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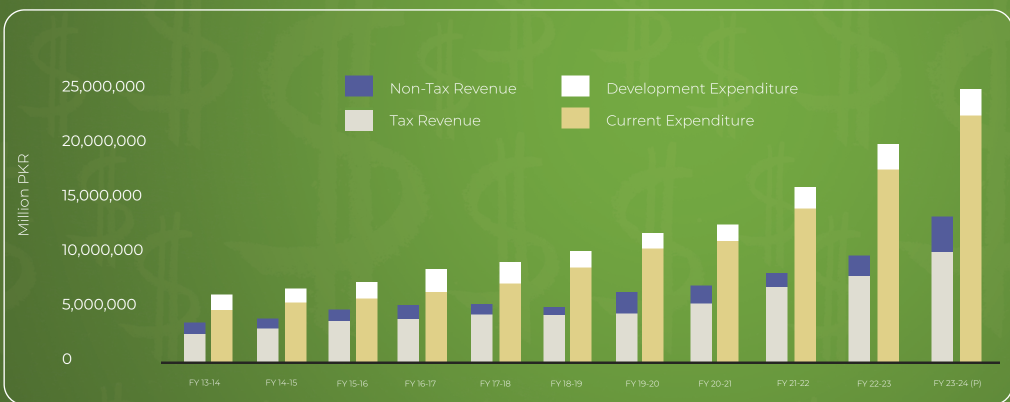
DISCOURSE

BUDGET 2025-26

BUILDING A TRILLION DOLLAR DREAM

Budget Beyond Numbers
A Blueprint of the Nation's Ambition



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Discourse is a quarterly magazine from Pakistan Institute of Development Economics. This issue of discourse focuses on the budget of the financial year 2025-2026 which holds great importance in Pakistan's efforts for an economic recovery after initial stabilization efforts. The Discourse Magazine this time brings together incisive analysis from the leading policymakers, scholars and practitioners, offering a comprehensive analysis and recommendations regarding reform initiatives that must be undertaken in the Fiscal Year 2025-2026.

This issue provides a critical examination of the economy's fiscal side, particularly the taxation policies, debt management, and expenditure rationalisation among others. . Furthermore, it underscores the importance of effective utilisation of development expenditure to extend maximum benefit to the general public and country both.

Without doubt, the Discourse Magazine Budget Issue is a timely effort that brings together research supported ideas and recommendations from experts belonging to various fields and professions at the same place to support the budget making process and upcoming policies for inclusion and consideration in the upcoming fiscal budget.

Together, the contributors of this discourse map out a clear roadmap for policymakers, while also keeping the wider audience informed and stimulating discourse around pressing issues that warrant attention.

We hope you enjoy this issue of Discourse!

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TAX REFORMS IN PAKISTAN: PROGRESS MADE, PITFALLS AHEAD, AND THE ROAD FORWARD

Muhammad Ammad Ansari

INTRODUCTION: THE CRITICAL IMPERATIVE FOR SYSTEMIC REFORM

Pakistan's taxation system stands at a critical juncture in its economic development trajectory. The persistently low tax-to-GDP ratio, which has remained stagnant at approximately 9.1% for the past decade, represents one of the most significant structural weaknesses in the country's fiscal framework. This alarming statistic places Pakistan among the lowest revenue-generating nations relative to its economic size, significantly below regional peers such as India (17%) and Bangladesh (12%). The implications of this fiscal underperformance extend far beyond mere budgetary constraints, creating a cascading effect that undermines economic stability, limits development spending, and perpetuates reliance on unsustainable debt financing.

THE KEY PATHOLOGIES: A STRUCTURAL VICIOUS CYCLE

The roots of Pakistan's taxation crisis are multifaceted and deeply entrenched in the country's political economy. At its core, the system suffers from three fundamental pathologies that reinforce each other in a vicious cycle.

First, the Pakistan's extremely narrow direct tax base, capturing less than 1% of the population (approximately 0.57% in 2023), stands in stark contrast to comparable developing economies, reflecting systemic failures in revenue mobilization. This discrepancy becomes particularly glaring when examining peer nations with similar economic structures and development levels such as India stands at 6.1% of population and Bangladesh at 3.8%.

Second, the Pakistan's tax regime exhibits some of the most severe horizontal inequities observed in modern fiscal systems, creating a distorted burden-sharing mechanism that privileges economic elites while punishing salaried professionals and formal sector entities. This systemic injustice manifests across multiple dimensions of the taxation architecture.

Comparative Burden Analysis

Taxpayer Category	Share of Tax Base (%)	Contribution to Revenue (%)	Effective Tax Rate (%)
Comparative Burden Analysis	0.5	42	15-35
Corporate Sector	0.03	38	29
Agriculture	0.004	0.1	0.01
Real Estate	0.001	0.3	0.05

Third, the Pakistan's tax administration suffers from debilitating institutional weaknesses that actively facilitate tax evasion while discouraging voluntary compliance. These structural deficiencies permeate every level of the Federal Board of Revenue (FBR), creating what the World Bank has termed as a "self-sabotaging revenue system."

Comparative Institutional Metrics

Parameter	Pakistan	India	Bangladesh	Best Practice
Staff per 1k taxpayers	0.4	2.4	1.8	5.0
Digital processing (%)	32	89	76	100
Audit coverage (%)	0.3	3.1	2.4	5.0
Assessment time (days)	240	45	60	70

THEORETICAL FRAMEWORK: PRINCIPLES FOR EFFECTIVE TAXATION SYSTEMS

Contemporary tax theory provides valuable lenses through which to analyze Pakistan's challenges and formulate appropriate policy responses. The optimal taxation framework developed by Nobel laureate James Mirrlees in 1971, emphasizes the need to balance two sometimes competing objectives:

- Economic efficiency (minimizing distortions to productive activity) and;
- Equity (fair distribution of the tax burden).

Pakistan's current system fails on both counts. The proliferation of sector-specific exemptions and preferential treatments creates substantial economic distortions that drive activity into the informal sector, estimated to constitute 35-50% of the formal economy. Simultaneously, the disproportionate burden on formal sector employees and large corporations violates basic principles of horizontal equity, where economic actors in similar circumstances should bear similar tax burdens.

Behavioral economics offers particularly relevant insights for understanding Pakistan's compliance challenges. Groundbreaking research by Luttmer and Singhal in 2014 demonstrates that taxpayer behavior responds not just to enforcement mechanisms and penalties, but fundamentally to perceptions of fairness and reciprocity.

In the Pakistani context, this explains why the extensive network of withholding taxes and punitive measures has yielded limited success in improving compliance while generating substantial resentment among already-compliant taxpayers. The widespread public distrust in how tax revenues are utilized, with only 19% of citizens believing their taxes are properly spent according to recent surveys (PIDE, 2023), fundamentally undermines voluntary compliance regardless of enforcement efforts.

GLOBAL LESSONS: HOW DO OTHER COUNTRIES TRANSFORM? INDIA'S DIGITAL TAXATION REVOLUTION (2017-2023)

India's GST implementation provides the most relevant comparative model for Pakistan. By replacing 17 disparate taxes with a unified system supported by the GST Network processing 5 billion invoices monthly, India achieved remarkable outcomes:

- Taxpayer base expansion from 6.4 million to 14 million entities,
- 12% compound annual growth in collections reaching Rs. 1.87 trillion monthly,
- 20% reduction in small business compliance costs.

The system's automated invoice-matching and AI-driven risk analytics offer particularly valuable lessons for Pakistan's fragmented provincial-federal tax structure.

BRAZIL'S PRESUMPTIVE TAXATION BREAKTHROUGH

Facing informality levels comparable to Pakistan's, Brazil's Simples Nacional program created a simplified regime for 8 million small businesses based on presumed income rather than complex accounting. Results were transformative:

- Compliance time plummeted from 200 to 20 hours annually.
- Collections increased 40% from this segment, proof that reducing administrative barriers can enhance revenue from hard-to-tax sectors.

UNITED STATES' AI-DRIVEN COMPLIANCE SYSTEM

The IRS's machine learning systems analyze 200+ data points per taxpayer, achieving 93% accuracy in evasion detection. This technology enabled targeted enforcement, audit rates for high-income taxpayers rose from 2% to 8% while reducing burdens on compliant filers. The $56 billion in additional

2022 revenue demonstrates the potential of advanced analytics for Pakistan's enforcement challenges.

ARGENTINA'S ELITE WEALTH TAXATION (2023)

Argentina's crisis-response "Solidarity Contribution" imposed a one-time 3.5% levy on million-dollar assets, raising $2.4 billion for pandemic recovery. The success stemmed from integrating 17 government databases and using AI to identify underreported assets, a model for taxing Pakistan's propertied elites who currently contribute minimally.

SWEDEN'S CARBON TAX SUCCESS STORY

Since 1991, Sweden's carbon tax has grown from 26 to 130/ton CO_2 while remaining revenue-neutral through offsetting other taxes. The results are enviable as 27% emissions reduction alongside 78% GDP growth (1990-2020), with renewables now supplying 54% of energy. This demonstrates how environmental taxes can achieve dual objectives. Pakistan's climate vulnerability makes this particularly relevant.

BANGLADESH'S THIRD-PARTY DATA INTEGRATION (2018-2023)

Bangladesh's National Board of Revenue (NBR) transformed compliance by implementing mandatory electronic tax identification numbers (e-TINs) linked to all financial transactions. By integrating 22 government databases including bank accounts, property registries, and utility connections, Bangladesh expanded its taxpayer base from 2.1 million to 7.2 million within five years. The system's automated cross-checking of lifestyle indicators against declared income forced 1.4 million high-net-worth non-filers into the tax net, boosting direct tax revenue by 58% (NBR Annual Report, 2023). This demonstrates how systemic data integration can overcome Pakistan's chronic enforcement gaps.

Comparative Tax Reforms Metrices

Parameter	India (GST)	Brazil (Simples)	USA (AI Audits)	Argentina (Wealth Tax)	Sweden (Carbon Tax)	Bangladesh (e-TIN)	Pakistan Status
Tax Base Expansion	+118% (6.4M-14M)	+8M SMEs	+12M high-income	1.2M HNWIs	N/A	+243% (2.1M-7.2M)	0.57% pop.
Revenue Increase	12% CAGR	40% from SMEs	$56B (2022)	$2.4B one-time	2.1% of GDP	58% direct taxes	9.1% tax/GDP
Compliance Cost Reduction	20% for SMEs	90% time saved	35% for filers	N/A	0.5% admin costs	42% for individuals	Increased 18%
Technology Adoption	GSTN (5B invoices/mo)	Digital presumptive	200+ data points	17 DB integration	Autom. energy tracking	22 DB linkages	14 fragmented systems
Enforcement Rate	3.1% audits	2.8% inspections	8% HNI audits	89% asset verification	100% carbon tracking	92% property checks	0.3% audits
Timeframe	6 years	3 years	5 years	1 year emerg	30-year phase-in	5 years	Stalled
Political Cost	High (trader protests)	Medium (SME lobby)	Low	Very High (elite pushback)	Low (cross-party)	Medium (bank resistance)	Extreme (all lobbies)

PAKISTAN'S TAX REFORM CHALLENGES: PERSISTENT PITFALLS BLOCKING PROGRESS

The Pakistani taxation system presents a paradoxical case of superficial administrative improvements coexisting with deeply entrenched structural deficiencies. While recent digitization initiatives by the Federal Board of Revenue (FBR) demonstrate measurable progress, they constitute merely palliative measures that fail to address the fundamental pathologies plaguing the nation's revenue mobilization framework. This section provides a rigorous analysis of these partial advancements while exposing the persistent institutional and policy failures that continue to constrain Pakistan's fiscal potential.

SUPERFICIAL DIGITIZATION MASKS SYSTEMIC FAILURES

The FBR's much-publicized technological upgrades, particularly the IRIS electronic filing system processing 85% of returns and sector-specific track-and-trace mechanisms, have indeed yielded tangible outcomes. Empirical evidence from the tobacco, cement, and sugar industries reveals a 28% reduction in evasion within monitored sectors (FBR Annual Report, 2023). However, these gains must be contextualized within the broader institutional ecosystem where they remain isolated successes rather than systemic transformations.

The digitization drive suffers from critical limitations:

- Platform fragmentation (14 unconnected IT systems)
- Inadequate analytical capabilities (only 32% automated processing)
- Failure to integrate with provincial revenue authorities

SECTORAL IMBALANCES

Three structural failures fundamentally undermine these administrative improvements:

AGRICULTURAL SECTOR

First, the agricultural sector's continued exemption from meaningful taxation represents a glaring policy failure. Contributing 24% of GDP while generating merely 0.1% of tax revenue (State Bank of Pakistan, 2023), this sector epitomizes the elite capture that distorts Pakistan's fiscal architecture. Provincial governments collected a trivial Rs. 3.2 billion from agriculture in 2022-23, with effective tax rates below 0.01% for large landholdings (PIDE, 2023). This contrasts sharply with regional peers like Indian states that derive 5-8% of revenue from agricultural taxation through progressive land-based levies.

REAL ESTATE SECTOR

Second, the real estate sector operates as a parallel economy, contributing just 0.3% of taxes despite constituting 7% of GDP. The 2022 abolition of capital gains tax, coupled with benami transactions estimated at Rs. 4 trillion annually (KNM Report, 2023), has cemented its status as Pakistan's premier tax haven. Property valuation rates frozen at 2016 levels institutionalize systemic undervaluation.

DIGITAL ECONOMY

Third, the burgeoning digital economy remains conspicuously absent from the tax net. Approximately 5 million freelancers generating $3 billion annually operate in a regulatory vacuum, reflecting the state's failure to adapt to 21st century economic realities. This neglect contrasts starkly with India's 1% TDS on digital transactions and Bangladesh's mandatory e-TIN requirements for online commerce.

INSTITUTIONAL PARALYSIS

The FBR's institutional capacity constraints exacerbate these policy failures. With audit coverage at 0.3% (versus India's 3.5% and Bangladesh's 2.4%), staffing levels at 0.4 officials per 1,000 taxpayers (compared to the 5.0 international benchmark), and average assessment times of 240 days (World Bank, 2023), the administration lacks both the resources and technical capabilities to enforce compliance effectively. Transparency International's 2023 ranking of the FBR among Pakistan's most corrupt institutions further underscores how organizational dysfunction facilitates elite tax avoidance while punishing compliant taxpayers.

POLICY DESIGN FLAWS AND IMPLEMENTATION GAPS

Pakistan's tax reform efforts continue to be undermined by fundamental weaknesses in policy architecture and execution. The over-reliance on withholding taxes has created a counterproductive system, with 227 separate provisions that primarily burden already compliant taxpayers rather than expanding the tax net. This complex web of deductions has fostered an adversarial relationship between the state and taxpayers while doing little to curb widespread evasion. Equally problematic are the excessive exemptions that drain Rs. 1.4 trillion annually from potential revenues equivalent to 4.1% of GDP, with these benefits disproportionately accruing to privileged sectors. Perhaps most glaring is the system's failure to adapt to modern economic realities, as evidenced by its complete lack of mechanisms to effectively tax the burgeoning digital economy, despite 5 million freelancers generating an estimated $3 billion in annual income.

PUBLIC DISTRUST AND COMPLIANCE CULTURE

The erosion of taxpayer morale presents perhaps the most insidious challenge to Pakistan's fiscal reforms. A vicious cycle has taken place, where poor service delivery reinforces perceptions of inequity, which in turn further diminishes compliance. Recent surveys reveal only 19% of citizens believe their tax contributions are being properly utilized for public welfare (PIDE, 2023), while a staggering 82% view the system as fundamentally rigged in favor of economic elites. This crisis of confidence is exacerbated by the grossly disproportionate burden shouldered by the salaried class, which constitutes just 0.5% of the population yet contributes 42% of direct tax revenues. Such glaring inequities have created deep-seated resentment that undermines the social contract essential for sustainable tax compliance, making comprehensive reform not just an economic imperative but a crucial step in rebuilding public trust in governance.

Indicator	Pakistan	India	Bangladesh	Required Benchmark
Audit Coverage (%)	0.3	3.5	2.4	≥5.0
Digital processing (%)	32	89	76	100
Tax Staff per 1M Pop	400	2,100	1,800	5,000
Avg. Case Resolution	8.2 year	1.2 years	2.3 years	≤1 year

WHY PARTIAL REFORMS FAIL

The Federal Board of Revenue's incremental digitization measures, including POS integration and electronic filing systems, have failed to produce meaningful systemic transformation due to several fundamental limitations. These piecemeal efforts remain constrained by the continued protection of elite economic sectors, with no substantive measures implemented to properly tax agriculture, real estate, or wholesale trade.

The overreliance on 227 withholding tax provisions has created a compliance regime that prioritizes coercion over voluntary participation, failing to foster the necessary behavioral shift among taxpayers. Compounding these issues is the FBR's entrenched institutional culture, which remains rooted in patronage rather than meritocracy, actively resisting the professionalization and modernization essential for effective tax administration.

THE PATH FORWARD: BEYOND COSMETIC CHANGES

Achieving Pakistan's target of increasing its tax-to-GDP ratio from 9.1% to 15% demands bold, comprehensive reforms rather than superficial adjustments. The government must first eliminate the structural inequities in the system by implementing progressive agricultural income taxes targeting large landholdings and reinstating capital gains taxation on real estate transactions.

Simultaneously, the FBR requires complete institutional transformation, including its replacement with an autonomous National Revenue Agency modeled after Bangladesh's successful NBR, equipped with artificial intelligence-driven enforcement capabilities. Expanding the tax base through mandatory electronic Tax Identification Numbers linked to property ownership, vehicle registration, and international travel would provide the necessary foundation for broader compliance.

CONCLUSION: A SYSTEM AT BREAKING POINT DEMANDING THE URGENT NEED FOR COMPREHENSIVE REFORM

Pakistan's taxation framework stands at a critical juncture, plagued by structural injustices and administrative deficiencies that render current digitization efforts insufficient. The system's survival depends on confronting the entrenched elite interests that benefit from the status quo, fundamentally restructuring tax institutions, and establishing equitable burden-sharing mechanisms. The nation faces an unavoidable choice between implementing genuine, comprehensive reforms or resigning itself to perpetual fiscal instability and dependence on external financial support. The window for meaningful change is narrowing, demanding immediate and decisive action from policymakers.

True reform requires bold action on three fronts:

1. Eliminating sectoral exemptions through agricultural income tax and restored capital gains tax
2. Replacing the FBR with an autonomous National Revenue Agency
3. Implementing mandatory e-TINs linked to assets and travel

With only 19% of citizens believing taxes are properly spent, the system suffers from a crisis of legitimacy. The choice is clear: either maintain the status quo of fiscal instability or pursue transformative reforms that can achieve a 15% tax-to-GDP ratio. The time for half-measures has passed - Pakistan needs courageous leadership to build a fair, effective tax system worthy of its citizens.

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BUDGET 2025-26: A BUSINESS-GROWTH-ORIENTED STRATEGY

Dr. Nasir Iqbal

Pakistan is once again entering the season of fiscal planning, with the budget for the fiscal year 2025–26 just presented. However, for more than a decade, these budgets have mostly followed a routine pattern—focused more on projecting revenues and expenditures than on delivering transformative reforms. They tend to prioritize maintaining the status quo over introducing meaningful change.

Pakistan is at a critical juncture where in the past routine budgeting will no longer suffice. In this year, there is a need to shift away from the conventional fiscal framework and present a business-growth-oriented budget. A budget that invigorates entrepreneurial aspirations and elaborates the sectors of production even further, unlocking the real potential of Pakistan's economy

Over the course of the past decade, consecutive government budgets have mostly focused on debt payments, military, and current expenditures. There has been very little attention paid to encouraging innovation, providing assistance for small and medium-sized enterprises (SMEs), or generating development that is led by the private sector. However, even though budget expenditures are increasing—from 3.9 trillion Pakistani rupees in 2014–15 to nearly 14.4 trillion Pakistani rupees in 2023–24—the quality of spending and its impact on the actual economy continue to be abysmal. Over the past decade, budgets have consistently followed shifting themes, from infrastructure development to fiscal tightening, but have lacked a coherent long-term reform strategy focused on business-led growth. The table below summarizes the key focus areas of each budget since FY 2014 -2015.

Table 1 Key Focus Areas of Federal Budget from 2015 to 2025

Fiscal Year	Key Focus
Budget 2014-15	Energy sector reforms, tax base expansion, and infrastructure development.
Budget 2015-16	CPEC investments, tax reforms, and social safety nets (BISP allocations increased).
Budget 2016-17	Infrastructure (CPEC projects), agriculture subsidies, and FBR reforms.
Budget 2017-18	Election-year budget with tax relief, higher PSDP, and energy projects.
Budget 2018-19	Austerity measures, IMF negotiations, and fiscal consolidation.
Budget 2019-20	IMF-backed reforms, tax hikes, social protection (Ehsaas Program).
Budget 2020-21	COVID relief, healthcare boost, and stimulus packages.
Budget 2021-22	Growth-oriented budget, Kamyab Jawan Program, and tax incentives.
Budget 2022-23	Flood relief, IMF conditions, and fiscal tightening.
Budget 2023-24	Austerity, tax hikes, and IMF deal compliance.
Budget 2024-25	Economic stability and growth, fiscal consolidation, efficient use of Public Money, improving balance of payments, revitalizing private sector,

Source: Pakistan Economic Survey (Various Editions)

A quick look at budget trends over the last ten years shows where our priorities are. The table below presents yearly allocations as percentages of total budget outlays from FY2015 through FY2025. What stands out is not just what is included, but what is left out: The sharp fall in education allocation—1.5% in FY2015 to 0.5% in FY2025—underscores misplaced priorities. Health expenditure is even worse, remaining at 0.1-0.3%. In return, more than 60% of the federal budget is eaten up by defense and debt repayment. Such a composition has made the budget a growth-retarding rather than growth-stimulating instrument.

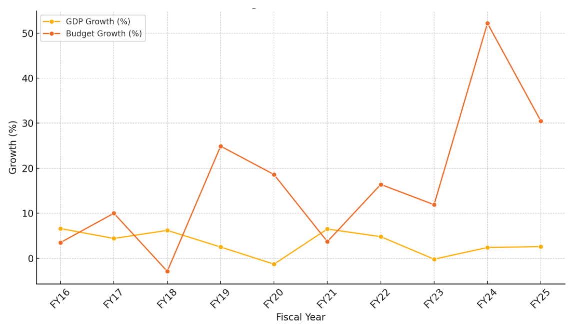
Table 2 Yearly allocation as percentage of total budget outlay (2015 - 2025)

Year	Total Budget (PKR Trillion)	Defence	Debt Servicing	Education	Health	Subsidies	Social Protection
FY15	4.30	16.3%	30.8%	1.5%	0.2%	4.7%	0.04%
FY16	4.45	17.6%	28.8%	1.7%	0.2%	3.1%	0.04%
FY17	4.89	17.6%	27.8%	1.7%	0.2%	2.9%	0.04%
FY18	4.75	19.4%	28.7%	1.9%	0.3%	2.9%	0.04%
FY19	5.93	18.5%	27.3%	1.6%	0.2%	2.9%	0.04%
FY20	7.04	16.4%	41.1%	1.1%	0.2%	3.9%	2.71%
FY21	7.29	17.7%	40.4%	1.1%	0.3%	8.8%	3.17%
FY22	8.49	16.2%	36.0%	1.1%	0.3%	8.0%	3.01%
FY23	9.50	16.5%	41.6%	1.0%	0.2%	7.0%	3.90%
FY24	14.46	12.5%	50.5%	0.7%	0.2%	7.4%	3.32%
FY25	18.88	11.3%	51.8%	0.5%	0.1%	7.2%	3.22%

Source: Pakistan Economic Survey (Various Editions)

Even with large increases in budgetary allocations over the last decade, Pakistan's economic growth has been uneven and largely unresponsive. A comparison between GDP growth and budget growth shows a wide divergence—years of high budget growth did not coincide with higher GDP growth. For example, the federal budget grew well above 52 percent in FY24 with only modest 2.4 percent GDP growth. More examples: the budget increased by almost 19 percent in FY20 and the economy contracted by 1.3 percent; more again, the economy grew 6.5 percent in FY21, but the budget grew only 3.7 percent. Such data points imply that greater fiscal outlays are not being converted into actual economic development. The key problem is the way the budget is set up: a big part is used by unproductive spending like paying off debts and security, which leaves little room for putting money into sectors that improve growth— such as human capital, new ideas, and industrial productivity.

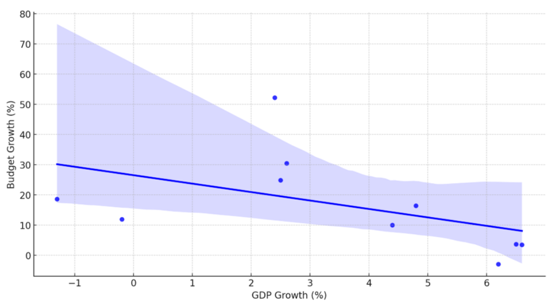
GDP Growth vs Budget Growth in Pakistan (FY16-FY25)



Source: Pakistan Economic Survey (Various Editions)

The analysis reflects a negative correlation of about -0.48 between GDP growth and budget growth over the last 10 years in Pakistan. It means there is no evident or positive correlation between the size of the budget and economic growth. More so, in many years when the budget grew significantly, GDP growth stagnated or even declined — indicating that most of the times, the budget has not functioned as a growth engine.

GDP Growth vs Budget Growth Pearson Correlation: -0.48



The disconnect between budgetary expansion and GDP growth shows a fundamental flaw in how fiscal priorities are set and executed in Pakistan. Each year, public finances have grown in size, but spending remained inward – looking (internal government operations and short-term obligations). Which further substantiates the argument for a budget design that is reoriented toward productivity, private sector facilitation, and human capital investment—rather than merely expanding fiscal outlays without impact.

A business-as-usual approach has failed to translate contemporary budgeting exercise into meaningful economic outputs. This neglect is most visible in the limited support for small businesses and startups despite their critical role in employment generation and value creation. Pakistan's growing population, especially its youth and women, holds significant entrepreneurial potential which at present is dead capital. To unlock it and shift from fiscal expansion to real economic transformation, the budget must begin to directly empower those who drive innovation and productivity. To that end, we propose five key shifts:

Firstly, reassign at least 2% of the federal budget to a "Business Innovation Fund/Innofund" for SMEs more women and youth entrepreneurs. The main barrier is access to finance; currently, only 6% of Pakistani SMEs have bank loans. This fund shall put forth interest-free micro-investments and technical support. Models like Rwanda's Youth Connekt or Bangladesh's SME Foundation offer viable blueprints.

Secondly, remove the red tape and instead roll out the red carpet for businesses. Initiate a "One-Click Business Registration Portal" for all parts of the country, linked with NADRA and FBR, only requiring CNIC and bank details. Eliminate NOC regimes and departmental approvals; startup costs can be reduced by 70% along with the time taken—Georgia's business reform model demonstrates this and pushed it into the top 10 of the World Bank's Ease of Doing Business Index.

Third, introduce a special tax regime for new businesses with a three-year tax holiday and simplified tax return. Countries like Vietnam and Turkey have used such incentives to incubate a vibrant startup ecosystem and attract FDI.

