



TAX EXPENDITURES IN PAKISTAN

Business Facilitation to Fiscal Burden

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Tax expenditures have become an increasingly prominent, widely used policy handle, yet insufficiently scrutinized, instrument of fiscal policy. Commonly defined as deviations from a benchmark tax system and categorized such as exemptions, deductions, tax credits, and preferential rates. These reduce tax liabilities for specified sectors, activities, or groups (Asian Development Bank, 2023⁸⁰; World Bank, 2024⁸¹). While these measures are often justified as tools for promoting investment, supporting industries, and facilitating economic development, they also represent implicit public spending in the form of forgone revenue (International Monetary Fund, 2019)⁸² hence need to be scrutinized on similar levels as of the normal budgetary allocations.

However, unlike direct expenditures, tax expenditures are embedded within tax legislation, schedules, and statutory instruments. Consequently, they often escape the determination of volume, degree of scrutiny, prioritization, and performance evaluation typically applied to budgetary spending. This institutional feature raises a central policy question: whether tax expenditures function as effective instruments for influencing business behavior or primarily operate as mechanisms that enhance profitability only without generating meaningful economic outcomes.

80. <https://www.adb.org/sites/default/files/publication/932086/tax-expenditure-estimation-tool-kit.pdf>

81. <https://documents1.worldbank.org/curated/en/099062724151636908/pdf/P174543148ba880bb188fd1ce06f588a6aa.pdf>

82. Tax expenditures—How to measure and evaluate them. International Monetary Fund.

TAX EXPENDITURES BEHAVIORAL IMPACT

From a business development perspective, the government's employ tax expenditures as incentives to promote private investment, encourage sectoral development, and enhance export competitiveness. In principle, such measures are intended to influence firm behavior by altering relative costs and returns. However, the critical element in effectiveness of these instruments depends critically on their design and conditionality.

A key analytical distinction arises between:

Income-based incentives: reduced tax rates and exemptions, and

Input-based incentives: concessions on raw materials and intermediate goods

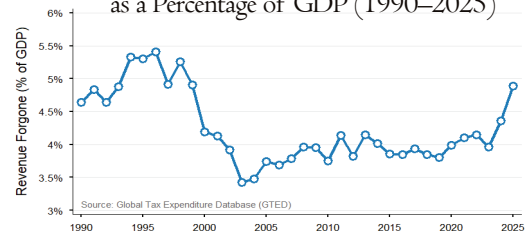
Both categories reduce the tax burden, but neither necessarily ensures a change in economic behavior. Income-based incentives tend to increase after-tax profitability without guaranteeing additional investment or productivity gains. Similarly, input-based incentives reduce production costs but do not directly promote value addition, export performance, or technological upgrading.

In the absence of clearly defined performance criteria, allowed budget and sun-set clauses the causal link between tax expenditures and desired economic outcomes remains weak. This limits their effectiveness as instruments of business policy and complicates their evaluation.

GLOBAL EVIDENCE AND POLICY LESSONS

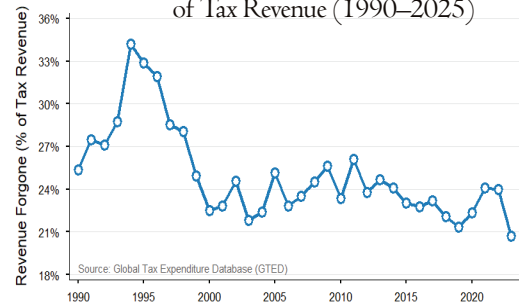
From Figures 1 and 2, based on Global Tax Expenditure Database, it can be seen that tax expenditures constitute a significant share of fiscal systems globally, often ranging between 3 and 5 percent of GDP (with increasing trend) and 20-25 percent of Revenue (decreasing trend). While their magnitude is comparable across countries, their institutional management differs substantially.

Figure 1: Revenue Forgone from Tax Expenditures as a Percentage of GDP (1990–2025)



Source: Author's Compilation

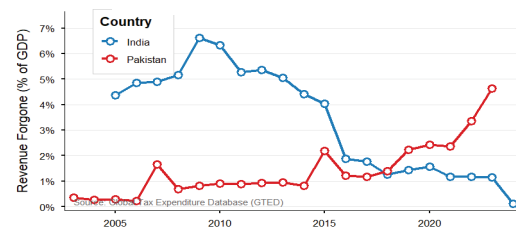
Figure 2: Revenue Forgone as a Percentage of Tax Revenue (1990–2025)



Source: Author's Compilation

Figure 3 also provides an important comparative perspective for Pakistan in this regard. India's experience demonstrated that the fiscal cost of tax expenditures can be reduced through policy reform (OECD, 2011)⁸⁴, including the rationalization of exemptions and the broadening of the tax base. The observed decline reflects a transition toward a more rule-based and transparent system, supported by periodic review and policy discipline.

