Policy Implementation Gaps and Institutional Fault Lines in the Context of Tax Evasion, the Informal Economy, Fiscal Constraints and their Impact on Social Spending in Pakistan

Tajdar Khan[1], Asad Sarwar[2], Hussain Wazir[3], Raeesa Attache[4], Dr. Muhammad Riaz Khan[5], Dr. Muqeem ul Islam[6]

KJPP

Khan, T., Sarwar, A., Wazir, H., Attache, R., Khan, M. R., & Islam, M. U. (2025). Policy implementation gaps and institutional fault lines in the context of tax evasion, the informal economy, fiscal constraints and their impact on social spending in Pakistan. Khyber Journal of Public Policy, 4(2), Summer 2025, PP- 190-261

Article Info:
Received: 15/05/2025
Revised: 20/05/2025
Accepted: 25/05/2025
Published: 31/05/2025

Abstract:

Pakistan's fiscal system faces persistent challenges rooted in tax evasion, a large informal economy, and weak institutional frameworks. With a tax-to-GDP ratio of merely 9.5%, significantly below regional benchmarks, the country struggles to mobilize domestic resources and finance essential public services. Policy implementation gaps and institutional inefficiencies—such as weak enforcement, bureaucratic inertia, and corruption—exacerbate fiscal constraints, impeding education, healthcare, and poverty alleviation. The informal sector, comprising up to 40% of GDP, and annual tax evasion losses exceeding $1 billion further erode the revenue base. This paper examines the historical and structural roots of Pakistan's fiscal challenges, highlighting how political will, institutional reforms, equitable tax policies, and enhanced enforcement mechanisms are critical to strengthening the fiscal framework. Recommendations include restructuring the Federal Board of Revenue, rationalizing tax exemptions, and expanding the tax net to improve equity and public trust. Broad-based reforms are essential to ensure sustainable, inclusive development.

Key words: *Pakistan, Tax evasion, Informal economy, Fiscal policy, Institutional reform*

[1]*Ministry of Energy, Email tajdar.dgpc@gmail.com*
[2] *Provincial Management Service (PMS-KP) Email asad_sarwar77@hotmail.com*
[3] *Information Group (IG) Email: hussainwazir14@gmail.com*
[4] *Postal Group Email: raeesa.attacha@gmail.com*
[5] *Faculty Advisor, National Institute of Public Administration, Peshawar Email mkriaz83@gmail.com*
[6] *Chief Instructor, National Institute of Public Administration, Peshawar Email: muqeemz@gmail.com*

Introduction

Pakistan's fiscal landscape is characterized by persistent challenges that undermine its capacity to deliver essential public services and achieve sustainable economic development. Central to these challenges are policy implementation gaps and institutional fault lines that exacerbate tax evasion, perpetuate a sprawling informal economy, and impose severe fiscal constraints. These issues collectively limit the government's ability to fund social spending, critical for addressing poverty, education, and healthcare needs in a country where 42% of the population lives below the poverty line and 40% of children under five suffer from stunting (World Bank, 2025). With a tax-to-GDP ratio languishing at approximately 9.5%, significantly below the Asia Pacific average of 19.3%, Pakistan struggles to mobilize domestic resources, relying heavily on external borrowing and indirect taxes that disproportionately burden lower-income groups (LUMS MHRC, 2023).

Tax evasion, estimated to cost over $1 billion annually in lost revenue, thrives in an environment of weak enforcement, complex tax systems, and low public trust in governance (PIDE, 2023). Concurrently, the informal economy, encompassing 30–40% of GDP, operates outside regulatory oversight, further eroding the tax base through unregistered businesses, informal employment, and cash-based transactions. These phenomena are not merely economic but deeply institutional, rooted in policy inconsistencies, bureaucratic inefficiencies, and corruption that undermine the Federal Board of Revenue (FBR) and other agencies. The resulting fiscal constraints, with a fiscal deficit of 6.7% of GDP in FY25, restrict social spending, leaving critical sectors like education (1.8% of GDP) and healthcare (1.1% of GDP) underfunded (World Bank, 2025).

This research paper examines the interplay of policy implementation gaps and institutional fault lines in perpetuating tax evasion and the informal economy, and their cascading effects on fiscal capacity and social spending in Pakistan. Policy implementation gaps refer to the disconnect between formulated tax policies and their execution, often due to inadequate resources, lack of coordination, or resistance from vested interests. Institutional fault lines encompass structural weaknesses, such as corruption, overlapping mandates, and lack of accountability, that hinder effective governance. By analyzing these dynamics, the paper aims to identify actionable reforms to strengthen Pakistan's fiscal framework, enhance revenue mobilization, and prioritize social investments for equitable development.

The study is structured as: a historical overview traces the evolution of Pakistan's tax system and institutional challenges; subsequent sections analyze policy gaps, institutional weaknesses, and their impacts on fiscal space and social spending, drawing on qualitative and secondary data from sources like the World Bank, IMF, Economic Survey of Pakistan, FBR publications, KPRA Annual Report and local research institutions and newspapers articles. For the finalization of this paper, primary sources were also consulted to verify the existing literature from the experts from FBR and Tax Consultants to pin point the gaps between theory and practice. Therefore, this paper concludes with recommendations to address these challenges, emphasizing institutional reforms, policy coherence, and public trust-building measures.

Literature Review

The literature on Pakistan's fiscal challenges, tax evasion, informal economy, and social spending highlights structural, institutional, and socioeconomic factors that perpetuate low revenue mobilization and constrain development. Key sources include academic studies, institutional reports, and news analyses, providing a robust foundation for understanding policy implementation gaps and institutional fault lines.

Tax Evasion

Economic deterrence theory (Allingham-Sandmo, 1972) frames tax evasion as a rational choice driven by low detection risks and weak penalties, highly relevant to Pakistan, where only 1% of tax returns are audited. Behavioral economics emphasizes low tax morale, with only 40% of Pakistanis trusting government revenue use, fueling evasion (PIDE, 2023). Institutional theory highlights weak governance, with Transparency International (2024) ranking Pakistan 135/180 on corruption, and FBR scandals undermining enforcement. FBR informed National Assembly on registered businesses in the country depicting with only 12.5 million registered taxpayers, and exemptions for agriculture (22% of GDP) cost PKR 100 billion annually. The World Bank (2025) underscores that tax evasion, costing USD 1 billion yearly, is exacerbated by complex tax systems and low compliance.

Informal Economy

The informal economy, estimated at 30–40% of GDP, employs 70% of Pakistan's workforce, evading taxes through cash transactions and unregistered businesses (PIDE, 2023). Dualist theory views informality as a survival strategy for marginalized groups, with 42% of Pakistanis below the poverty line relying on informal livelihoods (World Bank, 2025). Structuralism theory (Castells & Portes) sees informality as integral to formal economies, with unregistered retail (50% of urban activity) undercutting formal businesses (PIDE, 2023). De Soto's legalist perspective attributes informality to high compliance costs (PKR 50,000–100,000 for small retailers) and bureaucratic inefficiencies (PIDE, 2023).

VOA News (2024) highlights smuggling in Balochistan, costing PKR 227 billion annually on account of Petroleum Levy only, as a socioeconomic necessity in regions (Balochistan) with 70% poverty. Arby et al. (2010) trace informality's growth to 1970s nationalization policies and weak state presence in border areas.

Fiscal Constraints

Pakistan's fiscal deficit, averaging 6–8% of GDP, reflects low revenue and high debt servicing (51.8% of the budget) (World Bank, 2025). The FBR's reliance on indirect taxes (60% of revenue) and exemptions for influential sectors narrows the tax base, forcing borrowing (public debt PKR 67 trillion in 2024) (LUMS MHRC, 2023). Khan (1999) and Husain (2005) note historical weaknesses, with colonial legacies and post-independence elite capture entrenching low taxation of agriculture. IMF (2024) conditions, such as tax hikes, often increase informality, creating a feedback loop. The 18th Amendment's devolution of power has led to provincial underperformance, with provinces contributing only 1% to the tax-to-GDP ratio despite 57% federal revenue transfers and 57.7% contribution of Services sector to the GDP (World Bank, 2025).

Social Spending

Welfare state theories (Esping-Andersen) contextualize Pakistan's underfunded social sectors, with education (1.8% of GDP) and healthcare (1.1% of GDP) below regional averages (World Bank, 2025). Public choice theory explains limited spending as a result of political incentives favoring elite exemptions over public goods (LUMS MHRC, 2023). The fiscal capacity framework links low revenue to inadequate social investments, resulting in 44 million out-of-school children and 40% child stunting (World Bank, 2025). The Economic Survey (2023) notes federal spending on devolved sectors like health (PKR 45 billion) and education (PKR 114 billion) in FY2023-24, reflecting coordination failures post-18th Amendment. Dawn (2024) highlights regional disparities, with Balochistan's schools lacking basic facilities.

Comparative Insights

India and Vietnam offer lessons for Pakistan. India's GST unified indirect taxes, boosting collections to INR 1 trillion monthly, while digital tools like GSTN enhanced compliance (World Bank, 2023). Vietnam's VAT and phased tax reforms doubled revenue, with digitization reducing informality to 15% of GDP (IMF, 2023). Both countries simplified tax structures and limited exemptions, contrasting with Pakistan's complex system and widespread concessions (PIDE, 2023).

Gaps and Contributions

While the literature comprehensively addresses tax evasion and informality's economic impacts, less attention is given to institutional fault lines like post-18th Amendment coordination failures and elite capture's role in sustaining exemptions. Primary consultations with FBR experts, as noted in the document, bridge this gap by pinpointing practical implementation challenges. This study contributes by integrating theoretical frameworks (economic deterrence, structuralist, fiscal capacity) with empirical data and comparative analysis, offering actionable reforms to address Pakistan's fiscal and social challenges.

Theories, Conceptual and Theoretical Framework of Tax Evasion, Informal Economy and Social Spending

Conceptualizing Tax Evasion, Informal Economy, and Social Spending

Tax Evasion: It refers to illegal practices to avoid paying taxes, including underreporting income, inflating deductions, and hiding money in offshore accounts. It is distinguished from tax avoidance, which, though legal, exploits loopholes to reduce tax liability.

The informal Economy: It comprises unregulated and often untaxed economic activities that are outside the formal institutional framework. This includes unregistered businesses, undeclared employment, and shadow markets. While it offers livelihood in underdeveloped economies, it also undermines formal state revenue collection.

Social spending: It encompasses government expenditure on welfare programs like education, healthcare, pensions, and social safety nets. It reflects a government's redistributive role and impacts socio-economic development and inequality reduction.

These three concepts are interconnected. Tax evasion and a large informal economy reduce state revenues, limiting the fiscal capacity for social spending. Conversely, inadequate social services may incentivize individuals to operate informally or evade taxes, creating a vicious cycle.

Theoretical Frameworks

A. **Theories of Tax Evasion**

Economic Deterrence Theory (Allingham-Sandmo Model, 1972)

This neoclassical model conceptualizes tax evasion as a rational choice based on a cost-benefit analysis. Taxpayers weigh the expected utility of evading taxes (benefit) against the probability of detection and punishment (cost). Enforcement strength and penalty severity are thus central to compliance.

Behavioral Economics Approach

It challenges the purely rational model by incorporating social norms, intrinsic motivations, tax morale, and trust in institutions. Factors like perceived fairness, civic duty, and societal norms play a significant role in influencing tax compliance.

Institutional Theory

It emphasizes the role of state institutions, legal frameworks, and governance quality. Weak institutions and corruption can erode trust in government, thereby increasing tax evasion.

B. Theories of the Informal Economy

Dualist Theory:

It sees informality as a survival strategy by marginal groups excluded from the formal economy. It highlights structural rigidities like lack of formal employment opportunities or barriers to entry (licenses, regulation).

Structuralist Theory (Castells and Portes);

It views the informal sector as subordinated to and exploited by the formal economy. It is not isolated, but rather integral to capitalist systems, often serving to reduce labor costs.

Legalist/Institutionalist Perspective (de Soto)

It argues that excessive regulation and bureaucratic inefficiency push entrepreneurs into informality. Reforming property rights, simplifying registration, and enhancing legal access can help transition to formality.

Political Economy Perspective:

It focuses on power relations and governance. States may tolerate or even benefit politically from informality, especially in clientelist systems where informal actors are mobilized for political support.

C. Theories of Social Spending:

Welfare State Theories (Esping-Andersen)

It categorizes welfare regimes (liberal, corporatist, social democratic) based on state-market-family relations. These regimes differ in their redistributive priorities and social expenditure patterns.

Public Choice Theory:

It analyzes social spending through the lens of political incentives. Politicians expand social programs to maximize electoral support, sometimes at the cost of fiscal prudence.

Fiscal Capacity and Political Will Framework;

It emphasizes that social spending depends not only on resource availability (tax revenue) but also on political will and institutional quality. Low tax collection (due to evasion or informality) limits the state's ability to invest in social sectors.

Conceptual Framework

The dynamics of social spending in Pakistan are shaped by a reinforcing cycle involving tax evasion, informality, and public trust. A large informal economy and low tax compliance narrow the national revenue base, limiting the government's fiscal capacity to invest in critical social sectors like education, health, and social protection. This underinvestment results in inadequate and unequal service delivery, particularly in underserved and marginalized areas, which in turn erodes public trust in state institutions and reduces tax morale.

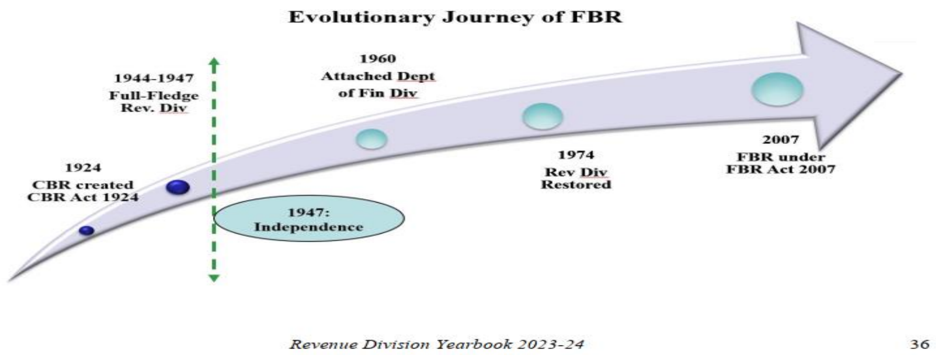
As citizens perceive limited returns on their tax contributions, non-compliance becomes normalized, further entrenching informality and evasion. Weak governance and institutional inefficiencies perpetuate this cycle, deepening structural constraints on development. This framework is especially pertinent to developing countries like Pakistan, where persistent informality, limited social investment, and fragile state-citizen relations create enduring barriers to inclusive and sustainable growth. Addressing this cycle demands a comprehensive approach that expands the tax base, enhances service delivery, and strengthens governance through transparency, accountability, and civic engagement.

Historical Context

Evolution of Pakistan's Tax System

Pakistan's tax system has its roots in the colonial era, with the British introducing land revenue and customs duties as primary revenue sources. Post-independence in 1947, the nascent state inherited a rudimentary fiscal framework, heavily reliant on agriculture, which contributed over 50% to GDP but was lightly taxed to maintain political support from feudal landowners (Khan, 1999). The Income Tax Act of 1922, carried over from British rule, formed the basis of direct taxation, but its scope was limited, targeting urban elites and formal businesses. By the 1950s, indirect taxes, such as sales and excise duties, emerged as significant revenue sources, reflecting the government's preference for administratively simpler mechanisms in a largely informal economy.

The 1960s and 1970s saw efforts to modernize the tax system under military and civilian regimes. The establishment of the Central Board of Revenue (CBR, predecessor to the FBR) in 1960 aimed to centralize tax administration, but its effectiveness was hampered by limited capacity and political interference. The introduction of the General Sales Tax (GST) in the late 1970s marked a shift toward consumption-based taxation, driven by the need to broaden the revenue base amid growing public expenditure. However, exemptions for agriculture and influential sectors, coupled with weak enforcement, kept the tax-to-GDP ratio below 12% (Husain, 2005).



Rise of the Informal Economy

The informal economy, encompassing unregistered businesses, informal labor, and barter trade, has been a persistent feature of Pakistan's economic landscape. In the 1970s, nationalization policies under Prime Minister Zulfiqar Ali Bhutto pushed many small enterprises into the informal sector to evade state control. High tax rates and complex compliance requirements further incentivized informality, particularly in retail and services, which grew as urbanization accelerated. By the 1980s, estimates suggested the informal economy accounted for 20–25% of GDP, driven by cash-based transactions and lack of documentation (Arby et al., 2010).

The informal economy's growth was particularly pronounced in regions like Balochistan and Khyber Pakhtunkhwa, where weak state presence and cross-border trade with Afghanistan and Iran facilitated smuggling and undocumented activities. Balochistan border regions, home to 2.4 million people reliant on informal livelihoods, became hubs for tax evasion, with smuggled goods and unreported income escaping FBR oversight (VOA News, 2024). The informal sector's expansion was not merely economic but also social, as low literacy (59% national rate) and poverty (42% below the poverty line) limited formal employment opportunities, embedding informality in Pakistan's socioeconomic fabric.

Institutional Challenges and Policy Gaps

Institutional fault lines emerged early in Pakistan's history, shaped by political instability, bureaucratic inefficiencies, and elite capture. The CBR, tasked with tax collection, faced chronic understaffing and corruption, with reports of bribery undermining audits and enforcement (Khan, 1999). Overlapping mandates between federal and provincial authorities, particularly after the 1973 Constitution, created coordination failures. For instance, agricultural income tax, a provincial responsibility, was rarely enforced due to resistance from powerful landowners, leaving a significant revenue source untapped (LUMS MHRC, 2023).

Policy implementation gaps became evident in the 1980s and 1990s as structural adjustment programs, backed by the IMF and World Bank, pushed for tax reforms.

The 1991 Tax Reforms Committee recommended broadening the tax base and reducing exemptions, but implementation faltered due to political opposition and bureaucratic inertia. The introduction of the Value Added Tax (VAT) in 1996 aimed to streamline indirect taxation, but poor administrative capacity and public resistance led to widespread evasion, with only 30% of eligible businesses registering (Husain, 2005).