Fourth, set up "Business Growth Zones" in every district having co-working spaces with digital infrastructure plus tax facilitation counters next to logistics support. Utilizing existing public sector buildings like schools after-hours or Basic Health Units for training as well as incubation centers would further develop these zones—akin to the earlier proposed Village Economic Zones model.

Fifth, harmonize fiscal and monetary policies to realize pro-growth outcomes. For instance, with inflation now less than 4% and interest rates having fallen from 22% to 11%, the forthcoming budget should indicate a unified fiscal-monetary stimulus. This should include guidelines on how to direct public expenditure towards sectors that enable exports—IT, agriculture, green energy. Pakistan can gain from regional trade if barriers are removed and logistics streamlined.

This reorientation has been shown to have a number of different advantages. Studies conducted by the International Monetary Fund and the World Bank indicate that reforms aimed at small and medium-sized enterprises (SMEs) in East Asia contributed more than forty percent to the increase of the GDP between the years 2000 and 2020. Currently, India's startup ecosystem is responsible for contributing $100 billion to the country's economy. This contribution is driven by public investments in digital infrastructure and laws that are favorable to startups. Pakistan is able to follow a similar path by establishing key performance indicators (KPIs) in the budget for the fiscal year 2025–2026. These KPIs include the creation of one million new formal employment, the reduction of the regulatory burden on small and medium-sized enterprises (SMEs) by 50%, and the expansion of exports by 20%.

This budget must not be an accounting exercise. It must be a growth manifesto.

Dr. Nasir Iqbal is an Associate Professor at Pakistan Institute of Development Economics (PIDE) specialising in areas of Social Protection, Governance and Poverty. He is also serving as the Registrar at PIDE.

INCENTIVES OR ILLUSIONS: THE COST OF TAX TREATY IN PAKISTAN

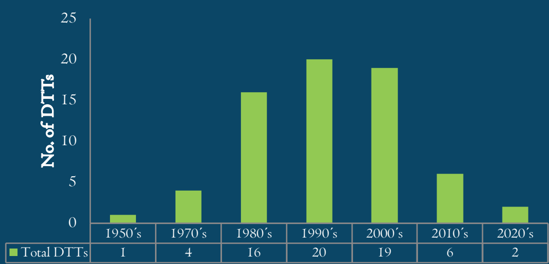
Karishma Kiran

In today's globalized economy, countries are in constant competition to attract foreign investment, stimulate economic growth and integrate globally. To address this, after WW-II developed countries came together and created an international economic agreement designed by developed countries which is built upon two type of agreements; International Trade Agreements (ITAs) and Double Taxation Agreements (DTAs). These were intended to support the flow of investment, promote exports and fairly divide taxing rights between countries. These instruments, particularly double tax treaties, have become a popular tool to reduce tax related barriers and provide certainty to foreign investors. The underlying assumption is simple, if investors are protected from being taxed twice on the same income, they will be more willing to invest across borders. Over the past few decades, both developed and developing countries have actively signed these treaties, expecting to boost the foreign direct Investment (FDI), create jobs and accelerate economic growth. These agreements are e.

a debate for researchers, some have suggest that double tax treaties are eroding the domestic tax base of developing countries while others have concluded that double tax treaties promote development, encourage investors to invest and thereby expand the tax base[1].

Internationally there are more than 2500 International Investment Agreements (IIAs) in effect. This includes over 300 bilateral treaties and also contains important rules and protections related to investment. In this connection, Pakistan may also list and adopt these treaties and is a useful case to study because it signed many international economic agreements quickly during 1980s, 1990s, 2000s and 2010s. Interestingly, Pakistan signed the world's first ever investment agreement with Germany in 1959. It was one of the first developing country to sign tax treaties with major powers like UK and then with USA and so on. Infact, Pakistan was the first developing country to sign a treaty with the United States. However, this rush may have come with a cost. It is believed that due to these agreements, Pakistan bears a significant loss and this loss is linked to tax base erosion, tax evasion and illegal movement of money, called illicit financial flow by multinational companies operating in the country[2]. Such studies clearly highlight that the majority of developing countries are now generally thought to have entered into these treaties without first going through a cost-benefit analysis and without become integrated into or associated with broader macroeconomic structure.

Decade-Wise Data of Pakistans DTTs

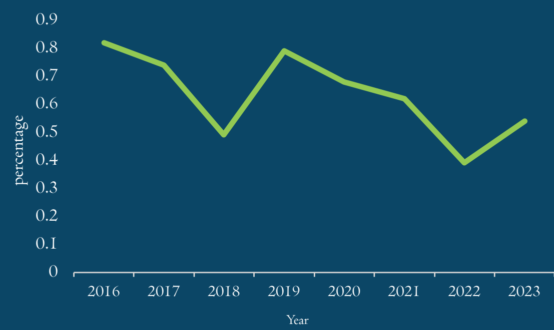


Source: FBR

So far, Pakistan has signed 68 DTTs with the expectation that these agreements would bring in foreign investment and contribute to the country's economic growth. However looking at the outcome so far, these goals have not been achieved and have created loopholes that are being misused. For example the domestic investors, in the hope of gaining some incentives, send their capital abroad through any illegal sources or shelf companies and then bring it back into home countries as indirect FDI known as Round tripping FDI. They often invest this money in brownfield projects, allowing them to claim tax benefits meant for genuine foreign investors. As a result, the government gains nothing from such arrangements and continues to face a growing budget deficit and during the period for making policies of trade liberalization amounting to $30 billion capital flight takes place[3].

In many developing countries, including Pakistan, a lack of proper record-keeping makes it challenging to distinguish between value-seeking investments which contribute to growth and rent-seeking investments, which may lead to revenue loss. In 2023, Pakistan's FDI-to-GDP ratio stood at 0.54%, up from 0.39% in 2022. However, this ratio remains relatively low compared to India, which had an FDI-to-GDP ratio of about 1.5% in 2022 and 2% in 2023, as shown in the figure below.

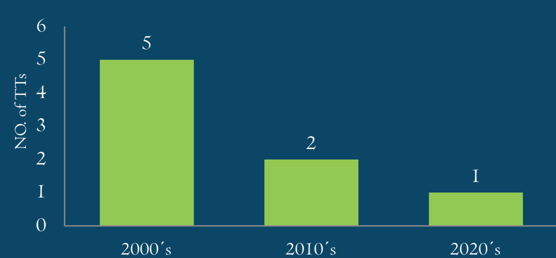
FDI to GDP Ratio



Source: Global Economy

There are two distinct concepts at play, trade and tax treaties. It is a common misconception that both serve the same purpose. In reality, they are designed for different economic objectives. While both may involve the use of tax rates as a tool, trade treaties primarily focus on reducing tariffs to promote the exchange of goods and services, whereas the tax treaties aim to eliminate double taxation to encourage cross border investment and promote easy of doing business. Since early 2000, Pakistan participation in ITAs is steadily proceeding. In 2004, Pakistan has joined the South Asia Free Trade Area (SAFTA) along with Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal and Sri Lanka. This marked a significant step in economic integration efforts. Subsequently Pakistan has operationalized its FTA with Sri Lanka in 2005, followed by the Pakistan-Iran PTA, which became effective on September 2006. The trend continued with the signing of PTAs with Mauritius on July 2007. During this period, Pakistan also engaged in negotiation with china. Below the graph provides a decade wise ITAs Pakistan sign.

Decade-wise Trade Treaties



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This distinction between trade and tax treaties become even more important in light of rising concern over the abuse of tax treaties, particularly by multinational enterprises engaging in treaty shopping, tax avoidance and profit shift to low tax jurisdictions. To address these challenges, the Organization for Economic Corporation and Development (OECD) launched the Base Erosion and Profit Shift (BEPS) initiative. This global reform aims to close the loopholes in international tax rules and minimum corporate tax rate of 15% reducing the incentives for companies to shift profit to tax heavens to avoid paying taxes. The OECD inclusive framework on BEPS is a global platform established in 2016, for cooperation and collaboration on international tax matters to try and improve global tax problems and the framework was created as a way for countries to work collaboratively on solution. One of the key elements of the BEPS action plan is the Multilateral Instrument (MLI), which seeks to update existing tax treaties in line with new anti-abuse standards. For developing countries like Pakistan which has signed a large number of bilateral tax treaties over the decades without computing their benefits and the BEPS framework offer both a challenges and opportunities. On one hand it exposes the vulnerabilities in Pakistan tax treaty network and other side, it provides a framework to renegotiate outdated agreements and protect the domestic tax base more effectively.

As a part of its commitment to international tax reform under the BEPS framework, Pakistan became a signatory to the Multilateral Instrument (MLI), allow updating and aligning its existing tax treaties with international standard aimed at preventing treaty abuses. Through the MLI, 21 of Pakistan's bilateral tax treaties have been brought under the new global standards, particularly to limit treaty shopping, strengthen anti-abuse provisions, and improve dispute resolution mechanisms. The BEPS framework is not necessarily easy for developing countries to adopt, even though it includes a well define 15 point action plan because BEPS action requires technical expertise, legal reform, administrative capacity and international negotiation skills, which developing countries often lacking.

In the race to attract foreign investment, developing countries like Pakistan have embraced international tax treaties with high expectations but often without fully assessing their long-term consequences. Rather than delivering sustainable economic growth, these agreements have opened doors to tax avoidance, capital outflows, and abuse by both foreign and domestic actors. This paper sheds light on how Pakistan's rapid and extensive adoption of such treaties, absent strong oversight and strategic alignment, has weakened its tax base and distorted investment incentives. By contrasting trade and tax treaties, and examining global corrective measures like the OECD's BEPS framework and the Multilateral Instrument (MLI), the analysis calls for a more cautious, evidence-based, and reform-oriented approach to international tax policy, one that protects national interests while engaging with the global economy on fairer terms.

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REVISITING THE BUDGET CYCLE: FIXING THE FOUNDATION FOR FISCAL DISCIPLINE

Hasnat Ahmed

Pakistan's fiscal stance has long been marked by persistent deficits, rising debt and underfunded priorities. A robust budget process from realistic formulation through disciplined execution and transparent oversight is essential for fiscal stability. Yet Pakistan's budget cycle suffers from deep structural flaws. Recent analyses highlight chronically low revenue, rigid expenditure, and systematic slippage in annual budgets[1]. This article dissects the problems in Pakistan's budget formulation, execution and monitoring stages, examines how political pressures distort fiscal decisions, and draws lessons from successful reforms in other countries. We then propose evidence-based reforms from stronger parliamentary scrutiny to independent fiscal institutions to rebuild Pakistan's budget foundations and restore discipline.

PROBLEM ANALYSIS

FORMULATION: UNREALISTIC TARGETS AND WEAK FORECASTS

Budget formulation in Pakistan has historically been process-driven rather than data-driven. Governments often set overly optimistic revenue targets and politically influenced spending plans. Tax policies remain complex, poorly administered, and prone to ad hoc changes, fueling a culture of evasion[2]. The result is that revenue projections repeatedly fall short of targets, forcing unplanned borrowing. For example, the IMF finds that budgeted revenue has consistently been overestimated, even as expenditure forecasts are underestimated[3]. As a result, the fiscal deficit has overshot original plans by an average of 25% over FY2017–23[4]. In short, Pakistan's budget books often assume away fiscal constraints rather than set them.

Part of the problem lies in the institutional set-up.

The Finance Division and related units are fragmented and understaffed, with limited macro-fiscal expertise. The World Bank/IMF Public Financial Management review notes that the Budget Wing "had little capacity to scrutinize" spending proposals, so most are accepted without challenge[5]. Pakistan's budget "call circular" the instructions sent to ministries is notably less comprehensive than those of peer countries, often omitting macroeconomic assumptions, spending limits, or strategic goals. One IMF study tabulates that India, Sri Lanka and Kenya include fiscal context and medium-term projections in their circulars, whereas Pakistan's circular contains none of these elements[6]. Without a strong top-down framework, each ministry submits wish lists that go unchecked.

Politicians also drive a lot of the content. Budgets are inevitably shaped by election-cycle concerns and power-sharing agreements. During elections, parties pressure governments to introduce populist subsidies, pay raises, and projects with little regard for affordability. The result is short-term pandering and last-minute revisions. Moreover, successive finance ministers have prioritized sectoral allocations according to political influence rather than long-term economic rationale. This politicized approach corrupts budget credibility: rather than adhering to a multi-year fiscal strategy, budgets become episodic compromises. One analyst notes that "expenditure ceilings in Pakistan's budget are revised frequently, with the executive taking extraordinary latitude to approve supplemental spending without prior parliamentary approval[7]".

Technocratic forecasting bodies (e.g., the Erstwhile Planning Commission or now the Ministry of Planning and Development) have limited influence. Macroeconomic assumptions often reflect a dream. For instance, growth and revenue projections assume high growth rates and tax buoyancy even as structural constraints persist. The IMF report stresses that domestic revenue forecasts are significantly overestimated, pointing to "systematic interference with the forecasting model" that undermines tax collection performance[8]. Put bluntly, Pakistan's budget estimates often ignore historical patterns and avoid setting tight fiscal targets. This chronic over-optimism in the planning stage ensures that expenditure plans are not grounded.

EXECUTION: SLIPPAGES AND UNCHECKED SPENDING

Even when a budget is passed, Pakistan struggles to stick to it. The execution phase is undermined by rampant in-year deviations. The most glaring symptom is the runaway use of supplementary grants. Under Article 84 of the Constitution, the government may sanction additional grants from the Consolidated Fund during the year. In practice, this provision has allowed massive overruns. IMF analysis shows that in FY2023 supplementary and technical grants exceeded 50% of the original budgeted spending[9]. In other words, more than half of what Parliament approved of spending was later increased through executive decree.

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The figure below illustrates this execution laxity. In each year from FY2016–17 to FY2022–23, actual domestic borrowing (grey bars) far exceeded the original budget projections (red bars). Pakistan routinely needed far more financing than planned, and thus often rolled out new spending beyond what the budget allowed .

These overruns occur through various channels. Supplementary grants are used not only for true emergencies (e.g., flood relief, energy subsidies) but also for recurrent expenditures and development spending that was omitted or cut during budget drafting. The IMF reports that in FY2023 some Rs 1,910 billion (22% of the budget) was added via such grants . Development projects are especially vulnerable: the IMF's "Figure 5" table shows federal PSDP (development) estimates repeatedly slashed mid-year, while the freed resources bolstered current outlays (like debt servicing and subsidies) . Thus, the government "frontloads" current spending and defers development, further weakening long-term growth prospects.

Beyond grants, arrears and off-budget spending further erode discipline. Delays in releasing funds and under-execution of development budgets have led to large unpaid bills. Ministries and state-owned companies often accumulate payments arrears, but these too are eventually honored through supplementary financing or circular debt accumulation. In effect, budget ceilings become porous: what was not spent on one program is later re-allocated to another without parliamentary scrutiny.

The cumulative effect is that budget credibility is extremely low. Despite frequent revisions and emergency spending, Pakistan's fiscal outcomes are still worse than planned. Debt service now consumes 40–60% of budgeted revenue , crowding out development and social spending. In FY2022–23 alone, interest payments reached Rs 7.3 trillion (40% of government revenue) . In practical terms, the government routinely breaks its own budget rules. The IMF highlights those key constraints such as the existing cap on fiscal deficit in the Fiscal Responsibility Law have been routinely violated, necessitating another IMF program.

MONITORING AND OVERSIGHT: WEAK SCRUTINY

The third link in the cycle is oversight. Here, too, Pakistan falters. Parliament's role in budgeting is formally strong on paper, but weak in practice. The National Assembly votes on the Budget and is supposed to hold the government to account. Time for debate is often too short (sometimes only a few days), and by convention MPs do not alter the budget in substance. The parliamentary committees meant to examine budget proposals are under-resourced and often bypassed[15]. One expert explains that threats of party-discipline dismissals (Article 63A) effectively prevent members from voting independently on money bills, leaving "heads of political parties with tremendous control"[16]. In short, the legislature rarely edits the budget's content.

Further, post-budget scrutiny is lax. The Auditor General prepares annual reports identifying misuses and discrepancies, but follow-up is minimal. The Public Accounts Committee (PAC) meets irregularly, and its recommendations are seldom enforced. In the one example with clear political overtones, the Supreme Court forced the government to release election funds via supplementary grant, yet this was portrayed by insiders as the executive "using parliament to protect itself"[17]. Parliament agreed afterward, but only after that fact. This episode underscored that Pakistan lacks a strong ex-ante check on budget amendments: even the highest court resorted to post facto approval.

Moreover, budget information is not sufficiently transparent. While the Finance Division releases budget documents, the data is dense and often arrives late. There is no regular forecast comparison in the public domain; budget strategy papers are often limited to one year (until very recently) and the Medium-Term Fiscal Framework is not fully credible. Civil society and media analysis play some role, but with low civic engagement most citizens are unaware of detailed budget mechanics. In short, Pakistan has far to go before achieving the level of budget transparency and scrutiny expected of emerging economies.

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POLITICAL VS. TECHNOCRATIC DYNAMICS

Underlying these weaknesses is the balance of power between politics and technocracy. Pakistan's parliamentary system has historically strengthened the executive's dominance over fiscal matters. As one analysis notes, the budget process "is dominated by the Executive and the federal bureaucracy," a carryover of colonial administrative traditions and the nature of the coalition government[18]. In contrast to presidential systems (where an independent budget office or legislative veto might balance the executive), Pakistan's parliament is subordinate to party leadership. Indeed, recent Supreme Court interpretations of party-whip rules (Article 63A) ensure that even dissenting MPs cannot block budget votes[19]. As a result, the finance ministry and cabinet typically set the numbers, with limited pushback from politicians.

This dynamic means that fiscal policy often follows political incentives rather than technocratic advice. Politicians prefer visible spending (roads, subsidies, pay hikes) to unpopular tax reforms or spending cuts. The bureaucracy, trying to safeguard its share of the pie, tends to acquiesce. Attempts at long-term planning (such as the Medium-Term Budget Framework introduced in 2019) struggle to take hold when every new government reshuffle priority. By contrast, true technocratic decision-making like evidence-based project screening or strict fiscal rule compliance – is weak. The result is that budget outcomes reflect short-term political bargaining as much as they reflect macroeconomic realities.

A telling critique is that Pakistan's budget contestation is minimal. Ministries push for more resources, but almost none of their proposals are cut back. Even the Budget Wing of the Finance Division lacks the technical staff to challenge unrealistic requests[20]. In well-functioning systems, a consolidated budget office or fiscal council would vet assumptions and moderate political pressures. Pakistan lacks such counterweights. If anything, when disagreements arise, the solution has often been just to add another supplementary grant rather than to revise assumptions or enforce limits.

In sum, Pakistan's budget cycle is skewed toward politics and ad hoc fixes. Technocratic governance – with rigorous forecasts, spending reviews, and rule enforcement – is too weak to offset the executive's prerogatives. Without a stronger balance, the fiscal foundation remains fragile: as governments yield to political stimuli, budget credibility erodes.

POLICY SOLUTIONS

Based on the above analysis and international lessons, Pakistan should undertake a multipronged reform of its budget cycle:

Strengthen Budget Formulation: Reform the call circular and budgeting guidelines to require realistic macro assumptions and medium-term ceilings. The Finance Division should be reorganized into a unified Budget Office with sectoral teams – a structure common in advanced systems[21] so that technocrats challenge proposals. Building capacity for robust macro-fiscal modeling (e.g., better revenue forecasting tools) is essential. The IMF technical assistance recommends leveraging digital systems (e.g., integrated fiscal management information systems) to support real-time projections[22]. Pakistan could also formally adopt a multi-year budgeting framework (expanding the recently introduced Medium-Term Budgetary Framework) with binding targets on deficits and debt paths.

Rein in Execution Slippages: The use of supplementary grants must be curbed. One practical step is to amend Article 84 to require prior legislative approval for any supplementary grant that alters the total expenditure[23]. The Dawn editorial suggests such a move, noting that the current wording gives the government "almost unlimited power" to spend from the Consolidated Fund[24]. In parallel, Pakistan should pursue stricter commitment controls: setting hard ceilings on spending categories and enforcing "no-bailout" rules for departments that overspend without cuts elsewhere. Experience shows that establishing a Treasury Single Account (already underway) and improving cash management can prevent the accumulation of unauthorized borrowings. To minimize ad hoc bypasses, the practice of rolling old budget surpluses into new obligations should be replaced by transparent contingency reserves. In effect, emergencies should be built into budget planning (with an explicit small buffer) rather than patched later.

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Empower Parliamentary Oversight: Pakistan's National Assembly must reclaim its budgetary authority. The parliamentary Standing Committees on Finance should be given more time and support to examine the budget. This could include hiring independent analysts for MPs and holding pre-budget hearings with ministries. "Ex-ante scrutiny" mechanisms – whereby Parliament approves significant changes before they are implemented – should be introduced. For example, any reallocation exceeding a small percentage of a ministry's budget would trigger parliamentary debate. Such rules would deter dubious reallocations. The Dawn analysis even suggests requiring the executive to get a vote on any supplemental budget beforehand, except in true emergencies[25]. In short, moving from post-facto ratification to pre-approval (as practiced in Ireland and South Africa for large shifts) would restore accountability.

Establish an Independent Fiscal Council (IFC): Pakistan lacks an impartial body to assess fiscal policy. An IFC or Parliamentary Budget Office (like Chile's IFC or the UK's OBR) would provide nonpartisan analysis of budget proposals and economic forecasts[26]. For example, the IFC could regularly publish its own growth and revenue estimates alongside the government's and evaluate adherence to fiscal rules. Independent counsels help curb over-optimism and inform the public debate. Given Pakistan's varied economic shocks (security costs, climate disasters, commodity swings), an IFC could also develop structural balance estimates to guide stabilization.

Promote Transparency and Accountability: Budget documents should be more accessible. Summary reports, contingency funding, and mid-year reviews ought to be published promptly. Strengthening the Auditor General's office and ensuring that its reports are debated in Parliament will improve post-budget accountability. Furthermore, link fiscal allocations to performance: introducing program budgeting (with clear objectives and outputs) can help Ministries justify spending based on results, making it harder to claim funds for unfunded mandates.

Cultivate Political Consensus: Reforms must overcome entrenched incentives. Political leaders need to commit to a long-term fiscal strategy. This may require a broad political consensus on the rules – for instance, cross-party support for the Fiscal Responsibility Act – akin to the bipartisan backing Chile's rule enjoyed. Public engagement and media scrutiny can also bolster this consensus: if voters appreciate the importance of fiscal balance, they may pressure parties to resist wasteful spending.

institutions; Indonesia shows that a well-run calendar and active committees can professionalize budgeting. Pakistan's leaders must break the cycle of crisis and compromise. Embracing strict fiscal discipline – by reforming the budget process itself – is the first step toward sustainable growth and fiscal health.

CONCLUSION

Pakistan's chronic fiscal instability stems from a broken budget cycle. Fixing the foundations – namely, making budgets realistic, execution transparent, and oversight effective – is imperative before other reforms can succeed. The challenges are great: vested interests resist limits, and short-term politics often dominates. But as the international evidence shows, even difficult reforms can take root when professionally designed. Chile and Ghana teach that legal fiscal rules must be backed by monitoring institutions; Indonesia shows that a well-run calendar and active committees can professionalize budgeting. Pakistan's leaders must break the cycle of crisis and compromise. Embracing strict fiscal discipline – by reforming the budget process itself – is the first step toward sustainable growth and fiscal health.

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PENSIONS CRISIS IN PAKISTAN: A FAILURE OF PUBLIC POLICY REFORMS

Dr. Shujaat Farooq

Many nations still have welfare plans and systems that offer financial assistance to different facets of society, such as those experiencing unemployment, old age, or disability. Providing financial stability to sustain a fair standard of life during the retirement or unemployed time is the major goal. The majority of pension plans are financed by employer contributions or by the mandated savings of individuals [1].

The Constitution of Pakistan declares that the state will promote the social and economic wellbeing of citizens. Accordingly, as listed in sub-article (C) "to provide for all persons employed in the service of Pakistan or otherwise, social security by compulsory social insurance or other means". The same has been mentioned in National Commission for Government Reforms (NCGR) 2015 "to grant of a living wage and compensation package, including decent retirement benefits to all civil servants" [2]. However, pension facility in Pakistan is available to only a limited number of public sector employees as a vast majority of the population (90%+) is working in the private sector and majority of them are in the informal sector. The old-age income support coverage (i.e., pensions, health and/or social security insurance) is only 6% in Pakistan, much lower than the 20.3% average of developing economies [3].

The Employees' Old-Age Benefits Institution (EOBI) offers public sector employees a tax-based (DB) defined-benefit plan and a contributory system for the private sector. However, in a nation with a labor force of over 75 million, only 8 million private employees are registered under EOBI. According to census data, around 3 million persons get EOBI pensions, and government-sector pensions cover about the same percentage of the elderly; the overall coverage for individuals over pension age varies between 7 and 10% [4]. Pakistan's demographic transition may result in a 4% GDP reduction as pension spending moves from 1.2% to 3.5% of GDP due to increasing fiscal deficits and taxation.

A pay-as-you-go (PAYG) plan, in which working people pay for retired pensions, is more costly as the reliance ratio increases [5].

Changes in demographics, disparities in funding, and systemic inefficiencies have put Pakistan's pension system in a precarious position. Longer life expectancies, an older population, and defined-benefit public-sector pensions have all contributed to the existing system's vulnerability. What was once a manageable budgetary strain is now a potential source of new sustainability concerns, calling for quick and extensive changes. Pension reform in Pakistan is quickly becoming an economic and social imperative, despite its polarizing nature. This article provides an analysis of the pension system, looks at recent policy changes, compares it to similar models in other countries, especially developed ones, and then uses that information to create data-driven suggestions.

PAKISTAN'S PUBLIC SECTOR PENSION FRAMEWORK AND CRISES

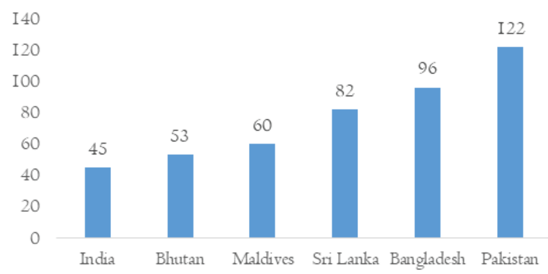
After independence, the country opted the underlying principles of the civil-service pension from the British Pension's Act 1871 that protect the rights of pension and gratuity of civil servants working in the federal and provincial governments. Subsequently various South Asian countries made reforms. For example, India introduced reforms in 2004 by adopting a defined contribution scheme for new recruitment, and facility was extended for the private sector employees in 2009. A similar reforms were adopted by Maldives in 2009 [6].

Despite Pakistan's best efforts, no significant reforms have materialized as of yet. An opt-funded pension scheme with a defined employee contribution was proposed by a Pension Review Working Group in 2003, but it was never accepted [7].

A defined benefit mechanism based on non-contribution is still used by the public sector pension system. Pensions and other retirement benefits are guaranteed by the government to employees who do not make personal contributions from their income under this pay-as-you-go (PAYG) system. There is no substantial structure in place to pay the pension from the invested amount; instead, the money is paid straight to the retirees from the tax payers.

