

Sajid Amin Javed

State, Society and Progressive Taxation in Pakistan

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Foreword

At a time when Pakistan faces profound economic and social challenges, this paper provides a timely and necessary contribution to one of the most critical debates in our national discourse: how to build a fair, equitable, and socially just taxation system.

Tax policy is far more than a matter of revenue collection. It is a reflection of the social contract between the state and its citizens. A progressive, transparent and equitable tax system is essential not only for sustainable economic growth but also for strengthening trust, cohesion, and legitimacy in governance. This study powerfully illustrates how Pakistan's current tax architecture, marked by its dependence on indirect taxes, elite capture, exemptions, and unequal burden-sharing, has entrenched inequality and weakened this social contract. The evidence presented on income and wealth disparities, intergenerational mobility traps, and the disproportionate burden placed on salaried and low-income groups underscores the urgency of comprehensive reform.

The paper's emphasis on progressive taxation as a pathway to economic justice aligns deeply with the core values of the Friedrich Ebert Stiftung. As Germany's oldest political foundation, grounded in the social democratic tradition, FES has long advocated fairness, solidarity, and inclusive development. We strongly believe that economic governance must prioritise equity and that the state must guarantee all citizens equal access to opportunities, regardless of socioeconomic background or privilege. In this context, the author's call for a new social contract rooted in transparency, reciprocity, accountability, and taxation according to ability to pay, offers a compelling vision for rebuilding trust and fostering a more cohesive society.

The findings and strategic recommendations presented here are relevant not only to policymakers but also to civil society, academia, the media, and development partners. They provide a robust analytical foundation for informed debate on reforms such as wealth taxation, reducing reliance on consumption taxes, broadening the tax base while protecting vulnerable groups, increasing women's participation in tax governance, and simplifying administration to reduce compliance costs.

We want to extend our gratitude to the author Dr. Sajid Amin Javed for his rigorous work and commitment to expanding the discourse on economic justice in Pakistan. We also thank the FES Pakistan team for supporting this publication as part of our wider efforts to strengthen democratic governance and promote inclusive economic policymaking.

We hope that this study will stimulate deeper reflection, energise public debate, and inspire bold policy choices that advance a more equitable and socially just Pakistan.

December 2025

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Abstract

This paper frames tax policy as a foundational pillar of achieving economic and distributive justice. It seeks to broaden the discourse on taxation in Pakistan by arguing that progressive taxation, if implemented in its true construct, can serve as a powerful institution to fostering a more equitable, cohesive, and productive society with strong economic and social foundations. It emphasizes that regressive taxation—by failing to adequately tax the wealthy and redistribute income and wealth—has, over time, deprived the lower segments of society of equitable access to economic and social opportunities. This has contributed to widespread public distrust in governance, particularly in the fairness and legitimacy of the tax system. In this regard, the paper proposes a strategic agenda including i) a new state-society social contract for taxation ii) implementing wealth and inheritance tax to shake foundations of inequality, iii) reducing reliance on withholding taxes based on consumption, iv) increasing proportionate representation of women in tax policy decision making forums/bodies and v) developing a narrative around and political constituency for taxation for equitable society by public engagement. The message of this work is directed toward policymakers, civil society, development partners, academics, and the media, with the aim of stimulating a more inclusive research agenda and public policy dialogue on taxation in Pakistan.

Introduction

This paper positions taxation in a broader economic and social perspective, going beyond a narrow focus on revenue targets. It argues that progressive taxation is key pillar of both social and economic prosperity. The term progressivity in this paper applies not only to tax rates—where the wealthy contribute more through higher rates—but also to the overall governance of taxation, including policy design, and administration. This approach goes beyond numerical figures and embraces a more wholistic role of taxation in society. At its core, a progressive tax regime is rooted in economic and distributive justice. Guided by the goal of building a more equitable society, it addresses income and wealth inequality as a primary objective, with revenue generation as a secondary—but important—outcome.