Fiscal Constraints and Social Spending

Pakistan's fiscal constraints have historical roots in low revenue mobilization and high debt servicing. By the 1990s, debt servicing consumed 40% of the budget, crowding out social spending (IMF, 1998). Education and healthcare allocations remained below 1.8% and 1.1% of GDP, respectively, contributing to persistent poverty and human development challenges. The fiscal deficit, averaging 6–8% of GDP since the 1980s, reflected structural weaknesses, with tax evasion and informality limiting revenue growth (World Bank, 2025).

The 2000s saw renewed reform efforts, including the FBR's establishment in 2001 to enhance tax administration. However, outcomes were modest, with the tax-to-GDP ratio stagnating at 7–10%. Corruption scandals, such as the 2010 fake refund scam involving FBR officials, eroded public trust, further encouraging tax evasion. The 18th Amendment in 2010, devolving powers to provinces, aimed to improve governance but exacerbated coordination challenges, as provinces lacked capacity to enforce taxes like agricultural income tax.

Recent Developments

Since 2015, Pakistan has pursued tax reforms under IMF programs, including the 2019 Extended Fund Facility, which mandated increasing the tax-to-GDP ratio to 15% by 2024. Measures like the 2025 Budget's removal of withholding taxes and income tax reductions aimed to simplify compliance, but their impact remains limited, with only 12.5 million taxpayers registered out of a 241 million populations. The informal economy is estimated at around 30–40% of GDP, continues to thrive, driven by high compliance costs and low enforcement (PIDE, 2023). Institutional fault lines, including FBR inefficiencies, lack of political will, pervasive tax-evasion culture and judicial delays in tax evasion cases, persist, while fiscal constraints limit social spending, with 20 million people lacking clean water and 44 million children out of school (World Bank, 2025). The growing fiscal deficit as a result of excess debt servicing further exacerbates the limited fiscal space available for social spending.

Pakistan's tax system and institutional framework have evolved amidst structural challenges, from colonial legacies to modern reform efforts. Historical policy gaps, such as exemptions for agriculture and weak enforcement, have entrenched tax evasion and informality, constraining fiscal space and social spending.

Understanding this historical context is crucial for analyzing current challenges and designing effective reforms to strengthen Pakistan's fiscal and institutional capacity.

Pakistan Tax Revenue (2023-24) - A Reality Check

The FBR successfully achieved its revised revenue target of Rs. 9,252 billion, surpassing it slightly at 100.5% in FY2023-24. The total revenue collected amounted to Rs. 9,299 billion, marking an increase of Rs. 2.1 trillion from the previous fiscal year and achieving an impressive growth rate of 29.8%. Notably, this year marked the first time FBR's revenue collection crossed the Rs. 9 trillion thresholds in the country's history. A breakdown of tax-wise performance shows that the Federal Excise Duty (FED) experienced the highest growth at 56.1%, followed by direct taxes at 38.5%. Sales tax and customs duty also saw significant increases, with growth rates of 19.1% and 18.5% respectively. This performance is particularly commendable given the prevailing economic downturn.

In the context of rapid technological advancements, the FBR has achieved a remarkable 29.8% year-on-year growth in revenue collection. This success can be attributed to improved taxpayer engagement, the effective integration of new technologies, and enhancements to our digital infrastructure, among other factors. These accomplishments reflect the steadfast dedication, relentless efforts, and perseverance of everyone at the FBR

Table 1: Comparison of Collection FY2023-24 vis-a-vis Target

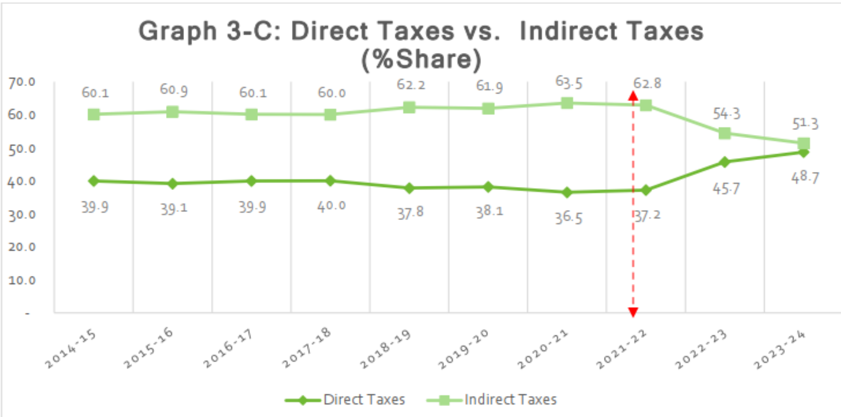
(Rs. Billion)

Tax Heads	Target	Collection (*)	Absolute (Achievement)	Percentage (Achievement)
Direct Taxes	3,721.0	4,530.7	809.7	121.8
Sales Tax	3,607.0	3,086.8	-520.2	85.6
Federal Excise	600.0	577.5	-22.5	96.3
Customs Duty	1,324.0	1,104.1	-219.9	83.4
Total	**9,252.0**	**9,299.1**	**47.1**	**100.5**

(*) The Collection for FY2023-24 is provisional

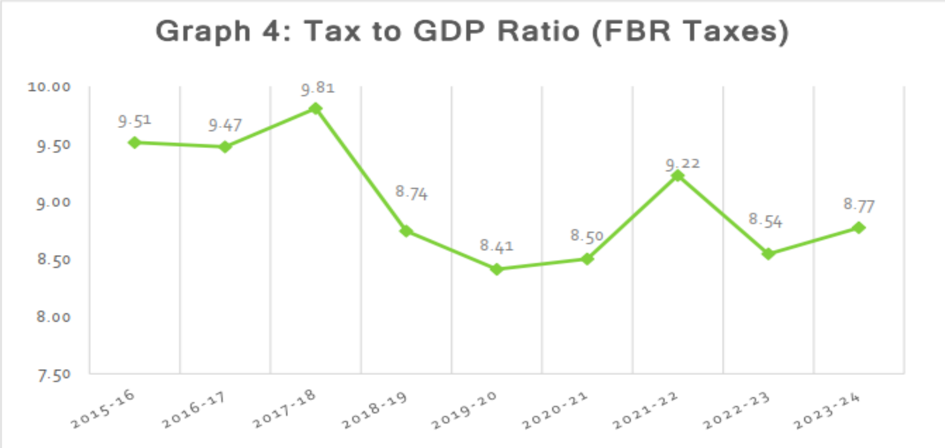
Table 2: Comparison of Net Collection FY2023-24 vis-a-vis FY2022-23				
				(Rs. Billion)
Tax Head	**FY2023-24 (Provisional)**	**FY2022-23**	**Growth**	
			Absolute	**%**
Direct Taxes	4,530.7	3,270.8	1,259.9	38.5
Sales Tax	3,086.8	2,591.4	495.4	19.1
Federal Excise	577.5	369.9	207.6	56.1
Customs Duty	1,104.1	931.7	172.4	18.5
All Taxes	**9,299.1**	**7,163.8**	**2,135.3**	**29.8**

Over the past several years, there has been a consistent upward trend in the share of direct taxes. This is a positive development, as direct taxes are considered progressive, meaning they are based on the taxpayer's ability to pay, with higher earners paying a larger percentage.



Tax to GDP Ratio:

The tax-to-GDP ratio is a key metric for assessing a country's tax revenue in relation to its GDP size. It offers insight into the general trajectory of tax policy and allows for global comparisons of tax revenues relative to economic scales. This ratio also reflects how effectively a nation's government allocates its economic resources through taxation. Typically, developed nations exhibit higher tax-to-GDP ratios compared to developing countries. Higher tax revenues enable a country to invest more in essential areas such as infrastructure, healthcare, and education. According to the World Bank, tax revenues that exceed 15% of a country's GDP are crucial for fostering economic growth and reducing poverty. There was a notable 30% increase in FBR tax revenues during FY2023-24, which improved the Tax-to-GDP Ratio from 8.54 to 8.77, as illustrated in Graph 4. With the continued growth in tax revenues, it is anticipated that the Tax to GDP ratio will further improve in the coming years.



A detailed breakdown of the Tax-to-GDP ratio by tax head can be seen, which shows a trend of the past four years, whereas, proportion of direct taxes to GDP has seen a positive trend, increasing from 3.10 in FY 2020-21 to 4.27 in FY 2023-24. This shift towards a greater reliance on direct taxes, coupled with a decreasing share of indirect taxes, is a promising development for Pakistan's tax structure.

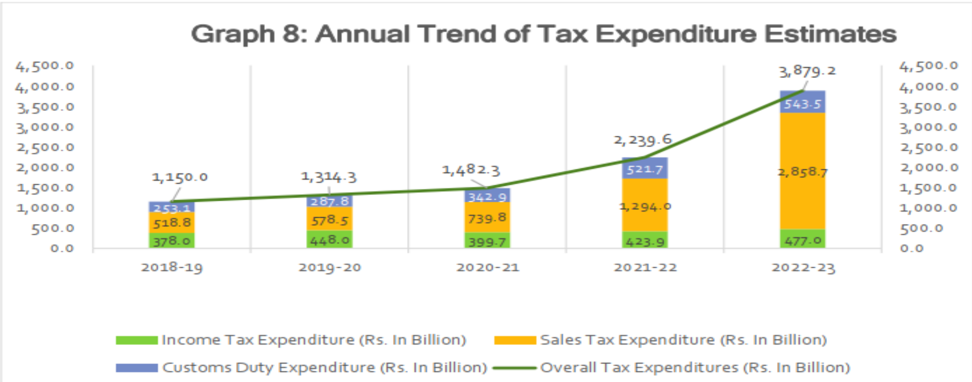
Table 6: FBR Head-wise Tax GDP Ratio

FY	DT	ST	FED	CD	Indirect Taxes	FBR
2015-16	3.72	3.98	0.57	1.24	5.79	9.51
2016-17	3.78	3.74	0.56	1.40	5.69	9.47
2017-18	3.92	3.79	0.54	1.55	5.89	9.81
2018-19	3.30	3.33	0.54	1.57	5.44	8.74
2019-20	3.20	3.36	0.53	1.32	5.20	8.41
2020-21	3.10	3.56	0.50	1.34	5.40	8.50
2021-22	3.43	3.80	0.48	1.52	5.80	9.22
2022-23	3.90	3.09	0.44	1.11	4.64	8.54
2023-24	4.27	2.91	0.54	1.04	4.50	8.77

Payments with Returns: This category encompasses payments made at the time of submission of annual Income Tax Returns, as shown in Table 8. For FY2023-24, collections amounted to Rs. 162 billion, compared to Rs. 119 billion in the previous fiscal year, marking an impressive growth of 35.8%.

Table 8: Advance Tax / Payments with Returns			
			(Rs. Million)
Heads	**FY2023-24**	**FY2022-23**	**Growth (%)**
With Returns	161,534	118,933	35.8
Advance Tax	1,529,533	974,635	56.9
Total	**1,691,067**	**1,093,568**	**54.6**

Tax expenditures: It includes special provisions within the tax code, such as exclusions, deductions, deferrals, credits, and reduced tax rates, designed to benefit certain activities or taxpayer groups. A tax expenditure report quantifies the amount of revenue that the government loses as a result of these provisions. This report prepared by the FBR offers a thorough summary of various tax concessions granted during Tax Year 2024, providing insight into the economic responses of different sectors to these tax benefits. Globally, it is observed that developed countries have higher tax expenditures compared to less developed nations.



(Revenue Division, Year Book 2023-24)

Table 20. Pakistan: General Government Budget, 2018/19–2028/29
(In% of GDP, unless otherwise indicated)

Description	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24		2024/25	2025/26	2026/27	2027/28	2028/29
	Actual					Prog.	Est.	Proj.				
Revenue and grants	11.3	13.3	12.4	12.1	11.5	12.5	12.6	15.4	15.0	15.5	15.8	15.8
Revenue	11.2	13.2	12.4	12.1	11.5	12.5	12.5	15.3	15.0	15.4	15.7	15.7
Tax Revenue	10.2	10.0	10.3	10.4	10.1	10.6	10.5	12.3	13.0	13.4	**13.7**	**13.7**
Federal	9.3	9.1	9.4	9.5	9.3	9.8	9.8	11.5	11.9	12.0	11.9	11.9
FBR Revenue	**8.7**	**8.4**	**8.5**	**9.2**	**8.6**	**8.8**	**8.8**	**10.6**	**11.0**	**11.1**	**11.1**	**11.1**
Direct Taxes	**3.3**	**3.2**	**3.1**	**3.4**	**3.9**	**4.3**	**4.3**	**4.7**	**4.9**	**5.0**	**5.0**	**5.0**
Federal Excise Duty	**0.5**	**0.5**	**0.5**	**0.5**	**0.4**	**0.5**	**0.5**	**0.9**	**0.9**	**0.9**	**0.9**	**0.9**
Sales Tax	**3.3**	**3.4**	**3.6**	**3.8**	**3.1**	**3.0**	**2.9**	**3.7**	**3.8**	**3.8**	**3.9**	**3.9**
Customs Duties	**1.6**	**1.3**	**1.4**	**1.5**	**1.1**	**1.0**	**1.0**	**1.3**	**1.3**	**1.4**	**1.3**	**1.3**
Petroleum surcharge	0.5	0.6	0.8	0.2	0.7	0.9	1.0	0.9	0.8	0.8	0.8	0.8
Gas surcharge and other	0.0	0.1	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
GIDC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Provincial	0.9	0.9	0.9	0.9	0.8	0.8	0.7	0.8	1.1	1.5	1.8	1.8
Nontax revenue	1.0	3.2	2.1	1.6	1.4	1.9	2.0	3.0	2.0	2.0	2.0	2.0
Federal	0.8	3.0	1.8	1.4	1.2	1.7	1.8	2.8	1.8	1.8	1.8	1.8
Provincial	0.2	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2

https://www.imf.org/en/Publications/CR/Issues/2024/10/10/Pakistan-2024-Article-IV-Consultation-and-Request-for-an-Extended-Arrangement-under-the-556152

Fiscal Management and Social Expenditures

Pakistan's fiscal management has long been a barrier to economic stability, with poor revenue mobilization coupled with unchecked government expenditure intensifying the crisis. The challenges are further exacerbated by the over-reliance of provincial governments on the federal government for revenues, with little effort to strengthen their own revenue collection authorities.

According to fiscal operations by the Ministry of Finance, the combined tax collection by all four provinces was Rs774.20 billion in FY24, against a whopping Rs2,683.88 billion in expenditures. With provinces contributing only 1% of the tax-to-GDP ratio, the federal government collects an overwhelming 90% of revenue.

Since 57% of the federal government's revenues are transferred to provinces following the 7th NFC Award passed in 2010, provincial governments have not collected revenues at their potential, causing the federal government to rely on domestic and foreign debt to bridge the deficit.

According to data from the Debt Management Office, Pakistan's public debt has surged dramatically since 2010, rising from Rs9 trillion to Rs67 trillion in 2024. This reflects a substantial increase in domestic and external debt over the past decade.

A possible explanation is the NFC Award, which caused the country's debt to surge due to fiscal imbalances created by elevated expenditures while tax collection remained stagnant.

Considering the fiscal management or mismanagement at both levels of government, it is unsurprising that the International Monetary Fund (IMF) included the National Fiscal Pact (NFP) in its programme, binding provincial governments to raise tax collection and thus contribute more to overall revenue collection.

As reported, the NFP aims to redistribute revenues and align provincial and federal taxation policies. The pact will also prevent provincial governments from setting agriculture support prices, which is a positive development. The transfer of some fiscal responsibilities to provinces will compel them to contribute more to revenue generation. While the pact is ambitious and has been signed by all the provinces, certain caveats exist that could undermine the credibility of the NFP. Firstly, aligned with the 18th Amendment, the NFP focuses on tax revenue generation by provincial governments, specifically from historically under-taxed sectors like agriculture. While revenue collection is critical for economic growth and to prevent reliance on debt, expenditure reduction is equally, if not more, crucial.

Without effectively addressing expenditure control at the provincial level, the perpetual risk of fiscal indiscipline will remain. Focusing only on revenue collection will burden taxpayers without effective expenditure rationalization. A benchmark should be provided to provinces to manage their spending within the revenue collection domain. Similarly, the federal government should provide performance-based grants to provinces to enhance accountability and incentivize adherence to benchmarks.

Another inefficiency in the expenditure framework is the duplicity in spending in certain areas, including the Public Sector Development Programme (PSDP). Following the 7th NFC Award, sectors like education, health, and agricultural subsidies were devolved to provincial domains, requiring their financing by provincial governments. However, the federal government continues to fund health and education projects, creating inefficiencies and overlaps. This acts as a double-edged sword, increasing fiscal deficits and contributing to mounting debts when expenditures are financed through borrowing. According to the World Bank, the federal government spent Rs. 328 billion in FY-22 on devolved subjects such as education and health. Redefining roles to eliminate these redundancies is crucial to enhancing federal-provincial coordination and phasing out federal spending on devolved sectors.

Similar to education and health, the social protection sector is also a provincial domain. However, as per the FY25 budget, there has been an increase in the Benazir Income Support Programme (BISP) allocation from Rs466 billion to Rs592 billion. Being a devolved subject, hefty federal spending on social protection can be curtailed by transferring the responsibility entirely to the respective provincial governments.

A legitimate concern is the lack of transparency regarding the NFP, as it has not been made public. This secrecy prevents meaningful debate on the topic and questions the credibility of the pact. The non-disclosure raises scepticism and concerns that provincial governments may inequitably raise tax revenues.

The National Fiscal Pact revisits the National Finance Award to address the lack of provincial capacities that hinder the country's effective fiscal management. The current arrangement, which requires the federal government to transfer 57% of revenue to provinces, is unsustainable, especially when it bears the burden of debt servicing and defence, which consume around 75% of revenues. To ensure a balanced fiscal approach, either the NFC distribution formula must be revised to reduce federal transfers below 50%, or some expenses must be shifted to provinces while encouraging them to significantly increase tax collections. Otherwise, Pakistan's fiscal federalism will falter.