Various regulatory frameworks protect the pension rights of civil servants, i.e., the Pension-cum-gratuity Scheme (1954), the Provisions of Civil Servant Act, 1973, and the Liberalized Pension Rule and Ancillary Instructions, 1977. Subsequently, the government made various amendments to revise the pension structures by adding more allowances in pension bill. Resultantly, the country is facing a high gross pension replacement rate—the ratio of pension pension entitlement divided by gross pre-retirement earnings). The utilization of fiscal revenues to pay pensions (both by federal and provincial governments) resulted into never-ending growth in pension expenditure and puts unsustainable pressure on the fiscal accounts, thereby crowding out other social and development priorities.

Gross Pension Replacement Rate in South Asian Countries



Pension spending is increasing at a pace of 25% per year and is now surpassing the PSDP budget, making this ad hoc structure fundamentally unsustainable. Pension funding accounted for almost one trillion dollars in the federal budget for 2024–25. If present trends continue, the pension will consume more than half of all spending by 2050, up from 6-7 percent now. Life expectancy increases, medical allowance additions, and inflation adjustments are among the main sources that will increase the pension bill, which is expected to double every four years. A comparable predicament is also besetting the provinces. The income of the provinces of Punjab and Sindh, for instance, is almost equal to their pension expense. Seventy percent of the Railway's yearly income goes on pensions [2]. The results show that the public financial management system is inadequate, since the economy is growing at a rate of only 3-4% and the tax-to-GDP ratio is low, leading to insufficient revenue generation. In contrast, the budget goes a long way toward funding things like interest payments, pensions, subsidies, and the operation of civil government, so the budget deficit is getting worse.

The Pay and Pensions Commission will review the recent reforms every three years. These reforms include the following: a ban on dual pension eligibility; a change from final pay to a 24-month average for pension calculations; increases only to baseline pensions; and the implementation of digital administration. For new recruits after July 2024, the government also instituted a pilot contributing scheme, which mandates shared contributions from employers and employees, as a precursor to defined contribution (DC). In line with PIDE's demands, experts advise establishing a separate investment board and pension regulatory body. Tier 2 assets would be closely monitored by these groups, and system transparency would be enhanced. Fiduciary management would also be enforced. The current digitization of government pension record-keeping have improved the data integrity for over 300,000 employees. Coverage in the informal economy remains poor, and systemic problems persist despite improvements.

TOWARDS A PENSION REFORM PROCESS

It is already too late to prevent present and future losses because the nation is falling behind in changing the pension obligation. According to the PIDE's findings, if we start the reform process now, it will take two to three decades to contain damages. Government workers' productivity and efficiency have been negatively impacted by the underfunded pension scheme, which has enticed them to quit their jobs. Workers under a defined contribution (DC) system are free to move around within the company, which in turn helps to recruit top talent.

We urge the adoption of the DC scheme by increasing pension coverage for private sector workers based on worldwide experiences. Pension policies must be flexible enough to accommodate shifting demographics, such as longer life expectancies at retirement and indexation systems, and the need to elevate the management of pension funds to a professional level. In order to adapt its population demographics and reduce budgetary risks, Pakistan, like many other industrialized nations, must adopt a complex multi-level framework that offers diverse funding and strong institutions. In order to invest the pension money in a health competition and mobilize domestic resources for investment, the capital market must play a role.

Key Features of Selected Developed Pension Systems

Country	Primary Funding Model	Retirement Age Indexing	Occupational Pensions	Private Pensions	Notable Feature(s)
Germany	PAYG + Mandatory DC/DB	Yes (Life Expectancy)	Mandatory	Voluntary	Jointly funded employer/employee contributions
Sweden	Three-Pillar	Implicit	Mandatory	Voluntary	Notional Defined Contribution (NDC) system
Switzerland	Three-Pillar	No	Mandatory	Voluntary	Strong emphasis on funded occupational pensions
Canada	Pre-funded (CPP) + PAYG	No	Voluntary	Voluntary	Large professionally managed fund (CPPIB)
Netherlands	Three-Pillar	Yes (Life Expectancy)	Mandatory	Voluntary	Extensive industry-wide collective pension schemes

According to local and international experience, Pakistan's pension reform proposal should include:

- Multi-Pillar Mandate: Establish a three-tiered system.
    - Tier 1: Universal Basic Pension.
    - Tier 2: Mandatory employer-employee DC scheme
    - Tier 3: Incentives for voluntary savings.
- Legal Coverage Mandates: Enforce participation in the public and private sectors, including informal economy workers and female contributors.
- Asset Management Oversight: Establish a Pension Regulatory Authority and a separate investment board to manage Tier 2 assets competently.
- Population policymaking: Adjust retirement age, contribution rates, and indexing as needed based on population estimates.
- Transparency and Accountability: Ensure that all public pension systems use accrual-based accounting to accurately reflect actual liabilities
- Financial Transition Strategy: Budget short-term expenses for current pensioners while implementing a funded scheme for new entrants.
- Safety Nets for Unprotected Seniors: Provide a minimum social pension through tax-financed transfers to seniors who do not receive contributing benefits.

Reforming long-standing pension systems is, to put it simply, primarily an institutional and political issue. Reforms that lower benefits or raise contributions will certainly face resistance from public-sector unions, bureaucrats, and retirees from the military. When economic responsibility and justice are compromised in favor of elite advantages, the public becomes furious.

In addition, governments may not have the short-term financial resources to establish the necessary financial buffer to cover current liabilities and future system needs when transitioning to DC networks. Waiting for change will exponentially increase expenses and erode macroeconomic stability, according to PIDE's estimates.

A lot of ground still needs to be covered before we can call the reforms of 2025 a contemporary, strong pension system. An essential part of the reform as a whole is the expansion of coverage, the implementation of contributing mechanisms, the establishment of supervisory agencies, and the alignment of policy with demographic trends. Now that public awareness is on the rise and international examples are providing support, Pakistan has the means and the responsibility to undertake thorough pension reform.

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TAX COLLECTION IN PAKISTAN: ITS CHALLENGES AND ROAD TO IMPROVEMENT

Muazma Hanif

INTRODUCTION

Developing countries frequently struggle to meet their tax revenue targets due to inefficiencies within their tax administrative systems. This study identifies several key determinants that influence tax collection in Pakistan. Persistent challenges measure such as political instability, an underdeveloped economic structure, unclear taxation policies, and weak institutional capacity, have hindered the establishment of an effective tax regime.

Numerous macroeconomic variables influence Pakistan's economic situation, complicating the task of isolating the effects of specific factors within this analysis; therefore, the report aims;

Rationally estimate Pakistan's feasible income tax base. Assess the current revenue potential from the untapped sector. Analyze the impact of tax revenue on GDP growth. Evaluate whether Pakistan's tax structure is regressive and progressive. Identify the deficiencies in the current tax system and propose actionable improvements.

The report further examines the socio-economic effects of a regressive tax system, highlights enforcement gaps and legal loopholes that facilitate evasion and non-compliance strategic policy recommendations. These include enhancing tax compliance, broadening the tax base, and strengthening revenue mobilization.

Additionally, it proposes practical such as digitalization of the tax system, harmonization of sales tax, introduction of agriculture income taxation and local government empowerment to build a fair, efficient and sustainable tax framework.

DEMOGRAPHIC AND STRUCTURAL ISSUES

According to the national census 2023, our popu lation stood at 241,499, 431 which has since increased to 253,959,011 as of March 7, 2025, based on the real-time monitoring. Demographically, approximately 35% dependent population is under age 15 children, and 4% are senior citizens aged 65 and above. Alarming nearly 140 million population remain below the poverty line, surviving a less than 2$ a day. According to the economic survey of Pakistan 2024, the employed labor force is estimated to be around 72 million with the majority residing in rural region 48.5% most of these rural worker is earning incomes either below the taxable threshold or derive earning from agriculture, which exempt from the scope of the income tax ordinance 2001.

Tax non-acquiescence remains widespread due to the simplicity of avoiding the tax complexity of paying them. Many tax authorities impose intricate and varied tax rates, making acquiescence expensive and burdensome. The excise and taxation department, multiple agencies, provisional bodies, and the FBR continue to operate independently. This inefficiency encourages tax evasion and allows many to remain informal sector without fulfilling their tax obligation.

Extensive exemptions and concessions reduce the taxable base, while a lack of coordination between federal and provincial tax authorities leads to fragmentation and inefficiencies.

Policy Case Study: Pakistan Refinery Limited:

Area	Policy change/ finance importance
Sales Tax Regime	Exemption of petroleum sales –loss of input tax adjustment- reduces margins.
Refinery Policy 2023	Extended incentives and a deemed duty to support upgrade projects.
Operational loss	Rs. 2.35 billion in Q1, 2025, due to lower demand and tax treatment issues.
REUP Status	FEED completed EPCF tendering, and investor engagement is ongoing.

Source: Pakistan Refinery Limited

According to Pakistan Refinery Limited, Policy changes have exempted sales of petroleum has been exempted from sales tax. This exemption led to input tax adjustment, which means the company cannot reclaim input tax paid on goods/services used in the production process. It reduces the profit margins, making the operation less profitable. The Government has extended the incentives and is deemed under the refinery policy 2023. These measures are aimed at encouraging refineries to invest in upgrading and modernization. It provides financial assistance and support.

The company reported an operational loss of Rs. 2.35 billion in the first quarter of 2025. Due to a slowdown economy and or market, changed demands decreased and suffer tax treatment issues. Refinery upgrade project status (RUPS) FEED has been completed. EPCF tendering has been underway. Investor engagement is ongoing. The project is moving toward implementation, which is positive for long-term capacity and efficiency improvement.

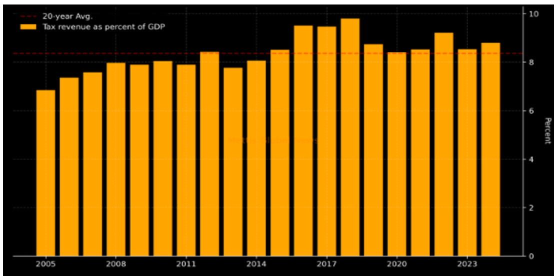
TAX SYSTEM REGRESSIVE AND INFLATION IMPACT

According to the 2023 World Bank report, the tax system is regressive, with the poorest 10% of the population paying a proportion of the income tax in both of the relative and absolute terms to their pretax income, then the wealthiest 10%. Poverty has increases 43% while indirect taxes and high inflation 17.4% disproportionally burden the population. Both rich and poor face the same tax on goods and services, contributing to a shrinking middle class, which has declined from 42% to 33%.

PAKISTAN'S TAX TO GDP RATIO AND PERFORMANCE AND TREND

According to the World Bank that tax revenue exceeding 15% of GDP is essential for promoting economic growth and reducing poverty. However, Pakistan has remained below over the past many decades, limiting its fiscal capacity and development potential.

Pakistan's Tax-to-GDP Ratio



Source: Federal Board of Revenue

Pakistan is tax to GDP ratio remain significantly below, its potential, which the World Bank estimates at 22.3% of GDP. This gap is highlight substantial under performance in revenue collection under the capacity of the country.

The Federal Board of Revenue (FBR) achieved 100.5% of its update revenue target for the fiscal year 2023-24, collecting Rs. 9,299.1 billion –a 29.8% increase from Rs 7,163.1 billion in the previous fiscal year. This includes a surplus of 121.8% or Rs 809.7 billion over the direct tax target of 2.1 trillion in the year significance achievement.

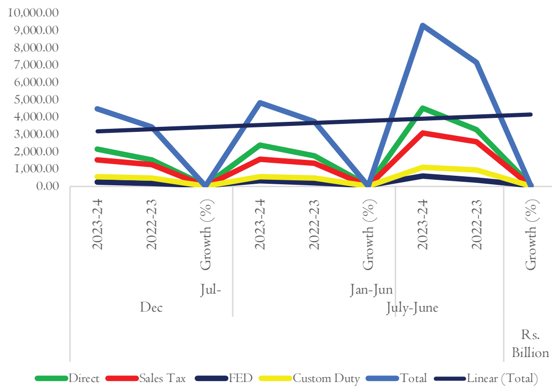
COMPARISON OF NET REVENUE COLLECTION:

Comparison of Net Revenue Collection

Rs. Billion									
	Jul-Dec			Jan-Jun			July-June		
Tax Head	2023-24	2022-23	Growth (%)	2023-24	2022-23	Growth (%)	2023-24	2022-23	Growth (%)
Direct	2,148.90	1,525.70	40.8	2,381.80	1,745.20	36.5	4,530.70	3,270.90	38.5
Sales Tax	1,515.30	1,272.00	19.1	1,571.50	1,319.50	19.1	3,086.80	2,591.50	19.1
FED	264.6	164.3	61	312.9	205.6	52.2	577.5	369.9	56.1
Custom Duty	540.5	466.9	15.8	563.6	464.8	21.3	1,104.10	931.7	18.5
Total	**4,469.30**	**3,428.90**	**30.3**	**4,829.80**	**3,735.10**	**29.3**	**9,299.10**	**7,164.00**	**29.8**

During the fiscal year 2023-24 Federal Board of Revenue (FBR) recorded impressive tax collection growth despite significant national and international challenges. The industrial and services sector growth 1.21 while large-scale manufacturing (LSM) grew by 0.7% flood Flood-related expenditure, along with global economic slowdown, intensified by regional geopolitical instability, disrupted supply chains, and strained fiscal space. Fiscal Year 2024, tax collection growth remains 30.3% in the first half and 29.3% in the 2nd half, as illustrated upper table.

Comparison of Net Revenue Collection (FBR)

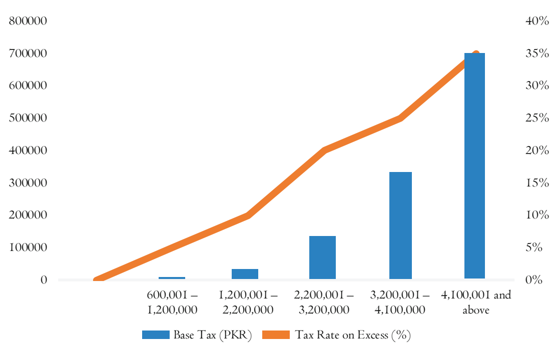


Author estimates: Data Source: Federal Board of Revenue (FBR) Division Year Book 2023-24.

Policy or enforcement improvements may have contributed to better collection in 2023-24. A consistent increase in direct tax collection could suggest better compliance or an expanded tax base. The upward trend in total revenue supports a narrative of improvement in fiscal policy performance by the FBR.

According to the worldwide tax in Pakistan, individual income tax, this bottom figure shows the progressive income tax structure for individuals in Pakistan.

Comparison of Tax Rate and Base Tax



Author estimate: data source: (Pakistan - Individual - Taxes on Personal Income)

As increase in income both the base tax and marginal tax rate both are increase, where higher earner pays not only more tax in total but also a higher rate on income above a threshold.

ENFORCEMENT CHALLENGES AND INFORMAL SECTOR:

Pakistan faces numerous challenges that underscore the need for comprehensive reforms, including a heavy reliance on indirect taxes, widespread corruption, and pervasive tax evasion.

The reality is that the rich and powerful are not fulfilling their tax obligation, are taking advantage of tax exemption deductions and protections, including in tax laws in addition to benefitting from tax laws in addition to benefiting from recurring, and assertive forgiveness scheme offered by the government.

Pakistan's tax-to-GDP ratio stands at approximately 12%, significantly lower than the OECD average of 34%. This disparity constrains Pakistan's ability to underwrite public investment of the revenue it does raise, the bulk, about 6.3% of the GDP, comes from indirect levies on goods and services. The remaining 2.4% of the GDP direct taxes is chiefly extracted via business withholding on transactions, eliminating the need for individuals to file voluntarily, and as a result, individual tax compliance remains exceedingly low.

This is a broad agreement that robust enforcement boosts tax revenue, weak enforcement can take many forms, from a property tax official accepting a bribe a turning a blind eye to assessments to a tax authority simply lacking the resources and capacity to carry out its duties effectively.

THE NEGATIVE IMPACT OF HIGH INDIRECT TAX AND WITHHOLDING TAX BURDEN:

FBR experts must engage in some serious introspection to diagnose what has gone wrong and why so many taxpayers seem to have disappeared. Numerous analyses cautioned about the ruinous impact of high indirect levies and the heavy burden of withholding taxes. Yet the government pushes ahead with these measures even at low-income levels, and the consequences are play to be seen: widespread tax resistance. This will be reflected in the surge of nil and loss filling returns, the decline in the filers remitting their full tax liabilities, and rampant evasion under the withholding tax framework.

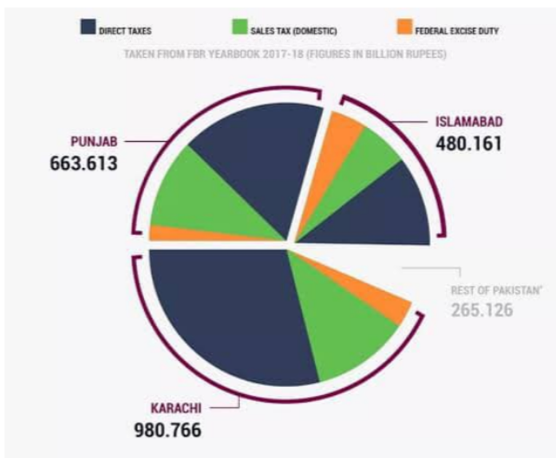
REVENUE EXPANSION POTENTIAL:

Recent study examine Pakistan is true tax rising capacity $ 30 trillion (15% of the GDP including the informal sector) at the federal level and $ 34 trillion overall. Yet the FBR has not even tapped into the 10 million retailers who each earn more than $2 million annually. Taxing their income alone current rate could yield around $3 trillion. Expanding the net to capture all exemptions and bring the entire undocumented economy under taxation could leave total income tax revenues at nearly $15 trillion.

POTENTIAL FROM HARMONIZED SALES TAX AND AGRICULTURE INCOME TAX:

Meanwhile, a unified 10% harmonized sales tax has the potential to generate about $12 trillion. If all existing federal and provincial levies on goods and services are consolidated under a single efficient national tax authority or national tax council, customs duties, federal excise duties could contribute another $3 trillion. Provinces by institution and properly enforcing an agriculture income tax collection, an additional $4 trillion.

WHO PAYS TAX, AND HOW MUCH?



Sources: Federal Board of Revenue, Govt. of Pakistan

According to FBR, Punjab has a more diversified economy but still contributes less than Karachi, likely due to a higher proportion of agriculture and a smaller scale of industries. Karachi, despite being the largest contributor, faces significant tax evasion, particularly in the business and fashion industries. Under invoicing, informal cash transactions, tax collection, and fake invoicing are common issues. As given in the case study:

SECTORAL CASE STUDY: FASHION INDUSTRY EVASION IN KARACHI;

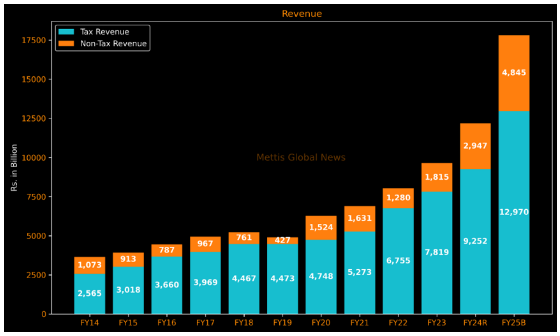
The cooperate office tax in Karachi has filed an FIR against prominent fashion designer Nomi for committing major sales tax fraud of Rs1.2 billion over nearly seven years. Acc ording to FBR, as under a group of associated entities is declared under the declaration of taxable sales from 2018 to 2025.

This case not only underscores the fraud of 1.2 billion sales tax but also highlights the broader concern over compliance, transparency, and enforcement within Pakistan's high-end retail and fashion sector.

REGIONAL COMPARISON AND INFORMAL ECONOMY:

Pakistan's Informal Sector: 60% of the GDP, Affected by its Revenue Collection:

Pakistan's vast informal economy poses a significant barrier to effective tax collection in Pakistan, which sector is estimated from 60% of the economy's GDP. This vast unregulated segment significantly undermines the government's ability to collect taxes as businesses and individuals with in typical do not file returns, pay taxes, or appear on official records, making revenue mobilization a persistent challenge Out of the total projected revenue, the FBR is expected to collect Rs 12.97 trillion in taxes, reflecting a year-on-year increase of 40%. And non-tax revenue is estimated at 4.85 trillion, making a substantial service 64% year-over-year rise. Petroleum development levy, which is projected to bring 1.3 trillion, up to 33% from the previous year



Sources: global. news (2025)

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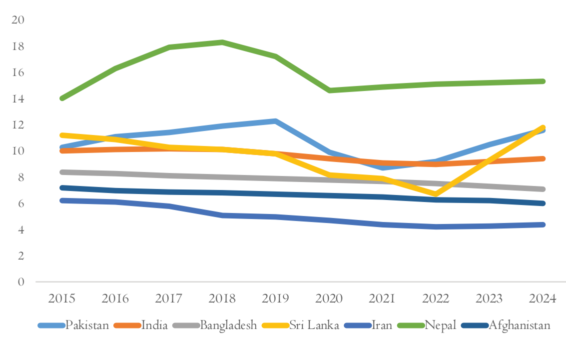
CASE STUDY: REGIONAL COMPRESSION:

Comparative analysis Tax Revenue (%GDP): 2015-24



Data Sources: Country economy (2022), Global Economic Data, OECD, Public Finance, Ychart, Data bank, The Hindu, etc.

Pakistan is tax-to-GDP ratio remains lower than India, Nepal as a regional comparison that this is not inevitable, suggesting room for improvement in the tax policy in tax policy and administration. Neighboring countries, Sri Lanka and India, are also lower than by terms of compare to Pakistan. There is an upward trend is positive, but it needs reforms in its tax structure. In contrast, Bangladesh has a declining ratio, highlighting potential issues in tax compliance and economic structure. Sri Lanka's recent recovery exhibits the impact of changes in policies and economic stabilization efforts. Iran is decreasing under the external economic pressure. Afghanistan's figure in tax revenue to GDP% % needs structural reforms to improve fiscal capacity.

REVENUE POTENTIAL AND POLICY RECOMMENDATION:

Despite persistent challenges, Pakistan must confront its income tax shortcomings, particularly rampant tax collection and tax evasion, and a narrow tax collection base tax to raise more revenue and ensure the tax system needs comprehensive digital modernization and mechanisms to curb leakages.

Empowering local communities with the authority to levy the collected revenue potential in Pakistan. Although around 38% population lives in urban areas, these cities contribute more than 55% of the GDP. If urban tax collection is better managed and decentralized, it allows local government to directly raise and reinvest revenue. The Punjab government could increase tax revenue through the property tax, which is approximately Rs 25 billion.

FBR'S DIGITAL REFORMS AND LOCAL IMPROVEMENT:

The Federal Board of Revenue (FBR) has placed strong emphasis on digitizing the economy and automating its initial and automating its internal processes. These initiatives are designed to reduce compliance costs for taxpayers, bring more economic activity into the formal sector, and expand the tax base. Over time, such digital reforms are expected to enhance transparency, improve efficiency, and set the foundation for sustainable revenue growth.

ROAD TO IMPROVEMENT: "GOVERNMENT CREATES JOBS THROUGH TAX CUTS IN PAKISTAN"

The government of Pakistan should consider strategic tax cuts to stimulate economic activity and create jobs. In particular, a 20% cut in business taxes could incentivize private sector investment, encourage business expansion, and boost job creation. Furthermore, a 10% cut in individual income tax would increase disposable income, boost consumer spending, and further increase demand for goods and services, ultimately supporting economic growth and employment. These tax measures, if well-targeted and timely, can serve as effective tools for fiscal consolidation and labor market improvement.

POLICY REFORMS MODEL FOR ECONOMIC GOVERNANCE OF PAKISTAN;

Structural Overhaul of the Tax System;

Transition to a simple, broad base and low rate TAC regime featuring a 10 % individual income tax rate (with an alternative minimum wealth tax of 2.5% for net wealth above Rs. 45 million).
20% corporate tax rate and 8% uniform sales tax on goods and services (0% for export), 5% customs duty, and target excise duty (e.g., 500 billion cigarettes and related products). Eliminating most withholding taxes except on salaries, dividends, interest, and non-resident payments.

Creating the Unified National Tax Agency (UNTA);

Established a unified, federalized, and autonomous National Tax Agency to coordinate and replace currently fragmented tax authorities at both the federal and provincial levels. Merge FBR and provisional tax agencies into a single entity responsible for tax collection across responsible for all government-level administrative functions of social and economic benefit programs. Digital integrates database taxpayer information across all sectors and government tiers for improved compliance and e-government.

Federalization and Harmonization of Tax Policy;

Fully harmonize the value-added tax (VAT) across provinces through the National Tax Council (NTC). Reforms exciting legislation FBR Act 2007) and utilize Article 144 of the constitution of the provisional consensus to establish the unified authority. Adopt international best practice (Nepal, Canada CRA) for federal and provincial tax coordination and social program administration.

Fiscal Policy Alignment and Social Goals;

Link tax compliance to the provision of universal social services, including education, healthcare, and pension and income support programs. Shift public expenditure toward a social contrast-based tax model promoting inclusivity and trust in governance.

Target Outcome and Fiscal Target;

Reforms in income and sales tax should be Rs. 30-31 trillion. At the provisional level, through a harmonized VAT regime, Rs. 4 trillion. Through customs and excise duties, Rs. 1.5 trillion.
Achieve sustainable GDP growth above 5% by integrating tax reforms, macroeconomic reforms, and government reforms.

CONCLUSION:

The implementation of targeted tax cuts in Pakistan can play a significant role in boosting economic activity and reducing unemployment. By reducing the tax burden on businesses and individuals, the government can encourage investment, increase consumer demand, and help create sustainable jobs. However, to ensure long-term benefits, such fiscal measures should be accompanied by reforms to public financial management and broadening the tax base.

Pakistan's tax collection system is beset with deep-rooted structural, administrative, and policy-level challenges that continue to undermine its fiscal potential and economic stability. Despite repeated reforms, the system remains regressive. The analysis reveals substantial untapped revenue potential, especially in the urban sector, the service sector agriculture through harmonized sales taxation. It also addresses policy loopholes, simplifying tax structure and moving toward a more equitable and broad-based system. Recent digital reforms by the FBR and recommendations for a unified national tax authority mark a positive shift, but implementation remains critical.

To achieve long-term success, Pakistan must adopt a modernized, transparent, and efficient tax regime that prioritizes equity compliance and institutional coordination. Emphasizing local government, leveraging digital tools, and integrating fiscal policy with social development goals can help build public trust, broaden the tax net, and ensure that taxation becomes a pillar of economic governance rather than an obstacle to development.

