through the use of a quantitative research design) had to be used. This means the study relied on numerical data as well as the numerical analysis of that data. Statistical methods used included the chi-square test of categorical data while other tests used included correlations among others. These are discussed under section 3.5.

Both discrete (definite) and continuous data were sought after in the study although most of the data were continuous. Continuous data included monthly and annual revenues generated by the informal traders, number of years they had been trading in the sector as well as characteristic data on age among others.

Since the study was descriptive and the positivist paradigm was employed, measurement was very important. White (2000) explains that there are different
measurement scales namely nominal (categorical), ordinal, interval or ratio data. The study made use of almost all scales of measurement. Categorical data were collected in the form of descriptives such as age, gender, marital status, highest level of educational qualification, household size of the owners as well as ownership type of the informal business among others.

3.3.2 Survey Research Design

Survey research is a quantitative process of collecting data from a sample of existing large population units with no particular control over factors that may affect the population characteristics of interest in the study. As such, the researchers should plan and conduct the survey in a systematic manner (Saunders et al., 1997). Best and Khan (1993) observed that surveys can be descriptive or explanatory. In this study, the researcher employed the survey research design which entailed collecting data from informal traders at the Mbare Magaba Informal Market Place. According to Saunders et al. (1997), the findings can be generalized to the target population and this was one of the major reasons for the use of the survey research design.

A survey design is defined by Creswell (2003) as a design which provides a quantitative or numeric description of some fraction of the population (the sample) through data collection, a process involving asking people some questions. This study was a descriptive analysis of tax evasion in the informal sector and focused
on factors associated with tax evasion at the Mbare Magaba Informal Market Place. Sampling was done as part of the survey research design and this is explained under section 3.3.4 of this chapter. The respondents in a sample gave their experiences and opinions in order for the researcher to generalize their findings to a population that the sample was intended to represent (Dane, 1990). Data were gathered from a relatively large number of respondents at the Mbare Magaba Informal Market Place. The sample size is discussed under section 3.3.4.

3.3.2.1 Advantages of using the survey research design

Advantages of conducting a survey research, noted by Robson (1993), are as follows;

- Survey research can gather large amounts of data from both large and small population with relative ease. The sample size was 150 informal traders in this study and the survey research made it easy to collect and analyse data through the use of the survey questionnaire.

- Survey research is accurate - the accuracy of properly drawn samples can give a remarkably accurate portrait of causes, effects and possible solutions. This was mainly aided by the fact that survey research is scientific in nature and therefore the accuracy of the results is increased (through systematic sampling in this case as well as the collection of data on standardised questions, hence, statistical analysis of the data produced an accurate recording of factors associated with tax evasion at Mbare Magaba)
which is one of the reasons why the results could be generalised to the population.

- Results of a survey research could be generalised – Because survey research is scientific, the data collection and data analysis processes were also scientific and therefore the results of the study could be generalised to the study population. The generalization was also done in terms of patterns realized in the data thereby coming up with generalizations or theories developed from the phenomenon of tax evasion in the informal sector.

- Survey research allowed the use of a variety of instruments such as questionnaires and interviews for collecting data.

- Survey research focused on a small and manageable group of 150 informal traders at Mbare Magaba in- stead of the entire population of 1500.

### 3.3.2.2 Disadvantages of using the survey research design

Survey research also has disadvantages and these include;

- Survey research design demands a lot of time and money – This challenge was reduced by pre-planning and following the plan in order to stick to the timelines of the study. The amount of money used was also well managed through a strict budget.
• Survey research can temporarily lift the respondent out of his or her own social environment which may make results invalid since there is a possibility that the personality appearance of the researcher might influence a respondent in a certain way. In order to reduce this challenge the researcher made sure he was presentable and articulate as well as objective in the whole research process especially during data collection.

3.3.3 Study population
The population of the study comprised all the 1500 informal traders at the Mbare Magaba Informal Market Place. For the purposes of this study, this population only comprised those in makeshift structures in the fenced area of Mbare Magaba and this did not include those trading on sidewalks.

3.3.4 Sampling procedure and sample size
To start with, the researcher selected a sample of 150 informal traders from the Mbare Magaba Informal Market Place. The method of selection employed was the systematic sampling method and this is explained below.

According to Saunders et al. (1997) there are two types of sampling methods namely probability and non-probability sampling. In this study, the researcher employed probability sampling methods.
Probability sampling procedures make use of random sampling where each unit has an equal chance of being selected into the sample (Saunders et al., 1997). These include simple random sampling, stratified, systematic and cluster sampling methods.

- **Simple Random** - Simple random sampling selects samples by methods that allow each possible respondent to have an equal probability of being picked and each item in the entire population to have an equal chance of being included in the sample. The two common procedures used are the gold fish bowl and the random digit/number. Simple random sampling is applicable when the population is homogeneous (Cohen and Marion, 1999).

- **Systematic** - In systematic sampling, elements are selected from the population at a uniform interval that is measured in time, order or space (Saunders et al., 1997).

- **Stratified Random** - In stratified sampling, the population is divided into relative homogeneous groups, called strata and examples of strata may be sex/gender, age groups, level of education or managerial level. Selection is done at random from each stratum and this guarantees that every element in the population has a chance of being selected (Saunders et al., 1997).

- **Cluster** - Cluster sampling is applicable when the elements are separated by geographical features (Denzin, 2000). In cluster sampling, the population is divided into groups or clusters and then a sample is randomly selected...
from the clusters. The assumption is that the individual clusters are representative of the population as a whole.

Systematic sampling was used in this study. According to Dane (1990), systematic sampling is accomplished by choosing elements from a randomly arranged sampling frame according to ordered criteria, choosing the $n^{th}$ element in the sampling frame. In this case, N was calculated in the following manner;

Sample size = 150

Population size = 1500

$N = \text{Inverse of } 150/1500 = 10$

Hence, the researcher selected the first sampling unit from the main entrance of the study site (the area of Mbare Magaba with makeshift structures/shelters) and then selected every 10th unit from the first going on until a sample of 150 informal traders was selected. However, the first unit selected had to be random and this was done by randomly picking a number from a hat between 1 and 10 inclusive.

The major assumption made in this regard was that all the informal traders were arranged or designated in a random manner and that there was no pattern or trend in their order of arrangement. This assumption was made to make sure the sampling frame was in a random order in order for random sampling to be applicable and valid.
It was easy to employ systematic sampling since the informal traders at the study site were arranged in a linear manner.

3.4 DATA COLLECTION INSTRUMENTS AND PROCEDURES

3.4.1 Survey Questionnaire

A survey questionnaire was used in this study. Leedy (1992) states that a questionnaire is a formal approach to measuring characteristics, attitudes, motivations, and opinions as well as past, current and possible future behaviours. The information produced from a questionnaire can be used to describe, compare or predict these facts. With the foregoing in mind, the survey questionnaire was deemed the most applicable.

According to White (2000) a questionnaire is regarded as a series of questions, each one providing a number of alternative answers from which the respondent can choose. The questions that made up the questionnaire were designed on the basis of the knowledge the researcher got from the literature on tax evasion and the informal sector. In order to remain objective in the questionnaire design, the researcher was guided on which questions to ask by the research objectives and the details of the specific questions came from the literature review. The questionnaire was divided into subsections, each covering a specific objective from Chapter One of this thesis. This means that each objective had a section in the questionnaire with questions corresponding to the objective.
The survey questionnaire started with an introductory letter, introducing the research topic and aim as well as assuring confidentiality to the respondent. Instructions were then provided on how to complete the questionnaire. This was followed by Section A of the questionnaire which was centred on demographic and background information of the informal trader and his/her business (In relation to Objective I which was to establish the major characteristics of informal traders at Mbare Magaba). Section B followed and it focused on reasons to become informal which included aspects of voluntary and involuntary informal employment as well as preferences between formal and informal employment. In Section C the questionnaire collected information on business progression prospects while Section D collected information on tax compliance/evasion. This section also collected, from the informal traders, information on factors contributing to tax compliance or evasion. The last section (Section E) of the questionnaire asked for recommendations from the informal traders on dealing with tax evasion and increasing tax compliance in the informal sector of Zimbabwe.

The design of the questionnaire was done in a format that encouraged the respondent to answer it with issues to do with tax evasion coming in the middle section of the questionnaire. Questions were well spaced and this allowed the respondent to answer without being concerned about the length of the questionnaire since each page took an average of two minutes to complete.

Most of the questions in the questionnaire were closed while a few open ended questions were included in order to reduce the amount of time to complete the
questionnaire. Closed questions were mainly used on questions with straightforward answers for which options were provided while open ended questions were asked to probe for more information from the respondents. Since the method of data collection was self-administration, the researcher was flexible to probe for more information whenever he saw necessary.