Budget 2024-25 at a Glance

(Rs. in Billion)

RESOURCES		EXPENDITURE	
Tax Revenue (FBR) - Federal Consolidated Fund	12,970	A Current	17,203
Non-Tax Revenue	4,845	Interest Payments	9,775
		Pension	1,014
		Defence Affairs & Services	2,122
a) Gross Revenue Receipts	17,815	Grants and Transfers to Provinces & Others	1,777
b) Less Provincial Share	7,438	Subsidies	1,363
I. Net Revenue Receipts (a-b)	10,377	Running of Civil Govt.	839
II. Non Bank Borrowing (NSSs & Others) - Public Account	2,662	Provision for Emergency and others	313
III. Net External Receipts - Fed. Consolidated Fund	666		
IV. Bank Borrowing (T-Bills, PIBs, Sukuk) - Fed. Consolidated Fund	5,142	B. Development & Net Lending	1,674
V. Privatization Proceeds - Fed. Consolidated Fund	30	Federal PSDP	1,400
		Net Lending	274
Total (II + III + IV + V)	8,500		
TOTAL RESOURCES (I to V)	18,877	TOTAL EXPENDITURE(A+B)	18,877

Fiscal Deficit and Financing of Budget 2024-25

(Rs. in Billion)

Fiscal Deficit		Financing	
A) Federal Revenue (Net)	10,377	A) Net External Financing	666
B) Total Federal Expenditure (i+ii)	18,877	Multilateral & Bilateral Sources	(10)
i) Current Expenditure	17,203	Commercial & Euro Bond	676
ii) Development and Net Lending (a+b)	1,674	B) Net Domestic Financing	7,803
a) Federal PSDP	1,400	National Saving Schemes, GP Fund and Deposit & Reserves	120
b) Net Lending	274	Bank (Govt. Securities)	7,683
		C) Privatization Proceeds	30
C) Federal Deficit (A-B)	-8,500	Total Financing (A+B+C)	8,500

BE & RE of FY 2023-24 and BE of FY 2024-25

(Rs. in Billion)

	Budget 2023-24	Revised 2023-24	Budget 2024-25
Revenue Receipt (FBR)	9,415	9,252	12,970
Non Tax Revenue	2,963	2,947	4,845
Gross Revenue (FBR+NTR)	12,378	12,199	17,815
Less: Transfer to Provinces (-)	(5,399)	(5,427)	(7,438)
Net Revenue for Federal Government	6,979	6,772	10,377
Expenditure	14,485	15,160	18,877
Federal Budget Deficit	(7,506)	(8,388)	(8,500)
Provincial Surplus	600	539	1,217
Overall Fiscal Deficit	(6,906)	(7,849)	(7,283)
Overall Fiscal Deficit as %GDP	-6.5%	-7.4%	-5.9%
Primary Surplus	397	402	2,492
Primary Surplus as %GDP	0.38%	0.4%	2.0%
Nominal GDP	105,817	106,045	124,150

(Source: Ministry of Finance)

FY2023-24 Federal Government Current Expenditure on Health, Education and Social Protection

This write-up covers current expenditures of the Federal Government on health, education and social protection, subjects which stand devolved to the provinces with the enactment of the 18th amendment to the Constitution in April 2010. The amendment transferred several subjects from the federal legislative list to the provincial domain, effectively decentralizing power and responsibility, and allowing provinces greater financial and legislative autonomy.

Expenditure on Health

Budgetary allocation for health in FY2023-24 stood at Rs. 24.2 billion. Rs. 9.6 billion was allocated for employee-related expenditures and Rs. 14.6 billion for operational requirements. (Economic Survey of Pakistan 2023-24)

Rs bn

	FY2023-24 Budget	FY2023-24 Actual Expenditure
Employee-related Expenses	9.6	11.8
Operational Expenses	14.6	11.9
EPI	-	21.3
Total	24.2	45.0

FY2023-24 actual expenditure of the Federal Government on health added Rs.

21.3 billion through provincial contribution for the Expanded Program on Immunization (EPI), a program running since 1978 to protect children against vaccine preventable diseases. The program remains critical to the commitment of the Government in providing safe and effective vaccination and for achieving Sustainable Development Goal 3 on reducing child morbidity and mortality.

Break up of EPI by provinces:

Rs. Mn

Provinces/Federal	FY2023-24 Actual Expenditure
Punjab	11,233
Sindh	5,120
Balochistan	1,155
KP	3,496
ICT	258.1
Total EPI	21,262.884

Expenditure on Education

Total expenditure on education including running current expenditure and grants is tabulated below:

Rs bn

	FY2023-24 Budget	FY2023-24 Actual Expenditure
ICT Education (Schools & Model Colleges)	16.9	21.5
FGEIs (Cantt.)	12.5	13.1
HEC (ERE/OE)	1.3	1.3
Others	1.3	0.9
Total Education (Current)	**32.0**	**36.9**
Grants (HEC)	65.0	68.5
Grant (Aspire)	1.5	8.6
Grand Total (Current + Grants)	**98.5**	**114.0**

Expenditure on Social Protection

Besides allocation for employee-related and operational expenditures, grant allocation is made each financial year by the Federal Government for BISP. For FY2023-24 this allocation was Rs. 466.0 billion. (PKR in Billions)

	FY-23-24 Budget	**FY 23-24 Actual Expenditure**
Benazir Kafalat-UCTs	361.50	358.033
Special Relief Package for Daily Wage Workers on Chaman Border, Balochistan	-	0.308
Benazir Nashonoma /Nutritional Program	32.268	34.665
Taleemi Wazaif CCT	55.423	59.716
Scholarships for Undergrads	5.928	4.098
Poverty Graduate Program	1.0	-
NESR Project	2.26	3.183
Direct Cost of Cash Transfers	4.525	3.426
Payments for Services	0.916	0.639

Procurement of Assets	0.98	0.066
Hybrid Social Protection & Digital Financial Literacy	0.75	-
PM Ramzan Relief Package	-	1.827
Media, Communication and Outreach	0.2	0.025
Policy Research Unit	0.25	0.014
ERE and Administrative & General Expenses	5.683	5.149
Total	**471.683**	**471.149**

A smaller component of Federal Government expenditure on social protection is through Pakistan Bait-ul-Mal, an autonomous body contributing to poverty alleviation through various poorest of the poor focused services and assistance to destitute, widows, orphans, invalid, infirm and other needy persons.

(PKR in Billions)

	FY2023-24 Budget	**FY2023-24 Actual Expenditure**
Grant to Bait-ul-Mal	4.3	4.2
Employee-related and Operational Expenses	3.4	3.4

Social investments in Pakistan reach new highs in 2023-24

The Federal Government of Pakistan significantly ramped up its current expenditure on key social sectors during the fiscal year 2023-24, with major allocations and actual spending exceeding initial budgets in health, education, and social protection, according to a report released by Finance Ministry on Tuesday. Despite these areas being constitutionally devolved to the provinces following the 18th Amendment, the Federal Government continues to play a vital supplementary role.

Health Sector Sees Over 85% Increase in Spending

In FY2023-24, the federal government allocated Rs. 24.2 billion for health-related expenditures. However, actual spending soared to Rs. 45 billion—an 85% increase. The rise was primarily driven by Rs. 21.3 billion contributed by provinces for the Expanded Program on Immunization (EPI), which remains a central effort in Pakistan's child health protection strategy.

The Pakistan Institute of Medical Sciences (PIMS) and the Federal Government Polyclinic (FGPC) in Islamabad remained key beneficiaries. PIMS alone received Rs. 5.2 billion, up from its Rs. 4.0 billion budget. Other notable disbursements included Rs. 4.9 billion for Sheikh Zayed Hospital in Lahore and Rs. 3.93 billion for FGPC.

The EPI initiative—targeting preventable childhood diseases—was significantly bolstered through contributions from Punjab (Rs. 11.23 billion), Sindh (Rs. 5.12 billion), Khyber Pakhtunkhwa (Rs. 3.49 billion), Balochistan (Rs. 1.15 billion), and ICT (Rs. 258 million).

Education Spending Crosses Rs. 100 Billion Mark

Expenditure on Education has seen a rise from an original allocation of Rs. 98.5 billion, whereas, an actual spending in this regard has been observed as Rs. 114 billion. Major chunk in this regard has been in grants through the Higher Education Commission (HEC), which received Rs. 68.5 billion, higher than its original allocation of Rs. 65 billion.

In Islamabad Capital Territory, schools and colleges consumed Rs. 21.5 billion, while Federal Government Educational Institutions (FGEIs) nationwide used Rs. 13.1 billion. Significant investments were made under the World Bank-supported ASPIRE program, with Rs. 8.6 billion spent against an initial budget of Rs. 1.5 billion.

Education funding focused on expanding access and quality from primary levels to higher education, including scholarship and research support. Over Rs. 9 billion were spent through HEC on universities and research programs in ICT, AJK, and Gilgit-Baltistan. (Economic Survey 2023)

Moreover, an educational emergency was declared in 2024, the Federal Government and provinces overall allocated 1.91pc of the Gross Domestic Product (GDP) for education. However, to fulfil the international commitment of 4pc of the GDP for the sector, an amount of Rs4,242 billion would be required. The Federal Government also allocated Rs 215 billion, whereas, Punjab allocated Rs. 673 billion, Sindh Rs. 508 billion, KP Rs. 393 billion, Balochistan Rs. 162 billion, AJK Rs. 48 billion and Gilgit-Baltistan Rs. 33 billion. In the allocation of the federal government's Rs215 billion, 46pc was for development and 54pc for current expenditures.

Federal & Provincial Governments	**Allocation for 2023-24 (PKR Billion)**
Federal Government	215
Punjab	673
Sindh	508
Khyber Pakhtunkhwa	393
Balochistan	162
Azad Jammu & Kashmir	48
Gilgit Baltistan	33

(Economic Survey of Pakistan 2023-24)

It may be noted that the country's education sector is neglected in budgetary allocations to meet the challenges that include over 26 million out-of-school children, issue of quality education in public sector schools and poor infrastructure.

A report on the performance of the education sector released by the Pakistan Institute of Education, a subsidiary of the education Ministry, showed a harrowing state of affairs in the sector, particularly the disparity in the availability of essential facilities such as toilets, potable water and boundary walls in different regions of the country.

The Pakistan Education Statistics 2021-22 underscored a lack of funds, poor pupil-teacher ratio, missing basic facilities as well as the out-of-school children. The report covered 313,418 education institutions, catering to 54,870,964 students with the support of 2,139,631 educators. It said that there was a pressing need for strategic planning and sustainable investment in critical sectors, particularly education, to build a resilient and inclusive society. As per the report, Punjab, Islamabad Capital Territory and Khyber Pakhtunkhwa fared comparatively better in terms of educational facilities. An alarming number of schools across Pakistan lacked toilets, potable water among other basic facilities. Balochistan's education sector faced significant challenges. It is further highlighted that only 23 per cent of primary schools in the province had access to potable water. Moreover, Azad Jammu Kashmir had 31pc primary schools with access to drinking water followed by 61pc in Sindh. Similarly, Gilgit-Baltistan's 63pc primary schools had potable water. The situation was not much better in middle schools either only 40pc schools in Balochistan and 52pc in AJK had access to potable water. According to the same report, only 59pc of Sindh's schools, 39pc in Balochistan, 31pc in AJK and 61pc in GB had boundary walls.

Electricity availability also showed significant regional discrepancies. Punjab and ICT had managed to provide electricity to all primary school. Whereas, figures were lower in other provinces and regions: 15pc in Balochistan, 21pc in AJK, 38pc in Sindh and 44pc in Gilgit-Baltistan were powered.

It said 24pc of primary schools across Pakistan did not have toilet facilities, adding 10pc middle and 3pc high schools were also without this basic facility. (News Report Published in Dawn, July 16th, 2024)

Health Sector

The enhancement of public health is essential for building a thriving society and driving economic prosperity. The Government of Pakistan, under Article 38 of the constitution, is committed to providing the necessities of life i.e. to ensure a healthy population. In this regard, life expectancy has increased from 65.7 to 67.3 years from 2015 to 2022 due to a wide range of government initiatives, such as the program for the elimination of Hepatitis, the control of diabetes, and the expanded program on immunization, all of which have proved to be significant contributors to the increase in life expectancy.

Table 11.1: Health Indicators of Pakistan

	2015	2021	2022
Incidence of Tuberculosis (per 100,000 people)	270	266	258
Life expectancy at birth (years)	65.7	66.1	67.3
Immunization, Measles (% of children ages (12-23) months	75	81	82
Prevalence of HIV, Total (% of population ages 15-49)	0.1	0.2	0.2
Immunization DPT (%age of children under 12-23 months)	72	83	85
Tuberculosis treatment success rate (new cases)	93	94	-
Maternal mortality ratio (per 100,000 births) as per PDSH 2019	187	186(2019)	-
Neonatal Mortality rate (per 1000 live births)	45.2	39.4	-
Mortality rate, Infant (per 1000 live births)	62.2	52.8	-

Source: WDI, Global Health Observatory, UNICEF

Regional comparison in the Asian region, the health landscape remains challenging, although there has been slight improvement in recent years. As of 2021, the average life expectancy of South Asian countries stood at 71.6 years. Currently, health expenditures in South Asia account for 3.1 percent of GDP, with maternal mortality rates in South Asian countries recorded at 138 per 100,000 live births. Moreover, the infant mortality rate in 2021 was 30.8 per 1000 live births, while the mortality rate of children under 5 years stood at 37.1 per 1000. Below are the key health sector indicators of South Asian countries' averages based on recent available data. This data is presented in the following table to compare with the health situation in Pakistan.

Pakistan Economic Survey 2023-24

Table 11.2: Regional Comparison of Health Indicators of South Asia and Pakistan

Indicators	South Asia	Pakistan
Life expectancy at birth (years)	71.6	67.3
Maternal mortality ratio (per 100,000 births)	138(2020)	186(2019)
Birth rate (Crude) per 1000 people	18.3	27.5
Mortality rate, Infant (per 1000 live births)	30.8	52.8
Prevalence of HIV (total %age of population 15-49 years of age)	0.20	0.2

Source: WDI, Global Health Observatory, UNICEF

Health expenditures

To achieve universal health coverage, it is crucial to allocate a significant percentage of GDP to public sector health expenditures. In Pakistan, health expenditure as a percentage of GDP is currently very low, but there are positive signs that this allocation will increase over time compared to previous years. The table below shows the consolidated funds allocation position of federal and provincial expenditures over the last 7 years, while Figure 11.1 illustrates Pakistan’s total health expenditures.

Table 11.4: Federal and Provincial Health Expenditures (Rs million)

Years		Current Expenditure	Development Expenditures	Total Expenditures	Percent of GDP
2017-18	Federal	16721	18129	34850	1.1
	Punjab	173992	44906	218898	
	Sindh	77399	6342	83741	
	Khyber Pakhtunkhwa	44587	12909	57496	
	Balochistan	16334	5148	21482	
	Pakistan	329033	87434	416467	
2018-19	Federal	16853	10278	27131	1.0
	Punjab	187943	30982	218925	
	Sindh	91929	6216	98145	
	Khyber Pakhtunkhwa	46995	8675	55670	
	Balochistan	19434	2473	21907	
	Pakistan	363154	58624	421778	
2019-20	Federal	11439	12856	24295	1.1
	Punjab	220854	40403	261257	
	Sindh	115303	3815	119118	
	Khyber Pakhtunkhwa	58289	15132	73421	
	Balochistan	22030	5290	27320	
	Pakistan	427915	77496	505411	
2020-21	Federal	41309	9613	50922	1.0
	Punjab	221469	52705	274174	
	Sindh	150668	4057	154725	
	Khyber Pakhtunkhwa	56179	20778	76957	
	Balochistan	24981	4511	29492	
	Pakistan	494606	91664	586270	
2021-22	Federal	153030	9530	162560	1.4
	Punjab	258860	152367	411227	
	Sindh	177735	10047	187782	
	Khyber Pakhtunkhwa	95302	28865	124167	
	Balochistan	27362	6320	33682	
	Pakistan	712289	207129	919418	
2022-23 (P)	Federal	31397	4495	35892	1.0
	Punjab	303056	147554	450610	
	Sindh	199474	5158	204632	
	Khyber Pakhtunkhwa	111368	10980	122348	
	Balochistan	22012	7685	29697	
	Pakistan	667307	175872	843179	

P: Provisional

Source: PRSP Budgetary Expenditures, Finance Division

Table 11.5: Health Sector Projects in the Federal PSDP for FY2024 (Rs million)

Sr. No.	Name of Ministry /Organisation	No. of Projects	Total Cost	2023-2024 PSDP Allocation
1	Ministry of National Health Services, Regulation and Coordination	40	148812.76	13100.00
2	Province and Special Areas	9	31723.53	1197.75
3	Defense Division	2	5000.00	728.13
4	Interior Division	1	6479.88	1197.75
5	Pakistan Atomic Energy Commission	6	13670.69	5764.32
6	Narcotics Control Division	1	456.38	124.06
	Total	59	206143.24	25282.17

Source: Ministry of Planning, Development & Special Initiatives. (M/o PD&SI)

Provincial Performance in the Health Sector in FY 2024

Punjab

The Punjab government has undergone a unique budgeting cycle for the FY 2023-24, owing to an interim government setup. Unlike the traditional 12-month budget cycle, a series of four-month budget cycles is implemented. Each of these cycles is independent, just like a completely new fiscal year.

During the first four-month budget period called ADP 2023-24 (July 2023 - October 2023), funds amounting to Rs 14,410 million were allocated to the Primary & Secondary Healthcare Department (P&SHD). Rs 4,952 million were released by the Finance Department, and by the end of October 2023 (the terminal month), funds amounting to Rs 4,327 million were utilized. The 2nd four-month budget, called ADP 2023- 24 (November 2023 – February 2024), funds amounting to Rs 15,060 million have been allocated, and Rs 11,086 million have been released. Out of the released funds, Rs 2,922 million have been utilized until the end of January 2024. The third four-month budget for FY 2024, called ADP 2023-24 (March 2024 – June 2024), is currently under implementation with focus on preventive and curative health facilities. Moreover, to address the population issue, a US $ 100 million loan with the support of the World Bank is utilized.

Sindh

The government of Sindh is spending around Rs 234.286 billion (Development portfolio Rs 19.739 billion and Recurrent portfolio Rs 214.547 billion) during the financial year 2023-24 covering primary, secondary, and tertiary health care services. To ensure a robust monitoring mechanism, strengthening of the monitoring and surveillance system, integrated MIS, and up-gradation of the District Health Information System (Roll out of DHIS-2) has been initiated under the World Bank funded National Health Support Programme with the provision of equipment and material support for data recording & reporting to ensure timely availability of data for evidence-based decision making as to have better health outcomes. Moreover, a tele-heath system was also introduced in the province.