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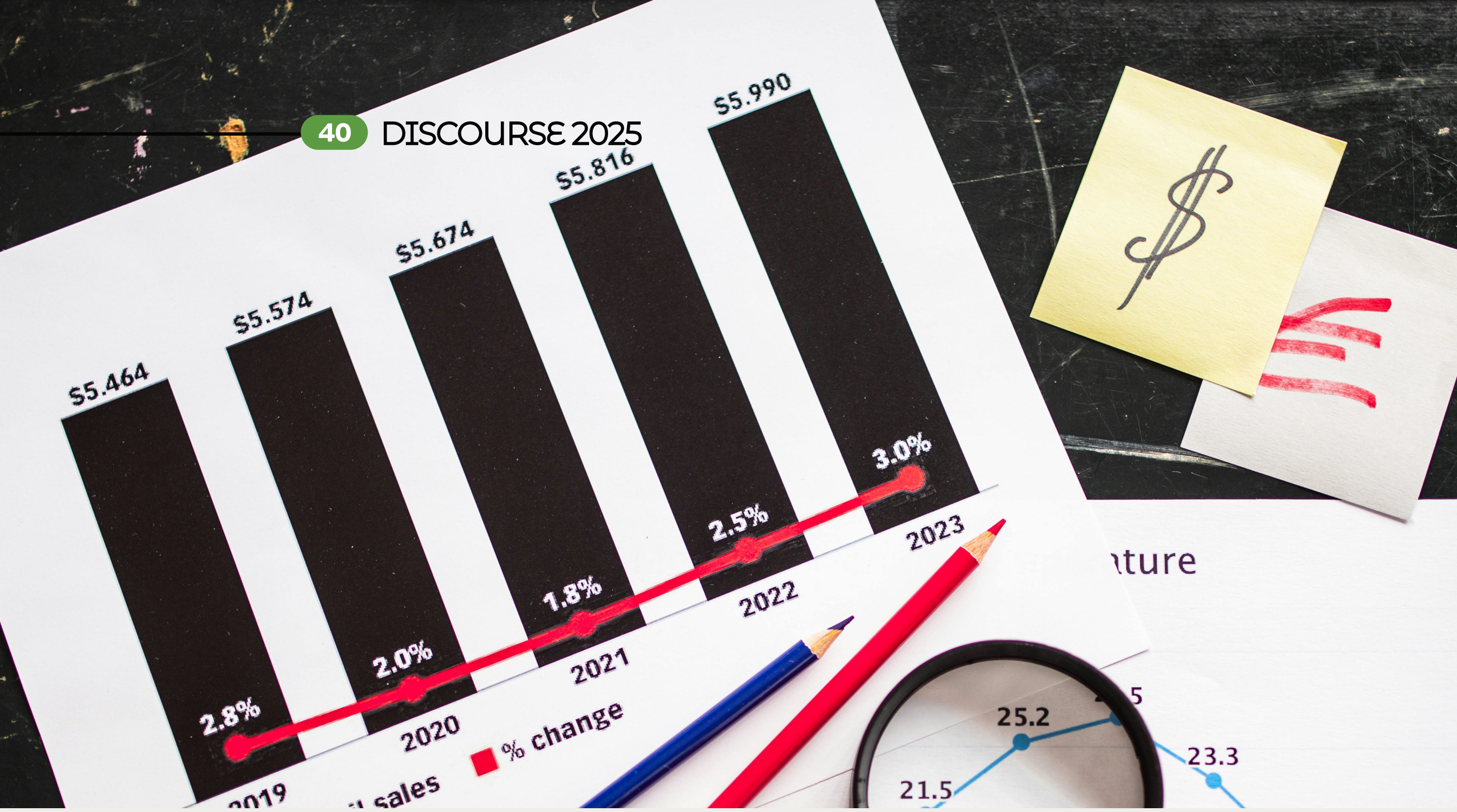

EXPLORING THE FORECASTING STRUCTURE OF FEDERAL TAX REVENUE IN PAKISTAN

Syeda Um Ul Baneen

Tax revenue forecasting works as a base for budget estimates: the more accurate the tax revenue forecasts, the better the fiscal decisions. Pakistan's economy has been suffering from poor fiscal decisions since its independence. The tax revenue forecast errors were a stimulus for wrong budget allocations. The system of data collection and forecasting needs a critical diagnosis. Once real reasons for these loopholes are identified, solutions can be suggested accordingly.

The Strategic Planning Reforms & Statistics (SPRS) wing of the Federal Board of Revenue (FBR) is responsible for forecasting federal tax revenue forecasting. SPRS does forecasting every year in June for the next fiscal year. It also sets targets based on these predictions. Table I shows tax revenue collection of the FBR for the last five years. On the other hand, table 2 shows targets versus net collection of federal taxes.

Table 1: FBR Tax Collection (Rs. Billion)

Tax Head	2018-19	2019-20	2020-21	2021-22	2022-23	Five-Year Average Collection
Total Taxes	3,828	3,997	4,745	6,148	7,164	5,176
Direct Tax	1,446	1,523	1,731	2,285	3,279	2,053
Sales Tax (Domestic)	649	720	872	792	975	802
Sales Tax (Imports)	810	876	1,116	1,741	1,618	1,232
Custom Duties	685	627	748	1,011	931	800
FED	238	250	277	321	370	291

Source: FBR Evidence-Based Revenue Forecasting Report (2023-24) and Author's Computations

Table 2: Total Tax Targets Versus Net Collection (Rs. Billion)

Year	Targets	Collection	Target Achieved (%)
2016-17	3,521	3,368	95.7
2017-18	3,935	3,844	97.7
2018-19	4,150	3,828	92.2
2019-20	3,908	3,997	102.3
2020-21	4,691	4,745	101.2
2021-22	5,829	6,149	94.8
2022-23	7,470	7,164	95.9
2023-24	9,252	9,299	100.5

Source: FBR Year Books (2020-21 to 2023-24)

SPRS forecasts through the Buoyancy approach, in which each tax is predicted using its previous year's Buoyancy with respect to its base tax. After getting buoyancies, they are multiplied with the forecasted values of GDP to get the forecasts for different taxes.

Tax revenue buoyancy means the total response of tax revenue to change in the tax base or proxy tax base. Buoyancy is given as:

base. Buoyancy is given as:

$$\text{Buoyancy} = \frac{(\Delta T/T)}{(\Delta GDP/GDP)}$$

And tax revenue forecast through Buoyancy:

$$Tax_f = \text{GDP grwoth(f)*Tax buoyancy}$$

A tax is buoyant if the proportionate change in tax revenue is more than the proportional change in the tax base.

The taxes and their relevant bases are given in table 3.

Table 3: Taxes and Respective Bases

Tax	Base
Total Taxes	GDP
Direct Tax	Non-agricultural GDP
Sales Tax (Domestic)	Large Scale Manufacturing
Sales Tax (Imports)	Imports value
Custom Duties	Imports Value
Federal Excise Duty	Large Scale Manufacturing

Source: FBR, 2024

The errors in revenue forecasts may lead to budget errors. The fiscal policy efficiency depends upon the accuracy of the tax revenue forecasting. Bad decisions would be made keeping in view the provided forecasts by FBR. There would be a lower tax to GDP ratio than predicted. Development expenditure would not be as desired. In the end, there would be a decline in economic growth.

The reasons for these forecasting errors could be many. They can be managerial or strategic. Some measurable reasons for tax revenue forecasting errors can be data discrepancy issues, inappropriate forecasting methods, or choice of parameters. The managerial reasons are qualitative and can't be measured so accurately.

FBR annually gives tax revenue estimates in June. Till that time, real data on taxes and bases are not available. FBR has to rely upon the revised data to calculate the buoyancies. Moreover, the tax revenue forecasts also use GDP growth estimates in addition to tax revenue buoyancies. The Ministry of Finance provides these estimates. The tax revenue forecasts will malfunction if these estimates are inaccurate due to data, method, or administrative reasons. Data accuracy can be a game-changer for tax revenue forecasting.

Inaccurate federal tax revenue forecasts can result from an inappropriate forecasting method. FBR uses the buoyancy approach for forecasting purposes. The buoyancy approach involves a couple of steps. Firstly, buoyancies are calculated. Secondly, these buoyancies are multiplied with respective tax base forecasts. The ultimate results are taken as tax revenue forecasts for the coming fiscal year. The errors in forecasts suggest that the buoyancy approach may not be suitable for Pakistan's tax revenue forecasting.

The buoyancy approach uses GDP growth for forecast purposes. Moreover, every tax head has its own base for buoyancy calculation. There may be a wrong choice of these parameters. What if we change the tax base of these tax revenues? What if we do not use a GDP growth estimate and use some alternative for multiplication purposes? What if the bases or GDP are misestimated? For example, the FY23 federal tax revenue estimate is 7,004 billion rupees. It is estimated using FY22's total tax revenue of 5,348 billion rupees and FY23's GDP growth estimate of 5 percent (Finance Division, 2022-23). The accuracy of the total tax revenue forecast is dependent upon the reliability of the GDP growth estimate. The alternatives may provide insights into tax revenue forecasting errors in Pakistan.

In a nutshell, effective forecasting of federal tax revenue plays a critical role in guiding a nation's economic decisions. In Pakistan, the current system for forecasting tax revenue faces significant shortcomings. These inaccuracies often result in reduced public spending and increased national debt. The root causes may include unreliable data, flawed methodologies, incorrect parameter selection, and managerial inefficiencies. Addressing these challenges through the adoption of more accurate and robust forecasting methods could significantly improve the reliability of Pakistan's revenue projections.

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DISCRETION VERSUS DEVELOPMENT

Dr. Ikram Ullah

In Pakistan, the misuse of discretionary powers in the allocation of development funds has long been a source of inefficiency and political favoritism. Back in 2018, the then Prime Minister of Pakistan, upon forming the 22nd cabinet, pledged to curb this practice by ending the discretionary use of public funds[1], a move announced during his first cabinet meeting. Subsequently, the government of Khyber Pakhtunkhwa introduced an Annual Development Program (ADP) policy prior to the 2020-21 budget that abolished the Chief Minister's discretionary authority over the allocation of funds in the long-term ADP, signaling a shift towards more rules-based and transparent development planning[2].

The broader debate between rules and discretion, often framed as commitment versus flexibility in fiscal operations, has largely been resolved in favor of the rational, rule-based approaches. Economists widely agree that political governments tend to be present-biased, often prioritizing short-term gains over long-term efficiency[3]. While some degree of discretion over non-developmental spending may be justified, particularly in times of crises, development spending should not be subject to the same flexibility. The allocation of development budgets must be guided by principles of efficiency and, where appropriate, equity, rather than political convenience.

Sound economic policy demands that public sector commitments be matched by corresponding actions. Renouncing discretion in the allocation of public funds, especially development funds, is a commendable step, but it must be backed by consistent implementation. Unfortunately, this is seldom the case in Pakistan.

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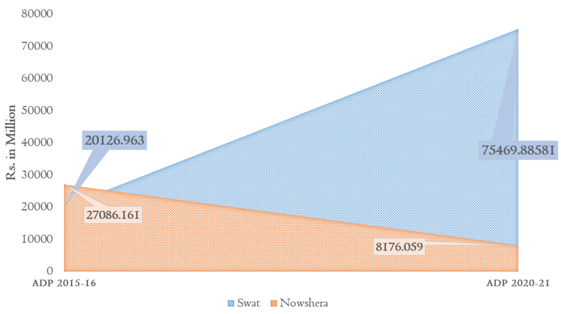
Figure 01: Reversal of Fortunes: Comparative ADP Representation of Nowshera & Swat, 2015-16 vs. 2020-21

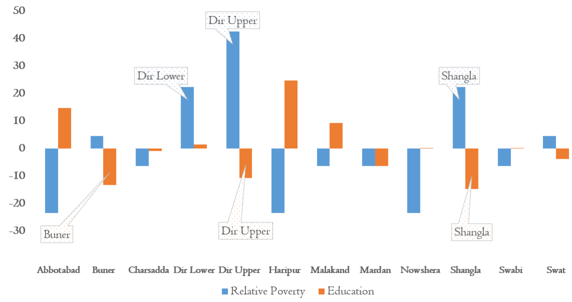


A glimpse of the gap between rhetoric and reality can be seen in Figure 01, which compares the total value of new projects listed in the ADP of 2015-16 and 2020-21 for two selected districts of Khyber Pakhtunkhwa[4]. In ADP 2015-16, the total value of new projects in Nowshera was 29 percent higher than in Swat. By 2020-21, the situation had dramatically reversed: the value of new projects in Swat increased by 116 percent, while Nowshera witnessed a decline of approximately 107 percent. Given the selection criteria applied in the analysis, both in terms of the types of projects[5] and the number of districts , the average share of new projects per district[6] in the ADP 2020-21 should have been around 8.33 percent. However, Swat alone received a disproportionate large share of 52.22 percent[7].

EQUITY IN DEVELOPMENT SPENDING: A MISSING PRIORITY?

One of the most critical yet overlooked questions in development spending is whether funds are allocated in a way that reflects the varying needs of different regions. In this context, equity can be understood as, "the absence of systematic disparities in resource allocation between regions with different levels of underlying social [and economic] advantage/disadvantage". Before assessing whether such disparities exist in the allocation of development funds, Figure 2 and 3 illustrates the underlying economic and social conditions of the selected districts[8] in Khyber Pakhtunkhwa. The first indicator, shown in Figure 2, is relative poverty in the selected districts[8], where Dir Upper, Dir Lower, and Shangla emerge as the three most disadvantaged districts. In terms of relative educational attainment[9] (Figure 2), the most deprived districts are Shangla, Buner, and Dir Upper.

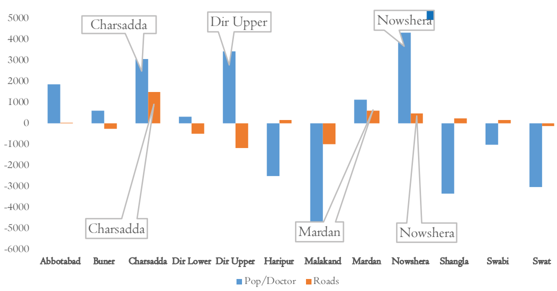
Figure 2: Relative Poverty and Education Levels in Selected KP Districts



4. The selection of the two ADPs is deliberate: the 2015-16 ADP represent the second ADP of Pervez Khattak's tenure as Chief Minister, while the 2020-21 ADP corresponds to the second year of Mahmood Khan's tenure in the same office.
5. Project inclusion/exclusion criteria: The analysis includes projects that meet the following conditions: (i) they have clearly specified locations (such as district, multiple districts, or an administrative division); and (ii) they were either approved during the previous financial year (from July 1, 2014/2019 to the publication date of the respective ADPs are published) or are listed as new projects pending approved by the Provincial Development Working Party (PDWP). For projects covering multiple districts or an entire division, the total cost is evenly divided among the relevant districts, and the resulting share is attributed to each district. Projects that meet the inclusion criteria but have ambiguous titles, i.e., those whose geographic scope cannot be determined from their names (e.g., construction of ABC units of XYZ in Khyber Pakhtunkhwa) are excluded from the analysis.
6. Districts that were part of the former Federally Administered Tribal Area (FATA), as well as those associated with Frontier Regions (FRs), are excluded from the analysis.
7. If two mega projects for Swat, worth a combined total of Rs. 38905 million and listed at serial number 574 and 575 in ADP 2020-21, are excluded, Swat's share drops from 52 percent to 35 percent. Accordingly, these two projects are excluded from the remainder of the analysis.
8. Data for calculating this indicator (relative poverty) is collected from the Pakistan Poverty Alleviation Fund (PPAF) Annual Report 2019 for the selected districts [https://www.ppaf.org.pk/annual-reports]. The average poverty headcount of these districts was calculated, and each district's deviation from this average was computed by subtracting the mean from its individual score. Positive values indicate higher relative poverty compared to the group average, while negative values indicate lower relative poverty.
9. Data on education scores was obtained from Alif Ailaan [https://sdpi.org/alif-ailaan-pakistan-district-education-rankings-2015/publication_detail]. Relative education scores were calculated using the same method described in footnote 4. However, positive values indicate relatively better educational attainment, while negative values indicate relatively poorer educational attainment.

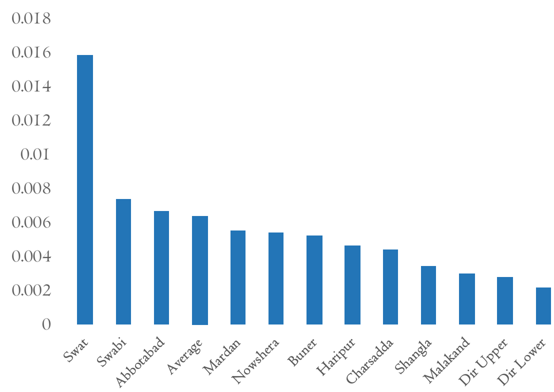
Figure 3 presents data on two indicators of relative public service provision in the selected districts of Khyber Pakhtunkhwa: population per doctor (reflecting relative health facilities) and population per kilometer of road (reflecting relative infrastructure access)[10] . Since these indicators are measured as deviations from the mean across the selected districts, higher values suggest weaker service provision. Based on this, Nowshera, Dir Upper, and Charsadda perform poorly in terms of health facilities, while Charsadda, Mardan, and Nowshera have the highest population per kilometer of road. Overall, the underlying conditions suggest that Dir Upper is the most deprived district, lagging in three dimensions, followed by Shangla, Charsadda, and Nowshera, each lagging in two dimensions. One the other hand, Malakand appears to be the most well-endowed, showing strength in three dimensions, followed by Haripur and Abbottabad.

Figure 3: Development Disparities Across Selected Districts of KPK



None of the most deprived districts, as identified in the analysis, are adequately represented in ADP 2020-21, a fact clearly reflected in the per district shares of the new projects across districts (Figure 4)[11]. In contrast, Abbotabad, one of the better-off districts based on the selected indicators, ranks among the top three districts with share in ADP 2020-21 significantly above the average, with Swat receiving the highest share overall. Based on the operational definition of equity used in this analysis, these patterns reveal systematic disparities in resource allocations. Therefore, it can be concluded that the ADP 2020-21, like its predecessor and successors, was not guided by equity considerations.

Figure 4: Per District Share in new Projects (ADP 2020-21) Across KPK



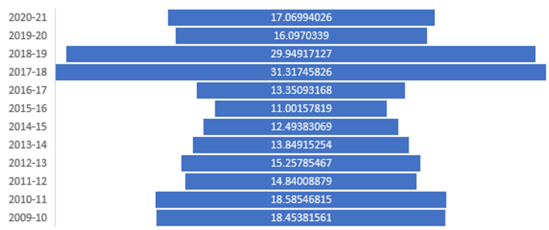
EFFICIENCY IN DEVELOPMENT SPENDING: A GUIDING PRINCIPLE OR AN AFTERTHOUGHT?

Allocating huge sums under the "development budget" will yield little benefits if the planning and approval processes remain rushed and poorly structured. As previously noted, discretionary power continues to dominate both project approval and fund allocation. In Pakistan, most approved PC-I and PC-II documents for social sector projects lack the critical element of 'economic viability'. A commonly repeated phrase in these documents is, "the financial benefits of the project cannot be quantified," or "the project is not intended to earn profit". Ironically, such justifications are routinely accepted, as evidenced by the approval of these projects. The absence of a proper cost-benefit analysis in approved PC-Is reflects a broader issue of unchecked discretion, a practice that must end if development funds are to generate meaningful and measurable outcomes.

10. Data on population per doctor and population per kilometer of roads were obtained from the Development Statistics of Khyber Pakhtunkhwa (2017) [https://kpbos.gov.pk/search/publication-detail?id=6]. Relative scores were calculated using the same method as in footnotes 4 and 5. The roads data includes both high-quality and low-quality roads within each district.
11. The data presented in Figure 4 may also serve as a standard indicator for assessing the equity of resource distribution among the districts of Khyber Pakhtunkhwa.

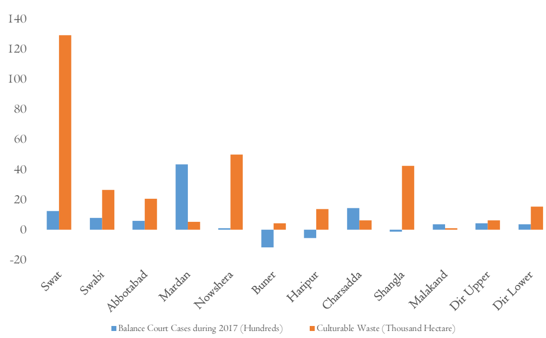
Figure 05: Roads and Transport Allocations in ADPs of KPK (% of ADP Size)

Respective ADPs of Khyber Pakhtunkhwa



Beyond the issue of discretion, the sectoral focus of the development funds may also contribute to inefficiencies. For example, Figure 5 shows annual allocations to the roads and transport sector in Khyber Pakhtunkhwa's ADPs overtime. Historically, around 18% of ADP allocations have been directed to this sector. In ADP 2020-21, the share of road-related projects among new projects for the districts of Abbotabad, Swabi, and Swat was disproportionately high (62%, 49%, and 40% respectively). While roads are undeniably important, an overemphasis on a single type of infrastructure, without a proper assessment of the local needs, risks inefficient use of public resources. For instance, Swat ranks relatively high in poverty, while Abbottabad performs poorly on the population-to-doctor ratio (as shown in Figure 2 and 3). In such contexts, prioritizing road construction is unlikely to address the core developmental challenges facing these districts.

Figure 06: Balance Court Cases (2017) & Culturable Waste (2015-16) in Selected Districts of KPK



Looking from another perspective, one might suggest prioritizing projects that enhance the efficiency of the criminal justice system or reduce culturable land waste in these districts (see Figure 6)[12]. In Khyber Pakhtunkhwa, one key factor behind high levels of culturable waste is unresolved land disputes. By improving court efficiency and expediting the resolution of such cases, agricultural productivity could be significantly increased. This example highlights a broader point: a balanced focus on both the "software" of the economy (institutions) and the "hardware" (factors of production) is essential for maximizing development outcomes and expanding the national economic pie.

FINAL REFLECTIONS

As the name suggested, the primary goal of the development budget should be to expand the national economic pie. However, this goal cannot be achieved if resource allocation continues to rely on heuristic or discretionary decisions. Instead, project selection must be grounded on rigorous cost-benefits and gap analysis. Furthermore, it is time to shift the focus from the traditional, infrastructure-heavy model toward strengthening the institutional "software" of the economy, an approach more likely to yield sustainable and inclusive growth.

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12. Figure 6 presents two variables. The first one, i.e., balance court cases, is calculated by subtracting the number of pending cases in January 2017 from those in December 2017 for each selected district's courts. The resulting values are then expressed as deviation from the group mean. Higher bars indicate comparatively poorer court performance. The second variable, i.e., culturable waste, is measured in thousands of hectares and represents land that remained uncultivated for two consecutive years despite being suitable for cultivation. Data on the two indicators is obtained from: http://ljcp.gov.pk/nljcp/home/publication, and https://kp.gov.pk/uploads/2023/10/Land_Use_Statistics_(2015-16).pdf.

ECONOMICS OF EARLY RETIREMENT

Ajmal Kakar

Balance of payment crises and inadequate foreign exchange reserves are considered prominent conundrums of Pakistan's economy. However, the fiscal deficit which has historical roots and is further deteriorating, is often ignored[1]. Fiscal deficit, which erupt from time to time, led Pakistan to approach the IMF and other International Financial Institutions (IFIs) for budgetary and stabilization support. However, these programs provide emergency ward relief for the short run but do not prescribe long-term solutions. Because of these short-run arrangements, the chronic fiscal crises remerge with greater intensity leading to engagement with IMF and other IFIs on even tough terms and conditions. Continuous engagements with the IMF ultimately leads to a cycle of dependency. The massive public employees' pension obligation is one of the major factors of fiscal deficit[2].

In Pakistan on one hand, the pension liability is increasing significantly, for instance, In the fiscal year 2018-19, federal government superannuation and pension expenditures were almost 78% of the PSDP expenses value, growing to 87% in FY 2019-20 (PKR 463,419 million and PKR and 533,220 million). The pensions expenditure or liability as a proportion of current expenditures is also increasing over time, reaching nearly 7.6 % in FY 2019-20. And, for the fiscal year 2024-25, the government has allocated Rs1,014 billion for the pensions of federal government employees. It is predicted that by 2050 the share of pensions in current expenditure would be 56% and government will likely run out of funds for pension expenditures within 8-10 years[3]. On the other hand, the total number of federal government employees has been increasing rapidly. In fact, the size of federal government civil employees is 590585[4], armed forces 9,43,000[5] and Autonomous/ Semiautonomous Bodies/Corporations employees are 3,99,265[6]. Because of job security and granted pensions public sector job remain attractive for the public[7], PIDE[8] recent study also reports massive demand for public jobs.

Pension reforms are taking place rapidly due to demographic changes and fiscal challenges. However, unlike many other countries, Pakistan is yet to initiate meaningful pension reforms in the public sector. The existing structure primarily relying on pay-as-you-go defined benefit models resulting in accumulation of unfunded government liabilities, a system which is naturally unsustainable (particularly for developing countries like Pakistan). Nevertheless, this time news[9] was circulating in both print media and news channels that, the government is considering a proposal to reduce the average age of superannuation by 5 years to 55, against the exciting 60 years. According to Dawn News, this proposal is said to have been put forward by a multilateral agency as a part of the pension reforms. The objective of the reform is to reduce the burden of pension, which doubles every four years. In fact, in the long term, it seems unsustainable. However, in the past authorities were considering increasing the retirement age by two years to 62 with similar objectives, and now they are contemplating early retirement. But there is no literature on the consequences of such policies in Pakistan. Recently, a study conducted by the PIDE "Lifetime Cost of Public Servants[10]", estimates the financial implications including the salary, commuted pension and family pension of public servants in Pakistan, using revised pay scale 2022.However, the study does not take into account the implications of changing the superannuation or retirement age of public servants.

Thus, realizing the sensitivity of the policy and the literature gap, I have conducted a comprehensive study on the budgetary implications of such policy proposal (yet to be published). The study focuses on the implications (financial obligations) of both reducing and increasing the retirement age of government employees in Pakistan.

Let me first outline the stages at which public servants receive pensions after retirement. As illustrated in Figure 1, pension liability represents the accumulation of income flows across five distinct stages.

05 Total Pension

04 Monthly Pension to Daughter

03 Monthly Pension to Spouse

02 Monthly Pension to Employee

01 Commuted Pension

ESTIMATED PENSION LIABILITY AND RETIREMENT AGE POLICIES:

Figure 2 presents our estimates of the total pension liability, including commuted pensions, monthly payment to retirees, and survivor benefits or family pension for BPS Grades 1 to 19.

These estimates are for two alternative retirement age policies (changing from 60 to either 55 or 62 years) against the existing one as a part of pensions reform in Pakistan. In fact, our study findings reveal that, reducing the retirement age to 55 significantly increases the government's financial liability, as pensions must be paid over a longer period (assuming an average life expectancy of 76 years). On the other hand, increasing the retirement age to 62 reduces total pension outflows, making it the most fiscally optimal option among the three.

While financial savings are substantial with delayed retirement, policymakers must also weigh other critical considerations—such as workforce productivity, youth employment, and institutional capacity—before making a final decision on adjusting the superannuation age.

While financial savings are substantial with delayed retirement, policymakers must also weigh other critical considerations—such as workforce productivity, youth employment, and institutional capacity—before making a final decision on adjusting the superannuation age.

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Figure 2. Estimated Total Pension

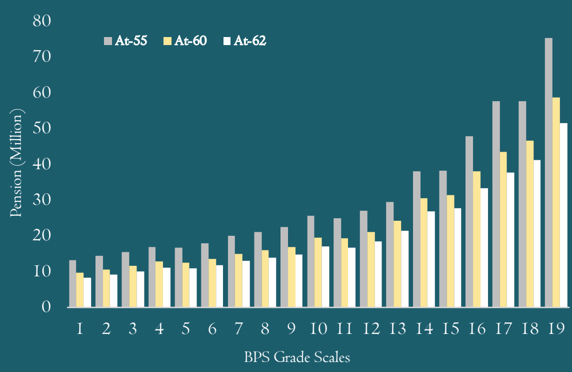

Figure 3. Average Net Savings in Pensions (Million PKR)

NET IMPACT OF CHANGING RETIREMENT AGE FROM 60 TO EITHER 55 OR 62?