The issue of economic and distributive justice is once again gaining prominence in economic policy discourse. A key driver of this renewed attention is the unprecedented rise in inequality—particularly the growing concentration of wealth in the hands of a few—and the significant societal and economic costs it incurs. These include inequitable access to social, economic, and political opportunities; the erosion of social trust and cohesion; and the dampening of long-term economic growth. (Atkinson, 2015), (Piketty, 2014), (Scanlon, 2017), (STIGLITZ, 2012), (UNDP, 2019), (IMF, 2017). As a result, the traditional scope and design of economic policy are now under critical scrutiny.

Economic policy remains one of the most effective tools for addressing inequality. Fiscal policy, in particular, has a direct impact on the distribution of income and wealth—but its effects can go in either direction. Progressive taxation on income and wealth, combined with targeted subsidies and protections for lower-income groups, can significantly reduce inequality, thereby enhancing social, economic, and political opportunities for all. However, in many developing countries, fiscal policy has often taken a regressive turn, inadvertently reinforcing inequality. A heavy reliance on indirect taxation—such as taxes on consumption rather than income—is disproportionately burdening the poor and exacerbating existing disparities.

As the (Murphy & Nagel, 2002) put it, *“Taxes are not just a method of payment for government and public services: they are also the most important instrument by which the political system puts into practice a conception of economic or distributive justice [...] How much should be paid by whom, and for what purposes, what should be exempt from taxation [...], what kinds of inequalities are legitimate [...]—these are morally loaded and hotly disputed questions about our obligations to one another through the fiscal operations of our common government.”*

The global debate on social content macroeconomic policies-- particularly on tax equity--is increasing (Renzio, 2020). From equity perspective, the question of *how the government raises revenue* becomes more important than *how much revenue it raises*. In other words, quality of revenue matters more than the quantity. However, in developing countries, the focus remains limited to the latter. The success of tax policy is often judged on how much money is collected, without considering who is

paying this money or social and economic costs of collecting it from indirect taxes and other regressive means.

Studying taxation from a social perspective in Pakistan is a distant idea, often discouraged. Mostly (macro)economists take pride in separating economic policies from their social implications. Tax rates and figures are often discussed as they exist in a vacuum with no consideration of their impact on people. For the government, tax is largely seen as a tool to meet revenue targets, usually benchmarked on figures from previous year and aimed at closing the fiscal gap—regardless how and from whom they are collected.

As a result, taxation in Pakistan has been largely reduced to few economic terms and statistics, structurally disconnected from its broader social objective and implications. Progressive tax reforms, often designed to increase revenue, are limited to hiking tax rates for taxpayers and adjustments in easy-to-use tools such as withholding tax. More substantive progressive tax measures such as taxing inheritance and wealth, which are central to building equitable society, has largely remained out of the scope and ambition of these efforts.

This latter approach of progressive taxation is in stark contrast to the standard economic view of taxation which places revenues as singular objective, mostly ignoring social implications. Tax policy in economic view is exclusively focused on meeting goals of increasing tax revenue, reducing fiscal deficits and generating primary surplus. Inequality, in this framework, is largely seen as secondary—a residual issue that is to be addressed later through social protection and social safety nets.

Progressive taxation, in true sense, however, integrates the goal of reducing inequality while designing and implementing tax policy to achieve revenue targets. In this broader context, taxation becomes a powerful instrument which has far reaching implications and affects the very fabric and structure of society. Reforms agenda for progressive taxation, therefore, goes far beyond adjusting tax rates and it serves as an institution for economic and distributive justice.

Evidence emerging from around the world— particularly highly influential work of Piketty— highlights that deep-rooted structural inequality can threaten social, political and economic fabric of society¹. This has brought redistribution of wealth, and inheritance to the forefront of taxation. In this regard, progressive taxation has emerged as one of the key instruments for equitable society where everyone has equitable access to opportunities for social mobility².