3.4.1.1 Pre-testing (Pilot study)

Pre-testing was done in order to test the questionnaire on ease of completion, timing, understanding and clarity. This was done on 10 informal traders in the Mbare Magaba Informal Market Place. However, care was taken to make sure that pre-testing was not done on the targeted respondents for the main data collection. This was done by doing the sampling of the main research first and marking the sampling units (10th unit from the first randomly picked unit). The researcher then systematically selected the ten respondents for pretesting by randomly picking a number that was different from the one picked in the main sample and then choosing the 10th unit until ten units were selected for pre-testing.

A few amendments were done on the questionnaire which incorporated observations from the pilot study. These were from Section C on number 19 and Section D on number 26 and 29. Number 19 was changed from “Do you have plans to become formal (registered, regulated by government, employing many more people and complying with tax and labour regulations) to “Do you have plans to become formal?” Number 26 was changed from “In the following table, please ONLY tick the two major factors that influence you not to pay taxes if you do not or
no longer pay taxes. If you pay taxes consistently, please ignore this question and move on to the next question” to “In the following table, please **ONLY** tick the two factors that influence you not to pay taxes if you do not or no longer pay taxes.” Lastly, number 29 was changed from “Do you know of any penalties for anyone who does not comply with the tax law or anyone who does not pay taxes in Zimbabwe informal sector?” to “Do you know of any penalties for anyone who does not comply with the tax law in Zimbabwe informal sector?”.

### 3.4.2 Self administration

The survey questionnaires discussed above were self administered during the data collection process. This was mainly because the researcher wanted to ensure a high response rate on the questionnaires as well as to deal with some illiterate informal traders. Through self administration, he could make sure each respondent responded to all the questions. This way, the researcher had flexibility to probe for more information whenever necessary.

A possible challenge with self administration could be the possibility of misinterpretation of the responses. This was resolved through the pilot study in which the researcher got familiar with the research respondents and accustomed himself to the interpretations.
3.5 DATA PRESENTATION ANALYSIS AND INTERPRETATION PROCEDURES

After data collection, the collected data were cleaned and entered into a computer using a statistical package called Epidemiological Information Version 3.5 (Epi-Info 3.5). This package was user friendly in data capturing and it made data capturing easy since a template of the questionnaire was first developed using the package which was used to enter responses. This way, the format of the questions on the questionnaire was maintained and responses for each question were captured by simply ticking the available responses. Epi-Info was also compatible with the Statistical Package for Social Scientists (SPSS) which was used for data analysis and data were easily exported from Epi-Info to SPSS. The software serves data in MS Access format and this was helpful in exporting the data to SPSS, the data analysis package.

Data analysis was done using another statistical package called Statistical Package for Social Scientists (SPSS version 12). The data was imported from Epi-Info and all responses to open ended questions were standardised by assigning a standard response to all similar but differently worded responses. Data checks were also done to make sure the data was recorded (in SPSS) using the correct scale before analysis.

The data analysis made use of statistical methods which included the calculation of percentages which were used to come up with graphs, tables and charts as well as chi-square tests of association. The chi-square tests were done to test whether
there was an association between voluntarism and tax evasion behaviour and to test for association between business progression prospects and tax evasion behaviour. These are discussed under section 3.5.1 below.

After data analysis, the results were presented and discussed in this thesis through the use of graphs, tables and charts.

### 3.5.1 Chi-square tests of association

The following null hypotheses were tested using chi-square tests of association.

**Null hypothesis 1**: There is no significant difference in tax payment behaviour on the basis of voluntarism (that is voluntary or involuntary informal employment has no significant effect on tax payment/compliance behaviour)

**Null hypothesis 2**: There is no significant difference in tax evasion behaviour on the basis of propensity to grow business enterprise (that is one’s propensity to grow business has no significant effect on his/her tax evasion or compliance behaviour)

These tests were mainly done to investigate if voluntarism and business progression prospects were factors that contributed to tax evasion. The following was the rejection criteria.

**Rejection criteria**: Reject H₀ if the p value is less than or equal to α (α=0.05 in this case since confidence level used was 95%).
The Pearson Chi-Square was used as the test statistic and its p-value was used to accept or reject the null hypothesis. Cross-tabulations were then used to find the direction of the association in the case where there was an association. These results are discussed in chapter four.

3.6 VALIDITY, RELIABILITY, CREDIBILITY OR TRUSTWORTHINESS

ISSUES CONSIDERATION

According to Dane (1990), respondents are generally unwilling to admit to any illegal or socially defiant activities. This posed a challenge to the study since collecting valid data had to make sure this challenge was eliminated or at least reduced. The researcher collected information on tax evasion and respondents could feel threatened and could have refused to give information or could give wrong information in order to protect themselves. However, the researcher gave each respondent the right to agree or disagree to answer to any questions before collecting any data from them. Further, the researcher assured and guaranteed that each respondent’s anonymity and confidentiality would be strictly upheld. The emphasis on anonymity and confidentiality as well as the explanation that the researcher was not from ZIMRA or acting on their behalf made the respondents to feel free to provide any information the researcher needed. Further, the researcher also guaranteed the respondents that the research was done for academic purposes only.
The above measures helped in making sure there was limited or no misrepresentation of information by the respondents. This assured the validity of the data collected and results of the study.

Reliability has to do with whether the same study would produce the same results if carried out by a different researcher using the same methodology. This means that reliability is more to do with the methodology of the study. In order to make sure of the reliability of the study results, the researcher made sure he followed the set theories on research methodology as well as studying in depth different books on research methods and research methodology. Further, reliability was also assured by using scientific methods all the way including scientific methods of sampling, data collection, analysis and presentation of results.

3.7 ETHICAL ISSUES

Churchill (1995) defines ethics as moral principles and values that govern the way an individual or group conducts their activities. The following ethical principles were adhered to in this study;

- The researcher only involved people with their consent or knowledge. Respondents were given enough information about the research before they were asked to answer any questions. The respondents had the right to withdraw or remove consent if they so wished. The information was
provided as the researcher first introduced himself, the study, its purpose and objectives as well as its importance.

- No respondent was coerced or persuaded to participate in the research. They had the right to choose for themselves whether to be subjects of the study or not.

- Although the study was on tax evasion, a sensitive issue in the informal sector, the researcher did not hide this to the respondents and so he explained the purpose of the study and its topic.

- Anonymity and confidentiality of the respondents and their information was maintained throughout the study. For this reason, there was no reference to any particular respondent whether by name or code or any identification.

- The researcher treated all respondents the same, with respect and used the motto “treat them as you would want to be treated” throughout the research.

- In order to avoid misinterpretation of the research findings, the researcher maintained ownership of the study from its inception, during and after.

### 3.8 SUMMARY

In this chapter, the researcher discussed the research methodology. The study was a descriptive analysis of factors associated with tax evasion in the informal sector of Harare with focus on Mbare Magaba Informal Market Place. It was a
descriptive survey which employed quantitative research and employed deductive reasoning to create knowledge. Discussed in the chapter are, the research paradigm, research design, research process, data collection instruments, data analysis, interpretation and presentation procedures and research ethics among other issues. The following chapter is a presentation, analysis and discussion of research results.
CHAPTER FOUR: DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1 INTRODUCTION

A number of issues have been discussed under literature review. Most of these issues revolve around the characteristics of the informal sector and its traders. Most previous studies have focused much on this view and this study extends on their findings by presenting the Zimbabwean case. The researcher goes further in this study to look into the behavioural perspective of the informal traders. These include issues to do with voluntary and involuntary informal employment (which looks at the decision to become informal and the factors related to that decision) as well as issues to do with business progression (which looks at the informal traders’ perception about the growth prospects of their business). These two issues will also be hypothesized and tested in this chapter in line with the related research questions. In other words, the researcher in this chapter presents, analyses and interprets the study findings in line with the research questions.

4.2 RESPONSE RATE OF QUESTIONNAIRES

As discussed in the previous chapter, the researcher administered 150 questionnaires at Mbare Magaba Informal Market Place. Out of these, 120 questionnaires were successfully completed giving a response rate of 80% which
was high enough to proceed with the rest of the analysis. Upon conducting follow ups on non-responders, the researcher found that some of them had relocated and could not be found while others were travelling to and from other cities such as Mutare and Bulawayo as well as outside the country to South Africa during the period of data collection.