Similarly, we projected average net impact[11] of shifting the retirement age to either 55 or 62 years, compared to the current age of 60, on pension liabilities as illustrated in figure 3. Contrary to the expectation of proposed strategy, our findings disclose that dwindling the retirement age to 55 significantly augment the budgetary stress on the government. For instance, if a public servant (BPS 1–19) is hired today and retires at 55 instead of 60, the government would take on an additional PKR 0.16 million in commuted pension and PKR 6.59 million in monthly pension payments over time. Consequently, this leads to in an overall increase of PKR 6.75 million per retiree.

In contrast, delaying retirement to 62 years yields substantial savings. Under this scenario, the government commuted pension liability would decline by around PKR 0.1 million and achieve average savings of PKR 2.90 million in monthly pensions, trimming the total pension cost by approximately PKR 3.0 million per employee.

To sum up, there is definitive fiscal trade-off between retirement age pension liability. Reducing the retirement age to 55 imposes a substantial liability whereas aggrandizing to 62 leads to significant savings. Accordingly, from a strictly cost-efficiency standpoint, elevating the retirement age to 62 emerges as the optimal policy alternative, demonstrably minimizing pension expenditures across all Basic Pay Scale (BPS) grades when juxtaposed with both the prevailing norm and premature exit at 55.

SUGGESTED POLICY PROPOSALS

Based on the findings of the study, the following policy recommendations are proposed.

- Implement the delayed retirement age policy (62 years instead of 60)
- Retain the prevailing retirement age strategy (60 years of age)
- Circumvent early superannuation policy (55 years)

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11. The average net impact shows savings in pension cost per employee (BPS 1-19) either reducing the superannuation to 55 or increasing the retirement age to 62, against the superannuation age of 60. The negative sign reflects the increase in pension liability and the positive sign indicates the serving in pension liability

CAN FISCAL POLICY REDUCE INEQUALITY IN PAKISTAN?

Eisha Jawaid Khan

INTRODUCTION: THE BUDGET'S FORGOTTEN PROMISE

Every year, Pakistan's federal and provincial governments unveil budgets amid bold promises: infrastructure development, economic growth, job creation, and social relief. Despite these pledges, deep-rooted inequality persists, with millions trapped in poverty while wealth concentrates in the hands of a few.

This paradox raises an urgent question: Is fiscal policy bridging the inequality gap or widening it?

Fiscal policy has the potential to reduce inequality through two primary tools: taxation and public expenditure. Ideally, taxation ensures that those with higher incomes contribute more, while targeted spending supports vulnerable populations. However, in Pakistan, these tools often function in ways that reinforce rather than reduce disparities.

This article evaluates how fiscal policy can be realigned to serve as a tool of social equity, drawing on global examples and the current policy framework in Pakistan.

AROUND THE WORLD: BUDGETS THAT WORK FOR THE PEOPLE

Globally, fiscal policy has played a transformative role in reducing inequality. Countries like Brazil, South Africa, and Mexico have leveraged redistributive mechanisms to lift millions out of poverty.

A progressive tax system charges higher rates to higher income brackets, thereby redistributing wealth more equitably. By contrast, regressive taxes, like sales tax or VAT, take a proportionally higher toll on the poor. South Africa and Brazil have both employed more progressive tax policies, contributing to modest reductions in income inequality.

Direct income transfers, education subsidies, and health benefits are powerful equalizers. Brazil's Bolsa Família program, for example, has been widely praised for reducing both poverty and inequality by providing conditional cash transfers to the poorest households. Similarly, Mexico's Prospera program improved child health and school attendance among low-income families.

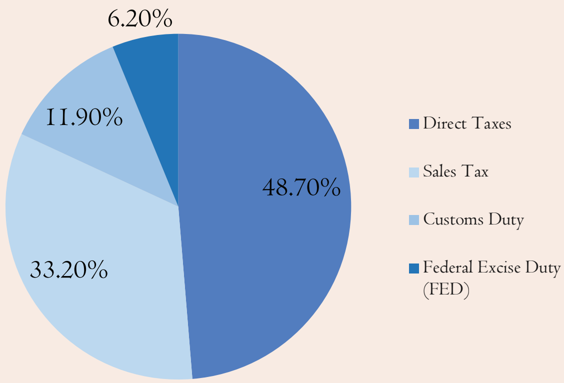
Universal access to public healthcare, education, and housing can drastically reduce out-of-pocket expenses for poor households, enhancing their economic security. The key lies in effective targeting, delivery, and governance—areas in which Pakistan still lags behind.

THE PAKISTANI PUZZLE: POLICIES WITHOUT PEOPLE

On paper, Pakistan has a range of redistributive policies, from progressive income tax brackets to cash transfer schemes. In practice, however, the implementation is flawed, and the fiscal framework disproportionately benefits wealthier groups.

Though Pakistan's income tax system is technically progressive, only 1% of the population pays direct taxes. The bulk of revenue comes from indirect taxes, such as sales tax and petroleum levies, which disproportionately impact low-income groups. In 2021, indirect taxes constituted nearly 60% of total federal revenue, exacerbating income inequality rather than mitigating it. In recent years, the country has initiated a shift from dependency on indirect taxes, lowering them to 51.3% (Figure 1). However, sales taxes, which are the main drivers of regressive taxation, remain a very significant part of the country's tax revenue system.

Figure1: Pakistan Tax Revenue Composition 2023-24



Source: Federal Board of Revenue [FBR], 2024

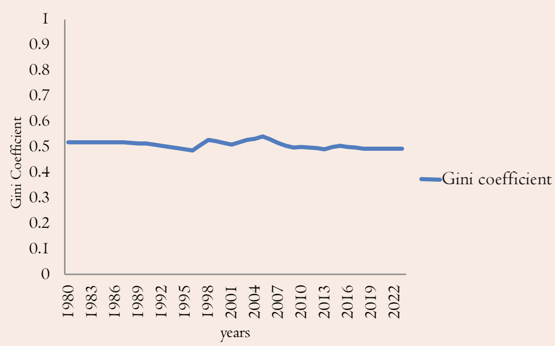
Large segments of government spending are allocated to blanket fuel, electricity, and agriculture subsidies, often dominated by wealthier interest groups. Simultaneously, tax exemptions for powerful sectors (e.g., real estate and agriculture) erode the government's capacity to fund pro-poor initiatives. While programs like the Benazir Income Support Programme (BISP) have made commendable strides in reaching the ultra-poor, their reach remains limited. BISP covers less than 10% of Pakistan's population, and millions who qualify are excluded due to data gaps, lack of awareness, or bureaucratic hurdles.

A significant share of development spending focuses on infrastructure projects in urban areas, with limited trickle-downn to rural or marginalized communities. This creates geographic disparities and sidelines regions most in need of public investment.

These policies lack fruitful coherence and intent. Despite decades of attempts, Pakistan's Gini Coefficient, a measure of statistical dispersion that represents income inequality within a nation, has remained stagnant at around 0.5 for the past 40 years (Figure 2)

Gini Index Of National Income, Pakistan 1980-2023

Figure 2: Gini Index of Pakistan 1980-2023



Source: World Inequality Database, 2025

THE BIG BLIND SPOT: WHO WINS AND WHO LOSES?

A core issue with Pakistan's fiscal management is the lack of robust policy analysis. Few efforts are made to evaluate who benefits from government spending or who bears the brunt of tax changes.

Globally, microsimulation models are used to assess the distributional impact of fiscal policies. These models simulate how changes in taxes or transfers affect household incomes across income brackets. In Pakistan, however, institutional capacity to use such tools is minimal. Policymakers often rely on anecdotal evidence or political considerations rather than empirical data.

This absence of analytical tools leads to suboptimal or even harmful policy decisions. For example, untargeted fuel subsidies often benefit higher-income hhouseholds, while the poorest 20% receive minimal relief. Conversely, spending cuts or tax increases, often part of IMF stabilization programs, tend to hurt the poor the most if not accompanied by compensatory social protection.
Without evidence-based policymaking, fiscal decisions can entrench inequality instead of correcting it.

WHAT NEEDS TO CHANGE

To turn fiscal policy into a genuine force for equity, Pakistan must undergo structural and institutional reform. Below are key recommendations grounded in the research:

Budgets must be evaluated not only for their impact on growth but for how they affect income distribution. Equity impact assessments should become a standard part of the policy design process; Reduce reliance on indirect taxes and strengthen direct taxation. Property taxes, capital gains taxes, and wealth taxes should be prioritized, while closing loopholes and eliminating exemptions for the powerful. Expand programs like BISP while integrating them with broader social registries. Use digital technologies and real-time data to better identify and serve vulnerable populations. Universal Basic Income pilots could also bee explored in extremely poor districts; Redirect development spending toward rural health, education, and infrastructure to reduce regional inequalities. This would also help mitigate urban migration and reduce pressure on urban services. Most importantly, the Planning Commission must engage citizens in the budgeting process through open budget portals and consultations. This can increase accountability and align spending with public needs. There is no shortage of academic research evaluating the impact of fiscal policy in Pakistan, it is time to acknowledge these efforts by making smart, evidence-based policy decisions.

CONCLUSION: A BUDGET THAT WORKS FOR EVERYONE

Pakistan faces a pivotal fiscal moment. Continuing with the current trajectory, where public finances often reinforce elite privilege, risks further polarizing society. Alternatively, a recalibrated approach that prioritizes fairness, evidence, and inclusion can turn the budget into a tool for transformative change.

Fiscal policy is more than just economics. It is a moral choice—a reflection of what kind of society we aspire to build. If Pakistan hopes to become more equitable, resilient, and humane, the journey must begin with how we raise and spend our public resources.

The budget is not just a technical document. It is a reflection of our values. Let it reflect fairness.

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GENDER RESPONSIVE BUDGETING

Dr. Fahd Zulfiqar

Gender Responsive Budgeting entails the process of adoption of public budgets for its securitization, allocation, and execution in a gender-sensitive fashion. The intent is not necessarily to allocate public budgets specially based on a person's gender, but to specify, audit, allocate and execute budgets to democratize the process, create equal opportunities and respond to gender-based inequalities in the society. Prioritizing gender responsive budgeting is concomitant to prioritizing budget allocations in key social and public policy areas where gender-based inequalities are rampant in Pakistan.

Speaking especially of Pakistan, the country ranked 142 out of 146 countries in the Global Gender Gap Index Report 2024. When disaggregated for educational attainment, economic participation, health and political empowerment, the situation becomes more dismal with Pakistan ranking 145th with respect to economic participation and economic opportunities for women, 135th in educational attainment for women, 143rd when it comes to healthcare and access, and 95th in political empowerment and participation. With statistics as grim as stated in the preceding text, the need for gender responsive budgeting is not just a normative concern, but also an incremental one, especially when half of the country's population is women.

The need for gender responsive budgeting was realized and hence been empirically operationalized by the Friedrich-Ebert-Stiftung in collaboration with the Omar Asghar Khan Foundation. The methodology adopted for targeting the areas where gender responsive budgeting can be made functional is the Gender Budget Tagging. The tagging methodology focuses on an array of areas ranging from social domains such as education health and employment to the systems and structures enabling ecosystem for gender inclusion and diversity. The targeting methodology was phased, including following three phases:

Phase 1: identifying the areas in the budget that have gender relevance.

Phase 2: specification of areas in the budget that have gender-relevant themes. Six such themes were identified: economic empowerment, economic services, climate change, gender-based violence, social protection and institutions ensuring women's rights.

Phase 3: assigning relevant weights to the themes to amplify the need for targeted budgeting for women's rights.

For the fiscal year 2023-2024, out of the total federal budget of PKR 14,454,563 million, PKR 949,778 million was included in the PSDP and PKR 13,504,778 million was allocated under the current budget. Of the total budget, only 3.38% was calculated to be of high relevance which could be of some use for women's practical needs, largely[1]. The lack of targeted investments, impact assessments of funds allocated to high-relevance themes, and gender assessments are also lacking.

One of the issues in the targeting methodology is that the definition of gender is confined to binaries only and hence doesn't categorically include the transgender persons. Secondly, the mere focus of federal and provincial budgets on women's practical needs is contriving, as for Pakistan, strategic needs are equally and at times more important such as body autonomy, legal, legislative and constitutional rights of women in Pakistan. Nevertheless, the gender targeting methodologies need to be applied widespread across federal and provincial government to reach at policy-level decision-making based on evidence, empirics and rigor. For evidence to inform pro-gender social and public policy, sex-disaggregated data will help specify the areas where more targeted allocation and auditing of budgets are needed for gender equality. For efficaciousness of investments in the projects of gender equality, integrating gender assessments in planning cycles is also critical. Investing in awareness, campaigning, dialogue and debate is also a key for behavioral change for women empowerment and inclusion.

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1. https://library.fes.de/pdf-files/bueros/pakistan/21283.pdf

BUDGETING FOR ECONOMIC DECLINE

Muhammad Mubasal

Pakistan's budget structure has fundamentally transformed between FY10 and FY25, creating severe fiscal constraints that threaten economic stability. After fifteen years of fiscal choices, Pakistan stands at the edge of economic disaster. A rigorous analysis of budget documents from FY10 through FY25 reveals not merely mismanagement, but a fundamental betrayal of the country's development path. Pakistan has effectively abandoned investment in its future to finance consumption today.

THE TRIPLE CRISIS: DEBT, DEVELOPMENT, AND TAXATION

The heart of Pakistan's fiscal crisis lies in three interconnected failures that have significantly worsened between FY10 and FY25.

First is the crushing debt trap that now dominates Pakistan's budget. Debt servicing has exploded by an astonishing 1,411% over fifteen years, from PKR 647 billion to PKR 9,775 billion. This single item now consumes 56.8% of all current expenditure and 7.9% of GDP (table 1). For comparison, the entire defense budget consumes just 12.4% of current expenditure. The debt service burden has reached levels that make meaningful economic policy nearly impossible.

Table 1: Social protection saw a staggering increase of 15,489% over the course of fifteen years, marking the highest growth in the budget. (All figures are in PKR Billion)

Sector	FY10	FY15	FY20	FY25	Total % Change FY10-FY25
General Public Services	1,189	2,543	5,607	13,640	1047%
-Debt servicing	647	1,440	2,892	9,775	1411%
-Pensions	70	175	421	1,014	1348.6%
Defence affairs	343	700	1,153	2,129	521%
Public order & safety	35	86	153	283	708.6%
Economic Affairs	85	48	84	358	321.2%
Environment Protection	0.4	0.9	0.5	7.3	1725%
Housing & Community Amenities	1.5	2.0	2.3	27.9	1760%
Health Affairs	6.5	10	11.1	28	331%
Recreation, Culture & Religion	3.7	7.1	9.8	18.5	400%
Education Affairs	31.6	64	77.3	104	229%
Social Protection	3.9	1.7	190.6	608	15489%

Source: Budget briefs of different fiscal years, Ministry of Finance

Second is the virtual abandonment of development spending that has occurred over this period. In FY10, the ratio between current and development expenditures was 2.2:1. By FY25, this ratio had catastrophically deteriorated to 10.3:1 (table 2). While current expenditure grew by 913%, development expenditure limped forward at just 119%. Even more telling, development's share of the total budget collapsed from 31% to a mere 8.9%. Pakistan is effectively consuming its seed corn rather than planting for the future.

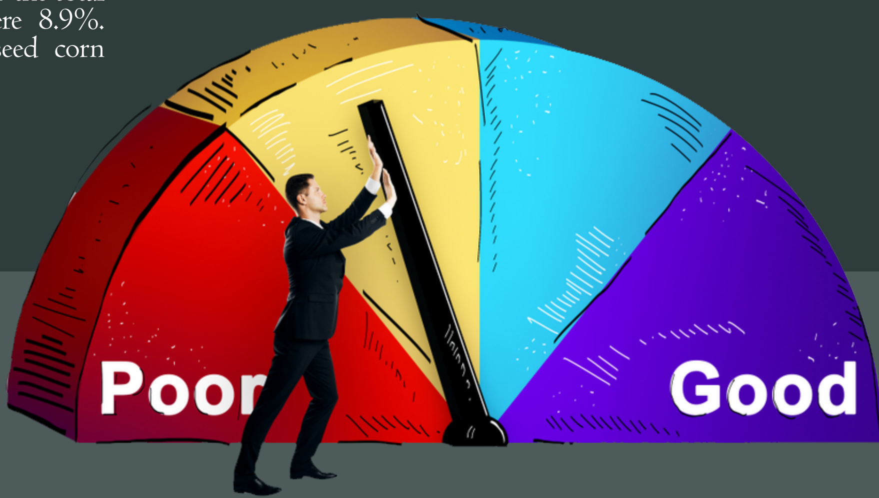

Table 2 The share of development in the budget has dropped from 31% to just 8.9% over the past fifteen years. (All figures are in PKR Billion)

Expenditure type	FY10	FY15	FY20	FY25	Total % Change FY10-FY25
Current expenditure	1,699	3,463	7,288	17,203	912.5%
Development Expenditure	763	839	950	1,674	119.4%
Current to Development Ratio	2.2:1	4.1:1	7.7:1	10.3:1	-
Development expenditure (% of budget)	31%	19.5%	11.5%	8.9%	-
Current expenditure (% of budget)	69%	80.5%	88.5%	91.1%	-
Current expenditure (% of GDP)	11.5%	11.9%	16.6%	13.9%	-
Development expenditure (% of GDP)	5.1%	2.9%	2.2%	1.3%	-

Source: Budget briefs of different fiscal years, Ministry of Finance

Meanwhile, the Public Sector Development Programme (PSDP) withered from 4.4% of GDP in FY10 to just 2.8% by FY25. This retreat from investment in infrastructure, energy capacity, and public services ensures Pakistan's growth potential remains permanently depressed.

Third is the persistent failure to expand the tax base. Despite fifteen years of promised reforms and an economy that grew by 737% in nominal terms, tax revenues increased by just 768% – barely keeping pace. The tax-to-GDP ratio remains stuck at around 10-11%, among the lowest in comparable economies.

This tax failure has forced increasingly desperate financing measures. State Bank of Pakistan profits (effectively printing money) increased by a staggering 1,567% over fifteen years. Bank borrowing – essentially pushing today's expenses onto future generations – grew by an even more alarming 3,471%. Meanwhile, external resources grew by just 31%, reflecting Pakistan's diminishing standing in international capital markets.

THE HUMAN COST: EDUCATION, HEALTH, AND FUTURE GROWTH

The most tragic aspect of Pakistan's budget evolution is the systematic underinvestment in its people. Despite rhetorical commitments to human development, the budget numbers reveal a stark truth: Pakistan has effectively chosen to sacrifice its future human capital to finance immediate consumption.

Education spending grew by just 229% over fifteen years from PKR 31.6 billion in FY10 to PKR 104 billion in FY25– less than one-third the rate of overall budget growth. Health allocations increased by 331%, better but still less than half the budget's growth rate. Combined, these two critical sectors receive a paltry 2.7% of current expenditure.

This underinvestment is not merely a moral failure but an economic one. Countries that have achieved sustained economic growth have invariably invested heavily in education and health. Pakistan's choice to neglect these sectors virtually guarantees continued economic underperformance and declining competitiveness in the global knowledge economy.

The contrast with other sectors is telling. While education and health were starved, pensions grew by 1,349%, defense by 521%, and subsidies by 933%. Most dramatically, social protection expenditures increased by an unprecedented 15,489% – from PKR 3.9 billion to PKR 608 billion.

This is not to suggest social safety nets are unnecessary, but rather that Pakistan has prioritized alleviating symptoms of poverty over addressing its root causes through education, healthcare, and productive infrastructure development.

THE ENERGY DRAIN: FIFTEEN YEARS OF FAILED REFORMS

No discussion of Pakistan's fiscal crisis would be complete without examining the energy sector's role. Despite at least five major reform programs across these fifteen years, power subsidies have grown by an extraordinary 1,676% – from PKR 67 billion to PKR 1,190 billion. This growth rate exceeds even the explosion in debt servicing.

These subsidies now consume 6.9% of current expenditure and represent a major failure of governance. Fifteen years of promised reforms have produced exactly one result: higher costs with little improvement in service. The power sector has become a financial black hole that diverts resources from productive investments while still failing to deliver reliable energy.

The contrast with food subsidies is instructive. Food subsidies decreased by 60% over the same period, from PKR 30 billion to PKR 12 billion, demonstrating that subsidy rationalization is possible when political will exists. The power sector's continued drain on public finances reflects not economic necessity but governance failure.

THE PROVINCIAL PARADOX AND CHANGING PRIORITIES

The implementation of the 7th NFC Award fundamentally altered Pakistan's fiscal landscape. Provincial share of federal resources increased by 1,036% over fifteen years, far outpacing the overall budget growth of 721%. Provincial governments now receive 41.8% of gross federal revenue, up from 32.6% in FY10.

This fiscal decentralization has produced mixed results. Provincial Public Sector Development Programmes grew at twice the rate of the Federal PSDP, indicating some potential for localized development planning. However, this shift has also created coordination challenges for national priorities and diluted accountability for development outcomes.

New budget priorities have emerged during this period. Climate change initiatives grew from negligible amounts to PKR 260 billion by FY25, reflecting both global commitments and recognition of Pakistan's extreme environmental vulnerability. Gender-responsive budgeting reached PKR 168 billion, and digital economy allocations increased substantially.

However, these emerging priorities remain dwarfed by the triumvirate of debt servicing, subsidies, and inefficient current expenditures. Their impact is further diminished by the overall collapse in development spending.

THE PATH FORWARD: DIFFICULT BUT NECESSARY CHOICES

Pakistan's budget trajectory over fifteen years points to an inescapable conclusion: the current fiscal framework is fundamentally unsustainable. Without significant structural reforms, Pakistan faces a future of perpetual economic crisis, stunted development, and diminished sovereignty as debt obligations consume an ever-larger share of public resources.

The budget data suggests five essential reforms:

1. Comprehensive debt restructuring to reduce the crushing burden of debt servicing that now dominates the budget. This will likely require difficult negotiations with both external and domestic creditors.

2. Dramatic expansion of the tax base, particularly bringing undertaxed sectors like retail, real estate, and agriculture into the tax net. The tax-to-GDP ratio must increase significantly to create fiscal space for development.

3. Fundamental power sector reforms that address governance and efficiency issues rather than merely adjusting tariffs. After fifteen years of failed half-measures, only structural solutions remain viable.

4. Rebalancing toward development expenditure, particularly in education and health. This will require difficult choices about reducing current consumption to finance future growth.

5. Rationalization of the current expenditure structure, including defense, pensions, and the bloated administrative apparatus that consumes resources without delivering services.

The article is an excerpt of report published by EPBD titled "Decoding Pakistan's Budget Dynamics: FY10 to FY25".

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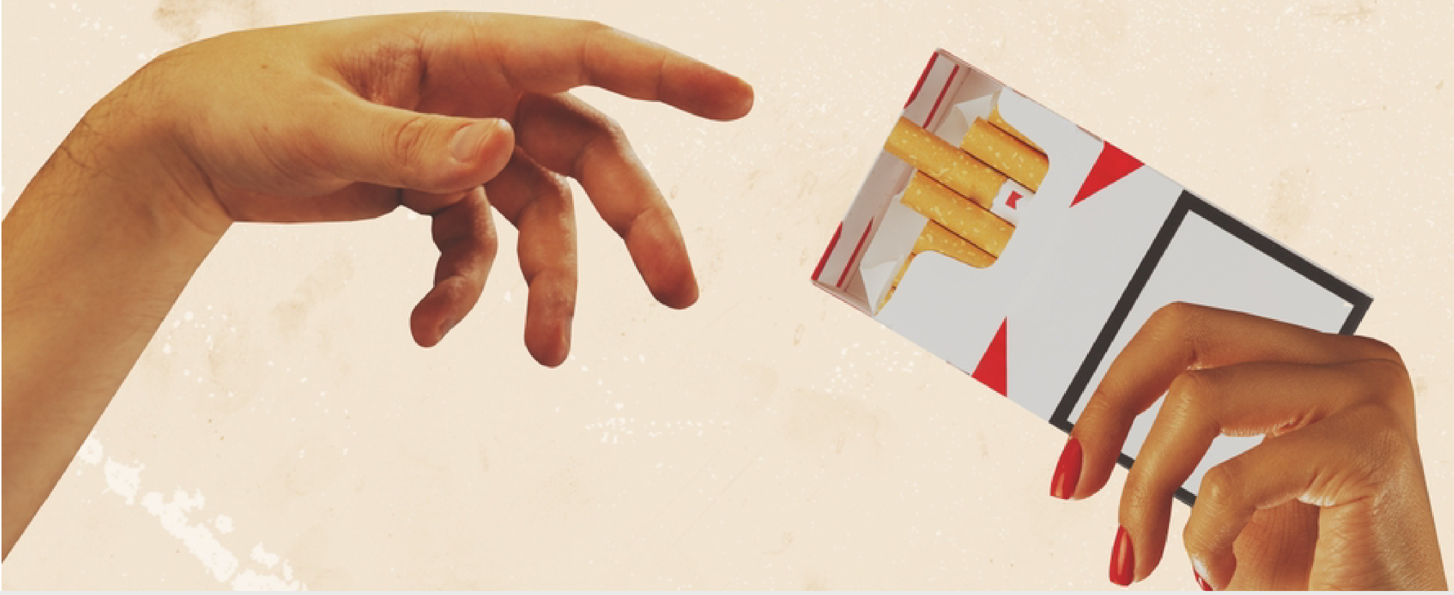


REVENUE VS EXPENDITURE; A CASE STUDY OF TOBACCO TAXES

Majida Yousaf

INTRODUCTION

Major environmental and health issues are associated with tobacco consumption. Consumption of tobacco comprises both smoking (roll-ups, cigars, and pipes) and smokeless formulas, all of which pose momentous health perils. The health issues formed by tobacco consumption are nicotine toxicity, pesticide exposure, and musculoskeletal injuries High death rates caused by prostate cancer are linked with smoking. Additionally, smokers have lower survival rates than other human beings. Research has shown that the harmful chemicals in tobacco not only exacerbate the risks of various cancers, but they also contribute to other chronic health conditions, including heart disease and respiratory illnesses. As awareness of these dangers grows, many countries are implementing stricter regulations to reduce smoking rates and promote healthier lifestyles The production of tobacco has detrimental effects on ranchers and societies in addition to its consumption. The production of tobacco negatively impacts the environment in such a way that it increases logging, soil attrition, water effluence, and biodiversity loss. The consumption of tobacco generates negative externalities in the economy. So a Pigouvian tax is the best justification for tobacco taxes. Pigouvian taxes increase the price of tobacco products. Pigouvian tax also highlighted the original social cost of its use to reduce its consumption. Public health theories also promote tobacco taxes to reduce smoking. The demand for tobacco products is inelastic to price. The change in consumption is less than the change in price, but demand for low-income groups and young people shows higher sensitivity to prices. In addition, there are significant social, economic, and developmental costs associated with tobacco smoking, which have a devastating effect on families, communities, and society. According to estimates, smoking costs the economy US$1.4 trillion annually in 2012, or 1.8% of the world's GDP. The significant negative effects of tobacco smoking on one's health and finances, which are likely to have risen since then, justify government intervention and stringent regulation of the tobacco product market. Beyond the urgent need to safeguard people's health and welfare, tobacco control should also aim to limit the market failures and adverse externalities associated with tobacco use, especially as these consequences can have a substantial influence on a nation's course for development (WHO report 2023).