Redistribution of income and wealth through taxation not only generates additional revenue, but it also helps to create a more economically active population—new consumers, producers and entrepreneurs contributing towards inclusive economic growth and development. By distributing the resources, those deprived of essential resources can gain access to health, education and other opportunities. This, in turn, fosters a more equitable society with broader access to public services. Over time, sustained redistribution of wealth reduces inequality, poverty and social exclusion leading to improved welfare of society.

1 [https://www.bruegel.org/blog-post/piketty-theory-controversy#:~:text=To%20put%20it%20differently%3A%20a,more%20persistent%20over%20time%20\(that](https://www.bruegel.org/blog-post/piketty-theory-controversy#:~:text=To%20put%20it%20differently%3A%20a,more%20persistent%20over%20time%20(that)

2 A comprehensive progressive tax regime is not limited to only higher income tax rate for rich but also includes capital gains— capital tax rate is higher than labour income tax—, inheritance taxes, corporate taxes, and even consumption taxes.

Rest of the paper is structured as follows: next section maps Pakistan's tax structure exploring its structural regressive nature. It highlights that the tax system is extractive by design, relying on consumption taxes and withholding taxes without any consideration of inequality and other social implications. It systemically extracts revenues from easy to grab groups of taxpayers such as salaried class. Section III showcases that failing to implement a tax system which targets income instead of consumption has led to sharp income and wealth inequality in the country.

Using data from Pakistan Social and Living Standard Measurement (PSLM) survey conducted during 2004-2019, the paper demonstrates that the inequitable distribution of income and wealth has limited the ability of bottom segment of society to participate in social and economic opportunities of health, education and employment. This, in turn, has created over time a social immobility trap depriving bottom segments of society to benefit from state resources, creating public distrust in tax system and fracturing the state-society contract.

Section-III identifies three main characteristics of class that has benefited from this factored taxation i) capacity of vote exchange—main voting bloc of political parties ii) street power to resist tax reforms and iii) ability to disrupt daily life of people through protests. The section summarizes that political parties do extend favors either by not expanding tax base to sector constituting their main voting bloc or by showing flexibility in implementation. Agriculture and real estate sectors present such examples of political favoritism, while retailers and traders exhibit both a voting bloc and source of street power, with ability to disrupt.

Section-IV outlines how progressive taxation shapes equitable society, both through two main fiscal policy channels, direct transfers and raising quality revenue for public investments and right signaling. Both of these when combined, enhance public trust and strengthen the state-society social contact. Section-V concludes by outlining a way forward for Pakistan to move toward progressive taxation in its true construct highlighting that a new social contract is the only viable path ahead.

Mapping Pakistan's Tax Structure: Regression and Elite Capture

Tax governance, both tax policy and administration, in Pakistan is profoundly regressive and largely characterized as unfair and inequitable (Ahmed, et al., 2015). Tax policy has been largely designed to meet the annual tax targets, often inflated with strict quarterly benchmarks set under the IMF programs³. It is built around a combination of targeting easily accessible taxpayers and relying on withholding tax and consumption taxes, such as General Sales tax, which have universal application and require minimal targeting or enforcement. This makes tax policy and administration regressive by very design where indirect taxation becomes major instrument.

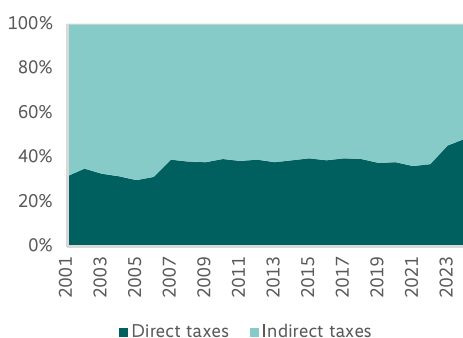
Figure 1a shows the share of direct and indirect taxes in total tax collection from 2001-2024⁴. In the early 2000s, the tax system was heavily reliant on indirect taxes, which accounted for around 68-70% of total tax revenue, while direct taxes made up only about 30-35%. This trend began to shift gradually around 2007, when the share of direct taxes started increasing, reaching close to 40% by 2010. From 2010-2020, the shares of direct and indirect taxes remained relatively stable, with indirect taxes contributing around 60-62% (figure 1a). However, during the pandemic years 2021-22) the share of direct taxes dipped slightly, likely due to reduced income and corporate profits, while indirect taxes increased marginally, possibly because of continued consumption and reliance on GST.