4.3 DEMOGRAPHIC AND BACKGROUND INFORMATION

The following table (table 4.1) presents the demographic information about the study respondents.
Table 4.1 shows that 79% of the respondents were male while 21% were female. Since the sample was random, this shows that the informal trading centre at Mbare Magaba has 3 times more men than women. This could be because the study did not cover pavements and sidewalks which had more women than men.
The table also shows that 22% of the respondents were 30 years old and below, 46% were 31 – 35 years old, 24% were between 36 years and 40 years old inclusive, 6% were 41 – 45 years old and 2% were above 45 years old. From these statistics, it shows that the majority of informal traders at Mbare Magaba were youths of 35 years and below.

It is also revealed in table 4.1 that 19% of the respondents were single, 17% were divorced, 13% were widows/widowers while 8% were single parents and 43% were married. This means that the majority of the respondents were family people who were married, divorced, single parents or widows/widowers. In other words it means the informal trading centre at Mbare Magaba was supporting many families.

It can be seen from table 4.1 that 23% of the respondents had Ordinary Level as their highest level of education, 12% went up to Advanced Level of education, 57% had a college certificate or diploma and 8% had at least a university degree. This shows that all the respondents had attained basic education. What remains to be seen is whether unemployment could be one of the major reasons for them to be in informal employment. On the other hand, this shows that the literacy rate in the informal sector at Mbare Magaba is very high (almost 100%).

From table 4.1 it is also seen that 63% of the businesses at the Mbare Magaba Informal Trading Centre were in sole-ownership (owned by individuals), 6% were partnerships and 31% were family ventures. This is inconsistent with some of the
reviewed literature such as Farrell and Fleming (2000), Matsebula (1996) who said that the majority of informal businesses were family ventures employing unpaid family members. In this case the majority of them were owned by individuals. Table 4.2 will show whether they were run by individuals as most of the previous studies say.

Lastly from table 4.1, it is shown that 61% of the respondents were members of a church while 39% were not church members. According to Abrie and Doussy (2006), an individual’s church membership and/or history of contribution towards a need in the community or church could also be an indicator of the individual’s chances of complying with tax laws. Church attendance could therefore be a factor associated with tax compliance. Further, since some churches encourage their members to comply with the law church membership could therefore have an effect on tax compliance behaviour.

The following table (table 4.2) is a presentation of other demographics of respondents including household size and number of employees.
Table 4.2: Household size and number of employees (N=120)

<table>
<thead>
<tr>
<th>DEMOGRAPHIC</th>
<th>CATEGORY</th>
<th>FREQUENCY</th>
<th>PERCENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Household size</td>
<td>1-3</td>
<td>13</td>
<td>11%</td>
</tr>
<tr>
<td></td>
<td>4-5</td>
<td>43</td>
<td>36%</td>
</tr>
<tr>
<td></td>
<td>6-7</td>
<td>47</td>
<td>39%</td>
</tr>
<tr>
<td></td>
<td>More than 7</td>
<td>17</td>
<td>14%</td>
</tr>
<tr>
<td>Number of employees</td>
<td>1</td>
<td>55</td>
<td>46%</td>
</tr>
<tr>
<td></td>
<td>2-3</td>
<td>47</td>
<td>39%</td>
</tr>
<tr>
<td></td>
<td>4-5</td>
<td>14</td>
<td>12%</td>
</tr>
<tr>
<td></td>
<td>More than 5</td>
<td>4</td>
<td>3%</td>
</tr>
<tr>
<td>Number of family members involved</td>
<td>None</td>
<td>63</td>
<td>53%</td>
</tr>
<tr>
<td>in business</td>
<td>1</td>
<td>34</td>
<td>28%</td>
</tr>
<tr>
<td></td>
<td>2-3</td>
<td>13</td>
<td>11%</td>
</tr>
<tr>
<td></td>
<td>More than 3</td>
<td>10</td>
<td>8%</td>
</tr>
</tbody>
</table>

Source: Own compilation from survey research (2013)

From table 4.2 it is seen that 11% of the respondents had 1-3 people in their household, 36% had 4-5 people in their household, 39% had 6-7 people and 14% had more than 7 people in their household. This is consistent with the previous result that the majority of the respondents were family people who were married, divorced, single parents or widows/widowers. Table 4.2 shows that the majority of the respondents were supporting families of at least one or more people.

Respondents were asked to state the number of employees in their business and table 4.2 shows that 46% of the businesses only had one employee (they were individuals), 39% employed 2-3 people, 12% employed 4-5 people and 3% employed more than five people. This shows that most of the businesses (46%) at
Mbare Magaba were run by individuals with the owner being the only employee while the majority (85%) of the businesses employed less than 4 people. This is in line with Yankson (1989) who argued that the typical informal sector enterprise is individually-owned and operated, with an average size of employment of four.

Table 4.2 also shows that 53% of the businesses had no family member apart from the owner, 28% had one family member as one of the employees, 11% had 2-3 family members among their employees and 8% had more than 3 family members among their employees. This means that 47% of the businesses had at least one family member among their employees.

**Figure 4.1: Monthly profits of informal businesses at Mbare Magaba (N=120)**

![Bar chart showing monthly profits of informal businesses at Mbare Magaba](image)

Source: Own compilation from survey research (2013)
Figure 4.1 shows that 4% of the businesses involved in this survey had an average monthly profit of less than US$150, 12% were making between US$150 and US$250 inclusive every month, 33% were making US$251-US$500 profit every month on average, 31% were making US$501-US$800 per month on average, 12% were making US$801-US$1000 every month on average, 6% of the businesses were making US$1001-US$1500 per month on average and 2% were making more than US$1500 per month on average. These results show that 51% of the businesses that participated in this survey were making more than US$500 profit per month on average. Since US$500 is said to be the normal cost of a consumer basket of Zimbabwe for a family of five, it shows that the majority of families (51%) supported by the Mbare Magaba informal trading centre is above the poverty datum line at the conclusion of this study. From a tax perspective this proves that the majority of businesses at Mbare Magaba informal trading centre have the ability to pay at least a dollar of tax to the government. This is mainly so because due to the tax threshold of US$250, an employee in the formal sector with a salary of US$300 is paying tax which means that those earning more than US$300 in the informal sector should be paying tax also. The issue here is not the amount they pay as tax but any amount paid by the informal traders will be of great value to the national fiscus.
4.4 TAX COMPLIANCE

Figure 4.2: Tax compliance (N=120)

Source: Own compilation from survey research (2013)

Figure 4.2 shows that only 10% said their businesses always pay tax, 8% said they used to pay tax and 82% said they never paid any taxes in their business. This is a confirmation of the problem at hand as discussed in chapter one from the Finmark (2012) observation that 98% of informal traders in Zimbabwe do not pay tax. This also confirms that the tax non-compliance rate is very high at Mbare Magaba informal trading centre. In this study, the researcher therefore investigated why informal traders did not pay tax and this is discussed under figures 4.3-9, table 4.3 and sections 4.4 and 4.5 to follow in this chapter.
Figure 4.3: Awareness of the tax requirement of the business venture (N=120)

From figure 4.3 it is seen that 13% said they were not aware that their businesses should pay tax, 33% said they were aware but it was difficult for them to pay tax (mainly due to low incomes and inability), 38% said they were aware but highlighted that it was unfair for them to pay tax while 16% said they were aware but they did not want to pay tax. This means that 16% evaded tax directly and deliberately while 38% believed it was not fair for them to pay tax, 33% believed they could not afford to pay tax and 13% were not aware. These four classes of tax evasion should be treated differently from this point. However, it is important to note that most of the respondents believed it was not fair for them to pay tax as previously highlighted. This could be because of the survival mentality that this
group had. The other group could be said to be almost similar to this group as they believed they could not afford.

If the 13% who were not aware of their tax obligations is subtracted there is still 87% who were aware. Considering that from figure 4.1, around 84% were earning more than $250 (tax threshold), it then means that tax evasion was high at Mbare Magaba.

Figure 4.4: Awareness campaigns by ZIMRA on tax (N=120)

![Figure 4.4: Awareness campaigns by ZIMRA on tax (N=120)](image)

Source: Own compilation from survey research (2013)

Figure 4.4 shows that 56% of the respondents said they had never been addressed by ZIMRA or any government official on tax matters while 44% said...
they had been addressed. This means that non-payment of tax could also be because of this lack of awareness campaigns by ZIMRA and government on tax matters.