Khyber Pakhtunkhwa

The KP Health Policy has been approved recently by the Government of Khyber Pakhtunkhwa. KP Health Sector Strategic Plan (2019-2025) (KPHSSP) was developed for the implementation of KP Health Policy. The Health Sector Strategic Plan provides a platform for program development and proposes activities to address the issues related to the health status of the population and to improve the health system in Khyber Pakhtunkhwa. The budget allocated to the health sector for FY 2023-24 was Rs 147.9 billion, with Rs 20.3 bn development budget and Rs 127.6 as the current budget. The innovative intervention includes E-transfer, the Medical Teaching Institution (MTI) Act, and the composition of the Policy Board & BOGs of MTIs are being revised, and the establishment of an Independent Monitoring Unit in the Health Department, Financial Management Cell, Procurement Cell, and Internal Audit Cell. The Project "Treatment of Poor Cancer Patients" is being executed at Hayatabad Medical Complex, Peshawar to provide life-saving anti-cancer medicines to cancer patients of Khyber Pakhtunkhwa.

Balochistan

Balochistan government is all set to revamp the health sector on modern lines and provide the latest equipment to the hospitals aimed to ensure the best healthcare facilities for the local people. The Balochistan government appointed 34 doctors and a health sector reform unit was established for governance and institutional reforms, legal framework, and quality assurance in the health sector of Balochistan. A historic milestone for the people of Balochistan this year was that the state Life Insurance Corporation of Pakistan and health care facility were launched by the government. Moreover, the Balochistan Health Care Commission started its operation.

Availability and accessibility of a quality healthcare system is not a privilege rather it is a fundamental right that indicates the progressiveness of a nation. Economic development of any country is intertwined with human capital development that incorporates top-notch healthcare services and nutrition security. In Pakistan, the health budget for the year 2023 holds immense significance as it lays the foundation for addressing the nation's healthcare challenges and driving positive change.

In Pakistan, the provincial and federal budgets 2023, in terms of health to GDP ratio was 1.4 per cent. The Federal Budget 2023 was passed on 9th June and the health sector was allocated PKR 24.25 billion making up 2.8 per cent of the total development budget and 0.05 per cent of GDP. According to Pakistan Medical Association (PMA), the health budget as per the recommendations of World Health Organization needs to be enhanced to 6 per cent of GDP. Unfortunately, seeing the current GDP makes 6 per cent of GDP a far-sighted avenue of growth. The failure of the government to invest in healthcare systems adds pressure to the already underperforming healthcare sector. Moreover, the reliance of people on the private sector will continue to increase. The underprivileged population that is unable to rely on the private sector will be forced at the cusp of vulnerability making the loopholes in healthcare system a grave concern.

The government’s Sehat Sahulat Program that was launched in 2019 had three objectives, i.e. foremost financial safety nets against health-related cost, access to healthcare and quality management. As of now, Rs 2298.584 million has been allocated to Sehat Sahulat Program indicating a downward trend in healthcare investment.

A recent report by the IMF clearly mentioned that the country’s Public Sector Development Program (PSDP) had become unaffordable due to the already approved project and their high cost. This explains the lack of policy continuity for projects like Sehat Sahulat Programme that demands a high surge in cost for its completion.

Social Protection Remains Top Priority

The largest share of Federal social sector spending in FY2023-24 went to social protection, with Rs. 478.7 billion disbursed. The Benazir Income Support Programme (BISP) received the lion's share—Rs. 471 billion—matching its budget exactly.

Under BISP, the Kafalat unconditional cash transfer program disbursed Rs. 358 billion to beneficiaries across Pakistan, with Punjab receiving the highest share at Rs. 169 billion, followed by Sindh (Rs. 95.7 billion), KP (Rs. 67 billion), and Balochistan (Rs. 17.8 billion).

Other social protection initiatives included the Taleemi Wazaif (Rs. 59.7 billion), Nashonuma Nutrition Program (Rs. 34.6 billion), and scholarships for undergraduates (Rs. 4.1 billion). Relief packages for daily wage workers and Ramzan subsidies were also provided.

Pakistan Bait-ul-Mal (PBM), another vital safety net program, received Rs. 4.2 billion for its poverty alleviation services, with additional Rs. 3.4 billion spent on operational expenses.

A Commitment to Inclusive Growth

The Federal Government's expanded role in social sectors reflects its continued commitment to inclusive development, especially in underserved regions and vulnerable populations. While the 18th Amendment devolved health and education to the provinces, federal spending continues to bridge resource gaps, strengthen national programs, and promote equity. With sustained allocations and rising actual expenditures, Pakistan's social sector investment during FY2023-24 marks a significant step toward achieving long-term human development goals.

Best Practices on Taxation

Most developing countries are increasingly focusing on domestic resource mobilization toward economic development. In this context, tax performance is of crucial importance, especially for a developing country, since it is the prime source for domestic resource mobilization. Many developing countries often face difficulty in augmenting tax revenue to the desired level and considerable attention is being devoted to formulating fiscal policy best suited for increasing revenue.

In this section we will analyze the tax performance of neighboring countries like India and Vietnam, since ground realities in all three countries are almost alike. More interestingly India and Pakistan have come a long way since British left them. Of the two nations India has seen by far most dramatic growth. Pakistan and India are clustered together at numbers 138 and 139 respectively in the UNDP's 174-country ranking of human development, which takes into account such components of well-being as life expectancy, education and gender equality.

In both countries tax revenues are below 15% of GDP and come largely from Indirect taxes like sales tax and customs, which discourages imports. India had a far slower growth rate than Pakistan's from about 1947 to the 1980, has not only improved its performance fundamentally over the last twenty years, but has also grown consistently for the past two decades leaving Pakistan far behind. Even Bangladesh, once considered as a "basket case "by some Pakistani economists and planners, has recently had several years of stable growth despite political uncertainty. With almost similar circumstances, India and Vietnam have achieved reasonable tax–to GDP ratio which in case of Pakistan is non-existent. So a comparative analysis of these countries will be helpful in coming up with analysis which contribute to broadening of our tax-to-GDP ratio.

Two International Best Practices and Key Lessons

India and Vietnam have undertaken transformative tax reforms to drive economic growth, enhance revenue collection, and align with global standards. In India, reforms included rationalizing corporate taxes, introducing levies for digital businesses, and aligning with the OECD's BEPS project. Modernization efforts, such as faceless assessments, data analytics, and digital tools, have improved transparency and efficiency, while initiatives like Vivad se Vishwas and repealing retrospective taxation fostered taxpayer trust, leading to record direct tax collections of over INR 14 trillion in FY 2021-22. The Goods and Services Tax (GST) unified multiple indirect taxes, streamlined compliance, and boosted collections beyond INR 1 trillion monthly. Vietnam's phased reforms focused initially on turnover, profit, and export-import taxes before introducing modern taxes like VAT and corporate income tax, reflecting its market-oriented shift and doubling revenues across phases. Expanding the tax base through personal income tax, natural resources tax, and land tax adjustments, Vietnam balanced urban and rural taxation and introduced an Environment Protection Tax to influence behavior and generate revenue. Both nations have leveraged these reforms to simplify processes, boost revenue, and achieve socio-economic goals, with India focusing on technology-driven modernization and Vietnam emphasizing sustainability and market alignment. Following is the comparative analysis of the tax systems of Pakistan, India and Vietnam in tabular form.

Pakistan Viz-a-Viz India

The Indian economy is the 12th largest in USD exchange rate terms and second fastest growing economy in the world. In terms of purchasing power parity, the Indian economy ranks the fourth largest in the world. India's GDP has touched US$1.25 trillion. The crossing of Indian GDP over a trillion-dollar mark in 2007 puts India in the elite group of 12 countries with trillion-dollar economy. The Central Board of Direct Taxes (CBDT) is a part of the Department of Revenue in the Ministry of Finance, Government of India.

The CBDT provides essential inputs for policy and planning of Direct taxes in India and is also responsible for administration of the direct tax laws through Income Tax Department. The CBDT is a statutory authority functioning under the Central Board of Revenue Act, 1963. The growth of revenue in India is not quite impressive, rising from a meager of 6.7%of GDP in 1950-51 to 10.2% in late 1990s and peak of 12.9% in 2008-09. Important point to note is that tax-to-GDP ratio has started increasing constantly from 2004 and has reached at 12.9% in 2009.while tax-to-GDP ratio in Pakistan has started declining from peak 13.2% in the last decade of millennium and has constantly declined since 2000 to 2009 reaching at 8.9 in 2009. By international standards the average level of taxation in India is below the average of high income developed countries and much lower than the industrial nations but can be compared well with the tax share exhibited by the low income developing countries like Pakistan. In case of India constant increase from 2004 onward reflects partly the increase in the role of the government and increasing revenue potential of the states.

In India, like many developing countries bulk of revenue is being collected from domestic indirect taxes mainly from excise and sales tax. Constitutional arrangements assign exclusive power to states to levy sales tax while the central government has to rely on excises, as consequence excise become major central tax instrument with more extensive tax coverage than other countries including Pakistan. Taken together sales tax &excise account for more than half of the total tax revenue in India. India has seen a rising dependence on foreign trade taxes in short. It is indeed administrative difficulties with direct taxes that lead to the major role for indirect taxes and corporate taxation in developing countries including Pakistan. Aside from the increased governmental efforts, the increase in non-agriculture sector has contributed to rise in tax collection as this sector is easier to tax. Secondly growing share of imports facilitated overall tax ratio as imports provide a significant base for imports duties as well as excise and sales tax.

There has been a steady decline in the share of direct taxes from 21 per cent in 1970-71 to about 14 per cent in 1990-91.

But after the introduction of tax reforms in 1992, as part of the shift in country's tax structure direct taxes paid by individuals and companies continued to account for the majority of tax receipts and revenue from direct taxes has grown faster than revenue from other taxes. So the distinguishing feature of Indian Tax system is that share of direct tax revenues has increased to 56% in 2008-09 because of strong enforcement mechanism.

The second most important feature of the Indian tax system is the contribution of the states in the country's overall ratio. In the Indian federal polity, both central and state governments exercise revenue powers and the latter raise about 37 per cent of total revenues. Tax assignment between different levels of government follows the principle of separation, as these separate taxes levied by the centre (excise duties, income tax, corporate tax), states (sales taxes, state excise duties, taxes on motor vehicles, goods and passengers), and local governments fall on the same tax base. It is baffling that provincial tax receipt in Pakistan is totals to an abysmal 0.7 percent of GDP.

Comparative Analysis

Aspect	Pakistan	India	Vietnam
Tax-to-GDP Ratio	**9-10%** (FBR, 2024). One of the lowest globally, with significant reliance on indirect taxes.	**16-17%** (World Bank, 2023). A robust tax base supported by progressive reforms and GST.	**19-20%** (IMF, 2023). High tax-to-GDP due to an efficient VAT system and streamlined tax policies.
Tax Base	**Narrow**: Only 2% of the population files income tax returns.	**Broader**: 5% of the population files returns, with significant tax base expansion.	**Broader**: Effective documentation of businesses and individuals through digitization initiatives.
Tax Structure	**Complex**: Overlapping federal-provincial taxes and frequent changes deter compliance.	**Simplified**: GST unifies indirect taxes, and Income Tax laws are consistent across states.	**Simplified**: Centralized VAT and corporate tax structures encourage compliance and investment.

Informal Economy	**35% of GDP**: Cash-based economy and undocumented sectors evade taxes.	**20-25% of GDP**: Substantial formalization efforts have reduced the informal economy.	**15% of GDP**: Rapid formalization through digital payment systems and tax incentives.
Technology and IT	**Outdated**: Limited use of AI and integration with databases (e.g., NADRA, SECP).	**Advanced**: GST Network (GSTN) integrates real-time transactions for compliance.	**Advanced**: E-tax portals and e-invoicing systems are fully operational.
Enforcement Capacity	**Weak**: Only 18,000 staff; low audit coverage and litigation backlog of PKR 4,357 billion.	**Stronger**: Better trained workforce and integration of tax offices with digital systems.	**Strong**: Risk-based audits and proactive enforcement using AI and data analytics.
Cost of Collection (CoC)	**0.43%** of revenue, insufficient for effective enforcement and technology upgrades.	**0.7-1%**: Higher CoC allows investment in enforcement and IT infrastructure.	**1.2%**: Higher CoC ensures robust enforcement and technological advancements.
Exemptions	Extensive: Widespread exemptions in agriculture, real estate, and economic zones.	Limited: Focused exemptions for priority sectors (e.g., renewable energy).	Limited: Rationalized exemptions targeting socio-economic development.

Key Lessons

1. **Expand the Tax Base**: Pakistan must formalize its informal economy and enforce mandatory registration of businesses and individuals. Lessons from Vietnam's digitization and India's tax registration campaigns can guide these efforts.
2. **Simplify Tax Structure**: Align federal and provincial tax systems, adopting a unified framework like India's Goods and Services Tax (GST) to reduce compliance costs and complexity.
3. **Leverage Technology**: Upgrade Pakistan's tax systems by adopting e-invoicing, AI-driven audits, and real-time data integration, modeled on Vietnam's and India's technological advancements.
4. **Increase Cost of Collection (CoC)**: Raising CoC to **1%** of revenue will enable better IT investments, training, and enforcement.
5. **Rationalize Tax Exemptions**: Limit exemptions to essential socio-economic sectors, as seen in India and Vietnam, to reduce revenue leakage.

Institutional Landscape

The institutional landscape in Pakistan, as it pertains to tax evasion, the informal economy, fiscal constraints, and social spending, is characterized by a complex interplay of federal and provincial entities, regulatory bodies, and informal networks. This section outlines the key institutions involved, their roles, mandates, and the structural fault lines that hinder effective policy implementation, contributing to persistent fiscal challenges and limited social spending as of May 17, 2025.

Federal Board of Revenue (FBR)

The Federal Board of Revenue (FBR) is Pakistan's primary tax administration authority, responsible for collecting direct and indirect taxes, including income tax, sales tax, and customs duties. Established in 2001 as a successor to the Central Board of Revenue, the FBR operates under the Ministry of Finance and is tasked with achieving revenue targets, enforcing tax compliance, and combating tax evasion. In FY2024-25, the FBR aimed to collect PKR 12.97 trillion, approximately 10% of GDP, but its performance has consistently fallen short due to structural inefficiencies (World Bank, 2025).

Key Challenges:

- **Weak Enforcement**: With only 2.5 million registered taxpayers out of a 240 million populations, the FBR struggles to broaden the tax base, particularly in the informal sector (Express Tribune, 2024). Audit rates are low, with less than 1% of returns scrutinized annually, enabling widespread tax evasion.
- **Corruption**: Reports of bribery and collusion between FBR officials and taxpayers undermine enforcement. The 2010 tax refund scam highlighted systemic issues, eroding public trust (Express Tribune, 2010).
- **Capacity Constraints**: Understaffing (approximately 21,000 employees for a complex tax system) and outdated technology limit the FBR's ability to monitor transactions or detect evasion (PIDE, 2023).
- **Policy Implementation Gaps**: Recent reforms, such as Budget 2025's removal of withholding taxes, have been poorly executed due to lack of awareness campaigns and coordination with taxpayers.

Ministry of Finance

The Ministry of Finance oversees fiscal policy, budget allocation, and economic planning, playing a central role in addressing fiscal constraints and funding social spending. It coordinates with the FBR to set revenue targets and negotiates with international lenders like the IMF to secure fiscal support.

The Ministry is responsible for allocating funds to social sectors, with education and healthcare receiving 2.3% and 1.1% of GDP, respectively, in FY2024-25 (World Bank, 2025).

Key Challenges:

- **Fiscal Deficit Management**: A persistent fiscal deficit (6.7% of GDP in FY2025) and high debt servicing (40% of the budget) limit resources for social spending (World Bank, 2025).
- **Policy Misalignment**: The Ministry's reliance on indirect taxes (60% of revenue) and exemptions for agriculture and real estate creates inequities and fuels evasion (LUMS MHRC, 2023).
- **Coordination Failures**: Overlapping mandates with provincial finance departments and the FBR lead to inconsistent policy implementation, particularly in tax collection and expenditure allocation.

Provincial Revenue Authorities

Following the 18th Amendment in 2010, provinces gained authority over certain taxes, including agricultural income tax and sales tax on services. Provincial revenue authorities, such as the Punjab Revenue Authority and Sindh Revenue Board, collect these taxes to fund local services, including education and healthcare.

Key Challenges:

- **Weak Capacity**: Provinces lack the expertise and infrastructure to enforce taxes effectively, with agricultural income tax collection negligible due to resistance from feudal landowners (LUMS MHRC, 2023).
- **Intergovernmental Tensions**: Disputes over revenue-sharing under the National Finance Commission (NFC) Award hamper coordination, with provinces often prioritizing local interests over national fiscal goals.
- **Informal Economy Oversight**: Provinces struggle to regulate informal economic activities, such as small retail and informal labor, which dominate rural economies (PIDE, 2023).

State Bank of Pakistan (SBP)

The State Bank of Pakistan regulates monetary policy and supports fiscal stability by managing inflation (6.0% in FY2025) and foreign exchange reserves. It indirectly influences the informal economy by overseeing financial transactions and anti-money laundering measures, which can detect tax evasion.

Key Challenges:

- **Limited Reach**: The SBP's financial inclusion initiatives, such as digital banking, cover only 30% of the population, leaving cash-based informal transactions largely unregulated (World Bank, 2025).
- **Policy Constraints**: Monetary tightening to control inflation increases borrowing costs, pushing small businesses into the informal sector to evade taxes.

Anti-Corruption and Judicial Institutions

The National Accountability Bureau (NAB) and judiciary play roles in addressing tax evasion and corruption within tax administration. The NAB investigates financial crimes, while courts adjudicate tax evasion cases.

Key Challenges:

- **Judicial Delays**: Tax evasion cases often face years-long delays, reducing deterrence (PIDE, 2023).
- **NAB's Limited Scope**: The NAB focuses on high-profile corruption but lacks resources to tackle systemic tax evasion in the informal economy.
- **Corruption**: Allegations of judicial and NAB complicity with influential taxpayers undermine accountability.