Figure 1a, 1b

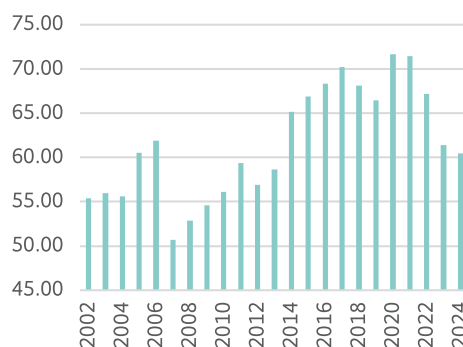
Share of direct and indirect taxes in total tax collections

1a) share of direct and indirect in total tax revenue

1b) Share of withholding taxes in direct taxes



Source: Economic Surveys of Pakistan



Source: Yearbooks FBR

3 Since 1958, Pakistan has been part of 24 different IMF Programms in last 67 years. [https://www.efsas.org/publications/study-papers/pakistan-economy-and-imf-may-2024/#:~:text=The%20International%20Monetary%20Fund%20\(IMF\)%20has%20been,develop%20a%20healthy%20and%20long%2Dterm%20growth%20trajectory.](https://www.efsas.org/publications/study-papers/pakistan-economy-and-imf-may-2024/#:~:text=The%20International%20Monetary%20Fund%20(IMF)%20has%20been,develop%20a%20healthy%20and%20long%2Dterm%20growth%20trajectory.)

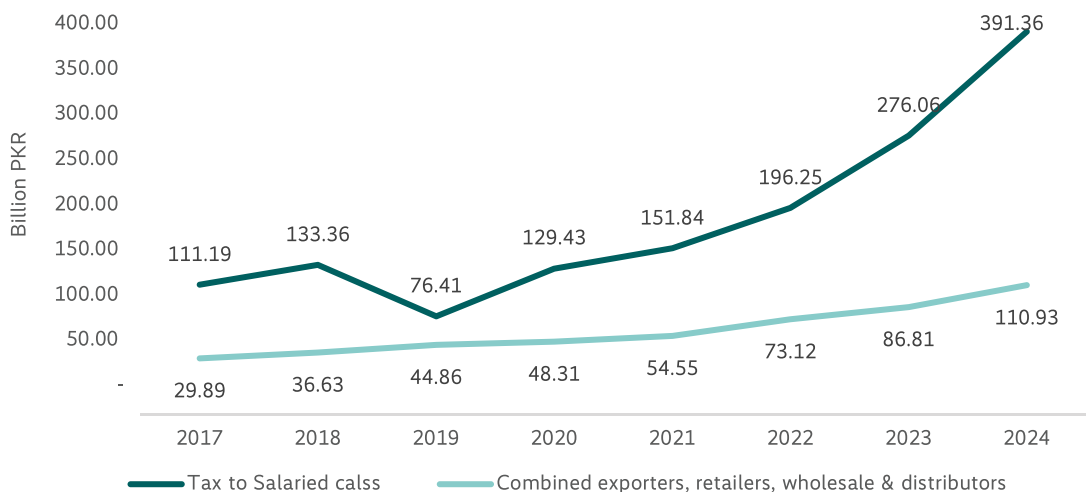
4 All numbers are in Financial Years

A significant shift becomes evident in 2023, and 2024 and the share of direct taxes rose sharply to 45.6% and 48.7% respectively, reducing share of indirect taxes to 54.4% and 51.3% respectively. Apparently, this shift may be attributed, as standard literature does, to improved tax compliance, digitization, expansion of the tax base, and other policy measures aimed at increasing direct tax collections. These factors might have contributed, but a closer look tells another story.