Table 4.3: Causes of tax evasion (N=104)

<table>
<thead>
<tr>
<th>STATEMENT</th>
<th>RESPONSE RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>I do not see the point in paying taxes</td>
<td>68%</td>
</tr>
<tr>
<td>The taxes are ill spent and mismanaged by government</td>
<td>41%</td>
</tr>
<tr>
<td>I do not trust ZIMRA or the government</td>
<td>23%</td>
</tr>
<tr>
<td>There is corruption in the tax system</td>
<td>13%</td>
</tr>
<tr>
<td>Careless spending by government does not justify paying taxes</td>
<td>32%</td>
</tr>
<tr>
<td>Government is doing nothing or too little to benefit us in the informal sector</td>
<td>79%</td>
</tr>
<tr>
<td>The taxes are too high</td>
<td>25%</td>
</tr>
<tr>
<td>There is too much paperwork and a lot of time is lost in paying tax</td>
<td>10%</td>
</tr>
<tr>
<td>I do not know how to pay tax</td>
<td>13%</td>
</tr>
</tbody>
</table>

Source: Own compilation from survey research (2013)

Table 4.3 shows the reasons for not paying tax given by those who were aware of their tax obligations (104). It is seen from table 4.3 that the major reason for tax evasion was that “Government is doing nothing or too little to benefit us in the informal sector” with 79% of the respondents highlighting it as one of their two major reasons for not paying tax. The second major reason from the table is “I do not see the point in paying tax” with 68% respondents highlighting it as one of their
two major reasons for not paying tax. Other reasons can be treated as minor and these include, “The taxes are ill spent and mismanaged by government” with 41% response rate and “Careless spending by government does not justify paying taxes” with 32% response rate among others shown in table 4.3.

These results are in line with a number of previous studies such as Pashev (2005), Everest-Phillips (2008), Lieberman (2002) and Brautigam et al. (2008) who all concurred that if the government fails to provide basic public goods and services or provides them insufficiently, citizens may not be willing to pay taxes and tax evasion and avoidance will be the consequence. The results are also in line with Oberholzer (2008a) who stated that although most of the respondents in his study felt that it was fair to pay taxes, the respondents unanimously agreed that corruption and careless spending by government was high, making it hard to justify paying taxes. This means that the people at Mbare Magaba had expectations from government and when these expectations were not met, it then became difficult for them to comply with tax laws from the same government who they thought was not doing its part.

Some of the respondents highlighted that the government had not been forthcoming in supporting the informal sector yet it is the same sector they purported to support.
Based on the results in figure 4.5 it is revealed that 17% of the respondents perceived the tax compliance of their fellow informal traders as average, 27% perceived it as low and 56% perceived it to be very low. This means that the majority of the informal traders generally perceived the tax compliance by their fellow informal traders to be low. According to Alm and Martinez-Vazquez (in Abrie and Doussy, 2006: 4), the social norms of an individual play a vital role in the decision to comply with the tax legislation and these include the perception that one has about the tax compliance of their fellow informal traders. Perceiving the
tax compliance of their fellow informal traders as being low could result in them not taking tax compliance serious and feeling comfortable in tax evasion.

Figure 4.6: Likelihood of detection when evading tax (N=120)

The results shown in figure 4.6 are such that 12% of the respondents agreed to some extent that it was most likely to be detected if one did not pay tax in Zimbabwe informal sector while 88% disagreed that one could be detected. This shows that the majority of the informal traders (88%) believed it was almost impossible for one to be detected when evading tax in the informal sector. This could give the informal traders even more propensity to evade tax.
According to Alm et al. (1992) and Alm and Martinez-Vazquez (2007), risk-averse individuals tend to pay more taxes attempting to avoid the risk of detection and punishment. However, in the case of Zimbabwe where as indicated in the results about, the chances of being detected if evading taxes are low, it then follows that the perceived risk would also be low thereby increasing the chances of one to evade taxes.

**Figure 4.7: Awareness of penalties for evading tax (N=120)**

[Pie chart showing 71% no awareness, 19% not sure, 10% yes]

Source: Own compilation from survey research (2013)

Based on figure 4.7 only 10% said they were aware that there were penalties for evading tax while 19% were not sure and 71% did not know of any penalty for tax evasion. This could also increase propensity to evade tax.
The likelihood of detection and the lack of awareness of penalties for tax evasion could be used as a sign for a weak enforcement of tax laws. According to the World Bank (2008), shortfalls in tax collection procedures as well as weak capacities of tax administrations to detect and prosecute tax violators are both factors that contribute to a low enforcement of tax legislation.

**Figure 4.8: Type of record keeping common at Mbare Magaba (N=120)**

![Graph showing record keeping types]

Source: Own compilation from survey research (2013)

The results in figure 4.8 reveal that 11% of the respondents said they did not keep any records while 69% said they only kept cash receipts while 20% said they kept basic income and expenditure accounting records. Since the majority of the informal traders kept some form of records, this shows that the problem of poor
record keeping was not a major factor contributing to tax evasion in the informal sector although it could be an important contributory factor. This is not in line with Schneider and Enste (2003) who highlighted lack of proper record keeping as a major challenge causing problems in taxing the informal sector.

Figure 4.9 shows whether respondents contributed financially to their community or whether they give to charity as individuals.

Figure 4.9: Financial contribution to charity and/or community (N=120)

Source: Own compilation from survey research (2013)

Based on the results shown in figure 4.9, only 3% of the respondents said they gave to charity or to their community financially many times, 14% said they gave sometimes, 35% said they did that once in a while and 48% said they had never
given to charity or to their community. The aspect of giving is said to be both psychological and spiritual. However, these results show that 48% of the respondents had never given to charity or contributed financially to their community. According to Abrie and Doussy (2006), an individual’s history of contribution to charity or towards a need in the community or church could be an indicator of the individual’s chances of complying with tax laws.

4.5 VOLUNTARISM AND REASONS TO BECOME INFORMAL

Figure 4.10: History of formal employment (N=120)

Source: Own compilation from survey research (2013)
From figure 4.10 it is seen that 75% of the respondents had been formally employed before while 25% had never been formally employed.

**Figure 4.11: Reasons for becoming informal (N=120)**

![Reasons for becoming informal](image)

Source: Own compilation from survey research (2013)

Figure 4.11 shows that 17% said they were not qualified enough to get a job in the formal sector; hence their only option was informal employment. In this case unemployment could be cited as a reason to be informal. From the same figure 4.11, 27% of the respondents said they were retrenched or lost their jobs and could not find another formal job and this made them become informal. Again, unemployment could be cited as a major reason to become informal. Twenty percent (20%) of the respondents said they were fired and could not find another job in the formal sector, 19% said their former job was not paying them enough to
meet their basic needs, 5% said they always wanted to start their own small business and 12% said informal employment offered them better opportunities than formal employment. Based on these results the researcher can make two observations at this point; unemployment and loss of employment were the major reasons cited for becoming informally employed by the informal traders and that informal employment was involuntary for the majority of the informal traders. This is in line with findings by Fields (1990) who argued that voluntarism in the informal sector has to look also at factors such as availability of formal employment opportunities as well as the characteristics of the individual concerned. Sakthivel and Joddar (2006: 2110) also concurred with Fields. What the previous studies did not do was to link this involuntarism to tax evasion behaviour and this is done in this chapter.

In order to further validate that informal employment was not voluntary for most of the informal traders, the researcher asked the respondents what they would prefer between formal employment and informal employment and figure 4.12 shows the results.
Figure 4.12: Preference between formal and informal employment (N=120)

Source: Own compilation from survey research (2013)

Figure 4.12 shows that 56% of the respondents said they would prefer formal employment to informal employment while 44% said they would prefer to remain in informal employment. This shows that for the majority of the respondents, informal employment was not voluntary but a way to survive.
4.5.1 Chi-square test of association between voluntarism and tax payment behaviour

\( H_0 \): There is no significant difference in tax payment behaviour on the basis of voluntarism (that is voluntary or involuntary informal employment has no significant effect on tax payment/compliance behaviour)

\( H_1 \): There is a significant difference in tax payment/compliance behaviour on the basis of voluntarism

**Rejection criteria**: Reject \( H_0 \) if the p value is less than or equal to \( \alpha \) (0.05 in this case since confidence level used was 95%).

**Table 4.4: Cross tabulation (voluntarism*tax payment)**

<table>
<thead>
<tr>
<th></th>
<th>Always pay tax</th>
<th>Never paid tax</th>
<th>Used to pay tax</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Involuntary</td>
<td>2</td>
<td>71</td>
<td>3</td>
<td>76</td>
</tr>
<tr>
<td>Voluntary</td>
<td>10</td>
<td>27</td>
<td>7</td>
<td>44</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>98</td>
<td>10</td>
<td>120</td>
</tr>
</tbody>
</table>

Source: Own compilation from survey research (2013)
Table 4.5: Chi-Square Test (voluntarism*tax payment)

<table>
<thead>
<tr>
<th></th>
<th>Value</th>
<th>df</th>
<th>Asymp. Sig. (2-sided)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Chi-Square</td>
<td>1.430E2a</td>
<td>6</td>
<td>.000</td>
</tr>
<tr>
<td>Likelihood Ratio</td>
<td>47.517</td>
<td>6</td>
<td>.000</td>
</tr>
<tr>
<td>N of Valid Cases</td>
<td>120</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. 8 cells (66.7%) have expected count less than 5. The minimum expected count is .07.