Institutional Fault Lines

Pakistan's institutional landscape is marked by structural weaknesses that exacerbate policy implementation gaps:

- **Corruption and Lack of Accountability**: Transparency International's 2024 Corruption Perceptions Index ranks Pakistan 133 out of 180, with tax administration cited as a key area of concern.
- **Fragmented Governance**: Overlapping federal and provincial mandates, post-18th Amendment, create confusion and inefficiencies in tax collection and enforcement.
- **Capacity Gaps**: Understaffed and undertrained institutions, like the FBR and provincial authorities, struggle with modern tax administration needs, such as digital tracking.
- **Elite Capture**: Powerful groups, including landowners and industrialists, secure tax exemptions, narrowing the tax base and fueling evasion (LUMS MHRC, 2023).
- **Low Public Trust**: Only 40% of Pakistanis trust government institutions to use tax revenue effectively, reducing compliance (PIDE, 2023).

Stakeholders Analysis

This section identifies key stakeholders involved in or affected by tax evasion, the informal economy, fiscal constraints, and social spending in Pakistan. It analyzes their roles, interests, influence, and potential contributions to addressing policy implementation gaps, using a stakeholder mapping approach.

Government Institutions

- **Federal Board of Revenue (FBR)**:
  - **Role**: Collects taxes, enforces compliance, and combats evasion.
  - **Interest**: Achieving revenue targets, improving efficiency, and gaining public trust.
  - **Influence**: High, as the primary tax authority, but limited by corruption and capacity issues.
  - **Contribution**: Can lead digitization efforts (e.g., Track and Trace system) and anti-evasion campaigns.
- **Ministry of Finance**:
  - **Role**: Designs fiscal policy and allocates budgets for social spending.
  - **Interest**: Fiscal stability, IMF compliance, and equitable taxation.
  - **Influence**: High, with authority over budget and policy, but constrained by political pressures.
  - **Contribution**: Can prioritize social spending and advocate for tax base expansion.
- **Provincial Revenue Authorities**:
  - **Role**: Collect provincial taxes and fund local services.
  - **Interest**: Increased revenue and autonomy in resource allocation.
  - **Influence**: Moderate, limited by capacity and political resistance.
  - **Contribution**: Can enforce agricultural income tax and regulate informal sectors locally.

Private Sector

- **Formal Businesses**:
  - **Role**: Pay taxes and compete with informal enterprises.
  - **Interest**: Fair tax policies and a level playing field.
  - **Influence**: Moderate, through chambers of commerce and lobbying.
  - **Contribution**: Can support digitization and compliance initiatives, advocating for simplified tax laws.

- **Informal Sector Operators**:
  - **Role**: Engage in unregistered activities, contributing to the informal economy (30–40% of GDP).
  - **Interest**: Low compliance costs and economic survival.
  - **Influence**: Low individually, but significant collectively due to scale (e.g., 2.4 million in Balochistan).
  - **Contribution**: Can transition to formal economy with incentives like low-cost registration.

Civil Society and Citizens

- **Taxpayers (Salaried and Self-Employed)**:
  - **Role**: Contribute to tax revenue, with only 1% filing returns.
  - **Interest**: Fair taxation and quality public services.
  - **Influence**: Low individually, but high through collective action (e.g., protests).
  - **Contribution**: Can increase compliance with transparent governance and simplified processes.
- **Non-Governmental Organizations (NGOs)**:
  - **Role**: Advocate for equitable policies and social spending.
  - **Interest**: Poverty reduction and improved public services.
  - **Influence**: Moderate, through policy advocacy and public campaigns.
  - **Contribution**: Can monitor tax revenue use and promote tax awareness.
- **Media**:
  - **Role**: Shapes public opinion on tax policies and governance.
  - **Interest**: Transparency and accountability in fiscal management.
  - **Influence**: High, through investigative reporting and public discourse.
  - **Contribution**: Can expose tax evasion and institutional failures, pressuring reforms.

International Actors

- **International Monetary Fund (IMF) and World Bank**:
  - **Role**: Provide financial support and policy guidance.
  - **Interest**: Fiscal sustainability and structural reforms in Pakistan.
  - **Influence**: High, through loan conditions (e.g., 2019 EFF targeting 15% tax-to-GDP ratio).
  - **Contribution**: Can fund capacity-building for FBR and support social spending programs.

- **Donor Agencies (e.g., ADB, USAID)**:
  - **Role**: Fund development projects, including tax administration reforms.
  - **Interest**: Economic stability and poverty alleviation.
  - **Influence**: Moderate, through targeted funding.
  - **Contribution**: Can support digitization and institutional strengthening.

Political and Elite Groups

- **Political Parties**:
  - **Role**: Shape tax policy and budget priorities through legislation.
  - **Interest**: Political support and economic stability.
  - **Influence**: High, but often prioritize short-term gains over reforms.
  - **Contribution**: Can legislate progressive tax policies and anti-evasion measures.
- **Feudal Landowners and Industrialists**:
  - **Role**: Benefit from tax exemptions and influence policy.
  - **Interest**: Maintaining low tax liabilities and economic power.
  - **Influence**: High, through lobbying and political connections.
  - **Contribution**: Resistance to reforms; potential to comply if incentives align.

Stakeholder Mapping

Stakeholder	Interest	Influence	Role in Solution
FBR	Revenue targets, efficiency	High	Lead enforcement and digitization
Ministry of Finance	Fiscal stability	High	Prioritize social spending
Informal Sector	Economic survival	Low (collective high)	Transition to formal economy
Taxpayers	Fair taxes, services	Low (collective high)	Increase compliance
IMF/World Bank	Fiscal reforms	High	Fund capacity-building
Landowners	Low taxes	High	Resist or comply with reforms

Analysis of Stakeholder Dynamics

- **Power Dynamics**: The FBR and Ministry of Finance hold significant authority but face resistance from feudal elites and informal sector operators, who benefit from the status quo. Political parties, influenced by elites, often prioritize short-term populist measures over long-term reforms.
- **Conflict Areas**: Tensions exist between federal and provincial authorities over revenue-sharing, and between formal businesses and informal operators over unfair competition. Public distrust in institutions fuels tax evasion.
- **Collaboration Opportunities**: NGOs and media can partner with the FBR to raise tax awareness. International donors can support FBR digitization and provincial capacity-building, aligning with IMF goals.

Pakistan's institutional landscape is marked by fragmented governance, capacity constraints, and corruption, which exacerbate policy implementation gaps in addressing tax evasion and the informal economy. Stakeholders, from government bodies to informal workers, have diverse interests and varying influence, necessitating a coordinated approach. Strengthening institutions like the FBR, aligning federal-provincial mandates, and engaging stakeholders through incentives and transparency are critical to enhancing fiscal space and social spending.

Institutional Landscape

Tax Evasion at Federal, Provincial, and Local Levels of Governance

Tax evasion, the deliberate act of avoiding tax obligations, is a pervasive issue in Pakistan, undermining fiscal capacity and restricting social spending critical for addressing poverty, education, and healthcare. With a tax-to-GDP ratio of approximately 10%, one of the lowest in the Asia Pacific region, Pakistan loses over $1 billion annually to tax evasion, exacerbating fiscal constraints (PIDE, 2023). This section examines tax evasion across federal, provincial, and local levels of governance, analyzing its forms, drivers, institutional fault lines, and impacts on fiscal space and social spending as of May 17, 2025. Drawing on secondary sources, including academic studies, news reports, and institutional data, it highlights policy implementation gaps and proposes pathways for reform.

Federal Level: Tax Evasion and Institutional Challenges

At the federal level, the Federal Board of Revenue (FBR) is the primary authority responsible for collecting direct taxes (income tax, corporate tax) and indirect taxes (sales tax, customs duties). Tax evasion at this level is

widespread, with only 2.5 million registered taxpayers out of a 240 million populations, and less than 1% of the workforce filing income tax returns.
The informal economy, estimated at 30–40% of GDP, significantly contributes to evasion by operating outside FBR oversight.

Forms of Tax Evasion

- **Underreporting Income**: Businesses and individuals, particularly in retail, real estate, and professional services, underreport earnings to minimize income tax liability. For example, small retailers often use cash transactions to evade sales tax, costing an estimated PKR 300 billion annually (PIDE, 2023).
- **Non-Filing of Returns**: Over 70% of potential taxpayers, including high-income professionals like doctors and lawyers, fail to file returns, exploiting weak FBR enforcement (World Bank, 2025).
- **Tax Fraud and Refund Scams**: Fraudulent claims for input tax credits and refunds, as seen in the 2010 FBR scam, divert significant revenue, with losses estimated at PKR 50 billion in that case alone (Express Tribune, 2010).
- **Exploitation of Exemptions**: Sectors like real estate benefit from tax breaks, with underreported property valuations reducing capital gains tax. The FBR's failure to standardize valuations enables evasion (LUMS MHRC, 2023).

Drivers of Tax Evasion

- **High Tax Rates**: Individual income tax rates up to 35% and corporate rates at 29% incentivize evasion, particularly among small businesses facing thin profit margins (World Bank, 2025).
- **Weak Enforcement**: The FBR conducts audits on less than 1% of returns due to understaffing (21,000 employees) and outdated technology, allowing evasion to go unchecked (PIDE, 2023).
- **Corruption**: Collusion between FBR officials and taxpayers, including bribes to avoid audits, undermines enforcement. Transparency International (2024) ranks Pakistan 133 out of 180 on the Corruption Perceptions Index, with tax administration a key concern.
- **Low Public Trust**: Only 40% of Pakistanis believe tax revenue is used effectively, reducing compliance. Perceptions of elite capture, such as exemptions for industrialists, further erode trust (PIDE, 2023).

Institutional Fault Lines

- **Capacity Constraints**: The FBR lacks resources for comprehensive audits or digital tracking, with the Track and Trace system covering only 10% of taxable transactions
- **Policy Implementation Gaps**: Reforms like Budget 2025's withholding tax removal aimed to simplify compliance, but poor awareness and coordination with taxpayers limited impact.

- **Judicial Delays**: Tax evasion cases face delays of 3–5 years in courts, reducing deterrence. For instance, only 5% of evasion cases result in convictions.

Impact on Federal Fiscal Space and Social Spending

Federal tax evasion contributes to a fiscal deficit of 6.7% of GDP in FY2025, with debt servicing consuming 58% of the budget (World Bank, 2025). This crowds out social spending, with education and healthcare allocated only 1.8% and 1.1% of GDP, respectively. The resulting underfunding leaves 20 million people without clean water and 44 million children out of school, exacerbating poverty (World Bank, 2025).

Provincial Level: Tax Evasion and Governance Challenges

Following the 18th Amendment in 2010, provinces gained authority over taxes like agricultural income tax, sales tax on services, and property tax, managed by entities such as the Punjab Revenue Authority and Sindh Revenue Board. However, provincial tax collection remains negligible, contributing less than 10% of total tax revenue, with evasion rampant due to weak enforcement and political resistance (LUMS MHRC, 2023).

Provincial Level Forms of Tax Evasion

- **Agricultural Income Tax Evasion**: Agriculture, contributing 22% to GDP, is minimally taxed due to exemptions and underreporting. Only 0.1% of agricultural income is taxed, with feudal landowners exploiting loopholes (LUMS MHRC, 2023).
- **Sales Tax on Services**: Service sectors, including hospitality and consulting, underreport transactions to evade sales tax. For example, Sindh collects only 60% of potential service tax due to cash-based transactions (PIDE, 2023).
- **Property Tax Evasion**: Urban property taxes are evaded through undervaluation, with local elites colluding with assessors to report lower values, costing provinces PKR 100 billion annually (World Bank, 2025).

Provincial Level Drivers of Tax Evasion

- **Political Resistance**: Powerful landowners and urban elites lobby against agricultural and property taxes, leveraging political influence to maintain exemptions (LUMS MHRC, 2023).
- **Weak Capacity**: Provincial revenue authorities lack trained staff and digital systems, with Punjab’s authority employing only 1,500 staff for a 120 million populations (PIDE, 2023).
- **Cultural Norms**: In rural areas, tax payment is viewed as unnecessary, with barter trade and informal labor dominating economic activity.

- **Coordination Failures**: Lack of data-sharing between FBR and provincial authorities hinders tracking of taxable entities, enabling evasion (World Bank, 2025).

Provincial Level Institutional Fault Lines

- **Fragmented Governance**: The 18th Amendment created overlapping mandates, with provinces and the FBR disputing tax jurisdictions, leading to enforcement gaps (LUMS MHRC, 2023).
- **Corruption**: Provincial tax officials are susceptible to bribes, particularly in property tax assessments, undermining revenue collection (Transparency International, 2024).
- **Policy Gaps**: Provinces lack standardized tax policies, with varying rates and exemptions across regions, complicating compliance and enforcement.

Impact on Provincial Fiscal Space and Social Spending

Provincial tax evasion limits resources for devolved sectors like education and healthcare, which rely heavily on provincial budgets. For instance, Punjab's education budget, at 15% of provincial expenditure, is insufficient to address 10 million out-of-school children (World Bank, 2025). Low revenue collection forces provinces to depend on federal transfers via the National Finance Commission (NFC) Award, straining national fiscal space.

Local Level: Tax Evasion and Administrative Weaknesses

Local governments, including municipal corporations and district councils, collect taxes such as property tax, professional tax, and local fees, but their contribution to revenue is minimal, less than 2% of total tax collection (World Bank, 2025). Tax evasion at this level is driven by weak administrative capacity and informal economic dominance, particularly in rural and peri-urban areas.

Local Level Forms of Tax Evasion

- **Property Tax Evasion**: Small property owners and businesses underreport property values or fail to register, with only 30% of taxable properties in Karachi assessed (PIDE, 2023).
- **Professional Tax Evasion**: Small-scale professionals, such as shopkeepers and artisans, evade local taxes by operating informally, contributing to the 30–40% informal economy.
- **Non-Payment of Fees**: Local fees for services like waste management are often unpaid, with compliance rates below 20% in rural districts (World Bank, 2025).

Local Level Drivers of Tax Evasion

- **Administrative Weakness**: Local governments lack trained staff and digital tools, relying on manual records prone to manipulation (PIDE, 2023).
- **Informal Economy Dominance**: There is a predominant informal economy operated at local levels, such as 2.4 million people rely on informal livelihoods through smuggled activities in border towns of Balochistan, moreover, cash-based transactions provide enough support to evade local taxes (VOA News, 2024).
- **Low Awareness**: Citizens, particularly in rural areas with a 59% literacy rate, are unaware of tax obligations or perceive no direct benefits (World Bank, 2025).
- **Corruption**: Local officials often accept bribes to waive taxes or fees, especially in property assessments (Transparency International, 2024).

Local Level Institutional Fault Lines

- **Capacity Gaps**: Local governments have limited resources, with budgets often below PKR 1 billion for districts serving millions (PIDE, 2023).
- **Lack of Autonomy**: Dependence on provincial transfers reduces local governments' incentive to enforce taxes, perpetuating evasion.
- **Policy Gaps**: Inconsistent local tax policies, varying by district, create confusion and opportunities for evasion.

Local Level Impact on Fiscal Space and Social Spending

Local tax evasion restricts funding for community services like water supply and sanitation, with 20 million people lacking clean water (World Bank, 2025). Underfunded local governments struggle to maintain infrastructure, exacerbating urban-rural disparities and limiting social development outcomes.

Comparative Analysis Across Federal, Provincial and Local Levels of Governance

- **Scale and Impact**: Federal evasion has the largest fiscal impact, costing $1 billion annually, due to the FBR's broad mandate. After 18th amendment, provinces are responsible for collection of sales tax on service, keeping in view, Pakistan's economy, wherein services sector is contributing 57.7% to the national GDP, this becomes imperative, to improve provincial taxation system. Whereas, provincial and local evasion may be smaller in absolute terms, however it significantly affects devolved sectors like education and healthcare.
- **Common Drivers**: Corruption, weak enforcement, and low public trust permeate all levels, with the informal economy enabling evasion across jurisdictions.

- **Unique Challenges**: Federal evasion is driven by complex tax systems and elite capture, provincial evasion by political resistance, and local evasion by administrative weaknesses and low awareness.
- **Policy Gaps**: Federal reforms lack implementation rigor, provincial policies face elite resistance, and local policies are inconsistent and under-resourced.

Impacts on Fiscal Constraints and Social Spending at All Levels

Tax evasion across governance levels perpetuates a vicious cycle of fiscal constraints and underfunded social spending:

- **Fiscal Deficit**: Combined evasion losses contribute to a 6.7% fiscal deficit, limiting government borrowing capacity (World Bank, 2025).
- **Crowding Out Social Spending**: Debt servicing (40% of budget) and low revenue reduce allocations for education (2.3% of GDP) and healthcare (1.1% of GDP), compared to regional averages of 4% and 3% (World Bank, 2025).
- **Socioeconomic Consequences**: Underfunding results in 44 million out-of-school children, 40% child stunting, and 20 million without clean water, deepening poverty and inequality (World Bank, 2025).
- **Informal Economy Feedback Loop**: Evasion fuels the informal economy, which further reduces the tax base, perpetuating fiscal constraints.

Policy Implementation Gaps and Institutional Fault Lines at All Levels

- **Federal Level**: The FBR's failure to implement digital tracking systems fully, despite Budget 2025 mandates, reflects resource and coordination gaps. Corruption and judicial delays further weaken enforcement.
- **Provincial Level**: Resistance from elites and lack of provincial FBR coordination hinder agricultural tax enforcement, with policy gaps in standardizing tax rates.
- **Local Level**: Inconsistent policies and reliance on manual processes limit tax collection, with corruption undermining local governance.

Pathways for Reform

- **Federal**: Strengthen FBR capacity through digitization (e.g., expand Track and Trace), increase audit rates to 5%, and expedite judicial processes for evasion cases.
- **Provincial**: Standardize agricultural income tax rates, train revenue staff, and integrate data with FBR to track taxable entities.
- **Local**: Digitize property tax assessments, launch awareness campaigns, and provide incentives for compliance, such as service discounts.
- **Cross-Level**: Enhance federal-provincial-local coordination via a unified tax database and joint anti-evasion task force.

Tax evasion at federal, provincial, and local levels in Pakistan is a multifaceted challenge driven by institutional weaknesses, policy gaps, and socioeconomic factors. Its impact on fiscal space restricts social spending, perpetuating poverty and underdevelopment. Addressing evasion requires targeted reforms to strengthen enforcement, close policy loopholes, and build public trust, ensuring equitable revenue mobilization for social investments.