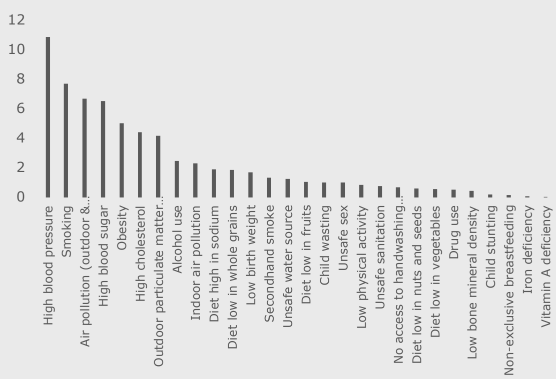
Pakistan is a developing country which have to finance its expenditure through revenue generated by taxes. Taxes are the major source of revenue in Pakistan. Taxes on tobacco consumption have also been seen a major source of government revenue. Taxation on tobacco is not only source of revenue for government but it is an effective way to reduce harms caused by tobacco consumption in Pakistan. In Pakistan, both GST and FED taxes were levied on tobacco production and consumption. Historically, Pakistan adopted a tiered tax system. A tiered tax system is a way of taxing different commodities according to their prices. But this system was not so workable in Pakistan because of the negative influence of corporate sectors. Pakistan has abridged its tax structure due to the force of WHO and native community health entities. Pakistan has moved toward a single-tier tax system in 2022. Numerous international commitments have been established to assess the economic impact over the past decade, particularly to deter tobacco usage and non-communicable diseases. These efforts are broadly aimed at reducing demand through pricing and taxation strategies. Global institution which includes WHO IMF and major philanthropic organizations agreed with WHO to accenting and firming the tax on tobacco use as a crucial health policy means. Most of the individuals knows very well that smoking and use of tobacco is very harmful for their health. But there are few who comprehend the gage of this harm.

HEALTH ISSUES AND EXPENSES CAUSED BY TOBACCO CONSUMPTION

More than 100 million of death in previous century were claimed by tobacco epidemic which were due to consumption of tobacco a use of second-hand smoke. This estimate is updated and now reaching 8 million deaths annually by use of tobacco. These estimates are for low- and middle-income countries which shows that how much global burden carried by developing world. Tobacco use causes many long-lasting diseases like cancer, premature deaths, lungs cancer, communally known as NCDS. To gauge the monetary cost of smoking attributable ailments in 2012, the cost illness approach was used. By using this approach economic cost might be direct or indirect. Direct cost includes hospitals bills whereas indirect cost is the loss of productivity by morbidity and mortality. This approach was employed for 152 countries with including all the essential data which signify 97% of worlds smokers. Health expenditure increases as the consumption of tobacco and smoking increases. Purchasing power parity (PPP) $467 billion (US$422 billion) was spent on smoking-related illnesses in 2012, which was accounted 5.7% of all health spending around the world. The yearly monetary cost of smoking was US$1436 or 1.8 percent of global GDP yearly. Nearly 40% of this expense was incurred in emerging nations, emphasizing the significant burden these nations tolerate.

According to the research, Pakistan's illegal cigarette sales are less than 9%, and the tobacco industry meticulously planned this revenue reduction (likely in 2013) in order to lower the excise rate. Three types of industry actions are highlighted: 1) forestalling, which involves producing more or stock in anticipation of a tax rise; 2) price over shifting, which involves raising the price of cigarettes above the tax rise and 3) overestimating the illegal trade by influencing public and legislators' perceptions.

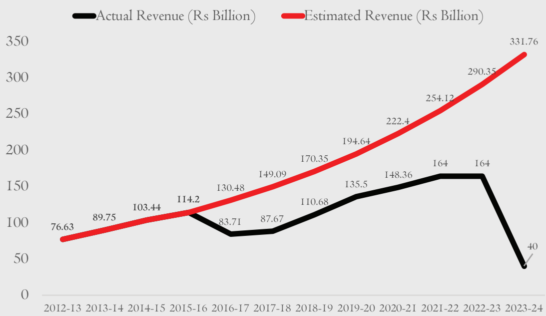
Deaths (millions)



Authors illustration

The Auditor-General of Pakistan (AGP) refuted the FBR's claims about the advantages of establishing the final level of the FED in a report that was sent to the special committee. The implementation of the third tier led to a 31% increase in the turnover of sales for Pakistan Tobacco Company and a 33% increase for Philip Morris International in the fiscal year 2017–18, according to the AGP (ibid). Currently the cost of tobacco use attributable diseases is RS 615.07 billion. RS 437 billion is the total direct and indirect cost which is formed by cancer, cardiovascular and respirational diseases. This cost is four time higher than the tax revenue collected by the government on tobacco consumption Nayab et al.

REVENUE LOSS BY REDUCTION IN TOBACCO CONSUMPTION



During the fiscal period of 2012-2013 the tax revenue of tobacco consumption is RS 76 billion which increased to RS 89 billion in 2013-2014. In 2014- 2015 the government meet the target of collecting revenue of RS 103.44 billion as previous year. In next fiscal year government collected revenue with 10% YOY growth. Authors illustration

In fiscal year 2019-2020 the tobacco industry generated revenue of RS 110.68 billion in contradiction of the target of RS 194 billion but the actual collection decline by -2.99 percent YOY. The revenue collected by FBR in fiscal year 2021-2022 is RS135.30 billion against 222.40 billion with more than 22% yoy growth. The tobacco industry's tax was estimated to be RS 290.35 billion in FY 2022–2023, while the actual amount collected was RS 164 billion, representing a 10.33% YoY increase. According to the statistics, the government expected to collect RS 1795.46 billion between 2013 and 2023 (FBR 2023), though the actual amount collected was RS 1228.12 billion. In summary, the tobacco industry's influence caused the government to lose RS 567.34 billion in revenue during this time. The gap is that government has fear of illicit trade due to which it is not putting tax on tobacco industry and lost a huge amount of tax revenue.

POLICY RECOMMENDATION

Numerous studies and evaluations of the illegal tobacco product trade have shown that strengthening the ability to combat the trade is a more effective strategy to address the issue than avoiding tax increases. Thus, the connection between illicit commerce and good governance must be taken into account. The level of illicit commerce will decrease in a nation with greater capacity to combat it overall. In addition to raising revenue tax policy should work to reduce the consumption of tobacco, it will improve the public health. Government should need to simplify tobacco tax structure, increase impact price level rates and adjust these rates on regular basis to account of economic growth and inflation. Government should excise tax strategy to reduce consumption of tobacco. Because excise taxes have the power to increase both absolute and relative costs, they are the most important taxes imposed on tobacco goods. Increases in the tobacco excise tax also bring in a sizable amount of revenue that will be maintained throughout the short to medium term. Long-term reductions in tobacco use and its effects will be much greater if tobacco taxes are raised further and other evidence-based tobacco control policies and programs are put into place. The implementation of a complete plan to decrease tobacco use maximizes the efficacy of tax increases in accomplishing public health goals, promotes public and political support for higher prices, and results in larger reductions in the adverse effects of tobacco use.

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FEDERAL BUDGET FY 2025-26: PAKISTAN'S OPPORTUNITY TO MANAGE FISCAL UNCERTAINTY

Amna Riaz

Pakistan's economic policymaking has long been clouded by unpredictability, especially in the realm of fiscal planning. Fiscal policy, a key instrument for steering economic activity, has in Pakistan been consistently undermined by erratic tax changes, inconsistent public spending, and ad hoc borrowing strategies. This persistent volatility—commonly referred to as Fiscal Policy Uncertainty (FPU)—has evolved into a structural constraint. It undermines macroeconomic stability, discourages investment, and stifles long-term growth.

As Pakistan prepares for Budget 2025–26 amid deepening economic fragility, understanding and addressing FPU is not just relevant—it is urgent. The upcoming budget presents a critical opportunity to move beyond routine expenditure frameworks and toward meaningful macroeconomic reform. Tackling FPU is essential for restoring investor confidence, ensuring policy credibility, and unlocking the full potential of fiscal tools.

Recent empirical evidence reveals the damaging effects of FPU. Riaz (2022), using a Vector Autoregressive (VAR) model based on data from 1980 to 2019, showed a significant negative effects of FPU on macroeconomic performance. For instance, in the short run, uncertainty depresses private investment and output growth; in the long run, it results in persistent underperformance across multiple economic indicators from GDP to employment.

Similarly, Waheed (2020) estimates the economic cost of fiscal uncertainty and showed that fiscal uncertainty alone can reduce GDP growth by up to 1.2% annually and crowd out up to 15% of private investment. Such staggering numbers reflect how the absence of credible, transparent fiscal planning restrains economic potential and leads to inefficient resource allocation. The table below consolidates the estimated short- and long-term effects of fiscal policy uncertainty on key economic indicators:

Table 1: Effects of policy uncertainty in Pakistan

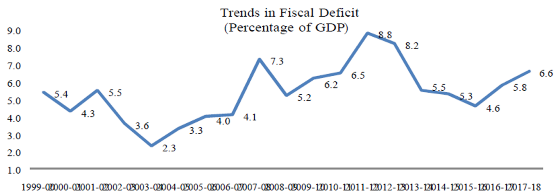
Economic Indicator	Short-Run Impact	Long-Run Impact
GDP Growth	-0.8%	-1.2%
Private Investment	-10%	-15%
Inflation	+0.5%	+1.0%
Employment	-2%	-3.5%
Public Investment	-5%	-8%
Exchange Rate Volatility	High	Persistent

The evidence suggests that fiscal policy uncertainty is not just a macroeconomic nuisance; it is a structural bottleneck. The government's inability to offer stable and predictable fiscal signals fuels speculative behavior in markets, discourages long-term investment, erodes investor confidence and misaligns resource allocation. It also diminishes the effectiveness of other policy instruments, such as monetary policy and public investment frameworks.

If the upcoming budget fails to confront this foundational issue, it risks repeating the past, missing growth targets, deepening market uncertainty, and leaving Pakistan trapped in a cycle of economic instability.

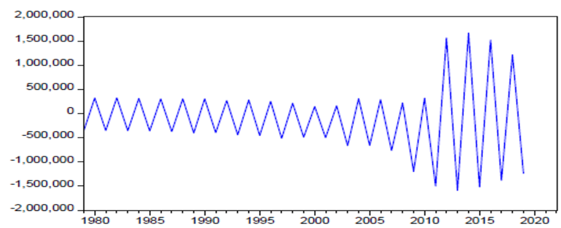
The fiscal performance of Pakistan's austerity measures has exhibited varied trends over the past few decades. The figure 1 illustrates the recorded progress of tax achievement. During the 1990s, the country experienced significant fiscal imbalances, largely due to weak revenue mobilization, high non-development expenditures, and rising public debt. The fiscal performance of the country showed notable improvement from 2002-03 to 2006-07, supported by economic reforms and better macroeconomic management. Following the period of 2006-2007, there has been a notable decline in fiscal outcomes, with the average budget deficit consistently hovering around 7% of GDP from 2008 to 2013. The situation primarily resulted from reduced tax collection, influenced by slower economic growth, persistent losses from inefficient public sector enterprises, increased public expenditures in response to severe flooding, rising debt service obligations, and sharper-than-expected revenue shortfalls. The graph below illustrates the evolution of the country's budget position from 2000 to 2018, highlighting the cyclical nature of fiscal policy and its structural weaknesses.

Figure 1: Trend Analysis of Fiscal Policy Determinants and Growth



This figure 2 illustrates Fiscal Policy Uncertainty over time, from 1980 to 2020, likely based on a measure of fluctuations in fiscal variables around expected trends or projections.

Figure 2: Fiscal Policy Uncertainty (FPU)



Source: Sheeba Waheed (2020)

GLOBAL EVIDENCE OF FISCAL POLICY UNCERTAINTY (FPU):

Across a range of economic systems—from advanced economies like the United States to emerging markets such as China—empirical research consistently shows that fiscal policy uncertainty (FPU) has recessionary effects on output, investment, and employment. These findings highlight a crucial lesson for countries like Pakistan: without credible and predictable fiscal planning, even structurally sound economies struggle to maintain growth and stability.

A study by Anzuini and Rossi (2021), finds that in US Fiscal policy uncertainty shocks have clear recessionary effects. An increase in fiscal uncertainty significantly lowers output, industrial production, and employment. For instance, in our VAR estimates, industrial production drops by 0.13% and employment by 0.08% following a one standard deviation FPU shock. These effects are even stronger in constrained environments like the zero lower bound (ZLB), where the inability of central banks to offset shocks amplifies the recessionary outcome.

Complementing these findings, Fernández et al. (2015) employ a New Keynesian business cycle model with time-varying volatility in tax and spending processes to analyze fiscal uncertainty in the U.S. They find that fiscal volatility shocks substantially reduce economic activity, with contractionary effects comparable to a 25-basis-point increase in the federal funds rate. This underscores the powerful dampening effect of fiscal uncertainty on consumption, investment, and output.

Similarly, Born and Pfeifer (2021) investigates the impact of policy risk—defined as uncertainty surrounding monetary and fiscal policy—on business cycle fluctuations in the U.S. Using an estimated New Keynesian model with Sequential Monte Carlo Methods, they find that while policy risk is empirically significant, its "pure uncertainty" effects on output are relatively small due to dampening general equilibrium mechanisms and counteracting partial effects. However, the study suggests that persistent unpredictability in fiscal policy can have meaningful macroeconomic consequences, particularly in environments already marked by structural weaknesses.

Fiscal policy uncertainty (FPU) can remain high even in countries with sustainable public finances, particularly when political polarization and weak fiscal frameworks are present (Kontopoulos & Perotti, 2002; Roubini & Sachs, 1989). In such settings, political transitions or unstable coalitions often result in erratic or unpredictable shifts in fiscal policy, amplifying FPU. Moreover, even in fiscally stable and institutionally sound countries, unexpected events can trigger fiscal uncertainty shocks that dampen economic activity by increasing precautionary savings and delaying private investment, ultimately leading to slower growth and reduced employment.

Adding to the global perspective, Empirical evidence from China's new energy sector (2007–2019) highlights the negative impact of fiscal policy uncertainty on corporate innovation investment. Wen et al. (2022) finds that FPU significantly reduces innovation spending, primarily by weakening the incentive effect of government support. Secondly, product market competition helps mitigate the adverse effects of FPU, lending support to the strategic growth option theory. Third, the main channel through which fiscal uncertainty constrains innovation is through bank credit constraints, as firms experience tighter lending conditions during uncertain fiscal environments

Together, these studies emphasize that fiscal policy uncertainty is not merely a cyclical challenge—it is a structural risk. When fiscal frameworks lack credibility, and political signals are erratic, uncertainty becomes embedded in the economy, distorting investment decisions, increasing precautionary savings, and ultimately slowing long-term growth. For Pakistan, where institutional capacity is weaker and fiscal vulnerabilities are higher, the implications of this global evidence are particularly sobering.

REFORMING THE FISCAL FRAMEWORK

What Pakistan needs now is a credible, transparent, and forward-looking fiscal policy framework. Anchoring fiscal rules, establishing independent fiscal councils, and releasing medium-term budget frameworks can help reduce the uncertainty premium embedded in investment and lending decisions. Moreover, eliminating arbitrary tax exemptions, expanding the tax base, and capping unproductive spending will improve both the efficiency and predictability of fiscal operations.

The solution lies not just in increasing allocations but also in creating predictability, transparency, and alignment with long-term objectives. This requires introducing a rules-based fiscal framework embedded in law, coupled with an annual "Fiscal Confidence Report" assessed by an independent council. It also means protecting development spending from political cycles and ensuring that all new expenditures meet clear economic and social return criteria.

The link between fiscal uncertainty and poor planning outcomes is not just theoretical. It is evidenced in the persistent mismatch between policy goals and fiscal actions. If 2025–26 is to be different, it must mark the beginning of a new fiscal doctrine—one centered on predictability, productivity, and participation.

Pakistan is preparing to announce next fiscal budget for 2025–26. The persistent economics fragility measured by low and cyclical economics growth (this year projected growth is around 2.6% well below to population growth), mounting debt—and inflation. Among others, the least discussed yet most impactful factors is fiscal policy uncertainty.

IMPACT OF FISCAL POLICY UNCERTAINTY

Drawing from recent research on the impact of fiscal policy uncertainty on macroeconomic performance in Pakistan, it is evident that unpredictable fiscal strategies have become a systemic drag on investment, consumption, and overall economic stability.

Fiscal policy uncertainty in Pakistan has historically stemmed from three main sources: frequent changes in tax regimes, volatile expenditure patterns, and ad hoc government borrowing. These inconsistencies create confusion among investors, both domestic and foreign, and undermine the confidence of the business community. When policies shift with every budget cycle or political change, businesses are unable to plan long term, leading to underinvestment in productive sectors.

Evidence indicates that high fiscal uncertainty significantly reduces private sector investment and depresses GDP growth. The negative effects are even more pronounced in Pakistan due to the absence of strong stabilizing institutions. Moreover, inflationary pressures become exacerbated when fiscal uncertainty translates into monetary instability — as budget deficits are often financed through borrowing from the central bank, weakening the rupee and increasing inflation.

One of the central findings is the asymmetric impact of fiscal uncertainty on different components of the economy. Consumption contracts more sharply during periods of high uncertainty, and government capital expenditures — the kind that foster long-term growth — are usually the first to be cut. This short-termist approach is deeply problematic and perpetuates a cycle of low growth and high vulnerability.

Table 4: Impact FPU on Economic Indicators

Economic Indicator	Short-run Impact (%)	Long-run Impact (%)
GDP Growth	-0.8	-1.5
Private Investment	-1.2	-2.1
Public Investment	-0.6	-1.3
Inflation	+0.5	+1.2
Interest Rate	+0.7	+1.5
Exchange Rate Volatility	+1.1	+2.0
Employment Rate	-0.9	-1.7
Consumer Confidence	-1.4	-2.3

Table 4 showing that FPU has significant and far-reaching consequences for Pakistan's economic trajectory. In the short run, it reduces GDP growth by 0.8%, and in the long run, the drag intensifies to 1.5%, clearly underscoring the structural damage it inflicts on long-term development. The investment climate is particularly vulnerable, with private investment declining by 2.1% in the long run. This contraction reflects how fiscal unpredictability undermines investor confidence, deters business expansion, and discourages foreign direct investment. Public investment also suffers, weakening infrastructure development and service delivery, further impeding growth potential.

Moreover, fiscal uncertainty fuels macroeconomic instability. Inflation and interest rates tend to rise in response to erratic fiscal signals, imposing additional burdens on households and firms. Exchange rate volatility also intensifies, with a long-run impact of 2.0%, disrupting trade competitiveness, remittance flows, and capital inflows. These fluctuations make long-term planning difficult for businesses and policymakers alike. Finally, fiscal volatility erodes employment prospects and weakens consumer confidence—both critical drivers of aggregate demand and inclusive economic growth.

CONCLUSION

FPU carries significant economic costs. It depresses growth, deters investment, undermines macroeconomic stability, and erodes public trust in government decision-making. As the evidence shows, both short-run and long-run impacts of FPU on GDP, investment, inflation, and employment are substantial. To mitigate these risks, Pakistan's budget for 2025–26 must be more than a revenue-expenditure statement—it must be a strategic tool for restoring credibility and ensuring predictability.

If upcoming Budget is to break from the past, it must move beyond firefighting. It must build trust. That starts with anchoring fiscal policy in predictability, transparency, and law—not political cycles. Without such a reset, uncertainty will remain Pakistan's most predictable fiscal outcome.

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SPECIAL BUDGETARY ALLOCATION: ENHANCING PAKISTAN'S NETWORK CENTRICWARFARE (NCW) CAPABILITIES

Dr. Fida Muhammad Khan

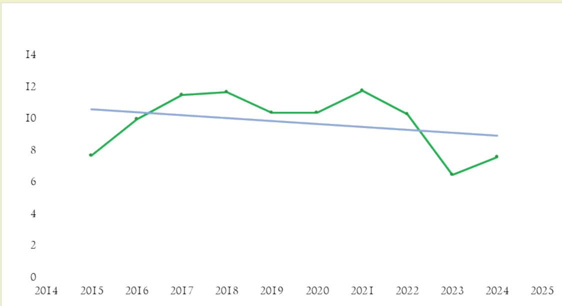
INTRODUCTION

One of the core strengths of network-centric warfare (NCW) is its potential-within certain limits-to offset disadvantages in numbers, technology, or position (Alberts et al., 1998). If we choose to fight on a network-centric rather than a platform-centric basis, we must fundamentally change how we train, organize, and allocate our resources (Alberts et al., 1998). Unfortunately, defense budgets often become the subject of public debate and criticism, fueled by media perceptions and political motives. However, it is crucial to understand that all else becomes irrelevant if the sovereignty of a state is endangered. To ensure a sovereign state-protected from threats, especially security threats that endanger its very existence and the honor of its people-it is vital that the state has a strong defense capable of deterring any aggressor, whether from outside or from any internal elements threatening the state and its people. A strong defense, therefore, is not a choice; it is a compulsion-a vital ingredient for survival. Defense budgets must be allocated with the prevailing threat environment in mind; this is not a matter of preference, but of necessity.

THE STATE OF OUR DEFENSE BUDGET OVER THE LAST DECADE

Over the past ten years, while Pakistan has been fighting on multiple fronts-countering terrorism, foreign-funded insurgency, and internal threats such as the Fitna-al-Khawarij-the armed forces' budget has been on a decreasing trend (figure 1). This is alarming for several reasons. It indicates that the parliament and policymakers have not fully appreciated the importance of military spending, especially when the country's armed forces face daily operational challenges. This downward trend (fig 1) becomes even more concerning when one considers the persistent and growing threat posed by India, which in recent days has made public statements about removing Pakistan from the face of the earth (Express Tribune, 2024). Modern warfare cannot be taken lightly; if this trend continues, it will eventually choke the armed forces, making it increasingly difficult to fight insurgents and terrorist entities-groups in which our enemies are investing heavily. And will also pose a grave challenge to deter the enemy.

PAksitan's Defense allocation over past ten years in USD millions



THE CHANGING NATURE OF WARFARE: WHY NCW IS ESSENTIAL

The world has changed. Modern warfare is quicker, more lethal, and significantly more expensive compared to wars of the past. NCW represents the new art of war,-a doctrine that aims to achieve information superiority over the enemy in a combat environment, enabling rapid decision-making and mission accomplishment (Garstka, 2003). In most cases, it is not just about who possesses this capability, but about who employs it early and executes it effectively. This capability comes at a financial cost, but a nation must be prepared to bear this cost, as the very survival of the state is at stake.

Information sharing, shared awareness, quick decision-making, and auto-synchronization of all players-enabled by high-performance information grid links-are the key features of NCW (Alberts et al., 1998; Garstka, 2003). This requires a constant inflow of funds. Below, I outline the key areas where NCW requires investment, which should be a central consideration in this year's defense budget allocation.

> One of the strengths of network-centric warfare is its potential, within limits, to offset a disadvantage in numbers, technology, or position.(Network-Centric Warfare - Its Origin and Future, 1998)

KEY NCW INVESTMENT AREAS

1. DEVELOPMENT, DESIGN, AND MAINTENANCE OF KEY INFRASTRUCTURE

In future wars and conflicts, Pakistan will have to rely on its own resources and make the best and most optimal use of them. NCW , as a doctrine, can turn our small numbers-otherwise a disadvantage-into an advantage. The first and foremost ingredient of a battle-worthy NCW-based defense is the required IT infrastructure. NCW relies on an efficient and secure IT infrastructure. High-performance information grids are essential for communication, computing, and serving as a strong backplane for supporting sensors and engagement systems. At the core of any NCW operation is the ability of the IT infrastructure to provide a real-time, complete picture of the battlefield to all players. This requires a robust, agile, and most importantly, secure NCW-oriented IT infrastructure. The high-performance grid and secure network backplane or backbone will require significant investment. The budget for 2025-26 should therefore have sufficient provisions for financing the development and adaptation of such infrastructure.

A high-performance, secure network backbone-information grid or backplane-is critical for NCW. It connects all nodes (sensors, command centers, shooters) across the battlespace, supporting multi-mode communications (wired, wireless, satellite, radio), dynamic routing, beyond-line-of-sight connectivity, and resilience to failures. It also enforces quality of service (QoS) parameters and robust security features such as encryption and intrusion detection (Defense News, 2022). Globally, nations are responding to the impact of IT advancements on warfare. For instance, in 2021, the U.S. Pentagon requested nearly \$11.9 billion for NCW modernization, with significant allocations for tactical network transport and secure communications (US DoD, 2021). India, Pakistan's primary regional rival, has invested approximately \$3 billion in establishing a strong communications network for its armed forces (Jain, 2023). International trends indicate that 30–45% of NCW investment should be directed toward developing and maintaining the information grid, as it is the backbone upon which all C4ISR (Command, Control, Communications, Computers, Intelligence, Surveillance, and Reconnaissance) operations depend (Market Research Future, 2024). The success of C4ISR will be deter mined by the quality and strength of the backplane.

2. SENSOR GRIDS

Sensor grids are another crucial component of NCW-based operations. All data collection units-whether ground-based radars, air defense systems, airborne AEW&CS, or satellites-serve as sensors. In NCW operations, these sensors must fuse data to create a complete, real-time picture of the battlespace. The data provided by the sensor grid is then processed and distributed by the information grid to command centers and shooters (Alberts et al., 1998). Global benchmarks suggest that at least 25% of NCW investment should be allocated to the improvement and development of sensor grids (Market Research Future, 2024).

Global Investment in Sensor Grids for NCW

Country	% of NCW Budget	Focus & Highlights
United States	25% – 40%	Heavy ISR, UAVs, satellites, radar networks. Sensor grids are a major NCW priority.
China	30% – 40%	Integrated sensor networks, space-based ISR, large UAV fleets for battlespace awareness.
India	35% – 45%	Radar modernization, UAVs, satellite sensors for situational awareness and data fusion.
Israel	40% – 50%	Sensor fusion, multi-sensor integration, real-time data sharing for battlefield superiority.
Russia	25% – 35%	Radar modernization, EW sensors, UAVs; significant but less transparent.
Japan & S. Korea	30% – 40%	Modernizing sensor networks, maritime radar, UAV surveillance for regional threat response.
Australia	25% – 35%	Sensor integration for joint ops and maritime domain awareness.
Gulf States	30% – 40%	Advanced radar, UAV, satellite sensors for situational awareness and air defense.

Table I provides a brief outlook of investments in sensor grids across different countries, illustrating that a minimum of 25% investment is required to ensure sensor grid improvement and development. The additional defense package I propose should account for this essential pillar of NCW.