Figure 3: Revenue Forgone (% of GDP) Pakistan v/s India (2005–2025)



Source: Author's Compilation

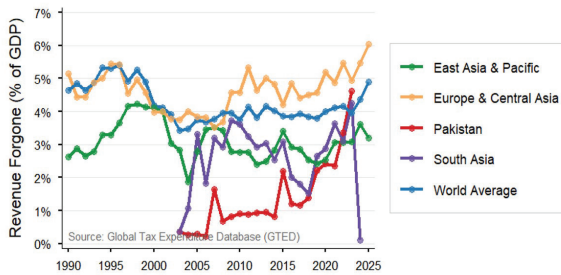
In contrast, Pakistan exhibits a persistent upward trend in tax expenditures as a percentage of GDP. This divergence suggests that the issue is not merely the existence of tax incentives but with least impact and the absence of systematic mechanisms for evaluating their relevance, effectiveness, and continuation.

84. https://www.oecd.org/content/dam/oecd/en/publications/reports/2011/06/oecd-economic-surveys-india-2011_g1g1166e/eco_surveys-ind-2011-en.pdf

PAKISTAN'S CASE: STRUCTURAL IMBALANCE IN FISCAL POLICY DUE TO TAX EXPENDITURES

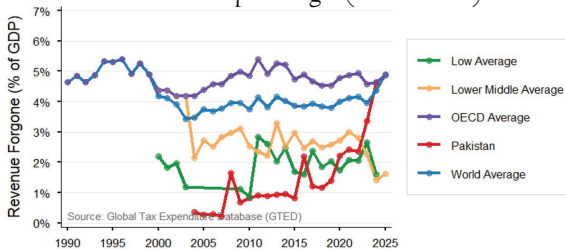
The relationship between tax expenditures and revenue mobilization in Pakistan reveals a notable structural imbalance. Figures 4 and 5 show a steady increase in tax expenditures, approaching 4–5 percent of GDP in recent years. At the same time, Figure 6 indicates that the tax-to-GDP ratio remains persistently low, fluctuating around 10 percent.

Figure 4: Revenue Foregone (% of GDP) Pakistan VS. Regional and World Averages (1990-2025)



Source: Author's Compilation

Figure 5: Revenue Foregone (% of GDP) Pakistan VS. World, OECD, and Income Group Averages (1990-2025)



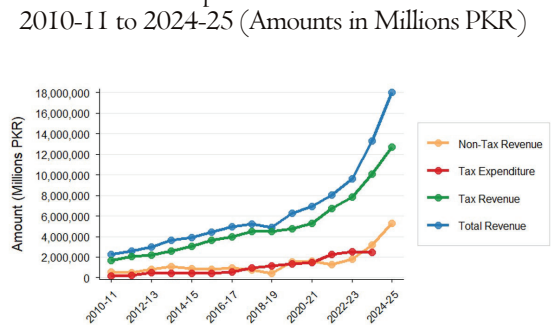
Source: Author's Compilation

This coexistence suggests that tax expenditures have not contributed to a commensurate expansion of the tax base. Instead, they appear to reduce effective tax rates without generating sufficient additional economic activity to offset revenue losses. The result is a weakening of fiscal capacity and a continued reliance on a narrow tax base.

STRUCTURE AND CONCENTRATION OF TAX EXPENDITURES

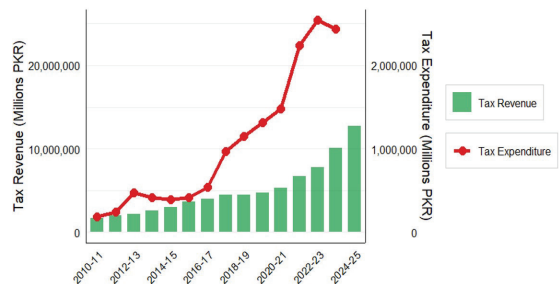
Tax expenditures in Pakistan are primarily embedded within the Income Tax Ordinance 2001, the Sales Tax Act 1990, and the Customs Act 1969, and are operationalized through schedules and statutory regulatory orders (FBR, 2025)⁸⁵. Figures 6 and 7 demonstrate that the fiscal cost of these provisions is substantial, while Figures 9 to 12 reveal that tax expenditures are highly concentrated within a limited number of provisions.

Figure 6: Pakistan: Revenue & Tax Expenditure Trends 2010-11 to 2024-25 (Amounts in Millions PKR)



Source: Author's Compilation

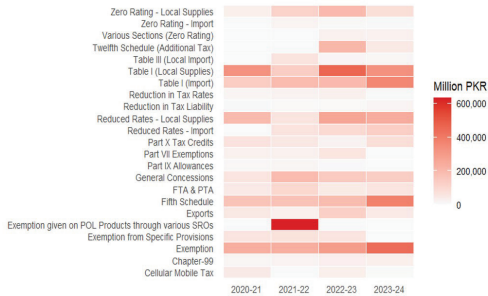
Figure 7: Pakistan: Tax Revenue VS. Tax Expenditure Tax Revenue (Bars) | Tax Expenditure (Line, Right Axis)