The rising share of direct taxes in these years is mainly financed by unprecedented higher tax collection from salaried class by imposing exceptionally higher tax rates (figure 2). The power brokers, including retailers, and the real estate sector either continue to remain out of tax net or pay much less rates. Those who have the power not to pay, do not pay. The growth of direct taxes, mainly coming from salaried class, creates this illusion that direct tax share is increasing more than indirect taxes. This, actually, is another kind of regressive taxation where salaried class is targeted to fill the tax revenues. Importantly, more than 60% of direct taxes are withholding taxes (figure 1b).

Figure 2

Share of salaried class viz a viz exporters, retailers, wholesale & distributor



Source: Yearbook FBR 2017-2024

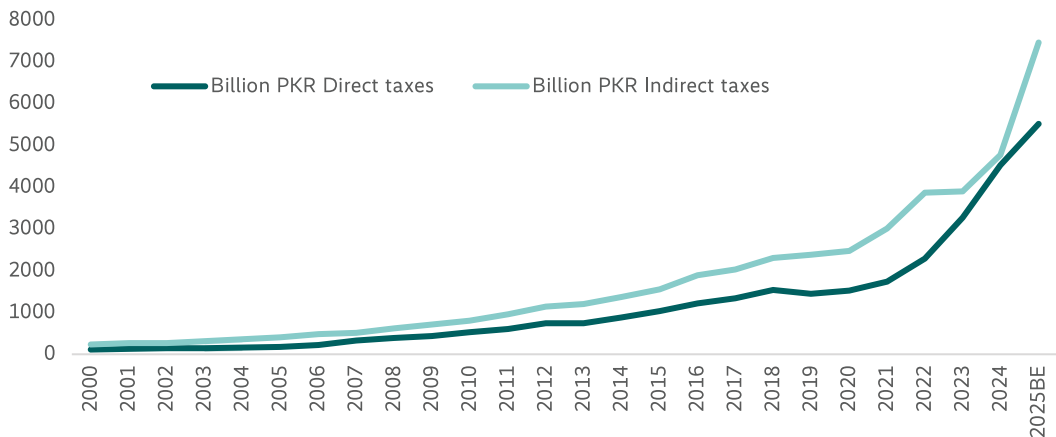
Data in figure 2 clearly denotes the extractive nature of taxation, salaried class paying more than combined retailers and exporters. The extraction, however, has been stark particularly since 2019. Tax collection from salaried class stood at PKR 391Billion in 2024 from PKR 276 billion in 2023, a staggering growth of 41.66%. The salaried class alone paid 3.5 times, 352% higher tax revenue than exporters, retailers, wholesalers and distributors combined (figure 2). A sheer extractive taxation.

Worryingly, it is not one-time random rise and denotes a systemic extraction. Tax collections from salaried class quadrupled, grew 412.6% in last five years, 2019-2024 compared to, widening the gap further (figure 2). This regressive direct taxation created an illusion that share of indirect taxes is reducing, and system is improving.

This warrants the question that what is actually happening in indirect taxation. Let's look into absolute tax collection from indirect taxes, to uncover masking effect hidden behind percentage figures. Putting the burden on poor, the gap between total collection from direct and indirect taxes has widened over time and collections from indirect taxes in absolute term has increased sharply since 2023 (figure 3), deterioration in taxation instead of improvement.

Figure 3

Tax collection from indirect taxes (PKR, billion), 2000-2025



Source: Economic Survey of Pakistan (based on data received from finance division)

Worryingly this sharp increase in indirect taxation is financed by higher GST (figure 4a), coming from a higher GST rate and high consumer prices as shown in figure 4b. The share of GST in indirect taxation reached 64.7% in 2024 from 57.4% in 2001, showing not only staggering reliance of system on GST but also deterioration (figure 4a). This increase comes from three regressive components, namely, rising GST rates over time, higher commodity and services prices.