3. ENGAGEMENT GRIDS

Engagement grids are networked systems that connect shooters and weapons platforms to sensor grids, allowing militaries to translate situational awareness into rapid, coordinated combat actions. Investment in engagement grids typically covers networked weapon systems (such as precision-guided munitions and hypersonic missiles), advanced fire control and targeting systems, secure communications infrastructure (including 5G and SATCOM), and AI-driven decision aids (Jain, 2023; Defense News, 2022). Globally, leading countries allocate about 20–45% of their NCW budgets to engagement grids. For example, the United States spends an estimated $15–24 billion annually, focusing on programs like JADC2, AEGIS, and F-35 sensor fusion, while China, Israel, India, and Russia also invest billions in integrating advanced missile systems, UAVs, and joint fires networks to enhance their engagement capabilities (US DoD, 2021; SIPRI, 2023).

Within each military branch, the nature of engagement grid investment varies. Armies prioritize networked artillery, integrated air and missile defense, and AI-driven targeting for ground forces. Navies focus on ship-based strike networks, cooperative engagement capabilities, and the integration of unmanned surface and underwater vehicles for distributed lethality. Air forces invest heavily in fifth-generation fighters (like the J-20, J-31, F-35,-Su-57), loyal wingman UAVs, and advanced battle management systems to enable multi-domain operations and real-time sensor-to-shooter links (Garstka, 2003; SIPRI, 2023). The costs for these upgrades are substantial, with advanced air forces and navies spending billions annually to maintain technological superiority.

Fifth-generation fighters and advanced UAVs/UCAVs play a pivotal role in modern engagement grids. These platforms act as network nodes, fusing sensor data and coordinating with other assets to execute precision strikes and swarm tactics. Stealth fighters provide first-look, first-kill advantages, while autonomous UAVs enable massed, resilient attacks and rapid ISR-strike loops. Ultimately, robust engagement grids are essential for compressing decision cycles, achieving massed effects, and maintaining the speed of command that defines success in network-centric warfare. Without these investments, even the best sensor and information grids cannot be fully exploited for battlefield dominance.

4. C4I SYSTEMS

Command, Control, Communications, Computers, and Intelligence (C4I) systems form the backbone of NCW, enabling rapid, accurate decision-making and coordinated action across the battlespace. Investments in C4I innovations focus on integrating existing command and control systems with advanced communication networks, computing infrastructure, and intelligence processing capabilities. This integration transforms raw data from sensors and reconnaissance assets into actionable intelligence, delivered in real time to commanders and warfighters (Alberts et al., 1998; Garstka, 2003). Modern C4I systems emphasize machine-to-machine data exchange, automated data fusion, and decision-support tools that enhance the speed and quality of command decisions while maintaining human oversight. The goal is to create a seamless "system of systems" where sensors, shooters, and command centers operate in a tightly coupled network, enabling shared situational awareness, increased tempo of operations, and self-synchronization of forces.

Global trends in C4I investment reflect the increasing complexity and scale of modern warfare, with major military powers prioritizing the modernization of their command and control architectures (US DoD, 2021; Jain, 2023). The United States, for example, continues to develop the Joint All-Domain Command and Control (JADC2) initiative, which integrates air, land, sea, space, and cyber domains through a resilient, cloud-enabled network. Similarly, allied nations and competitors invest heavily in upgrading their C4I capabilities, focusing on secure communications, advanced computing platforms, and artificial intelligence to automate data processing and enhance decision-making (SIPRI, 2023). Commercial off-the-shelf (COTS) technologies are increasingly leveraged to accelerate deployment and reduce costs, though integration and performance assurance remain challenging. Cybersecurity is a critical component, with investments ensuring the protection and resilience of C4I networks against sophisticated cyber threats. All around the world, militaries are realizing that to truly gain an edge in information and outperform adversaries in network-centric warfare, investing in top-tier C4I systems is absolutely vital..

Within military forces, investment in C4I systems spans all branches, reflecting their central role in joint operations. The Army focuses on mobile, robust command posts and battlefield management systems that enable real-time coordination of ground forces and integration with air and naval assets. Navies invest in shipboard C2 systems and secure, long-range communications, while air forces prioritize real-time data links, advanced mission planning, and automated threat detection. Across all domains, the emphasis is on interoperability, resilience, and the ability to operate in contested, degraded environments.

THE IMPORTANCE OF ADVANCED CHINESE FIGHTERS AND UPGRADING JF-17 CAPABILITIES

A critical component in strengthening Pakistan's NCW capabilities is the acquisition of advanced multi-role fighter aircraft and the modernization of existing platforms. Procuring advanced Chinese fighters such as the Chengdu J-10C offers a significant leap in operational capability. These aircraft are equipped with state-of-the-art Active Electronically Scanned Array (AESA) radars, advanced electronic warfare (EW) suites, and integrated data links that are essential for network-centric operations (Global Times, 2023). The successful use of the J10-c in BVR dog fight, where it downed Dassault Rafael speak the high return on investment of the J10 c, its integration with other system in the Pakistan's defense architecture.

Upgrading the JF-17 fleet with Chinese KLJ-7A v2 AESA radars or JF-17 Block 4 with KLJ-7a V2 and enhanced EW systems will further ensure that Pakistan's frontline fighters can operate as effective sensor and shooter nodes within the NCW framework (Defense News, 2022). These upgrades are essential to ensure smooth real-time data sharing, electronic countermeasures and multi-target engagement, which are vital for survivability and mission effectiveness in a contested environment. The integration of these technologies will not only enhance the Pakistan Air Force's ability to maintain air superiority but will also provide a force multiplier effect across the entire networked battlespace.

It is therefore the need of the hour to allocate funds for the upgrades, production (JF-17 block 3 and Possibly a superior variant of the JF-17) as part of enhancing overall capability of the Pakistan Armed forces in multi domain warfare. And acquire newer more advanced platforms.

NAVAL ARTILLERY, SAM SYSTEMS FOR THE ARMY, AND ANTI-SHIP/ANTI-AIR MISSILES FOR THE NAVY

To achieve true network-centric synergy across all branches of the armed forces, Pakistan has made significant progress in acquiring and operationalizing modern platforms, but further investment and integration remain essential. The Pakistan Navy has already inducted advanced Chinese systems such as the Type 730 and Type 1130 close-in weapon systems (CIWS) and the H/PJ-38 130mm naval gun, now operational on the latest Type 054A/P frigates, greatly enhancing layered defense and firepower (Jane's Defence, 2024). However, to fully realize the potential of networked maritime warfare, Pakistan must accelerate the integration of next-generation anti-ship cruise missiles like the YJ-18, and pursue the acquisition of the YJ-12 and long-range naval SAMs such as the HHQ-9. These systems will enable the Navy to deliver rapid, coordinated responses to both surface and aerial threats, closing the sensor-to-shooter loop in real time (Global Times, 2023).

On the land front, the Pakistan Army has already fielded the HQ-9B long-range surface-to-air missile system, providing robust area defense against advanced aerial threats. Yet, to ensure comprehensive, multi-layered protection and seamless integration with battlefield management systems, it is critical to acquire and operationalize additional platforms such as the HQ-16 for point defense and mobile operations (SIPRI, 2023). These future acquisitions will enable the Army to respond to evolving threats with greater agility and precision, while enhancing interoperability with air and naval assets in joint operations.

Looking ahead, Pakistan's continued investment in these advanced Chinese platforms is not just about expanding firepower, but about embedding interoperability, rapid data integration, and real-time decision-making at every level of the military. By acquiring and integrating these capabilities, Pakistan will be able to compress the sensor-to-shooter loop, maximize the effectiveness of its NCW doctrine, and maintain a credible deterrent in a rapidly evolving regional security environment. Prioritizing these acquisitions in the upcoming defense budget is essential for achieving true network-centric warfare capability and ensuring national security in the face of emerging threats.

While the Pakistan Army has made strides in modernizing its artillery arm, particularly with the induction of the A-100E multiple launch rocket system (MLRS) and the SH-15 155mm wheeled self-propelled howitzer-both capable of precision strikes and networked fire missions-significant gaps remain in achieving true network-centric synergy.

Current precision-guided munitions (PGMs) and digital fire control systems provide improved accuracy and responsiveness, but the majority of tube artillery still relies on legacy platforms with limited automation and integration. To fully exploit the advantages of NCW, Pakistan must invest in next-generation artillery systems such as the Chinese PCL-181 155mm self-propelled howitzer and advanced PGMs, which offer longer range, rapid deployment, and digital connectivity for real-time targeting and sensor-to-shooter integration (Jane's Defence, 2024; SIPRI, 2023).

Additionally, acquiring automated artillery fire direction centers, battlefield management systems, and counter-battery radars will enable the Army to conduct coordinated, precision strikes in joint and multi-domain

THE STRATEGIC NEED FOR PROCURING CHINESE DEFENSE TECHNOLOGIES

The availability of these advanced Chinese platforms presents Pakistan with a unique opportunity to rapidly enhance its NCW capabilities while maintaining cost-effectiveness and technological compatibility. Chinese defense products are not only battle-tested by PAksitan and reliable but are also designed with network-centric integration in mind (Jane's Defence, 2024). By investing in these systems, Pakistan can achieve a high degree of interoperability across its air, land, and sea domains. This will enable seamless data sharing, coordinated targeting, and synchronized operations-key tenets of NCW. Moreover, the strategic partnership with China ensures technology transfer and long-term support, allowing for continuous upgrades and adaptation to emerging threats. The timely procurement and integration of these platforms should be prioritized in the special defense package, as they will serve as the backbone of Pakistan's future warfighting capability.

THE CRITICAL IMPORTANCE OF TRAINING FOR ALL THREE SERVICES

No matter how advanced the technology or how modern the platforms, the effectiveness of NCW ultimately depends on the skill and proficiency of the personnel operating these systems. Continuous and realistic training is essential for pilots, sailors, and soldiers to fully exploit the capabilities of networked platforms and integrated weapon systems (Alberts et al., 1998; Garstka, 2003). For the Air Force, this means regular simulation-based and live exercises that focus on multi-domain operations, electronic warfare, and rapid decision-making in a networked environment. The Navy must invest in training for networked maritime operations, including real-time data fusion, cooperative engagement, and anti-access/area denial (A2/AD) tactics. The Army, meanwhile, requires ongoing training in integrated air defense, sensor-to-shooter operations, and battlefield management systems. Cross-service joint exercises, leveraging advanced simulation and virtual reality platforms, are crucial for building the interoperability and coordination that NCW demands. A dedicated portion of the special defense package must be allocated for the continuous professional development and technological upskilling of all three services, ensuring that Pakistan's armed forces remain agile, adaptive, and ready to meet the challenges of modern warfare

> if we decide to fight on a network-centric rather than platform-centric basis, we must change how we train, how we organize, and how we allocate our resources(Network-Centric Warfare - Its Origin and Future, 1998)

GLOBAL TRENDS AND THE NEED FOR A SPECIAL ALLOCATION

Globally, militaries are prioritizing investments in engagement and sensor grids alongside comprehensive arsenal modernization to achieve NCW dominance. The U.S. leads with initiatives like Project Convergence 2025, integrating Army, Air Force, and multinational systems to enhance joint command-and-control (C2) and sensor-to-shooter connectivity (US DoD, 2021). Similarly, China and India are investing heavily in networked missile systems (e.g., DF-21D, BRAHMOS-NG) and secure communications infrastructure, while NATO allies focus on interoperable battle networks for multidomain operations (SIPRI, 2023). For army modernization, advancements include AI-driven targeting systems, lightweight tripods, and polymer ammunition to boost mobility and precision. Navies are upgrading to hypersonic anti-ship missiles (e.g., LRASM) and ship-based C2 systems like AEGIS, while air forces prioritize fifth-generation fighters (J20,F-35, Su-57) and loyal wingman UAVs for swarm tactics. These efforts align with the $91.4 billion NCW market projected by 2032, driven by demand for real-time data fusion, resilient networks, and distributed lethality (Market Research Future, 2024). Across all branches, the emphasis is on closing the "kill chain" faster than adversaries through seamless integration of sensors, shooters, and decision-makers-a cornerstone of modern NCW strategy.

RECOMMENDATIONS FOR PAKISTAN'S DEFENSE BUDGET

Given these realities, it is imperative that the Government of Pakistan provides a special budgetary package-over and above the regular defense allocation-specifically aimed at enhancing NCW and C4ISR capabilities. The following recommendations are proposed:

- Allocate 30–45% of the NCW budget to the development and strengthening of the information grid and backplane.
- Ensure at least 25% of the NCW budget is directed toward sensor grid improvement and development.
- Dedicate 20–45% of the NCW budget to engagement grids, focusing on modernizing weapons platforms and integrating advanced targeting systems.
- Invest in the modernization and integration of C4I systems, with a strong emphasis on cybersecurity and interoperability.
- Support continuous training and skill development for armed forces personnel to ensure effective utilization of new technologies.
- Pakistan armed forces have been able to demonstrate the efficient use of scarce resources and have trained keeping in mind the resources at hand. Therefore, given our economic constraints we can not match global trends but we can still mange to provide finances which can at least fulfill the bare minimum.
- The budgetary provision for enhancing NCW capabilities should be in addition to the already provisioned budget. This should be an additional package, where in increases can be made from time to time

Evolving nature of modern warfare demands a proactive and well-funded approach to defense modernization. Network Centric Warfare is not just a technological upgrade; it is a doctrinal shift that requires sustained investment in information infrastructure, sensors, engagement systems, and human capital. The proposed special budgetary allocation is essential to ensure that Pakistan's armed forces remain capable of deterring and defeating any threat-now and in the future.

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TAXING LIKE THE 2020s, GOVERNING LIKE 1990s

Muzammal Rasheed

The discourse pertaining to the persistent fiscal challenges faced by Pakistan has become increasingly salient, underscoring a notable intensification in recent years. A primary challenge within this context is the country's limited and underutilised tax base. Although the principal focus of debate has been the reform of the domestic tax system, numerous aspects have been neglected. A crucial dimension of our overarching tax base pertains to the international taxation framework, which often receives insufficient emphasis during the policy formulation and related discussions. The international tax base arises from the interaction between the tax system of Pakistan and other countries, and from Pakistan's perspective, is marred by revenue leakages. These leakages manifest through mechanisms such as profit shifting via abusive transfer pricing practices, base erosion payments such as royalties, management and other charges. Other distortions to the tax base associated with international tax systems include stashing of assets overseas by Pakistanis through various means including sophisticated corporate or trust s tructures. Digital business models have also been exploited to allow foreign firms to conduct business in Pakistan without maintaining a physical presence (and possibly without paying taxes), a phenomenon that is exacerbated by the rapid evolution of the digital economy.

What contributes to these distortions to Pakistan's tax base the most is the lax tax framework, dearth of information exchanges and inability to enforce the tax reform agenda due to covenants of superior arrangements such as tax and investment treaties. But the fundamental question in this debate remains: how to legitimately claim this intervening tax base and enforce it successfull? This has partially been attempted by placing tax liabilities on Pakistani consumers, for instance, through imposing taxes at the import stage (for physical goods) or taxation at the time of remitting the payments to foreign companies for their services, particularly. This approach has limited benefit since it will likely displace the incidence of tax on domestic consumers (businesses or the end consumers), as it will increase the cost of doing business for consumers in Pakistan, and foreign firms will continue to receive their dues, net of taxes. This article examines Pakistan's approach, and the instruments used to address erosion of its global tax base and highlights the need to restructure these interventions.

Pakistan has traditionally used bilateral tax treaties for avoidance of double taxation and prevention of fiscal evasion ("tax treaties" or "DTTs") to address the allocation of taxing rights with other countries. However, various other instruments are now available as a result of adopting several international tax standards, especially during the last decade. These include measures based on the OECD/G20-led BEPS reform, transparency standards, and proposals from various other international forums. Pakistan's approach to following these international standards is reactionary in general in response to the external institutions' push to adopt these reforms; however, there is limited room for customisation of these global standards to domestic needs. While the adopted standards support achieving tax policy objectives, the domestic context, such as the large proportion of the informal economy, low compliance, and excessive reliance on withholding taxes, are some areas which retort robust implementation of these standards. A succinct analysis of the standards employed by Pakistan to address distortions in the international tax base is elaborated in the subsequent sections.

Pakistan has a robust DTT network consisting of 68 bilateral agreements. The primary objectives of Pakistan's DTT policy are to attract Foreign Direct Investment (FDI), set clear rules for income allocation, and prevent instances of double taxation. Although these treaties are widely recognized as beneficial, there are concerns regarding their misuse that may lead to Base Erosion and Profit Shifting (BEPS) within the tax system. Key challenges in Pakistan's DTT practices include a lack of reciprocity in distributing taxing rights, issues with source state taxation, the abuse of treaty provisions and treaty shopping. Research indicates that the tax treaties established by Pakistan have not sufficiently safeguarded the country's taxing rights[1]. Furthermore, the tax advantages provided to foreign companies through these treaties have contributed to the decline of local industries[2]. A positive step in this regard is to declare the supremacy of tax treaty subservient to the anti-avoidance rules contained in domestic tax code. Additionally, ensuring the maintenance of source and market taxing rights within the new model tax treaty and policy framework represents a significant policy advancement by FBR, although this initiative will apply to future treaties only.

Pakistan has introduced several international tax measures based on the work of OECD (Inclusive Framework for BEPS established by G-20 and OECD) and international tax guidelines in its tax code. However, it faces challenges in effectively implementing these reforms due to the supremacy of the DTTs it has signed over the domestic laws. Consequently, unless a tax treaty is amended/renegotiated, the amendments to domestic tax law in key areas will not create an effective taxing right or generate additional revenue for the country. To illustrate the issue, consider an MNC that does not have a physical presence in Pakistan but can engage with Pakistani consumers by providing services digitally and hence profit from market due to its virtual business model. To tax this kind of activity, Pakistan has introduced domestic tax measures based on the concept of a virtual permanent establishment, SEP and withholding taxes. However, neither of these concepts is typically included in Pakistan's DTTs. The principles outlined in these treaties for taxing income are primarily based on physical presence (called permanent establishment – "PE"). As a result of this overriding effect, our tax authorities cannot successfully apply domestic laws to tax the income of foreign companies operating in Pakistani market.

In the international tax ecosystem, renegotiating treaties to reallocate taxing rights constitutes a multifaceted challenge that necessitates a long-term strategic approach and is fundamentally bilateral in nature.

The second important instrument to counter base erosion is transfer pricing rules. These rules require associated businesses to conduct transactions at arm's length prices rather than controlled prices influenced by tax considerations. In simple terms, intra-group transactions should not be priced to

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2. Ahmed, M. A. (2020) "UN MTC Article 8: Was the Source Rule Surrender on Article 8 a Blunder? The Case Study of Pakistan, INTERTAX, Volume 48, Issue 1, 2020 Kluwer Law International BV, Netherlands

minimize the group's tax liabilities. For instance, a multinational corporation (MNC) may charge its subsidiary in Pakistan a royalty for using specific intellectual property, based on a percentage of the subsidiary's revenue. This arrangement allows the subsidiary to reduce its taxable profit, as royalty payments are tax-deductible. To comply with transfer pricing rules, the royalty charge must be justified by comparing it to similar transactions among independent entities, taking into account performed functions, utilized resources, risk assessment, and the market rate for the royalty. This process adheres to the arm's length principle in controlled transactions, promoting fairness and compliance in pricing. If the transaction doesn't meet the arm's length principle, the tax authority may reject or adjust the royalty deductions made by the subsidiary based on their analysis.

Transfer pricing rules have been provided under domestic tax law and in DTTs for a long time. However, enforcement and compliance levels in this policy area are below par. This is because the practice of examining transfer pricing has not been robust due to long-practised presumptive/final tax regimes. A final tax regime calculates a firm's tax liability by applying a fixed percentage of the receipts of business while disregarding the bottom-line profits of business operating results for tax computation. Moreover, the tax authority faces capacity constraints regarding robust transfer pricing examinations, which include the availability of or access to a public data repository of open market prices to be used as a benchmark, trained subject matter specialists in the tax authority, and a lack of specialization in transfer pricing enforcement and knowledge management.

Abuse of transfer pricing regulations by MNCs negatively impacts Pakistan's tax revenue base[3] .Changes in the legal and administrative regime can reduce the extent of tax evasion, including by issuing detailed guidelines for taxpayers and introducing safe harbour provisions/benchmarks. Once basic practices have been established, the Advance Pricing Agreement (APA) framework can also be established, reducing the need for monitoring.

The CbCR-enabled[4] taxpayer data presents an opportunity to tackle tax evasion driven by transfer pricing. Trying to achieve effective reforms in this area would be futile without first strengthening institutional capacity to implement targeted enforcement strategies. This involves enhancing institutional resources and collaborating with multilateral partners to access technical training, technology, and data resources. Establishing a dedicated and empowered Transfer Pricing (TP) Unit is vital for institutionalizing best practices. This TP Unit should adopt a "center of excellence" model rather than function as a traditional tax office. Additionally, Pakistani law permits the tax administration to engage third-party auditors, which highlights the potential for outsourcing TP audits to address the capacity gaps within the Federal Board of Revenue (FBR).

The most recent tool for addressing the distortions to tax base is the mechanism for the bilateral and multilateral exchange of taxpayer information, especially regarding offshore assets. A robust exchange of information (EOI) is essential in international taxation, as it compiles taxpayer data held by various authorities across multiple countries, which is critical for accurately assessing taxes on cross-border transactions. It enhances tax certainty and transparency.

Pakistan has recently made reforms to its EOI framework in response to public demand for closer examination of the offshore wealth held by Pakistani citizens. Previously, conventional EOI under bilateral tax treaties was inadequate, prompting Pakistan to engage with the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes. Consequently, it signed the Convention on Mutual Administrative Assistance in Tax Matters (MAAC) in 2016 and the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (CRS MCAA) in 2017. To facilitate compliance with the CRS MCAA, Pakistan has significantly updated its domestic laws and established dedicated Automatic Exchange of Information (AEOI) zones within major taxpayer offices. As a result, Pakistan has developed a robust EOI practice. However, the information obtained through Country-by-Country Reporting (CbCR) is not fully leveraged, primarily due to a lack of focus on transfer pricing practices, representing a missed opportunity.

3. Pakistan loses PKR 200 billion (US$ 720 million) annually to abusive transfer pricing by MNCs. (Haq, I., and Bukhari, H. (2020))."Tax Reforms in Pakistan: Historic & Critical View," Pakistan Institute of Development Economics, Islamabad: PIDE. http://www.pide.org.pk.
4. Country-by-country Reporting requirement as part of Transfer Pricing Documentation requirement introduced by implementing the BEPS Action 13 by signing the Country-by-Country Reporting Multilateral Competent Authority Agreement (CbCR MCAA) on 21st June 2017.

Pakistan's nascent but growing digital economy presents a unique tax challenge: how to effectively tax the revenue generated from cross-border digital services while ensuring a fair and sustainable system. While the overall economy itself is fast becoming digital, the lack of effective legal framework for accurately taxing digital economy transactions also has consequences for Pakistan's global tax base. The first step taken by FBR to tackle this challenge was the imposition of a final withholding tax on inbound digital services. Subsequently, the concepts of virtual PE and a nexus-based significant economic presence (SEP) rule have been added to the tax code. While Pakistan has a well-established framework for handling non-resident taxation through withholding taxes, implementing virtual PE and SEP rules requires careful consideration, as it is a new intervention. The principle of virtual PE, which deems a foreign company to have a taxable presence in Pakistan based on its digital activities, needs careful scrutiny. Not every service received in Pakistan should automatically translate into a (virtual) PE. Implementing a threshold-based approach, defining specific criteria for establishing a virtual PE, would mitigate the risk of overreach and ensure fairness. This threshold should be determined based on a cost-benefit analysis, which considers factors like the volume of transactions, revenue generated, and the extent of engagement with Pakistani consumers.

Similarly, the SEP rule, which establishes a taxable presence based on significant economic activity of foreign businesses within Pakistan, demands a robust framework. Determining the precise threshold for SEP requires careful analysis, considering the specific nature of digital services and their impact on the Pakistani market. A nuanced approach that considers quantitative and qualitative factors will be crucial to ensure a balanced application of the rule, but such an approach remains a missing link.

Further, analysing the incidence of tax is crucial, particularly in the case of withholding taxes. The current system raises concerns about its ultimate burden and the increase in the cost of doing business. The "net of tax" arrangements often result in Pakistani consumers bearing the tax burden. This potential for regressive taxation necessitates a thorough review of the tax structure, exploring options like shifting the burden to foreign digital companies. Lastly, all initiatives to tax the digital economy encounter challenges due to Pakistan's extensive tax treaty network, which hinders the successful application of withholding tax on digital services.

The solution lies in broader multilateral frameworks. In this regard, the Pillar One reforms proposed by the OECD should be explored to create a fairer, more equitable, and reliable system for distributing taxing rights in a globalised digital economy. Pillar One focuses on reallocating the taxing rights to market jurisdictions, which are primarily expected to be developing countries. Areas such as the number of in-scope MNCs and the tax base potential should be analysed in this exploration. The impact of forfeiting domestic taxes in relation to the potential presented by Pillar One also requires careful assessment.

In summary, Pakistan faces the challenge of losing its tax base linked to cross-border business transactions. To address international tax evasion, the country has developed a toolkit based on specific international standards it has adopted. However, these standards have not effectively closed the loopholes in the current tax system. Enforcement remains weak in certain areas, such as transfer pricing, owing to capacity constraints within the tax administration. In other areas, like enforcement based on EOI, institutional practices have been established but the revenue generated has been modest[5], focusing primarily on easily accessible opportunities instead of comprehensive solutions.

Moreover, existing tax treaties create hurdles for taxing digital business models, restricting enforcement to scenarios where these treaties do not apply. It is advisable to address these issues at international forums, such as the United Nations or the OECD, as unilateral reform is not an ideal policy option.

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5. FBR tells SC: Rs.880m recovered from people holding foreign accounts, properties. Business Recorder. Online: https://www.brecorder.com/news/40335804/fbr-tells-sc-rs880m-recovered-from-people-holding-foreign-accounts-properties

TAX AUDITS AS SIGNALS: DESIGNING SMARTER ENFORCEMENT IN PAKISTAN

Dr. Zehra Farooq

Tax audits have always been at the center of the tax enforcement debate. A popular opinion held by many is that the Federal Board of Revenue (FBR) lacks the technical capacity (and sometimes willingness) for true tax enforcement. Another, less popular opinion, is that no matter enforcement capacity, taxpayers, in particular large corporate taxpayers, will inevitably plan their way out of increased tax liability. While both these narratives hold merit, they oversimplify what is a complex paradigm of tax enforcement, especially in a country like Pakistan. Foundational to this claim is recent empirical evidence from Pakistan that suggests that tax enforcement is not simply a question of whether the state is enforcing tax laws, but integral to that discussion is how those laws are being enforced and on whom. Additionally, it is most important to know what the state is learning about taxpayer behavior and what the taxpayer is learning about state capacity as a result of these enforcement activities.

To form a near complete picture as to how taxpayers respond to tax audits, both in the short and long term, this article pulls insights from two different tax audit studies based on Pakistan: one that looks at the impact of randomized Value-added Tax (VAT) audits (Waseem, 2021) and the other that looks at the impact of randomized income tax audits (Farooq, n.d.) on corporate firm behavior. Given Pakistan's specific context, a conclusive result from these studies is that while firms may respond to audits, the inclination to become more compliant or more evasive will depend greatly on what firms learn about state capacity as they undergo the audit process. Audit, then, serves as a signal to the taxpayer in addition to serving (in some cases) as a deterrent to tax evasion.