Ballooning Debt Servicing in Pakistan

Pakistan's escalating public debt is a critical factor exacerbating fiscal constraints, limiting social spending, and amplifying the challenges posed by tax evasion and the informal economy. As of May 17, 2025, Pakistan's total public debt stands at approximately PKR 81 trillion (USD 290 billion), equivalent to 81.2% of GDP, with external debt accounting for USD 130.7 billion (World Bank, 2025). This ballooning debt, driven by persistent fiscal deficits, low revenue mobilization, and reliance on external borrowing, crowds out resources for social sectors like education and healthcare, which receive only 2.3% and 1.1% of GDP, respectively (World Bank, 2025). Tax evasion, costing over USD 1 billion annually, and the informal economy, encompassing 30–40% of GDP, further erode the tax base, perpetuating a cycle of borrowing and fiscal strain (PIDE, 2023). This section examines the causes, dynamics, and consequences of Pakistan's debt crisis, highlighting policy implementation gaps and institutional fault lines, and their interplay with tax evasion, the informal economy, and social spending.

Causes of Ballooning Debt

Pakistan's debt accumulation is rooted in structural economic weaknesses, policy missteps, and institutional inefficiencies, compounded by external pressures and domestic governance challenges.

Persistent Fiscal Deficits

Pakistan has maintained fiscal deficits averaging 6–8% of GDP over the past four decades, with FY2025 recording a deficit of 6.7% (World Bank, 2025). Low revenue collection, driven by a tax-to-GDP ratio of 10%—compared to the Asia Pacific average of 19.3%—forces the government to borrow to finance expenditures (LUMS MHRC, 2023). Tax evasion, with only 2.5 million registered taxpayers out of a 240 million populations, and the informal economy's dominance reduce revenue potential, necessitating domestic and external borrowing (Express Tribune, 2024).

Low Revenue Mobilization

The Federal Board of Revenue (FBR) struggles to meet revenue targets, collecting PKR 12.97 trillion in FY2024-25, short of the IMF-mandated PKR 13.3 trillion. Overreliance on indirect taxes (60% of revenue) and exemptions for agriculture (22% of GDP) and real estate narrow the tax base (LUMS MHRC, 2023). Policy implementation gaps, such as the incomplete rollout of the FBR's Track and Trace system, limit efforts to curb evasion, forcing reliance on loans to bridge fiscal gaps.

High Debt Servicing Costs

Debt servicing consumes 40% of the federal budget, approximately PKR 7.3 trillion in FY2025, driven by high interest rates and short-term domestic borrowing (World Bank, 2025). External debt repayments, particularly to China (USD 26 billion outstanding) and multilateral lenders like the IMF, strain foreign exchange reserves, which stood at USD 10.7 billion in April 2025 (State Bank of Pakistan, 2025). These costs divert resources from social spending, exacerbating poverty and inequality.

External Shocks and Borrowing

Global commodity price spikes, such as oil and food in 2022–23, and climate-related disasters like the 2022 floods (USD 30 billion in damages) increased borrowing needs (World Bank, 2025). Pakistan's reliance on IMF programs, including the 2019 Extended Fund Facility and 2024 USD 7 billion loan, reflects external pressures to stabilize the economy, but strict conditions, like tax hikes, often fuel evasion and informality (IMF, 2024).

Institutional Fault Lines

Corruption and inefficiencies within the FBR and Ministry of Finance undermine revenue collection, with Transparency International (2024) ranking Pakistan 133 out of 180 on the Corruption Perceptions Index. Political interference and elite capture, such as tax exemptions for influential landowners, perpetuate low revenue, driving debt accumulation (LUMS MHRC, 2023).

Dynamics of Debt Accumulation

Pakistan's debt crisis is characterized by a vicious cycle where tax evasion and the informal economy reduce revenue, necessitating borrowing, which increases debt servicing costs and further constrains fiscal space.

Tax Evasion and Revenue Shortfalls

Tax evasion, particularly through underreporting income and non-filing of returns, costs Pakistan USD 1 billion annually (PIDE, 2023). The informal economy, including unregistered businesses and cash-based transactions, evades FBR oversight, with only 30% of taxable transactions captured.

This revenue shortfall forces the government to borrow domestically (PKR 54 trillion) and externally (USD 130.7 billion), increasing debt stock (World Bank, 2025).

Informal Economy and Debt Feedback Loop

The informal economy, estimated at 30–40% of GDP, employs 70% of the workforce, particularly in retail, agriculture, and services. Its tax-exempt status reduces fiscal capacity, compelling borrowing to fund public expenditure. High borrowing costs, with domestic interest rates at 15% in FY2025, further entrench the informal economy, as businesses avoid formalization to evade taxes (State Bank of Pakistan, 2025).

Policy Implementation Gaps

Recent reforms, such as Budget 2025's withholding tax removal and income tax cuts, aimed to broaden the tax base but faced implementation challenges due to poor FBR coordination and taxpayer awareness. The FBR's digital initiatives, like the Track and Trace system, cover only 10% of taxable entities, limiting their impact on evasion and revenue (PIDE, 2023). These gaps perpetuate reliance on borrowing, inflating debt.

External Debt and Currency Pressures

External debt, dominated by loans from China, Saudi Arabia, and multilateral institutions, creates repayment pressures, with USD 28 billion due by 2026 (World Bank, 2025). Currency depreciation (PKR 280 to USD in 2025) increases debt servicing costs, reducing fiscal space for social programs. The informal economy's reliance on cash transactions exacerbates foreign exchange shortages, as unreported earnings bypass banking systems (State Bank of Pakistan, 2025).

Consequences of Ballooning Debt

The escalating debt burden has profound implications for fiscal constraints, social spending, and socioeconomic outcomes, amplifying the challenges of tax evasion and the informal economy.

Fiscal Constraints

High debt servicing (40% of the budget) limits discretionary spending, with the fiscal deficit projected at 6.7% of GDP in FY2025 (World Bank, 2025). Revenue shortfalls from evasion and informality force reliance on short-term, high-cost domestic borrowing, with domestic debt interest payments at PKR 5 trillion annually (State Bank of Pakistan, 2025). This restricts fiscal flexibility, hindering investments in infrastructure and social services.

Impact on Social Spending

Social spending remains critically underfunded, with education (2.3% of GDP) and healthcare (1.1% of GDP) far below regional averages of 4% and 3% (World Bank, 2025).

The debt burden diverts resources, leaving 44 million children out of school, 40% of children under five stunted, and 20 million people without clean water (World Bank, 2025). Provinces, reliant on federal transfers via the National Finance Commission (NFC) Award, face budget cuts, further limiting local social programs.

Socioeconomic Impacts

The debt crisis exacerbates poverty (24% below the poverty line) and inequality, as regressive indirect taxes (60% of revenue) burden low-income households (LUMS MHRC, 2023). Reduced social spending perpetuates low human development, with Pakistan ranking 161 out of 191 on the Human Development Index (UNDP, 2024). The informal economy, while providing livelihoods for 2.4 million in regions like Balochistan, creates unfair competition for formal businesses, stifling economic growth (VOA News, 2024).

Institutional and Governance Challenges

Debt reliance highlights institutional fault lines, such as FBR corruption and Ministry of Finance inefficiencies in budget planning. Political pressures to maintain exemptions for elites, like agricultural landowners, undermine debt reduction efforts (LUMS MHRC, 2023). Low public trust, with only 40% of Pakistanis believing tax revenue is used effectively, fuels tax evasion, perpetuating the debt cycle (PIDE, 2023).

Policy Implementation Gaps and Institutional Fault Lines

Federal Level Gaps

- **FBR Inefficiencies**: The FBR's failure to expand the tax base, with only 1% of the population filing returns, reflects poor policy execution. Digital tools like Track and Trace are underutilized due to resource constraints and resistance from informal sectors.
- **Corruption**: Collusion between FBR officials and taxpayers, as seen in past refund scams, diverts revenue, necessitating borrowing (Express Tribune, 2010).
- **Coordination Failures**: Lack of alignment between the Ministry of Finance and FBR on revenue targets leads to unrealistic budgets, increasing deficit financing.

Provincial and Local Gaps

- **Weak Provincial Enforcement**: Provincial revenue authorities, tasked with agricultural and property taxes, collect less than 10% of potential revenue due to capacity gaps and elite resistance (LUMS MHRC, 2023). This forces reliance on federal loans, increasing debt.
- **Local Administrative Weaknesses**: Local governments' manual tax collection systems enable evasion, limiting resources and necessitating provincial borrowing (PIDE, 2023).

Institutional Fault Lines

- **Fragmented Governance**: Post-18th Amendment, overlapping federal-provincial mandates create confusion, with disputes over NFC transfers exacerbating fiscal strain (World Bank, 2025).
- **Elite Capture**: Exemptions for agriculture and real estate, driven by political lobbying, narrow the tax base, increasing borrowing needs (LUMS MHRC, 2023).
- **Judicial Delays**: Slow adjudication of tax evasion and debt-related cases reduces deterrence, perpetuating revenue losses (PIDE, 2023).

Interplay with Tax Evasion and Informal Economy

Tax evasion and the informal economy are both causes and consequences of ballooning debt:

- **Revenue Losses**: Evasion and informality reduce the tax base, forcing borrowing to cover deficits. For example, agricultural tax evasion costs PKR 100 billion annually, directly contributing to debt (LUMS MHRC, 2023).
- **Debt-Driven Informality**: High debt servicing costs lead to tax hikes, pushing businesses into the informal economy to avoid compliance costs, as seen with small retailers evading sales tax (PIDE, 2023).
- **Fiscal Feedback Loop**: Borrowing to fund deficits increases interest rates, squeezing formal businesses and encouraging informality, which further reduces revenue and necessitates more borrowing.

Impacts on Social Spending

The debt burden directly undermines social spending, with cascading effects on human development:

- **Education**: Underfunding (2.3% of GDP) results in 44 million out-of-school children, with rural areas worst affected due to provincial budget constraints (World Bank, 2025).
- **Healthcare**: Low allocation (1.1% of GDP) contributes to 40% child stunting and inadequate facilities, with only 0.8 doctors per 1,000 people (World Bank, 2025).
- **Poverty Alleviation**: Limited social safety nets, like the Benazir Income Support Programme, cover only 9 million households, leaving 24% of the population below the poverty line (World Bank, 2025).

Pathways for Reform

- **Enhance Revenue Mobilization**: Expand the tax base by taxing agriculture and real estate, targeting 15% tax-to-GDP by 2030, as per IMF goals (IMF, 2024). Fully implement FBR's Track and Trace system to capture 50% of taxable transactions.
- **Strengthen FBR Capacity**: Increase staffing to 30,000 and invest in digital tools to improve audit rates to 5% (PIDE, 2023).

- **Reduce Debt Servicing Costs**: Negotiate debt restructuring with creditors like China and extend IMF loan terms to lower annual repayments.
- **Formalize Informal Economy**: Offer low-cost registration and tax amnesty for small businesses, targeting 1 million new taxpayers by 2027 (LUMS MHRC, 2023).
- **Improve Governance**: Establish a joint federal-provincial task force to align tax policies and reduce elite capture, ensuring equitable taxation.
- **Prioritize Social Spending**: Allocate 20% of debt relief savings to education and healthcare, aiming for 4% and 3% of GDP, respectively, by 2030.

Pakistan's ballooning debt, driven by tax evasion, the informal economy, and institutional fault lines, severely constrains fiscal space and social spending. Policy implementation gaps, such as incomplete FBR reforms, and structural weaknesses, including corruption and elite capture, perpetuate a cycle of borrowing and revenue shortfalls. Addressing this crisis requires comprehensive reforms to boost revenue, formalize the economy, and prioritize social investments, breaking the debt-driven fiscal trap to foster equitable development.

Informal Economy

The informal economy in Pakistan, encompassing unregistered businesses, informal labor, and undocumented transactions, is a significant driver of limited fiscal space, tax evasion, and constrained social spending. Estimated to account for 30–40% of GDP and employing approximately 70% of the workforce, the informal economy operates outside regulatory and tax frameworks, costing the government over USD 1 billion annually in lost revenue (PIDE, 2023). This section examines the structure, drivers, and impacts of the informal economy in Pakistan, focusing on its role in perpetuating fiscal constraints and undermining social spending as of May 17, 2025. It highlights policy implementation gaps and institutional fault lines, drawing on secondary sources such as academic studies, news reports, and institutional data, and proposes strategies to formalize the informal sector for enhanced fiscal sustainability.

Structure and Scope of the Informal Economy

The informal economy in Pakistan is diverse, spanning urban and rural areas and involving a range of activities that evade formal regulation and taxation. It includes small-scale retail, street vending, informal labor in agriculture and construction, barter trade, and smuggling, particularly in border regions like Balochistan (VOA News, 2024).

Key Components

Unregistered Businesses: Small shops, workshops, and service providers, such as tailors and mechanics, often operate without registration, avoiding taxes like sales tax and income tax. These businesses account for an estimated 50% of retail activity in urban areas (PIDE, 2023).

Informal Labor: Approximately 70% of Pakistan's workforce, or 40 million workers, is engaged in informal employment, including daily wage laborers, domestic workers, and agricultural workers (World Bank, 2025). These workers typically receive cash payments, escaping income tax and social security contributions. Barter and Cash Transactions: In rural areas, barter systems and cash-based transactions dominate, particularly in agriculture (22% of GDP), reducing traceability and tax collection. Smuggling and Illicit Trade: In Balochistan, smuggling of goods, including petroleum (5–6 million liters daily from Iran), supports livelihoods for up to 2.4 million people but evades customs duties and taxes (VOA News, 2024).

Scale and Distribution

The informal economy is estimated at 30–40% of GDP, or USD 100–140 billion, based on studies from 2003 to 2023 (PIDE, 2023). It is most prevalent in:

Urban Areas: Informal retail and services dominate in cities like Karachi and Lahore, with 60% of small businesses unregistered (PIDE, 2023).

Rural Areas: Agriculture and barter trade, particularly in Punjab and Sindh, contribute to informality, with only 0.1% of agricultural income taxed (LUMS MHRC, 2023).

Border Regions: Balochistan and Khyber Pakhtunkhwa, with weak state presence, are hubs for smuggling and informal trade, driven by proximity to Iran and Afghanistan (VOA News, 2024).

Drivers of the Informal Economy

The informal economy thrives due to a combination of economic, institutional, social, and policy-related factors, reinforced by structural challenges in Pakistan's governance framework.

Economic Factors

Poverty and Unemployment: With 24% of the population below the poverty line and unemployment at 6.5% in 2025, informal activities provide a lifeline for millions unable to access formal jobs (World Bank, 2025). In Balochistan, 2.4 million people rely on smuggling due to limited economic opportunities (VOA News, 2024).

High Compliance Costs: Formalization requires costly registration, tax payments, and compliance with labor laws, deterring small businesses with thin margins.

For example, sales tax registration costs PKR 50,000–100,000 annually for small retailers (PIDE, 2023). Economic Instability: Inflation (6.0% in FY2025) and currency depreciation (PKR 280 to USD) increase operating costs, pushing businesses to operate informally to survive (State Bank of Pakistan, 2025).

Institutional Factors

Weak Enforcement: The Federal Board of Revenue (FBR) and provincial authorities lack capacity to monitor informal activities, with only 10% of taxable transactions tracked digitally (Photonews, 2025). Local governments, responsible for property and professional taxes, rely on manual records, enabling evasion (PIDE, 2023).

Corruption: Collusion between officials and informal operators, such as bribes to avoid registration, is widespread. Transparency International (2024) notes tax administration as a key corruption hotspot.

Fragmented Governance: Post-18th Amendment (2010), overlapping federal and provincial mandates create regulatory gaps, with provinces failing to enforce taxes like agricultural income tax (LUMS MHRC, 2023).

Social Factors

Low Tax Morale: Only 40% of Pakistanis trust the government to use tax revenue effectively, reducing incentives for formalization (PIDE, 2023). Cultural acceptance of cash transactions and informality further entrenches the informal economy.

Low Literacy and Awareness: With a 59% literacy rate, many informal workers and business owners are unaware of tax obligations or formalization benefits (World Bank, 2025).

Socioeconomic Dependence: In border regions, smuggling and informal trade are seen as legitimate livelihoods, supported by community networks and local power structures (VOA News, 2024).

Policy Factors

Complex Tax System: High tax rates (up to 35% for individuals) and complex compliance procedures discourage formalization. For instance, sales tax filing requires monthly submissions, overwhelming small businesses (PIDE, 2023).

Sectoral Exemptions: Agriculture and real estate, key informal economy components, benefit from tax exemptions, reducing incentives to formalize (LUMS MHRC, 2023).

Outdated Regulations: The 1977 Smuggling Act and 1969 Customs Act are misaligned with modern economic realities, failing to address informal trade effectively (Express Tribune, 2024).

Impacts of the Informal Economy

The informal economy has far-reaching consequences for Pakistan's fiscal capacity, social spending, and socioeconomic development, amplifying the challenges of tax evasion and fiscal constraints.

Fiscal Constraints of Informal Economy

Revenue Losses: The informal economy's tax-exempt status costs over USD 1 billion annually, contributing to a fiscal deficit of 6.7% of GDP in FY2025 (PIDE, 2023; World Bank, 2025). This limits government borrowing capacity and increases reliance on external debt (USD 130.7 billion).

Narrow Tax Base: With only 2.5 million registered taxpayers, the informal economy restricts the tax-to-GDP ratio to 10%, compared to the regional average of 19.3% (LUMS MHRC, 2023). Untaxed sectors like agriculture and informal retail exacerbate this issue.

Impact on Social Spending

Underfunded Public Services: Low revenue restricts social spending, with education (2.3% of GDP) and healthcare (1.1% of GDP) underfunded compared to regional averages of 4% and 3% (World Bank, 2025). This results in 44 million children out of school, 40% child stunting, and 20 million people without clean water.

Provincial Budget Constraints: Provinces, reliant on federal transfers via the NFC Award, face budget cuts due to low local revenue from informal sectors, limiting investments in devolved sectors like education and healthcare (World Bank, 2025).

Economic and Social Impacts

Unfair Competition: Informal businesses, free from taxes and regulations, undercut formal enterprises, discouraging investment. For example, formal retailers face 20% higher costs than informal competitors (PIDE, 2023).

Inequality and Poverty: The informal economy sustains low-wage, unstable jobs, perpetuating poverty (24% below the poverty line) and inequality, with limited access to social protections (World Bank, 2025).