Source: Own compilation from survey research (2013)

Test conclusion: Based on table 4.5 the p-value (less than 0.000) is less than 0.05 hence we reject H₀ and conclude that one’s tax payment behaviour is affected by his/her voluntarism (voluntary/involuntary informal employment). Based on table 4.4 those who voluntarily became informally employed had more propensity to pay taxes than those who involuntarily became informally employed.

4.6 BUSINESS PROGRESSION

4.6.1 General perception about business growth and progression

In order to find out the respondents’ beliefs in the future of their businesses, the researcher asked them to tell where they saw their businesses in ten years time. It seemed that only about 40% had some belief in the future of their businesses while the majority (about 60%) did not believe anything could change for their businesses to perform better. The majority of the respondents seemed to share the same belief that things were difficult and they were just surviving so in ten years,
they will be just surviving and just making ends meet. “Making ends meet…” was the common phrase among the majority of the respondents. However, there were some who had a clear vision of the future and they were very optimistic about the future of their business ventures. These believed that their businesses would be more than double their current sizes in terms of sales income, employment and profits. This means that there were prospects of business progression at Mbare Magaba informal trading centre. However, this was only true for about 40% of the informal traders.

Figure 4.4.13: Perception about business growth into large scale (N=120)

![Figure 4.4.13](image)

Source: Own compilation from survey research (2013)

Figure 4.13 shows that 42% of the respondents said that their business could grow to become fully fledged large scale businesses while 26% said to some extent this
will happen, and 32% said they did not think their businesses could grow to become fully fledged large scale businesses. This is consistent with the previous studies regarding the mentality and mindsets of the informal traders at Mbare Magaba informal trading centre. Around 40% believed in their businesses and about 60% believed it was just a matter of survival.

**Figure 4.14: Plans to formalize business (N=120)**

![Pie chart showing the percentage of informal traders with plans to formalize their businesses](chart)

Source: Own compilation from survey research (2013)

From figure 4.14, it is seen that only 28% said they had plans to become formal while 53% had no plans to become formal and 19% said they had never thought about it. This provides a few insights. First and most important regarding this study, that only a few of the informal traders had the intention to comply with the tax law; second, that there were significant prospects of business progression from the
informal sector to the formal sector and thirdly that the majority of the informal traders did not want to become formal. This is in line with the Finmark Trust report (2012) that highlighted that informal traders did not want to be formalized and as a result they were shunning banking services and other things that require them to be visible to the taxmen. Table 4.6 provides reasons and explanations for this finding.

### 4.6.2 Prospects to progress to formal business

The following table is a further investigation into the prospects of business progression. The understanding is that the more the prospects of business progression the more significant the discussion of taxing the informal sector becomes and the more the ability of the informal traders to pay tax. Dealing with tax evasion would therefore be most likely to translate into tax compliance of a good proportion of the informal sector. Further, prospects for business progression also means a shift of mindsets of the informal sector from survival to development and those who are development focused would be easier to deal with in tax language than those with a survival focus.
Table 4.6: Business progression prospects (N=120)

<table>
<thead>
<tr>
<th>STATEMENT</th>
<th>AGREE</th>
<th>SOMEWHAT AGREE</th>
<th>DISAGREE</th>
</tr>
</thead>
<tbody>
<tr>
<td>My business has obtained credit from a financial institution before</td>
<td>11%</td>
<td></td>
<td>89%</td>
</tr>
<tr>
<td>I have attended a business management course/training</td>
<td>18%</td>
<td>82%</td>
<td></td>
</tr>
<tr>
<td>I do strategic planning for 1 – 5 years to come</td>
<td>15%</td>
<td>85%</td>
<td></td>
</tr>
<tr>
<td>I set goals in my business and always set out to achieve them</td>
<td>20%</td>
<td>80%</td>
<td></td>
</tr>
<tr>
<td>Only my usual customers buy my products most of the time</td>
<td>19%</td>
<td>36%</td>
<td>45%</td>
</tr>
<tr>
<td>I make enough marketing efforts to get new customers always</td>
<td>18%</td>
<td>27%</td>
<td>55%</td>
</tr>
</tbody>
</table>

Source: Own compilation from survey research (2013)

The results in table 4.6 are such that 11% said their businesses had obtained credit from a financial institution before while 89% said their businesses had never obtained any credit, 18% agreed and 82% disagreed with the statement that they had attended a business management training/course, 15% said they did strategic planning for at least a year to five years while 85% said they did not, 29% said they set goals and always set out to achieve them while 71% said they did not, 19% agreed, 36% somewhat agreed and 45% disagreed with the statement that “only my usual customers buy my products most of the time” and lastly 18% agreed, 27% somewhat agreed and 55% disagreed with the statement that “I make enough marketing efforts to get new customers all the time”. From this it is observed that from a business planning perspective, only about 20% showed prospects of
business progression, from a management skills perspective about 18% showed prospects for business progression, from a marketing and market access perspective about 40% showed prospects for business progression and from a credit access perspective, 11% showed prospects for business progression. In other words, the prospects for business progression were there and were significant. With increased efforts the informal traders could surely progress to become formal or at least semi-formal.

4.6.3 Chi-square test of association between business progression prospects and tax payment behaviour

**H₀**: There is no significant difference in tax evasion behaviour on the basis of propensity to grow business enterprise (that is one’s propensity to grow business has no significant effect on his/her tax evasion or compliance behaviour)

**H₁**: There is a significant difference in tax evasion on the basis of propensity to grow business enterprise

**Rejection criteria**: Reject H₀ if the p value is less than or equal to α (0.05 in this case since confidence level used was 95%).
Table 4.7: Chi-Square Test (Tax evasion*propensity to grow business)

<table>
<thead>
<tr>
<th></th>
<th>Value</th>
<th>Df</th>
<th>Asymp. Sig. (2-sided)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Chi-Square</td>
<td>11.011a</td>
<td>7</td>
<td>.180</td>
</tr>
<tr>
<td>Likelihood Ratio</td>
<td>12.535</td>
<td>7</td>
<td>.095</td>
</tr>
<tr>
<td>N of Valid Cases</td>
<td>120</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. 7 cells have expected count less than 5. The minimum expected count is .18.

Source: Own compilation from survey research (2013)

Test conclusion: Based on table 4.7 the p-value (0.180) is greater than 0.05 hence we fail to reject $H_0$ and conclude that one's propensity to grow business enterprise has no effect on his/her tax evasion behaviour.

4.7 SUMMARY

In this chapter the researcher has presented, analysed and discussed the study findings. Common in the findings was that unemployment and lack of formal employment were the major reasons why the majority of informal traders became informal and that informal employment was involuntary. Chi-square tests showed that involuntary informal employment had a negative effect on one's tax compliance behaviour, that is, those who voluntarily became informally employed had more propensities to pay tax than those who involuntarily became informally
employed. On the other hand, business progression prospects were found not to affect one’s tax payment behaviour.

The majority of the informal traders believed it was unfair for them to pay taxes since they were only trying to survive. Another group just did not want to pay tax while the other was not aware that they should pay tax. The most common finding was that the majority of the informal traders seemed to blame the government for their difficult circumstances that led them to become informal, hence, they did not see the point in paying taxes coupled with the fact that government seemed to them to have paid a blind eye to the informal sector and only labelled them illegal and unwanted. The following chapter presents the conclusions and recommendations of the study.
CHAPTER FIVE: SUMMARY, FINDINGS, DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 THESIS SUMMARY

This study was an investigation into factors associated with tax evasion in the Zimbabwe Informal Sector and it was a survey of Mbare Magaba Informal Traders. The researcher employed the positivist paradigm with a combination of quantitative and qualitative research methods although biased towards quantitative methods. The questionnaire was used as the data collection tool. The researcher selected a systematic sample of one hundred and fifty informal traders at Mbare Magaba Informal Trading Centre and administered the research questionnaire on them.

The study faced a number of challenges: Some of the targeted respondents were illiterate, making it difficult to let them complete questionnaires on their own. The researcher employed the self administration method of data collection in order to deal with this challenge. In order to carry out a comprehensive study, the researcher had to make multiple visits to the research site and this proved to be costly. However, in order to cut down these costs, no questionnaires were left behind. This means the researcher collected all the questionnaires administered on each day and left those which were not completed. Information on tax evasion was considered confidential and threatening by the respondents such as their financial figures and whether they were paying taxes or not. This made the
respondents think twice and hesitant to provide the required information. However, this challenge was dealt with by assuring confidentiality to the respondents and adhering to the research ethics discussed in previous chapters.