Source: Author's Compilation

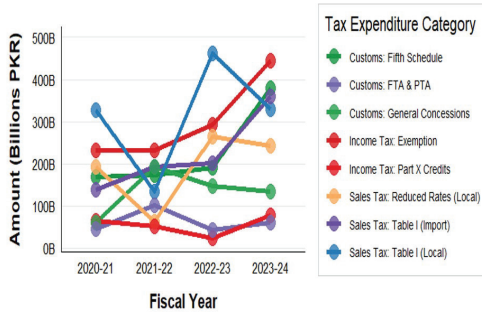
85. <https://download1.fbr.gov.pk/Docs/202595159423458TaxExpenditureReport2025.pdf>

Figure 8: Tax Expenditure Heatmap
Major Subcategories
(Amounts > 10,000 Million PKR)



Source: Author's Compilation

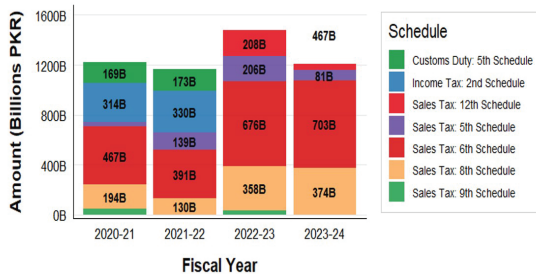
Figure 9: Top 8 Tax Expenditures:
Trend Analysis FY2020-21 to FY2023-24
(Amounts in Billions PKR)



Source: Federal Board of Revenue (FBR)

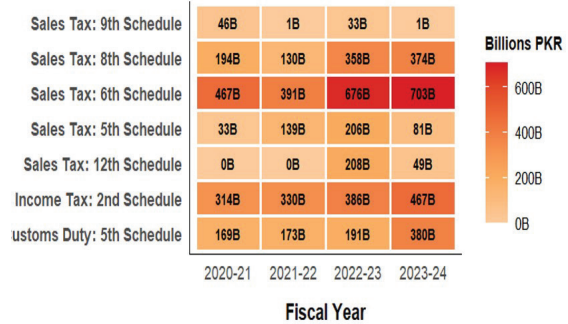
This concentration has dual implications. On the one hand, it suggests that targeted reforms could yield significant fiscal gains. On the other hand, it raises concerns regarding the criteria for inclusion and the persistence of such provisions as of now. The available evidence indicates that many entries lack clearly articulated objectives and are not subject to systematic evaluation.

Figure 10: Tax Expenditure by Schedule
FY2020-21 to FY2023-24
(Amounts in Billions PKR)



Source: Federal Board of Revenue (FBR)

Figure 11: Tax Expenditure by Schedule
Color intensity shows magnitude (Billions PKR)



Source: Federal Board of Revenue (FBR)

The reliance on schedules as a policy instrument further contributes to rigidity. Over time, these schedules tend to accumulate provisions introduced under varying economic conditions, without a corresponding mechanism for review or removal. This results in a system characterized by policy layering rather than policy design.

EVALUATING EFFECTIVENESS: KEY POLICY CONCERNS

The analysis highlights several critical concerns regarding the effectiveness of tax expenditures in Pakistan:

Weak linkage to performance outcomes: Most incentives are not tied to measurable indicators such as investment, exports, or employment. Limited evaluation mechanisms: There is little evidence of systematic ex-ante or ex-post assessment.

Policy persistence: Many provisions continue indefinitely without review or sunset clauses. **Administrative complexity:** The proliferation of schedules and SROs complicates tax administration.

Potential redundancy: Some incentives may provide benefits without altering economic behavior.

These issues collectively suggest that the current system lacks the institutional features necessary to ensure that tax expenditures function as effective policy instruments.

CONCLUSION

Tax expenditures in Pakistan represent a significant component of the fiscal system, both in terms of scale and structural importance. However, their current design and implementation raise important concerns regarding efficiency, effectiveness, and policy coherence.

The evidence indicates that tax expenditures are highly concentrated, predominantly input-based, and largely embedded within schedules and statutory instruments. Their alignment with measurable economic outcomes remains limited, and mechanisms for systematic evaluation are weak. As a result, many provisions appear to enhance profitability without exerting a meaningful influence on business behavior.

The central policy challenge lies not in the existence of tax expenditures, but in their design, targeting, and governance. A transition toward a more performance-oriented framework would require:

Linking incentives to clearly defined and measurable outcomes

Introducing sunset clauses and periodic review mechanisms

Reducing reliance on input-based concessions

Integrating tax expenditures within a broader business and industrial strategy

Without such reforms, tax expenditures risk functioning as inefficient fiscal instruments that erode the tax base while delivering limited economic benefits.

Alam Khan and Mahmood Khalid are working in the Tax Policy Office, Ministry of Finance. The views expressed are solely those of the authors and does not represent their office version on this issue.