Environmental and Health Risks: Informal activities, such as smuggled petroleum with high sulfur content, contribute to air pollution and health issues, particularly in Balochistan (VOA News, 2024).

Feedback Loop with Tax Evasion

The informal economy facilitates tax evasion by enabling cash transactions and unreported income, reducing traceability. In turn, tax evasion incentivizes informality, as businesses avoid formalization to escape high taxes, perpetuating a cycle of revenue loss and fiscal strain.

Policy Implementation Gaps and Institutional Fault Lines

The persistence of the informal economy reflects significant policy and institutional shortcomings that hinder formalization and revenue mobilization.

Federal Level Gaps

Incomplete Reforms: Budget 2025's tax relief measures, such as withholding tax removal, aimed to encourage formalization but lack implementation rigor due to poor FBR outreach and awareness campaigns.

Weak Digital Infrastructure: The FBR's Track and Trace system, intended to monitor transactions, covers only 10% of taxable entities, failing to capture informal activities (PIDE, 2023).

Corruption: Collusion between FBR officials and informal businesses undermines enforcement, with bribery reported in 30% of tax inspections (Transparency International, 2024).

Provincial Level Gaps

Failure to Tax Agriculture: Provincial authorities, responsible for agricultural income tax, collect only 0.1% of potential revenue due to elite resistance and capacity gaps (LUMS MHRC, 2023).

Lack of Coordination: Poor data-sharing between FBR and provincial revenue authorities hinders tracking of informal businesses, enabling tax evasion (World Bank, 2025).

Understaffing: Provincial revenue bodies, such as the Punjab Revenue Authority, employ only 1,500 staff for a 120 million populations, limiting oversight of informal sectors (PIDE, 2023).

Local Level Gaps

Manual Systems: Local governments rely on outdated manual records for property and professional taxes, facilitating evasion by informal businesses (PIDE, 2023).

Low Enforcement Capacity: District councils lack resources to monitor informal activities, with budgets often below PKR 1 billion (World Bank, 2025).

Corruption: Local officials accept bribes to overlook unregistered businesses, particularly in rural areas (Transparency International, 2024).

Institutional Fault Lines

Fragmented Governance: Post-18th Amendment, unclear federal-provincial roles create regulatory gaps, with provinces failing to enforce taxes on informal sectors (LUMS MHRC, 2023).

Elite Capture: Exemptions for agriculture and real estate, driven by lobbying from powerful groups, sustain informality (LUMS MHRC, 2023).

Low Public Trust: Perceptions of government inefficiency and corruption reduce willingness to formalize, with only 40% trusting tax revenue use (PIDE, 2023).

Interplay with Tax Evasion, Fiscal Constraints, and Social Spending

The informal economy is intricately linked to tax evasion, fiscal constraints, and reduced social spending, forming a self-reinforcing cycle:

Tax Evasion: Informal businesses and workers evade taxes through cash transactions and non-registration, costing USD 1 billion annually (PIDE, 2023). This fuels the informal economy's growth, as formalization becomes less attractive.

Fiscal Constraints: Revenue losses from informality contribute to a 6.7% fiscal deficit, increasing reliance on debt (USD 130.7 billion) and limiting fiscal space (World Bank, 2025).

Social Spending: Constrained budgets reduce allocations for education and healthcare, perpetuating poverty and low human development (HDI rank 161/191) (UNDP, 2024). In turn, poverty drives reliance on informal livelihoods, sustaining the cycle.

Case Study: Informal Economy in Balochistan

Balochistan exemplifies the informal economy's complexity, with 2.4 million people dependent on smuggling and informal trade due to limited economic opportunities (VOA News, 2024). Petroleum smuggling (5–6 million liters daily) evades customs duties, costing PKR 227 billion annually, while supporting local livelihoods in a region with 40% poverty (World Bank, 2025). Weak provincial enforcement and federal-provincial coordination gaps exacerbate the issue, highlighting the need for targeted interventions like job creation and border security.

Pathways for Reforms

Addressing the informal economy requires a balanced approach that encourages formalization, strengthens enforcement, and addresses socioeconomic drivers, while mitigating impacts on vulnerable populations.

Reforms at Federal Level

Simplify Tax Compliance: Reduce registration costs and streamline tax filing, targeting 1 million new taxpayers by 2027. For example, introduce a flat 5% tax rate for small businesses (PIDE, 2023).

Expand Digital Tracking: Fully implement the FBR's Track and Trace system to cover 50% of taxable transactions, capturing informal retail and services.

Anti-Corruption Measures: Increase FBR oversight and impose stricter penalties for collusion, aiming for a 50% reduction in reported bribery cases (Transparency International, 2024).

Reforms at Provincial Level

Tax Agriculture: Standardize agricultural income tax rates at 5–10%, targeting PKR 100 billion in annual revenue, with incentives for compliance (LUMS MHRC, 2023).

Build Capacity: Train 5,000 provincial revenue staff and adopt digital tax systems to monitor informal businesses (PIDE, 2023).
Data Integration: Establish a unified tax database with FBR to track informal activities, improving enforcement (World Bank, 2025).

Reforms at Local Level

Digitize Tax Collection: Implement digital property and professional tax systems in 50% of districts by 2027, reducing evasion (PIDE, 2023).
Community Engagement: Launch awareness campaigns on formalization benefits, targeting 1 million rural households (World Bank, 2025).
Incentives for Formalization: Offer tax holidays and low-cost loans for registering informal businesses, aiming for 500,000 new registrations (PIDE, 2023).

Reforms at Cross-Level Strategies

Alternative Livelihoods: Invest PKR 50 billion in Balochistan for vocational training and small-scale industries, creating 500,000 jobs to reduce smuggling reliance (VOA News, 2024)
Public Trust Building: Publish annual reports on tax revenue use, targeting a 20% increase in public trust by 2027 (PIDE, 2023).
Policy Alignment: Revise the 1977 Smuggling Act and 1969 Customs Act to address informal trade, ensuring federal-provincial coordination (Express Tribune, 2024).
Pathway to Reform: Pakistan's informal economy, a critical component of its economic landscape, significantly contributes to tax evasion, fiscal constraints, and limited social spending. Driven by poverty, weak enforcement, and policy gaps, it sustains a cycle of revenue loss and underdevelopment. Institutional fault lines, including corruption, fragmented governance, and elite capture, exacerbate the challenge. Addressing the informal economy requires comprehensive reforms to simplify compliance, strengthen enforcement, and promote alternative livelihoods, while ensuring equitable taxation and enhanced social investments. By formalizing the informal sector, Pakistan can expand its fiscal space, improve public services, and foster sustainable development.

Conclusion

Pakistan’s tax system and institutional framework have evolved amidst structural challenges, from colonial legacies to modern reform efforts. Historical policy gaps, such as exemptions for agriculture and weak enforcement, have entrenched tax evasion and informality, constraining fiscal space and social spending. Understanding this historical context is crucial for analyzing current challenges and designing effective reforms to strengthen Pakistan’s fiscal and institutional capacity.

Since 2015, Pakistan has pursued tax reforms under IMF programs, including the 2019 Extended Fund Facility, which mandated increasing the tax-to-GDP ratio to 15% by 2024. Measures like the 2025 Budget’s removal of withholding taxes and income tax reductions aimed to simplify compliance, but their impact remains limited, with only 12.5 million taxpayers registered out of a 241 million populations. The informal economy is estimated at around 30–40% of GDP, continues to thrive, driven by high compliance costs and low enforcement (PIDE, 2023). Institutional fault lines, including FBR inefficiencies, lack of political will, pervasive tax-evasion culture and judicial delays in tax evasion cases, persist, while fiscal constraints limit social spending, with 20 million people lacking clean water and 44 million children out of school (World Bank, 2025). The growing fiscal deficit as a result of excess debt servicing further exacerbates the limited fiscal space available for social spending.

Tax evasion at federal, provincial, and local levels in Pakistan is a multifaceted challenge driven by institutional weaknesses, policy gaps, and socioeconomic factors. Its impact on fiscal space restricts social spending, perpetuating poverty and underdevelopment. Addressing evasion requires targeted reforms to strengthen enforcement, close policy loopholes, and build public trust, ensuring equitable revenue mobilization for social investments.

Pakistan’s ballooning debt, driven by tax evasion, the informal economy, and institutional fault lines, severely constrains fiscal space and social spending. Policy implementation gaps, such as incomplete FBR reforms, and structural weaknesses, including corruption and elite capture, perpetuate a cycle of borrowing and revenue shortfalls. Addressing this crisis requires comprehensive reforms to boost revenue, formalize the economy, and prioritize social investments, breaking the debt-driven fiscal trap to foster equitable development.

Pakistan’s institutional landscape is marked by fragmented governance, capacity constraints, and corruption, which exacerbate policy implementation gaps in addressing tax evasion and the informal economy. Stakeholders, from government bodies to informal workers, have diverse interests and varying influence, necessitating a coordinated approach.

Strengthening institutions like the FBR, aligning federal-provincial mandates, and engaging stakeholders through incentives and transparency are critical to enhancing fiscal space and social spending.

In India the tax culture is quite strong because there is less political interference in tax collection, no exemptions for agricultural income and better enforcement which has led to the progress of revenue collection through direct taxation. While in Vietnam the main factor which is responsible for their better tax to GDP ratio stems in the incentives to the compliant and regular tax payers.

Pakistan has a greater potential for improvement, we have many untapped sectors which can contribute a lot in Pakistan's total revenue collection. Ours may be a low tax effort country but does have a high buoyancy ratio, implying that the policymakers of Pakistan should tap the potential to opt for greater revenue mobilization through internal resources in order to meet the budgetary deficit by overcoming unlimited tax exemptions, poor tax base, inequality of taxing, undocumented economy, repeated tax amnesty etc. Therefore, it is important to place greater emphasis on administrative reinvention and policy reform in order to identify and remove the loopholes in the revenue generation process.

In a nutshell, with all prevailing loopholes and deficiencies we have a greater potential for advancement and betterment of taxation system of Pakistan. The need of the hour is to deal with the main causes responsible for low tax to GDP ratio i.e. uncalled for exemptions, sectoral discrepancy, low tax base and weak audit etc., with iron hand and political will.

Issues and Challenges: Mitigation and Concrete Action Plan

Major Issues in Revenue Mobilization from Taxation

Pakistan's tax regime faces several challenges within its federal tax regime, resulting in a significant revenue shortfall. A narrow tax base, widespread exemptions, and a notable informal economy, coupled with complex structures further undermine tax compliance. Limited coverage, tax evasion, and monitoring challenges restrict indirect tax collection. Addressing these systemic issues through targeted measures may enhance revenue generation and promote fiscal stability.

Weak Enforcement

Weak enforcement across various tax categories results in an annual revenue loss of approximately PKR 5,700-6,000 billion. Income tax evasion and weak audits contribute to losses of PKR 300-400 billion annually. Sales Tax fraud, including underreporting and fake invoicing, lead to additional losses for PKR 400-500 billion. Customs duties are also detrimentally impacted by smuggling and under-invoicing, causing PKR 150-200 billion to the national exchequer. Non-compliance in withholding tax and challenges in the informal economy further result in PKR 400-550 billion in revenue loss. Additionally, PKR 4,357 billion assessed tax revenue under different statutes are pending adjudication at High Courts and Supreme Court of Pakistan (FBR Annual Report, 2024).

Narrow Tax Base

As per FBR, only 5.3 million Pakistanis file income tax returns out of a total population of 250 million (2%) (FBR, 2024). Pakistan's informal economy, estimated at 35% of the total GDP, remains largely untaxed and includes sectors such as agriculture and the real estate (World Bank, 2023). Resultantly, there is a heavy reliance on indirect taxation and an elaborate withholding tax regime accounting for over 60% of revenue collected. This arrangement shifts the burden of taxation to the lower income groups, creating inequity, reducing consumption patterns resulting in weak economic growth. Therefore, expanding the tax base through documentation of the informal economy through digitization processes is of paramount important for sustainable revenue growth.

Complex Tax Structure

Pakistan has a fragmented taxation system with various revenue authorities operating at the national and provincial levels. The structure of federal tax laws is complex and complicated. Overlapping laws, frequent policy changes, and procedural complexities further discourage tax compliance. The Income Tax Ordinance, 2001, contains numerous schedules and exemptions, leading to enforcement challenges and annual revenue losses of PKR 50-100 billion (FBR, 2024).

Similarly, the Sales Tax Act, 1990, with varied rates and zero-rating provisions, encourages exploitation through under-invoicing and fraud (IMF, 2023). Harmonizing federal and provincial taxes and streamlining procedures are critical for improving compliance.

Systemic and Operational Capacity Issues

FBR faces critical capacity challenges with only 18,000 employees serving 250 million people, compared to advance economies Japan (56,315 employees for 123 million) and the UK (80,000 for 69 million). This shortage, results in low morale and substandard tax assessments, undermining compliance (FBR, 2024). In appellate forums, untrained staff and inadequate legal resources have left 104,478 cases unresolved, involving PKR 4,357 billion (FBR Legal Wing, 2024). Pakistan's Cost of Collection (CoC) at 0.43% in 2023-24 is among the lowest globally, limiting enforcement capabilities, while countries like the USA achieve \$5–\$9 returns per dollar spent on enforcement (CBO, 2022; FBR Admin Wing, 2024). Limited District Tax Offices (DTOs) and successive amnesty schemes, such as the 2020 Asset Declaration Rules, have further weakened enforcement, incentivized evasion, and undermined compliance efforts (IMF, 2023; World Bank, 2023).

Informal Economy

The informal economy, comprising ~35% of GDP, significantly limits tax collection. Cash-based transactions and undocumented businesses evade taxation, resulting in annual revenue losses of PKR 300-400 billion (IMF, 2023). The lack of real-time integration with NADRA, SECP, and banking systems hampers FBR's ability to track high-risk entities. Expanding taxpayer registration and digitizing transactions are essential to integrate the informal sector into the tax net.

Underreporting and Fraud

Underreporting and fraud in income and sales tax contribute significantly to revenue losses. Practices like under-invoicing, fake invoicing, and misdeclaration result in losses of PKR 400-500 billion in sales tax and PKR 300-400 billion in income tax annually (FBR, 2024). Strengthening risk-based audits and deploying digital tracking tools are necessary to curb these practices.

Smuggling and Grey Market

Smuggling and grey market activities lead to annual revenue losses of PKR 150-200 billion. Weak border controls and inadequate enforcement mechanisms exacerbate the problem, particularly in high-value goods like petroleum and electronics (World Bank, 2023). Strengthening border security and implementing tracking systems are critical for addressing this issue.

Technological Limitations

The FBR's inefficient IT systems, such as IRIS, and lack of real-time database integration with other governmental agencies (organizations) hinder tax administration. Revenue losses due to technological inefficiencies are estimated at PKR 200-300 billion annually (FBR, 2024). Upgrading IT infrastructure and deploying advanced analytics tools are critical.

Tax Evasion

Tax evasion across all federal taxes results in an annual revenue loss of PKR 1,200-1,500 billion (FBR, 2024). Common practices include underreporting of income, fake and under-invoicing in sales tax, and smuggling of high-value goods such as petroleum and electronics. Weak enforcement, inadequate audits, and limited integration of data systems further exacerbate these issues, enabling individuals and businesses to exploit loopholes and evade taxes. Strengthening audits, deploying advanced technology, and enforcing penalties are essential to address this pervasive issue.

Elite Capture of Pakistan's Economy

The elite capture of Pakistan's economy is driven by the dominance of interconnected groups including military, industrial, feudal, religious, and business, who manipulate state resources to sustain and enhance their economic power. These elites exploit policymaking and enforcement mechanisms to secure benefits such as tax exemptions and subsidies, marginalizing the general population. This entrenched structure has turned Pakistan into a "captured state," prioritizing elite interests over sustainable economic reforms. It weakens state autonomy, impedes equitable development, and perpetuates inefficiencies, reflecting a nexus between power and privilege (Ahmed, n.d.).

Psychodynamics of tax morale in Pakistan

Tax morale in Pakistan is shaped by distrust in government institutions, perceived corruption, and inefficient governance, discouraging tax compliance (IMF, 2023; World Bank, 2023). Enhancing tax morale requires transparent governance, equitable policies, and visible public service benefits. Simplifying tax systems, educating taxpayers, and enforcing laws consistently are critical to fostering compliance and trust (FBR, 2024). A survey was conducted to solicit psychodynamics of tax culture in Pakistan, and it transpired that tax awareness, inclination and understanding of penalties etc., is quite low.

Fragmented Tax System

The fragmentation of taxation authority resulting from the 18th Amendment has significantly altered the landscape of tax collection in the country. By granting provinces the power to collect taxes on services and other sectors that were once under federal control, the system has become more complex.

Businesses are now compelled to navigate interactions with multiple tax authorities, both federal and provincial, leading to increased administrative burdens and challenges regarding compliance. Furthermore, the unclear delineation between federal and provincial tax jurisdictions has resulted in overlapping responsibilities, sparking disputes, especially related to the sales tax on services. This fragmentation underscores the need for clearer regulatory frameworks to streamline tax collection processes. Constitutions provisions limiting the Federal Government's tax collecting powers may need to be reviewed.

Deterrence

Pakistan's taxation regime faces significant challenges in establishing deterrence due to elite capture, institutional weaknesses, and governance issues. Influential interest groups resist reforms, while tax authorities lack independence and efficiency, compounded by corruption and political interference. Public trust in the system is eroded by perceptions of unfairness and misuse of tax revenues, discouraging voluntary compliance. Populist politics have avoided implementing structural reforms like broadening the tax base or imposing penalties to maintain voter appeal, while short-term policy focus undermines sustainable reforms. The system is further strained by insufficient use of technology and poor coordination among tax authorities, particularly following the 18th Amendment, which decentralized tax powers but led to fragmented and inefficient tax administration. To address these issues, Pakistan must strengthen political will, depoliticize and modernize institutions, promote public engagement, and implement equitable tax measures such as wealth and inheritance taxes, alongside strategies to effectively tax real estate wealth. These measures require robust policy frameworks, intergovernmental coordination, and transparency to build public trust and achieve sustainable revenue generation.