In-spite of these constraints, interesting findings and observations were made as follows.

5.2 FINDINGS

5.2.1 Major characteristics of informal traders at Mbare Magaba Informal Market Place

The study established that the majority of the respondents were young males of 35 years and below in age. These were found to have families of at least five members per household. It was also found that all the respondents had at least some basic education of Ordinary ‘O’ level.

From a business ownership point of view, it was found that the majority of the small informal businesses (63%) at Mbare Magaba were sole traders and around 31% were family ventures. This is inconsistent with most of the literature in developing countries which say that the majority of informal businesses are family ventures. Most of these small businesses (46%) did not employ any other person apart from the owner who was running the business (One man business) while about 51% employed between 2 and 5 employees inclusive. The majority (53%) of these businesses did not employ any family member apart from the owner. This is
inconsistent with previous studies which showed that the majority of businesses in the informal sector employed family members and were family run.

It was established in the study that only 16% of the small businesses were making profits of less than US$251 while 51% were making profits of more than US$500 every month on average. In comparison to formal employment especially civil servants, this is considerably higher than the lowest paid civil servant in Zimbabwe who earns less than US$300 per month (Considering that the majority of the informal businesses employed one or two people). Further, the study also established that 20% of the informal businesses were making more than US$800 in profits and this could be an indication that the informal sector is making enough money to be taxable.

The issue of record keeping has been raised as one of the impediments towards the taxation of the informal sector. This study found that the majority of informal traders did not keep proper accounting records but only kept cash receipt books. This could be a challenge. However, it may not be much of a problem in Zimbabwe since the informal sector is liable to presumptive tax which looks at the type of business and not necessarily direct incomes.

The aspect of giving is said to be both psychological and spiritual. It is believed that one’s giving behaviour is likely to cause him/her to pay or not to pay taxes. The study established that almost half of the respondents/informal business owners were giving to a need in their community. This rules out the idea of giving
behaviour being related to tax compliance behaviour since the informal traders in their multitudes were not paying taxes.

5.2.2 Reasons to become informal

The study established that the majority of the informal traders (75%) had been employed formally before they became informal. Unemployment and loss of employment were the major reasons cited for becoming informally employed by the informal traders. The majority of them either lost their jobs or they could not find jobs in the formal employment and then decided to become informal. It was also found that the majority of the informal traders (56%) preferred formal employment to informal employment while 44% preferred informal employment. These traders viewed informal employment as a safety net for them since they could not find alternative employment in the formal sector.

5.2.3 Perceptions of the informal traders on business progression

It was established in the study that the majority of the informal traders did not believe in their businesses progressing into large enterprises. These believed that their current small businesses were a survival means and things were most likely to remain the same. This aspect was that propounded by the dualists that the informal sector is only there as a safety net for the poor and those who fail to find employment in the formal sector. However, there were some (almost 40%) who believed their businesses could become large enterprises in the future. An
interesting finding was that 40% of the informal traders believed their businesses could progress into large enterprises but when it came to progression into formal businesses this percentage fell from 40% to 28% with 72% saying they had no intentions for their businesses to become formal. This further explains that the tax evasion phenomenon was more of intention than ability.

5.2.4 Factors accounting for high tax evasion in the informal sector

The study found that the majority of the informal traders at Mbare Magaba (82%) never paid any taxes to government ever since they formed their informal businesses while only 10% said they always pay taxes and 8% said they used to.

The study came up with four classes or groups of informal traders with regards to tax payment or non-payment; the first group was that of those who were aware that they should pay taxes but did not want to (16%). The second group was that of informal traders who were aware that their businesses should pay tax but believed it was unfair for them to pay taxes (38%). This group was not much different from those who clearly did not want to pay taxes as both groups decided not to pay taxes. The third group comprised those who believed they could not afford to pay taxes (33%) and the fourth group was that of those who were not aware that their businesses should pay taxes. Grouping informal traders in these groups helps understand the tax evasion phenomenon better and also to deal with each group differently regarding tax compliance and taxation.
Regarding factors contributing to tax evasion, the researcher classified them into two; general factors and the hidden factors. General factors are more outside bound, they emanate from the outside world of the informal sector and have to do with the government and tax authorities. Hidden factors on the other hand have more to do with the inside world of the informal traders. These have more to do with how the informal traders view themselves and their world.

5.2.4.1 General factors contributing to tax evasion

The most general factor is that of lack of awareness. It was found in the study that 56% of the informal traders said they had never been addressed by ZIMRA or government official on tax matters and this shows that there was lack of awareness campaigns from the tax authorities.

Some of the major general factors contributing to tax evasion included the following;

- Low risk of non-compliance to tax laws – first the study found that the majority of the informal traders believed there were low chances of one getting caught if evading tax in the informal sector. This was found to increase the informal traders’ propensity to evade taxes as the chances of detection were low. Secondly, the perceived penalty of non compliance was not harsh. In fact, the traders believed that the penalty of non-compliance was not harsh and this could also be increasing their propensity to evade taxes.
• The informal traders believed that government was doing nothing or too little to benefit them.

• Informal traders did not see the point in paying tax

• The taxes were ill spent and mismanaged by government

• Careless spending by government did not justify paying taxes

5.2.4.2 Hidden factors contributing to tax evasion

The study established that the majority of the informal traders at Mbare Magaba were involuntarily employed in the informal sector and did not believe their businesses could progress into the formal sector or become large enterprises. Chi-square tests showed that voluntarism was directly related to tax compliance, that is, those who voluntarily became informally employed were more likely to pay taxes than those who involuntarily became informally employed. Business progression prospects were found not to have an effect on one’s tax payment behaviour.

The findings seemed to align with the dualist school of thought that the informal sector was there as a safety net for the poor and those who failed to find formal employment. Therefore any attempts by the government to tax the informal traders would be considered unfair as it would result in reduced disposable incomes. For this reason, the informal traders were therefore making every effort to evade taxes.
The reason why the researcher believed that the majority of the informal traders had a survival mentality was that results on the ground in terms of profits and incomes proved otherwise. What is important to point out here is that the dualist school of thought is shared by the informal traders but the results on the ground seem to discredit this school of thought. In other words, what was happening and what the informal traders thought was happening were different. This shows that the majority of the informal traders had a survival mentality and this made them to believe that their informal employment was not better than formal employment, that they were only trying to survive and that there were better opportunities in the formal sector. A look into the formal sector of Zimbabwe shows that there are poorer employees in the formal sector who earn less than $300 per month yet the majority of those at Mbare Magaba were earning profits of more than $500.

The study also established that the majority of the informal traders perceived the tax compliance of their fellow informal traders as low or very low. This could reduce the informal traders’ propensity to comply with the tax laws.

5.3 DISCUSSION

5.3.1 Major characteristics of informal traders

Of all findings about the characteristics of the informal traders the study basically differs from previous studies on ownership type. This study found that the majority of the businesses at the Mbare Magaba Informal Trading Centre were in sole-
ownership (owned by individuals) whereas previous studies such as those done by Farrell and Fleming (2000) and Matsebula (1996) found that the majority of informal businesses were family ventures employing unpaid family members. In this study the majority of them were owned by individuals. In terms of number of employees this study reviewed that the majority of the informal businesses employed less than 4 people which was in line with Yankson (1989) who reviewed that the typical informal sector enterprise is individually-owned and operated, with an average size of employment of four.

Following research done by Fields (1990) on voluntarism in the informal sector which separated the informal sector into two (dualism), this study bears consistency with the findings by Fields. This study reviewed that the majority of the informal traders who participated in this study were making profits of more than US$500 per month which is above the minimum salary of government employees and also above the tax threshold. This means that there is dualism in the informal sector and some people operating in this sector are earning more than those in the formal sector.

5.3.2 Tax compliance and evasion

The study reviewed that tax non-payment was high (82%) in the informal sector at Mbare Magaba as a confirmation to the findings by the Finmark Trust (2012). If a deduction is made for those who were not aware of their tax obligation (13%), the tax evasion remains high. In this context those who were not aware of their tax
obligation cannot be classified as evading tax but those who did not pay taxes and also knew of their tax obligation can be classified as tax evaders.