While this is not new knowledge, for a country that already grapples with persistent tax evasion, this reframing of tax audits is especially important. The deterrent effect of tax audits is well grounded in public finance theory and states that if there is a positive probability that, one, any tax evasion will be detected, and two, tax evasion once detected will result in financial penalties, tax audits will deter evasion. However, evidence points to the fact that the deterrent effect of audits is not guaranteed and if detection fails, is partially successful, or is perceived as superficial, audits may not deter evasion at all. In fact, firms may upgrade their tax planning with the knowledge gained from audit and become more sophisticated in their non-compliance over time.

This is not to say that enforcement is failing; quite the contrary. It points to the growing need to reimagine how enforcement is measured and how enforcement tools should be designed. While used as a strong tax enforcement tool around the world, static one-off tax audits will not be enough to deter tax evasion as enforcement is no longer just about detection, but about what taxpayers think is the state's capacity to detect. The two strands of tax audit research shed light on exactly this.

So, does an increase in the number of audits lead to more deterrence? The first research that looks at a series of randomized income tax audits spanning seven consecutive years using a sample of 55,000 firms in Pakistan, finds that while audits impacted firm behavior, the effects were divergent by size of firm. The research reveals the small and medium sized firms responded to tax audits immediately by increasing their compliance (filing their tax returns and paying their taxes on time). However, the effects for large firms, those with generally a greater access to more sophisticated tax planning resources, behaved differently; in fact, three distinct behaviors emerged. While some firms responded by becoming more compliant, for most firms the deterrent effect was short-lived, and was followed by a decrease in reported income in the years post audit. Then again, for some firms, compliance in the immediate term (resulting in higher reported incomes) was immediately followed by an increase in indirect evasion where firms failed to deposit the full amount of taxes owed to the government exchequer including taxes collected by them as withholding agents. And finally, for some large firms, audits had no effect on compliance at all. These behaviors suggest that going through the process of audit, firms are able to assess a "safe" level of evasion for them, fueled by the perception that it will go undetected.

That this is in fact firm behavior in response to tax audits is also reinforced by the findings of the second research. The second study looks at randomized VAT audits across the entire tax population and finds that while audits do uncover a substantial amount of evasion (in fact an evasion rate of 80%), they had virtually no effect on taxpayer behavior at all. That is to say, taxpayers that were audited continue to file the same way in the years post-audit with no meaningful change observed in their reported net sales, input taxes, output taxes or overall tax liability.

Taken together, these two studies challenge the assumption that more audits, even those that detect and penalize evasion, will lead to an increase in compliance. To the contrary, they demonstrate that audits carry transferrable knowledge and that firms interpret that knowledge, learn from it, react to audits based on what they learn, and eventually recalibrate their behavior. But the question arises: what are firms learning about the tax administration? What are audits signaling about the capacity of the state to detect tax evasion, and as a result, how are firms perceiving future evasion risk? Determining answers to these questions are critically important not only because they determine compliance levels today, but also because they establish the credibility of tax enforcement in the future.

These results are not surprising because firms are only reacting to enforcement. And as they undergo audits, they create mental models of whether the state is or is not able to detect evasion. For instance, if audits only skim the surface of taxpayer declarations, and fail to probe into areas where certain taxpayers are consistently evading taxes, such as overstatement of purchases, declaring large amounts of transactions in cash, or consistently failing to pay due taxes, then the firm may believe that such behavior has a low risk of detection. This is perfectly in line with what literature refers to as "detection probability": a model of tax compliance where taxpayers' decision to evade is directly proportional to their perceived probability of detection.

What this tells us is that in Pakistan's context, where tax officers have nearly 3,000 tax returns falling within their jurisdiction and a skeletal team of support staff, conditions that as good as guarantee limited audit coverage and often partial detection, it is the signal of audit that matters more than the number of them. It is important to note that this revelation does not imply that all firms are inherently malicious and noncompliant, for they are reacting rationally to what are signals from the tax environment in which they operate. If they perceive detection to always be partial, it will result in compliance being partial as well.

This is exactly the tipping point, where tax audit policy in Pakistan now needs to shift towards a targeted, informed, and dynamic enforcement design; because if audits are signals, it is not their quantity that will matter, it is their credibility. Both research studies have shown us that much! When audits are used as an enforcement tool but without the capacity for enhanced real-time detection, the returns to audit can diminish quickly. In both VAT and income tax audits, we saw that despite detection of evasion, firms that had gained enough knowledge of the system either remained steadfast in their reporting patterns or found new margins of evasion. In both cases, the behavior was led by the perception that their reporting behaviors will go undetected by the tax administration during, what they will begin to perceive as, procedural rather than substantive audits.

The good news is that this recognition has started to shift Pakistan, in particular FBR's approach to tax audits[1]. Although public discourse is saturated with critiques on what the tax administration has failed to do, it is worth paying attention to the measures that it is getting right, slowly but surely. In the past year alone, the design of tax enforcement has evolved through a set of reforms that are grounded not in hyperbole but in actual data and empirical insights, viewed through a behavioral lens. This shift demonstrates that institutional understanding now recognizes that for enforcement to be stronger, it must be smarter. One of the most significant developments that flow directly from empirical evidence discussed earlier is the adoption of a Compliance Risk Management (CRM) system. This system is built not just to catch non-compliance but to effectively allocate limited enforcement resources. Accordingly, it uses the universe of tax data that spans years, to define behavioral markers and risk indicators. Based on these flags, the system then segments taxpayers by their filing behavior and risk profiling to determine when to audit, when to simply nudge, and when not to do anything at all. This segmentation happens at various levels starting within the same industry, within the same city, or even with the same tax office. With the adoption of this system, the FBR now moves beyond blanket enforcement and is geared to effectively target taxpayers for whom risk of non-compliance is the highest.

The past year has also seen FBR experimenting with behaviorally informed nudges. A lot has been written about the positive effect of nudges on tax compliance behavior, and they do stand out as the most cost-effective instrument for increasing tax compliance, favored by many tax administrations around the world[2]. Nudges are designed as a move away from standard tax notices and consequently long periods of compliance. Instead, nudges rely on targeted dispersion of tax compliance information that considers historical filing patterns, performance amongst peers, and identified risk factors. This makes the communication between the tax authority and the taxpayer more credible and tailored, thereby inducing not just a quick response but a strong signal that the state is keeping an eye. There are other reforms that have quietly taken shape in the past year. This includes an increased scrutiny in all registrations into the tax net, informed by the conscious decision that screening out what might be non-genuine registrations at an early stage will reduce the risk of fraud in sectors with a high risk of non-compliance or a higher rate of fraudulent refund claims. While these subtle reforms may not be a full-scale transformation of Pakistan's tax administration, they certainly mark a shift in how tax enforcement is now being viewed. It is evident that the trajectory of tax reform is focused on building credibility and in designing an enforcement framework that is grounded in evidence and developed to continuously evolve.

Having said that, in a country where tax compliance will always remain a challenge and the tax culture formidable, it is inviting to judge enforcement in binaries: absent or present; success or failure. But the foregoing discussion is evidence of that fact that tax enforcement is complex and without a clear understanding of this complexity, it is impossible to judge enforcement fairly. It is often quoted that "FBR has failed to enforce taxes". Given that we continue to have a low tax-to-GDP ratio, and the problem of tax gap continues to linger; this statement, prima facie, may seem just. However, when we frame it this way, we ignore two harsh realities: first, that tax enforcement operates in an environment that has structural limitations such as limited human resource, lack of data integration, legal processes, and a fragmented tax base; and second, enforcement needs to be forward looking – it is important to catch evasion in the present but it is even more important to design systems that prevent it in the future.

1. https://fbr.gov.pk/taxpayers-audit/142257/131272#:~:text=Taxpayers%20are%20selected%20for%20audit,be%20included%20in%20risk%20register.
2. https://academic.oup.com/ej/article-abstract/135/668/1033/7810274?redirectedFrom=fulltext

A similar statement is "audits just don't work"! This statement, again, cannot be viewed in isolation. It is clear via the evidence presented that taxpayers respond to audits and may even become more compliant, but only according to what they believe about the capacity of the state. It is also clear that this belief is not formed by numbers but instead, is shaped through a consistent dynamic stream of intelligent interactions between the taxpayer and the tax administration; ones that foster trust whilst at the same time create deterrence. The point here is not to defend enforcement but to demonstrate that viewing enforcement measures with narrow metrics such as the number of tax audits or the amount of revenues recovered, overlooks the broader agenda of a reform. Every notice, every audit, every enforcement action feeds into the taxpayers' perception, and this demands that true reform becomes an on-going interaction rather than a one-off measure.

Reforming tax enforcement in Pakistan will have to be a rolling conversation and the tax administration must focus on three key things to add weight to it. First, intentional investment in data and analytics, not just to ensure compliance in the short-term but to use data, behaviors and reporting patterns to understand taxpayers at a deeper level. Second, to purposefully build an enforcement framework that extracts feedback from enforcement models and dynamically upgrades its risk algorithm, thereby allowing the system to adapt to changing patterns of reporting. And third, to recognize that building a compliant tax culture is a slow process, and consistency will far outweigh swift gains when it comes to long term success. This includes recognizing that reform fatigue exists and perpetuates not just within institutions but also within societies. Therefore, intelligent communication and on-boarding of stakeholders throughout the evolving enforcement landscape needs to be a constant feature.

The future of tax enforcement in Pakistan is not written in the number of tax audits closed or the amount of penalties levied; it will depend on whether firms believe in the capability and consistency of the tax system. It is this belief that will shape tax compliance, and tax reform must earn this belief to be successful.

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PAKISTAN'S TAX SYSTEM: ADVANCEMENTS, CHALLENGES AND TRILLION-DOLLAR FUTURE

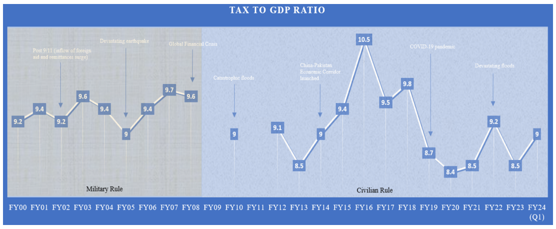
Husnain Shehzad

Pakistan is at a fiscal and development crossroads. With demographic potential, geo-economics importance, and digital capabilities waiting to be exploited, the country's ambition to become a trillion-dollar economy is not more than just a pipe dream with the current tax system and outcomes. It is heavily dependent on reinventing its fiscal foundations. The need to revamp the tax system is central to this transition, not merely as an administrative instrument but also as a foundation for inclusive growth, equity, and macroeconomic sovereignty. The language of deficits, both budgetary and current account, has long dominated the conversation on Pakistan's economic predicament, with a reactive engagement with the International Monetary Fund (IMF) serving as a stopgap approach. However, beneath the surface lies systemic fiscal dysfunction, including a restricted tax base, a regressive tax structure, and weak institutions that maintain figure 1 shows Pakistan`s tax-to- Gross Domestic Product (GDP) ratio, which was lower, than the OECD average of 34.0% and the Asia-Pacific average of 19.3%[1]. By the fiscal year 2024-25, it will have ended up to 10.6%, said Finance Minister Muhammad Aurangzeb. These traits limit budgetary space and distort the fundamental structure of the citizen-state contract.

The prevalent IMF financial bailouts in Pakistan indicate a structural fiscal system problem rather than episodic disruptions. The current tax structure shows a misalignment of government, trust, and social contracts. Before Pakistan can implement its trillion-dollar economic plan, it must first solve its fiscal problems.

1. OECD. (2024). Revenue Statistics in Asia and the Pacific 2024 - Pakistan

Figure 1: Authors Illustration



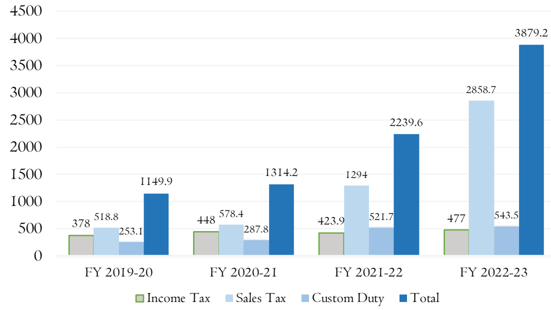
Source: Federal Board of Revenue (Revenue Division Year Books)

A TRILLION DOLLAR DREAM AND PAKISTAN`S TAXATION BASELINE

Taxes are involuntary charges imposed by the government to generate revenue but to sustain revenue; the tax policies must support growth, lower deadweight loss, and boost transaction volume[2]. Pakistan's tax system has long faced a paradox, a vast informal sector coexists with a small formal tax base. Despite more than twenty IMF stabilization programs, multiple Finance Acts, and a series of tax reforms, the country's tax-to-GDP ratio has remained stagnant at around 8% to 10%, shown in Figure 1, it needs to be improved, as said by the Chairman Federal Board of Revenue (FBR) reported by Associated Press of Pakistan. This ratio is much lower than the 15% threshold[3] usually required to sustain long-term economic growth, eliminate public debt, and support the functions of a modern, functioning state. The Pakistani tax-to-GDP ratio reveals significant institutional and political issues[4], including a hidden economy and a minimal tax-paying population. The system rewards non-payers but penalizes taxable individuals[5] despite continuous fiscal reform initiatives and external financial support.

Although IRIS 2.0 has played a crucial role in simplifying taxes, lowering superfluous documentation expenses is a measure to raise taxes, per the Pakistan Institute of Development Economics (PIDE) policy viewpoint[6] in 2020. However, to achieve a trillion-dollar economy, Pakistan needs to eliminate exemption networks (the tax expenditures shown in Figure 2), and digitize supply streams to avoid fraud, evasion, and malpractice that cost Pkr 6 trillion each year, according to media reports; even former Chairman FBR Shabbar Zaidi believes that it is around Pkr 10 trillion and through reward-based tax enforcement. These reforms require political advancement between taxpayers' trust and representation and visible public service delivery.

Figure 2: Tax Expenditures (Billion Pkr)



Source: Tax Expenditure Reports 'FBR'

In comparison to other developing market economies, figures 3 and 4 show that Pakistan's tax revenue as a share of GDP is noticeably low (except for Bangladesh) but also lower per capita tax, which raises questions on tax net issues for Pakistan. However, empirical assessments indicate that Pakistan has significant untapped tax potential. As of 2016, the country's tax capacity was assessed to be around 22.3% of GDP[7], implying that Pakistan has the potential to double its existing tax collection roughly. Moreover, Pakistan's economy has been burdened by more indirect than direct taxes, distorting resource allocation. 1949-50, direct taxes contributed 25% to total consolidated revenue, 33% in 1959-60, and 14-17% in the 1970s. The government attempted to increase direct tax revenue collection through fiscal policy in the 1990s, but the total tax-to-GDP ratio was not improved. In the fiscal year 2019-20, direct taxes contributed 32% of total taxes, yet 70% of those taxes came from withholdings.

Pakistan needs to move from a lower middle-income to an upper middle-income country[8] and sustain it or to become an emerging market economy (EME)[9]. EME had a tax-to-GDP ratio of 14.8% in 1990 and 19.7% in 2020[10] which provides a comprehensive understanding of what Pakistan needs to do fiscally to achieve a trillion-dollar economy.

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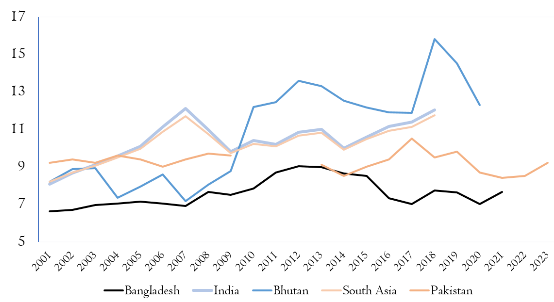
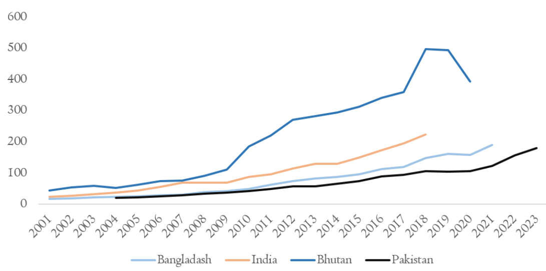
Figure 3: Tax to GDP %



Source: World Bank and FBR

Figure 4: Per Capita Tax (Constant USD 2020)



Source: Calculation based on World Bank and FBR Data

FBR ACTIONS AND TAX SYSTEM EFFECTIVENESS

An efficient tax system reduces complexity, costs, and revenue collection[11] while fostering economic growth and improved living standards through a competitive and neutral system[12]. Recent studies imply that capital income should be taxed to some extent, but not at the same rate as labour income, because leisure and future spending complement each other in a life cycle model. A positive capital income tax is part of an optimal tax system for high-productivity individuals who are more likely to save. Lower taxing on savings can lead to more uniform taxes, although the optimal level of taxation is unknown. Policymakers may accept deviations from tax neutrality in sectors with high or low tax elasticity of capital demand[13].

FBR initiated a tax reform strategy via three components: policy, administrative, and organizational reform in November 2001. The tax reform policy brought four core strategies, which included self-assessment by all parties under simplified rules abo, listing exemptions, and enhancing dispute resolution. Part of the administrative reform concentrated on developing functional tax units to enhance the income tax agency while optimizing manual procedures through staff capability enhancements. The organization implemented three changes through reorganization with fewer tiers while reducing its workforce. Pakistan has struggled with a chronic fiscal crisis characterized by a lack of tax income for defence spending, debt repayment, and basic public services. In response, the Tax Administration Reforms Program (TARP) was introduced by the Government of Pakistan (GoP) in 2005 to modernize the FBR, expand the tax base, and raise the tax-to-GDP ratio. TARP included organizational, administrative, and policy reforms, building on previous reform initiatives that started with creating a Task Force in 2000 and followed by IMF and stakeholder discussions. These included streamlining tax legislation, encouraging self-assessment for everybody, cutting back on exclusions and in-person contacts, and improving audit and enforcement capacities. The FBR established taxpayer facilitation centres, formed Regional Tax Offices (RTOs) and Large Taxpayer Units (LTUs), developed e-filing technologies, and reorganized operations. With funding from the Public Sector Capacity Building Project ($6 million) and the World Bank ($2.9 million) for initial design, TARP implemented automated customs procedures through CARE, introduced modern IT systems (such as SAP and ITMS), and carried out extensive capacity building.

Notwithstanding early difficulties, the initiative met its primary goals by 2011, which included exceeding income goals (Rs. 1,558 billion in 2010–11) and implementing changes that improved professionalism, transparency, and public trust[14]. FBR initiated IRIS 2.0 as their online e-return system, establishing a modern tax system. Through this system, internet users can easily process their tax payments. Through its, the Payment Slip IDs, Computerized Payment Receipts, and PSID search tool function prevents errors, speeds up payment processes, and helps create a business-friendly tax system[15].

8. According to the World Bank, the minimum threshold for upper middle-income countries is a GNI per capita of USD 4,516 for Fiscal year 2025.
9. According to the IMF, on average, EMEs have USD 6500 per capita GDP for 2025.
10. Countries can tap tax potential to finance development goals. (19 September 2023). IMF. Retrieved May 5, 2025,
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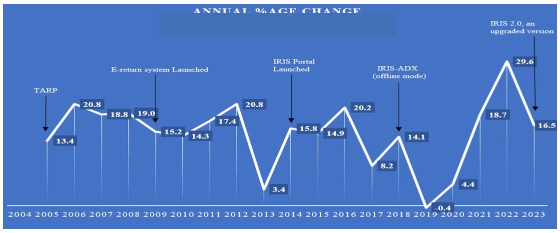
Figure 5: Annual %Age Change in Tax Revenue For Pakistan

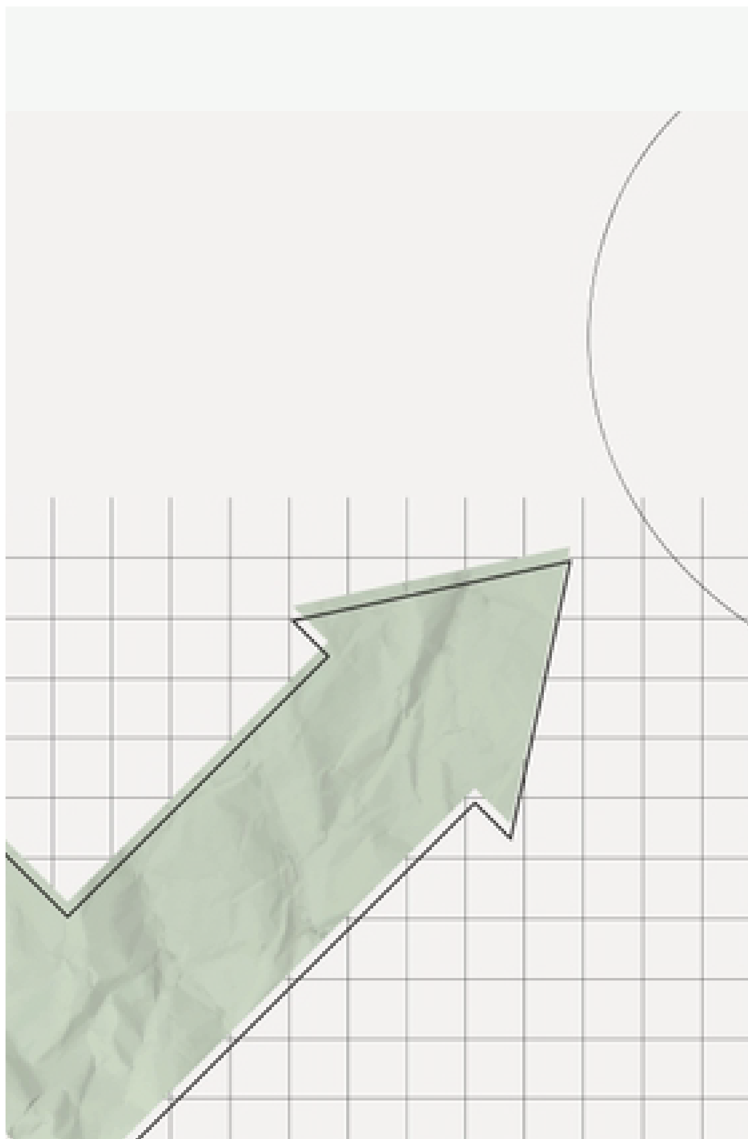


Source: Calculation based on World Bank Data

The TARP 2005 modernized FBR processes, led year-on-year (y-o-y) tax revenue growth, and the 2009 e-return system further accelerated growth to 20.8% by 2012. Implementing the Integrated Risk Information System (IRIS) as a modern portal replacement in 2014 brought a y-o-y revenue growth surge because of risk-based audit strategies and enhanced transparency. The launch of IRIS-ADX in 2018 later increased revenue growth with support in regions with poor internet connectivity. The IRIS 2.0 upgrade was late in 2023 due to data-driven enforcement. The FBR has reorganised its operations through modernisation efforts. However, these improvements fail to solve Pakistan's underlying tax framework challenges and systematic issues remain unsolved as illustrated in Figure 5, highlights the limited sustainability in tax collection and uneven impact of reforms. The modernisation strategies do not address indirect taxation issues or low tax rates in sectors such as agriculture, retail, and real estate. The new automated technique benefits existing tax collecting operations while having little influence on new entities and standard policy regulatory norms. With digital improvements, Pakistan has also taken legislative measures to tackle challenges and improve the tax system, notably around 10 amendments in the Income Tax Ordinance (ITO), 2001, and the Tax Law Ordinance, 2016. The Income Tax (Amendment) Ordinance of 2018 introduced changes to foreign income reporting requirements, concealed income tax regulations, and revised tax rate structures. Similarly, Ordinance No. XV of 2015: The withholding tax exemption granted to Pakistan Real-time Interbank Settlement Mechanism (PRSM) under sub-section (4) of Section 236P of the ITO, 2001 has been removed.

When the FBR (Pakistan's tax reforms) have been criticized for failing to overcome structural barriers and unpredictable implementation challenges. Despite implementing organizational modernization and restructuring, the tax base expansion and compliance have not significantly improved. The E-return system has not addressed taxation issues related to evasion, elite control, and administrative complexity. Also, high volatility over time rather than stability in year-over-year revenue growth raises questions about FBR's e-return system's effectiveness and public engagement.

Additionally, Pakistan's informal economy, shown in Figures 6, is reducing its effective tax base and harming its ambition to become an official trillion-dollar economy. Documenting the economy is a shared effort that involves every department in government and helps increase the revenue base[16]. To address this, the plan proposes incentive-based formalization schemes, real-time monitoring using NADRA, mobile wallet usage, and simplifying turnover-based regimes.



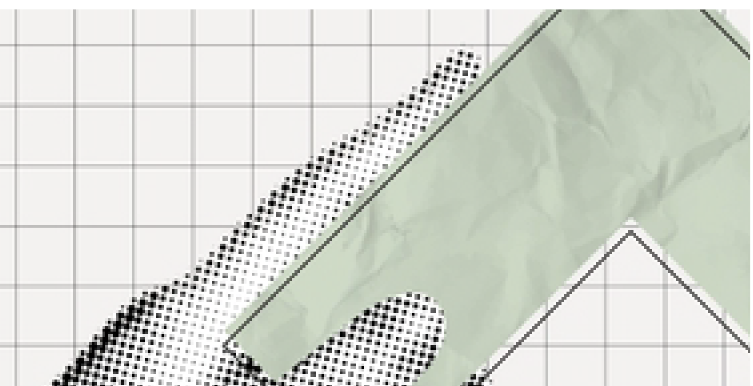
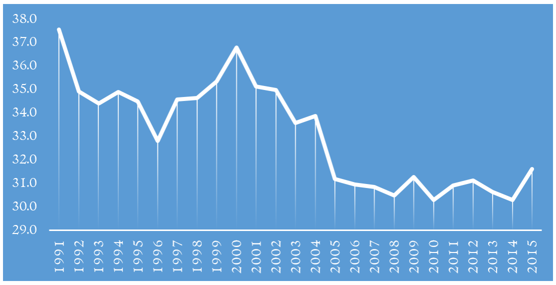


Figure 6: Size and Development of the Shadow Economy



Source: IMF Working Paper WP/18/17 [17]

Existing opportunities within Pakistan's economy support its path to becoming a trillion-dollar economy through overhauling its tax system. Necessary[18], future fiscal transformation for a fruitful economy requires formalizing unregulated economic activities through confidence-building measures, shifting from indirect to direct taxation strategies, and eliminating tax exemptions. Qualitative measures, including a digital financial culture, tax education, and institutional integrity, are essential. Moral elements, including political will, behavioural changes, and citizen-state contracts, are cores. Otherwise, the foundations will remain fragile.

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14. Article on Reform, FBR https://www.fbr.gov.pk/article-on-reforms/131167/174
15. FBR Introduces New Payment Creation System, https://www.fbr.gov.pk/fbr-introduces-new-payment-creation-system/174167
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18. It`s necessary because by formalizing unregulated economic activities (approximate USD 457 billion shown in figure 6) it adds up USD 41 billion or Pkr 11,422 billion (current USD) in tax

collection calculated with current Tax to GDP ratio (9%). Similar tax exemptions (shown in figure 3) which is equal to 52% of total tax collection in 2023.

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