Wealth stuck in Real State

Taxing wealth in real estate in Pakistan has become increasingly important as the sector serves as a primary destination for wealth parking, largely due to inadequate documentation, under-valuation, and minimal taxation. To effectively tax real estate wealth, several strategies can be employed. First, property valuation reforms are crucial, which include updating valuation tables to reflect true market rates rather than the artificially low figures recorded in government registries, and collaborating with private sector experts using satellite and geographic data for accurate assessments. Additionally, implementing a progressive capital gains tax with higher rates for short-term holdings can discourage speculative investments, while also closing loopholes that exempt luxury properties. Furthermore, establishing a centralized property ownership database will enhance compliance and prevent tax evasion, bolstered by public disclosure practices to create social pressure against tax evasion.

Lastly, introducing a vacancy tax can incentivize the productive use of underutilized properties, contributing to a more equitable and efficient taxation system in the real estate sector.

Potential Sectors (Undertaxed/Tax Evading Sectors)

Key sectors in Pakistan, including retail, wholesale, real estate, and transport, contribute significantly to the country's tax gap, which could be addressed through targeted strategies to unlock substantial revenue opportunities.

The retail sector, a major player in the informal economy, leads to an estimated annual revenue loss of PKR 300-400 billion due to tax evasion and non-compliance (FBR, 2024). Issues such as underreporting of income, resistance to POS adoption, reliance on cash transactions, and exploitation of tax exemptions have hindered tax collection. To address these challenges, proposed strategies include mandatory POS integration for Tier-1 retailers, with subsidies to offset costs, which is expected to increase revenue by PKR 100 billion. Risk-based audits in sectors like apparel and electronics could recover PKR 80 billion, while tax credits for adopting formal payment systems may generate PKR 60 billion. Expanding enforcement teams and monitoring capabilities is projected to add PKR 50 billion, and public awareness campaigns, digital platforms, and simplified tax procedures could contribute PKR 140 billion. Collectively, these measures are expected to unlock an additional PKR 430 billion in revenue for the retail sector.

The wholesale sector plays a critical economic role but remains under-taxed due to widespread tax evasion. Key issues include underreporting of sales, cash-based transactions, fake invoicing, and misclassification of goods to reduce tax liabilities. Weak enforcement mechanisms and low compliance with Withholding Tax (WHT) contribute to the problem. Many wholesalers operate informally, further complicating revenue collection. Proposed interventions for the wholesale sector aim to generate PKR 650-930 billion in additional revenue. Enforcing mandatory registration for wholesalers could contribute PKR 100-150 billion. E-invoicing and enhanced sales monitoring are expected to improve transparency and reduce fake invoicing, generating PKR 200-250 billion. Expanding POS integration for wholesalers could improve VAT compliance and yield PKR 150-200 billion. Strengthening enforcement with AI-driven risk audits and stricter WHT enforcement could add PKR 150-250 billion. Awareness campaigns and formalization incentives are projected to contribute PKR 50-80 billion. These strategies aim to formalize the sector, boost compliance, and improve tax system efficiency.

The real estate sector, a major contributor to Pakistan's economy, is under-taxed due to enforcement loopholes and regulatory gaps, leading to significant revenue losses. The primary issues in this sector include underreporting of property values, the prevalence of benami (concealed ownership) properties, weak enforcement of Capital Gains Tax (CGT) regulations, and cash-based property transactions, all of which enable tax evasion. To address these issues, proposed interventions aim to enhance transparency, enforce compliance, and increase revenue. Market-based property valuation using AI and updated Deputy Commissioner (DC) rates is projected to generate PKR 150-200 billion. A dedicated crackdown on benami properties, leveraging NADRA and SECP data, could yield PKR 100-150 billion. Strengthening CGT compliance, mandating electronic registration of property transactions, and penalizing undocumented transactions could contribute an additional PKR 150-250 billion. Establishing a centralized property database to link NADRA, banks, and provincial revenue boards would improve accountability, adding PKR 50-100 billion. Stricter enforcement of WHT mechanisms and rationalizing tax exemptions, particularly for agricultural land and luxury properties, are expected to generate PKR 200-300 billion. These combined measures could transform the real estate sector into a transparent and substantial revenue source, with an estimated impact of PKR 650-1,000 billion.

The transport sector is also a key component of Pakistan's economy but remains under-taxed due to enforcement gaps and informal operations. Issues include widespread underreporting of income, non-registration of transport businesses, and weak enforcement of Withholding Tax (WHT) mechanisms. Many operators in both passenger and goods transport services evade taxes by underreporting earnings and conducting non-documented cash transactions, reducing transparency and accountability. Tax exemptions for public transport and specific vehicle categories further shrink the tax base. The absence of digital tools for monitoring freight and passenger activities, coupled with vehicle misclassification by large fleet operators, exacerbates tax evasion. Proposed interventions to formalize the transport sector include mandatory registration of all transport businesses and database integration with NADRA, which could generate PKR 50-100 billion in revenue. Implementing GPS-based tracking systems linked to the FBR for monitoring freight and passenger services is expected to add PKR 100-150 billion. Strengthening WHT compliance, mandating electronic invoicing, and penalizing non-compliance could collectively contribute PKR 150-250 billion. Rationalizing tax exemptions and targeting large fleet operators and logistics firms would further broaden the tax base, generating an additional PKR 150-250 billion. These strategies aim to formalize the sector, enhance transparency, and transform it into a substantial revenue contributor, with an estimated impact of PKR 450-750 billion.

In conclusion, addressing these key sectors with targeted reforms, such as formalization, digitalization, and enhanced enforcement, offers a substantial opportunity to reduce Pakistan's tax gap and significantly increase revenue generation across multiple sectors.

Key Question

How can FBR field formations effectively broaden the tax base, reduce revenue leakages, and enhance compliance by leveraging targeted audits, horizontal integration across key databases, advanced analytics, real-time monitoring systems, and robust enforcement of laws, while addressing challenges posed by the informal economy, and under-invoicing to achieve sustainable revenue growth.

ACTION PLAN AND KPI's

Short-Term (0-1 Year)

Goal 01 Increase in Tax base and compliance				
INTERVENTION	ACTION PLAN	EXPECTED BENEFITS	OPERATIONAL ACTIONS	KPIS
Identification and Registration of Unique Bank Account Holders	Link NTN to all Bank Accounts of citizens 18+ and a minimum annual transaction of 0.6 million PKR (taxable income)	5 – 10% of total revenue	Existing 5.3 million *tax-filers* data available with FBR. Unique bank accounts *83* million	a. Bring 500,000 new taxpayers per annum b. Taxpayer growth rate (10%) for field formations
Maintain uptime of IRIS System	Ensure system uptime and implement real-time anomaly detection & public awareness mechanism	Increased Tax payer compliance and reduce processing time	Develop and deploy system upgrades in line with the increase in tax base; Timely communication of information about planned outages	System uptime (target: 99.9%) Planned downtime reduced to 8 hours per annum
Expand Field Operations	Establish 50 new Field Tax Offices in less monitored areas	10-15% increase in tax revenue, compliance, broadening of tax base	Allocate Budget and recruit staff, identify under monitoring areas based on the criteria; Contribution to GDP/Tax	Revenue Growth in New DTO Areas, & New Taxpayer
Goal 02: IT integration and formalization of economy				
Increase in Real Time Integration of Transactions	Mandatory POS integration for Tier-1 retailers and enforcing e-invoicing in key sectors	10-15% increase in revenue and compliance	Deploy POS Systems across outlets, monitor compliance through audits	i. 10% per month as per initial survey PS Integration Compliance Rates ii. 100% E-Invoicing Adoption Rates

				iii. 100% of Digitized Transactions

MEDIUM-TERM (1-3 YEARS)

INTERVENTION	ACTION PLAN	EXPECTED BENEFITS	OPERATIONAL ACTIONS	KPIS
Goal 01: IT integration and formalization of economy				
Strengthen Risk-Based Audits	Develop AI-powered audit systems to identify high-risk taxpayers and sectors.	30% Audit Time Reduction, 30% Audit Success Rate, 30% reduction in number of Random Audits 10% increase in revenue	Start a pilot program target one high-risk sector; Train staff to interpret AI generated audit reports; Awareness programs to increase deterrence	i. 50% AI System Accuracy ii. 25% Audit Coverage Expansion, iii. 10% increase in revenue collected from AI-identified Taxpayers iv. Voluntary assessment
Horizontal Integration of National and Provincial Databases	Integrate data from national and provincial databases such as NADRA, SECP, Banking Sectors, and Excise, etc.)	increase in compliance – 20%, 30% in audit success	Develop a centralized data hub that facilitates seamless real-time integration between different governmental and non-governmental agencies	i. Data Sources Integrated with IRIS – up to 80% ii. Reduction in Tax Evasion through definite information-up to 60% iii. Transparency in tax audits up to 70%
Goal 02: Streamline Tax Revenue				
Litigation Reforms	Establish specialized tax benches and improve legal capacity of FBR.	Reduce case backlog 30-40%, case resolution time by 30%	Propose to setup specialized tax benches in each High Court and Supreme Court for quick and efficient disposal Invest in training of the legal `staff in advanced tax laws etc.	i. Establishment of Specialized Tax Benches ii. Reduction in case backlog iii. Reduce case resolution time

LONG-TERM (3-5 YEARS)

INTERVENTION	ACTION PLAN	EXPECTED BENEFITS	OPERATIONAL ACTIONS REQUIRED	KPIS
Goal 01: Increase Tax Base and Revenue Generation				
Expand Track and Trace Systems	To extend the existing Track and Trace Systems (TTS) to additional sectors –petroleum, textiles, and electronics, food industry etc., to enhance tax compliance, monitor production, curb smuggling, and	10-15% increase tax revenue 25% reduction in smuggling	Begin with a phased integration of these sectors into the existing TTS framework; Mandatory for all manufacturers, distributors and retailers within these sectors;	10% increase Number of Registered units in TTS

	reduce counterfeit goods		Once TTS is fully implemented, monitor the sectors closely to identify trends in tax revenue. Adjust tax rates or enforcement efforts where necessary to further reduce tax evasion	
Goal 02: Investment in Human Resource, Logistics and documentation of Economy				
Increase Cost of Collection (CoC)	Raise CoC to 1% of revenue to fund IT upgrades, enforcement tools, and workforce expansion.	15-20% increase in Tax Revenue	Invest in the FBR's existing IRIS system, ensuring real-time data integration and enhanced user experience; Acquire state of the art equipment like forensic audit software, etc.	20% increase in CoC per annum
Increase Cashless transactions in targeted sectors of Economy	Incentivize digital payments and mandate documentation for cash-intensive sectors like retail.	15-20% increased revenue collection, Taxpayers in retail & hospitality sectors 25%	Provide tax rebates or subsidies for businesses adopting digital payment systems like POS terminals Require businesses in cash-intensive sectors to issue invoices and maintain transaction records as a prerequisite for operating licenses. Encourage consumers to demand digital payments or invoices by offering rewards like cashback, tax credits, or discounts Partner with fintech companies to provide affordable POS devices and ensure reliable digital payment networks.	i.20% Increase in Documented Transactions ii. 20% Digital Payment Incentive Utilization
Goal 3: Capacity Building				
Workforce Expansion and Training	Recruit additional 5,000 staff annually and provide specialized training in IT and enforcement.	200-300 PKR billion Improved tax compliance by 30% Registration of new tax payers- 500,000 per annum	Conduct yearly hiring drives. Develop training modules for specific roles.	i. Number of new recruits (target: 15,000 over 3 years) ii.Training hours per staff.

Potential International and National Events or Developments That Could Destabilize the Proposed Action Plan

The proposed action plan for enhancing Pakistan's tax system through expanding the tax base, leveraging technology and increasing enforcement capacities is highly contingent on stable national and international conditions. However, several potential events or developments could disrupt its implementation:

Foreseeable Events and Their Potential Impacts

Climate Change and Natural Disasters

Pakistan is highly vulnerable to climate change, with frequent floods, droughts, and other natural disasters causing widespread damage to infrastructure and economic activity. For instance, floods like those in 2022 could disrupt operations. The resources at the disposal of field formations may be directed towards unmonitored areas of the revenue generation hubs. Quick decision making through IT interventions can speed up the registration, imposition of taxes and penalties

Political Instability and Security Concerns

A change in government priorities or policy direction could lead to delays or alterations in implementing key actions like rationalizing tax exemptions, integrating databases, and expanding tax office networks. Political instability might also undermine public trust in the tax system, negatively impacting taxpayer registration and compliance.

Likewise, resurgence in terrorism, particularly in conflict-prone provinces like Khyber Pakhtunkhwa and Balochistan, could disrupt the establishment of new field offices and enforcement activities. Security concerns may also deter businesses in affected areas from adopting formal documentation or POS systems, further impeding revenue growth and compliance.

Recommendations

There is an urgent need for the government to broaden the tax base on an emergent basis; given the fact that country is at present heavily relying on foreign injections to meet its annual expenditures. This paper gives following recommendations in this regard:

- "Political will" is the sine qua non to increase the tax to GDP ratio in Pakistan. Unfortunately, in Pakistan political will has been a desire unfulfilled in relation to administrative matters and fiscal reforms. Frequent administrative changes and reforms have been proposed by the bureaucrats and the technocrats in the past but have suffered staled progress because of lack of political will.

- Political Government must ensure that the taxation system is equitable by doing away with all kinds of exemptions allowed to certain powerful lobbies, pressure groups and cartels and help reduce the burden on common tax payers.
- There is a need to define and clearly communicate the vision of our tax policy and exercise strict adherence to it. The principle of equity — both horizontal and vertical — should supersede all other tax objectives.
- There needs to be a strong and effective audit mechanism in place. Voluntary compliance is important. However, results from over-reliance on half-hearted administrative measures to minimise evasion have been elusive. Therefore, voluntary compliance must be backed by robust audits along with stern enforcement against tax dodgers and delinquents. Heightened risk of being caught and associated penalties can be a strong deterrent to concealment and under-reporting of income.
- A serious institutional reform of the FBR is crucially needed. This institution needs to be restructured into a professional, autonomous organisation with an independent board consisting of eminent personalities qualified in the fields of economics, public policy, law, chartered accountancy, finance, business administration, and IT. A change in the incentive structure in FBR will promote a culture of transparency and integrity. Such a restructuring plan is also needed in provincial revenue authorities.
- The following needs consideration on a macro level:
- Corporate tax rate should not be more than 20% including super tax etc.
- Income tax rate should be lowered to a maximum of 10% with an alternate tax of 2% on net wealth exceeding Rs. 100 million, whichever is higher.
- All individuals should be facilitated to file simple income tax returns [no wealth statement]—those earning below taxable limit should be paid income support [negative tax].
- The State must end the culture of appeasement—no more amnesties/immunities giving incentives to the dishonest and penalising the honest. Those who filed but underpaid be offered to make up the deficiency by paying due tax with no penal action/audit. It will yield much more than the target fixed for FBR at Rs. 12.970 trillion.

- For reducing the fiscal deficit to the level of 4% of GDP, it is imperative to (i) curtail unproductive and wasteful expenses by 30%, (ii) increase non-tax revenues by leasing out valuable state lands and assets e.g. palatial government houses, etc. through public auction and for specific activities to generate employment and boost economic activity and (iii) taxes at all levels—federal, provincial and local—should be made simple, low rate, broad-based and payable with ease.
- Instead of being overburdened with advance/heavy taxes/duties/other charges businesses should be facilitated by improving all indexes of 'Ease of Doing Business' and reducing 'Cost of Doing Business'. Tax credits/incentives for investing in human resource development (HDR) and research & development (R&D) to have a qualified workforce in all areas—providing employment to all and paying them as ordained in Article 3 of the Constitution.
- All possible facilities and incentives to all kinds of entrepreneurs/innovators, especially Small & Medium Enterprises (SMEs) to concentrate on innovations, growth, and productivity. The banking sector must be proactive in lending to SMEs and big businesses. Banks are overwhelmingly extending loans to the government considering it as a safe bet. Banking laws need to be amended for quick disposal of disputes as done in many countries.
- Facilities to foreign investors including grant of long-term visas and/or nationality. Many Afghans and Iranians are keen to invest.
- Central data creation/management of all citizens to determine their economic status. There should be universal pensions, and social security/food stamps for the needy, at the same time empowering them to unshackle themselves from the trap of poverty.
- National/provincial legislators should impose simple, predictable, and low-rate taxes—income tax on all incomes including agricultural income should be under the exclusive domain of the federal government, and harmonised sales tax on goods/ services exclusively to the provinces on the basis of goods produced/supplied and services rendered/performed within their territories—it would ensure fiscal consolidation making the country self-reliant.
- We must abolish multiple taxes and collect local taxes e.g. property, vehicle taxes, etc. to meet the needs of local residents by allocating funds to local governments to provide services of health, education, civic amenities of all kinds, recreation, etc.
- Taxation Authorities need technical staff, technological innovation and logistics for working in the field, therefore, Cost of Collection may be increased to cater the issues taxation authorities.

- Currently, Taxation Authorities are understaffing, therefore, more technical staff may be recruited to enhance tax base, strengthen monitoring and increase tax collection.
- Public awareness campaigns be launched on regular basis in order to facilitate the public in understanding the complex tax laws besides emphasizing the positive effects of tax compliance and inculcation of tax culture.

Bibliography

1. Pakistan Economic Survey 2023-24.
2. Ministry of Finance Year Book 2023-24
3. FBR Performance Report 2023-24
4. Ahmed, Khalid, "undocumented economy". Express Tribune, 16 August 2010.
5. Abid Ali Barki, "Budget and Strategy Paper", Journal name (February 2010) p-p
6. Bukhari, Huzaima & Haq, Akram. Income Tax Ordinance 2001, 12th ed. Lahore Law Publications, 2010
7. FBR Quarterly Reports, http://www.fbr.gov.pk/frs/
8. History of Taxation, http://www.incometaxindia.gov.in/HISTORY/PRE-1922.ASP (accessed January 2011)
9. Khatun, Fahmida. "Meeting the Major Targets". Daily Star, July 2010 Khan, Mubarak Zaib, "Low Tax Compliance". Daily Dawn, 17 March 2010
10. Pasha, Aisha Gaus. "Can Pakistan Get Out of the Low Tax-to-GDP Trap?" The Lahore Journal of Economics 15, (September 2010):171-185
11. Tapan K. Sarker, "Incidence of Income Tax in Bangladesh". http:// unpans 1.UN.Org/intradoc/groups/public/documents/UNPAN/UNPAN014405.pdf