5.3.3 Factors associated with tax evasion

One of the major factors found to be associated with tax evasion was that there was lack of trust in the government by the informal traders. In other words, the informal traders either believed government was careless in spending the tax revenues or believed government was not doing enough for them in terms of development. This made it difficult for them to justify paying taxes. Pashev (2005), Everest-Phillips (2008), Lieberman (2002) and Brautigam et al. (2008) all agreed to this findings and gave the same explanation that if the government fails to provide basic public goods and services or provides them insufficiently, citizens may not be willing to pay taxes and tax evasion and avoidance will be the consequence. Oberholzer (2008a) also added corruption and careless spending by government made it hard to justify paying taxes.

Another factor was that of low risk of detection or low risk of tax evasion. In other words, the risk of tax evasion was perceived as low by the informal traders due to weak enforcement of the tax laws by the government. According to Alm et al. (1992) and Alm and Martinez-Vazquez (2007), risk-averse individuals tend to pay more taxes attempting to avoid the risk of detection and punishment. Because of the low risk of tax evasion, it could only take one’s self motivation to pay taxes. This is the same sentiment shared by the World Bank (2008) which highlighted that shortfall in tax collection procedures as well as weak capacities of tax
administrations to detect and prosecute tax violators are both factors that contribute to a low enforcement of tax legislation.

Lastly, another major factor that was found to be associated with tax evasion was voluntarism. The circumstances leading to one's decision to become informally employed (whether voluntary or involuntary) were found to affect the individual's decision to comply with the tax laws or to evade taxes. This is new knowledge as the studies done on voluntarism only described and explained what voluntarism meant without linking it to the tax evasion behaviour of informal traders. Such studies include Fields (1990), Maloney (2004) and Sakthivel and Joddar (2006).

5.4 CONCLUSIONS

The following are the major conclusions of this study in line with the research questions;

- The informal traders at Mbare Magaba were mainly male, most of them supporting families of at least five members per household. The majority of these informal businesses were in sole ownership and employing less than four people. The majority of the informal businesses were making profits of at least US$500 and some made more than US$1000 every month on average.

- Voluntarism was found to affect one's decision to comply with tax laws or evade taxes. That is, those who voluntarily became informally employed
were more likely to comply with tax laws than those who involuntarily became informally employed.

- The perceptions of the informal traders about the prospects of their micro or small business progressing into formal enterprises had no effect on their tax evasion behaviour.

- The major factors associated with tax evasion included;
  
  o Lack of trust in the government,
  
  o Lack of government programmes that benefit the informal sector,
  
  o Low perceived risk of detection (low risk of tax evasion), and
  
  o Involuntary informal employment

5.5 RECOMMENDATIONS

Based on the conclusions made in the preceding section, the following recommendations were made.

5.5.1 The informal sector has to be the route of sustainable poverty reduction initiatives

This study established that informal traders at Mbare Magaba alone (almost two thousand in number of small businesses) supports households of at least five people. This translates into around 10000 people supported by informal
businesses at Mbare Magaba alone. These statistics indicate that the informal sector supports millions of people in the country. This means that poverty reduction initiatives have to target informal traders if they are to succeed. One of the major factors found in this study causing tax evasion is the survival mentality that tax evaders have which cause them not to accept anything that demands them to cede their income thereby resulting in reduced disposable incomes. Therefore, by targeting informal traders for sustainable poverty reduction programmes, government would be helping in dealing with the survival mentality and at the end tax morale is likely to increase.

5.5.2 Government support programmes for the informal sector

For a long time the informal sector has been treated as a black economy and unwanted. The government has paid a blind eye to the informal sector for a long time and therefore government has to make efforts in doing the opposite. It is true that the informal sector will never be depleted in this country and therefore government needs to accept this reality and start making efforts towards supporting informal sector businesses. This means there has to be a budget allocation for the informal sector. The informal traders need to be made to believe that government is working with them and not against them for them to finally comply with the tax laws. Currently, the majority of the informal traders do not want to hear anything to do with ZIMRA or tax simply because they think that tax is for the government and not for them since government is not doing anything to the advantage of the informal traders.
Some of these efforts should include training and improving access to markets for the informal traders’ products. Training should include business planning and management, marketing and the acquisition of other related skills.

5.5.3 Resource mobilization for taxing the informal sector

Introducing tax to entrepreneurs in the informal sector was critical because the economy was more inclined to the sector.

“There should be policies which are clear on how the informal sector should be taxed because business in Zimbabwe has changed.

“It is no longer defined by tall buildings and offices because many have joined the informal sector,” he said.

He said Zimra should start focusing on taxing the informal sector as much as the authority was doing on formal businesses and this would go a long way in improving the country’s revenue base.

“If a new Income Tax Act is crafted it will help the Government to have access to the revenue flowing in the informal sector which will be used to promote and grow local businesses,” Mgodi said.

5.5.4 New informal sector tax system

Sectoral Groupings

Presumptive-Fixed tax per sector or type of informal business
5.5.5 Awareness

There is no substitute for awareness raising in the tax language. Government through ZIMRA needs to set aside a budget for awareness campaigns in the informal sector. However, it is important to note that these campaigns should not be used alone as a cure to the tax evasion problem but in conjunction with other strategies discussed above.

5.5.6 Capacity building programmes in record keeping

The government needs to take an active role in enabling the capacity of the informal sector business people in areas of training so that they can to be equipped with basic financial and accounting skills. This will assist the entrepreneurs to keep the basic accounting and financial records that will ensure that IRS make positive and objective assessment of tax base. Such training programmes could be put in place by the IRS in tandem with the Ministries of Finance and Local Government. The programmes could then be decentralized to the unit committee levels so that all major identifiable informal business people are trained to have the ability to keep accurate financial records which will facilitate tracking all business activities of the informal entrepreneurs. This will go a long way to enable IRS objectively recover tax from, as many, informal businesses as possible. This recommendation is very crucial as an accounting variable having been identified as number one predictor of tax noncompliance in the informal sector.
5.5.7 Encourage grouping and associations and support informal sector formalisation

The informal sector needs to come up with groupings in which they form networks. Through these groups, banks, the government and the non-governmental organisations among others could then assist the informal sector.

The type of business advice and support available to people seeking to transfer their businesses into the formal economy needs to be appropriately designed for those trading informally. The current approach caters solely for people willing and able to go through a formal business planning process, currently used by Business Links and other government delivery agencies, for start-up or growth businesses.

5.5.8 Enforcement

There are some informal traders who simply do not want to comply with tax laws. Enforcement should therefore be a good cure for this group. Government should therefore make sure tax evaders are punished in the informal sector. A cost benefit analysis would help before allocating resources in order to see that the benefits of concentrating more on the informal sector in terms of enforcement would yield great tax revenues for the fiscus.

Several other costs are associated with formalization. A key factor driving the decision to become formal is the cost of formalization. A firm with a given level of revenues may choose informality in a country which has higher tax rates and much
greater compliance costs, compared to countries where such costs are low. It may also choose to remain informal if the benefits of formal registration are not realized because of poor delivery of financial or infrastructure services. It may also remain informal if compliance costs are low i.e. if inspectors are equally likely to seek bribes whether a firm is formal or informal.

5.6 AREAS FOR FURTHER STUDY

The following areas are proposed for further study:

i. Inclusion of informal sector in policies and strategies for national socio-economic development. Informal enterprises operate outside of the government system of regulation, which restricts government’s ability to incorporate them in policies and strategies in pursuit of national socio-economic goals. This study would be able to provide insights into the perceptions of governments of developing countries towards the inclusion of the informal sector in policies and strategies of national socio-economic development. It would also offer insights into the challenges and experiences of those who have tried or done so. Overall, increasing informalization is an indication of the failure of government to offer a formal environment conducive to small-scale enterprise development.

ii. One of the major areas of concern that came out of this study was the need for government to create adequate employment opportunities for those who are currently in informal employment but prefer formal employment. A
further study could therefore be carried out to investigate challenges in employment creation in Sub-Saharan Africa with particular focus on post-hyperinflation era in the case of Zimbabwe.

REFERENCES

BOOKS


Schneider, F. (2005), *Shadow Economies of 145 countries all over the world: What do we really know?* Mimeo: University of Linz.


**JOURNALS**


Alm, James and Jorge Luis Martinez-Vazquez (2001), Societal institutions and tax evasion in developing and transition countries. A paper prepared for a public finance in developing and transitional countries conference, Georgia State University.

Alm, James and Jorge Luis Martinez-Vazquez (2007), *Tax morale and tax evasion in Latin America*, Andrew Young School of Policy Studies. 1-90


Global Financial Integrity (2010), The Implied Tax Revenue Loss from Trade. Mispricing


Conference on the Hard-to-Tax, Andrew Young School of Public Policy, Georgia State University.


The Institute of Statistical, Social and Economic Research (ISSER, 2003), The State of the Ghanaian Economy, p. 193


Tokman V. E. (1976) Competition Between the Informal and Formal Sector in Retailing: The Case of Santiago World Development Vol.6 No. 9 p.10


Torgler, Benno and Friedrich Schneider (2009), The impact of tax morale and institutional quality on the shadow economy, Journal of Economic Psychology 30(2009), 228-245.


NEWSPAPERS


GOVERNMENT REPORTS


Tanzania Revenue Authority (TRA, 2010), Report on the Study for Establishment of Potential Tax Base in the Upcountry Regions, Dar es Salaam, July


World Bank (2008). World Development Indicators (online database), Washington, DC: WDI online


World Bank/Pricewaterhouse Coopers (2006), Paying Taxes, Washington, DC: WDI online


Zimbabwe Revenue Authority (2010), ZIMRA annual report Zimbabwe Revenue Authority (2012), Harare: ZIMRA


Zimbabwe Revenue Authority. ZIMRA Revenues Review First Quarter (2012), Harare: ZIMRA

WEBSITES

ZimbabweRevenueAuthority(ZIMRAonline).

INTRODUCTORY LETTER TO RESPONDENT

13 May 2013

To the respondent
Dear Sir/Madam

RE: QUESTIONNAIRE COMPLETION ON TAX EVASION IN THE INFORMAL SECTOR

My name is Cuthbert Masairambi and I kindly ask for your assistance in the completion of my questionnaire. I am a Zimbabwe Open University (ZOU) Higher Degrees Directorate student. As part of the requirements of the institution for the completion of the Doctorator of Philosophy in Business Leadership program, I am carrying out a research entitled; An investigation into factors associated with tax evasion in the informal sector of Zimbabwe: A survey of Mbare Magaba Informal Market Place. It is against this background that I kindly seek your opinions by completing the attached questionnaire.

This is a purely academic study and the results will be used for academic purposes only. Please feel free to say out your honest opinion and I assure you that all the information you provide will be treated in strict confidence. For any clarifications, please contact me on the details provided above.

Yours sincerely

Cuthbert Takawira Masairambi
APPENDIX II

QUESTIONNAIRE FOR INFORMAL TRADERS

Instructions

a) Please respond to all questions
b) Respond by ticking the applicable in questions where responses are provided and briefly explain where spaces are provided
c) There are no right or wrong answers, hence, please give the response that is closest to your opinion
d) Please note that all your responses will be treated with strict confidence and the study will be used for academic purposes only

Section A: Demographic and Background Information

1. Please tick your gender
   a) Male [ ]
   b) Female [ ]

2. Age group (Tick applicable)
   a) 30 years and below [ ]
b) 31 – 35 years

c) 36 – 40 years

d) 41 – 45 years

e) Above 45 years

3. Marital status
   a) Single
   b) Divorced
   c) Widow/widower
   d) Single parent
   e) Married

4. Please state your highest educational level. (Tick applicable).
   a) Primary education
   b) ‘O’ Level
   c) Advanced level
   d) College certificate/diploma
   e) University Degree or above

5. How many are you in your household? _______________________

6. Do you go to church?
   a) Yes
   b) No

7. How many are you in your business? _______________________

8. How many in the business are family members (excluding yourself)?
   _______________________

9. What is the ownership type of your business?
   a) Sole-ownership
   b) Partnership
   c) Family venture
   d) Cooperative

10. How much profit does your business make per month on average?
    _______________________

11. What form of accounting administration or record keeping does your business have?
    a) None
    b) Cash receipts only
    c) Incomes and expenditure accounting
    _______________________

224
12. Do you as an individual give to charity or contribute financially to your community?
   a) Many times [ ]
   b) Sometimes [ ]
   c) Once in a while [ ]
   d) Never [ ]

Section B: Reasons to become informal

13. Were you ever formally employed before you started trading in the informal sector?
   a) Yes [ ]
   b) No [ ]

14. What was the major reason you joined the informal employment? Please tick or write.

<table>
<thead>
<tr>
<th>STATEMENT</th>
<th>TICK</th>
</tr>
</thead>
<tbody>
<tr>
<td>I was not qualified to get a formal job</td>
<td></td>
</tr>
<tr>
<td>I was retrenched and couldn’t find a formal job</td>
<td></td>
</tr>
<tr>
<td>I was fired and couldn’t find a formal job</td>
<td></td>
</tr>
<tr>
<td>My former job was not paying me enough to cover basic needs</td>
<td></td>
</tr>
<tr>
<td>I always wanted to start my own small business</td>
<td></td>
</tr>
<tr>
<td>Informal employment had better opportunities than formal employment</td>
<td></td>
</tr>
<tr>
<td>Other (Specify)</td>
<td></td>
</tr>
</tbody>
</table>

15. Given your experiences in informal employment up to now, what would you prefer between formal employment and informal employment?
   a) Formal employment [ ]
   b) Informal employment [ ]
16. Can you say you are currently making a good living out of your business venture here?
   a) Yes [ ]
   b) To some extent [ ]
   c) No [ ]

Section C: Business progression

17. Where do you see your business in ten years to come?
   __________________________________________________________
   __________________________________________________________

18. Do you think your business will grow to become a fully fledged large scale business?
   a) Yes [ ]
   b) To some extent [ ]
   c) No [ ]

19. Do you have plans for your business to become formal?
   a) Yes [ ]
   b) No [ ]
   c) I have never thought about it [ ]
20. How far do you agree with the following statements? Please tick the most appropriate response corresponding to each statement.

<table>
<thead>
<tr>
<th>STATEMENT</th>
<th>AGREE</th>
<th>SOMEWHAT AGREE</th>
<th>DISAGREE</th>
</tr>
</thead>
<tbody>
<tr>
<td>My business has obtained credit from a financial institution before</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I have attended a business management course/training</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I do strategic planning for 1 – 5 years to come</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I set goals in my business and always set out to achieve them</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Only my usual customers buy my products most of the time</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I make enough marketing efforts to get new customers always</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Section D: Tax Compliance/Evasion

21. Does your business pay taxes to ZIMRA?
   a) Always                           [    ]
   b) Sometimes                        [    ]
22. If your answer to the above question is “Never paid any taxes”, are you aware that your business should pay taxes?

   a) Yes I am aware but I do not want to pay taxes  [  ]
   b) Yes I am aware but it is not fair for me to pay taxes  [  ]
   c) Yes I am aware but it is difficult to pay taxes  [  ]
   d) No I am not aware  [  ]

23. If your answer to question 21 is “Sometimes” please explain why you sometimes miss your tax obligations?

________________________________________________________________________

________________________________________________________________________

24. If your answer to question 21 is “Used to” please explain the reasons why you stopped paying taxes.

________________________________________________________________________

________________________________________________________________________

25. Have you ever been addressed by ZIMRA or any government official here or anywhere for tax purposes as informal traders?

   a) Yes  [  ]
   b) No  [  ]

26. In the following table, please ONLY tick the two factors that influence you not to pay taxes if you do not or no longer pay taxes.

<table>
<thead>
<tr>
<th>STATEMENT</th>
<th>TICK</th>
</tr>
</thead>
<tbody>
<tr>
<td>I do not see the point in paying taxes</td>
<td></td>
</tr>
<tr>
<td>The taxes are ill spent and mismanaged by government</td>
<td></td>
</tr>
</tbody>
</table>
I do not trust ZIMRA or the government
There is corruption in the tax system
Careless spending by government does not justify paying taxes
Government is doing nothing or too little to benefit us in the informal sector
The taxes are too high
There is too much paperwork and a lot of time is lost in paying tax
I do not know how to pay tax

27. How do you rate the tax compliance level of your fellow informal traders in the Zimbabwe informal sector?
   a) Very high       [  ]
   b) High            [  ]
   c) Average         [  ]
   d) Low             [  ]
   e) Very low        [  ]

28. It is most likely to be detected if one does not pay tax in Zimbabwe informal sector. How far do you agree with this statement?
   a) Agree           [  ]
   b) Agree to some extent [  ]
   c) Disagree        [  ]

29. Do you know of any penalties for anyone who does not comply with the tax law in Zimbabwe informal sector?
   a) Yes             [  ]
   b) Not sure        [  ]
   c) No              [  ]

30. If you think or know that there are penalties how harsh do you think the penalties are?
   a) Very Harsh penalties [  ]
Section E: Recommendations

31. What do you recommend to be done for you to fully comply with tax payment?

________________________________________________________________

________________________________________________________________

________________________________________________________________

32. Any further comments.

________________________________________________________________

________________________________________________________________

END OF QUESTIONNAIRE

Thank you for your time