GST increased to 18% in 2023 (figure 4b). While this increase of 1% may look insignificant apparently, it puts a heavy burden when multiplied by the prices. The Consumer Price Index (CPI), increased from 262.6 in 2022 to 386.8 in 2023 suggesting that prices of essential commodities increased 47.6% (4b). The people were therefore facing a double burden of high rate and higher prices, paying more GST on same amount/quantity of products/services. This led to sharp rise in indirect taxes (figure 3). Figure 4a highlights the critical role that GST plays as a revenue-generating tool for the country. Over the years, GST has emerged as the backbone of Pakistan's indirect taxation system, consistently contributing over 60% of total indirect tax revenue, reaching to a peak of 72.3% in 2012 (figure 4a).

Share of GST in total indirect taxes CPI and GST Rate



Source: Economic Survey of Pakistan

Source: WDI

Figure 4a shows a steady increase in GST's share through the 2000s, peaking in FY 2014 at 72.3%, and then gradually stabilizing between 64-66% in recent years. This trend reflects both administrative efforts to strengthen tax enforcement and external pressures from international lenders like the IMF, which have repeatedly urged Pakistan to raise domestic revenue through improved tax collection rather than excessive borrowing. Consequently, GST has become the centerpiece of revenue reform plans, largely because it offers a relatively easy and scalable way to collect taxes from consumption, especially in an economy with a narrow income tax base and large informal sectors.

This heavy reliance on GST is not accidental; it reflects a taxation structure deliberately designed to depend on indirect taxes as the primary means of meeting fiscal targets. In particular, GST has been instrumental in helping successive governments meet revenue benchmarks, especially during times of fiscal stress or when under IMF programs that emphasize tax reform, broaden the base, and improving documentation.

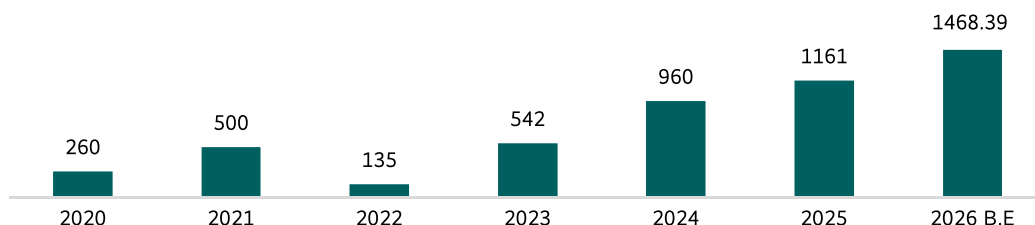
However, this reliance on GST and other indirect taxes comes with significant implications for the political economy. Indirect taxes, as mentioned earlier, are generally regressive, affecting lower-income groups more than the wealthy, and therefore can contribute to economic inequality. Yet, from a political standpoint, they are often easier to implement and enforce than direct taxes like income or wealth taxes, which tend to face greater resistance from powerful economic elites. As a result, Pakistan's tax system remains skewed, structurally favoring indirect taxation while direct taxes continue to be underdeveloped and weakly enforced.

Petroleum Development Levy (PDL) has emerged as another tool as quick fix to revenue shortfalls. Although not a tax in the strict sense, it burdens people in much the same way as indirect taxation. In the current IMF program, the government has committed to PDL of Rs. 100 per liter (Energy Update, 2025). In other words, Rs. 100 will be charged above and beyond the market price of petrol. Regressively, every rich and poor person has to pay the same rate. The government has budgeted an amount of Rs. 1468.35 billion to be collected from PDL, a staggering 10 times increase in just three years (figure 5),

Let's bring another perspective. This target of Rs.1468 billion PDL in 2025 is almost double the Rs. 716 billion allocated for Benazir Income Support Program (BISP). According to Minister of Energy, Mr. Awaiz Ahmed Leghari "motorcycles consume \$6 billion worth of imported petrol annually, with motorcycles and rickshaws accounting for 40% of the country's total petrol consumption" (Ahmadani, 2025). Technically speaking, the government has set a target of extracting Rs. 2 through PDL from the poor for every Rs. 1 distributed through BISP in FY2025-26.

Revenue from petroleum development levy (Rs. billion)

Figure 5



Source: Annual Budget Statement

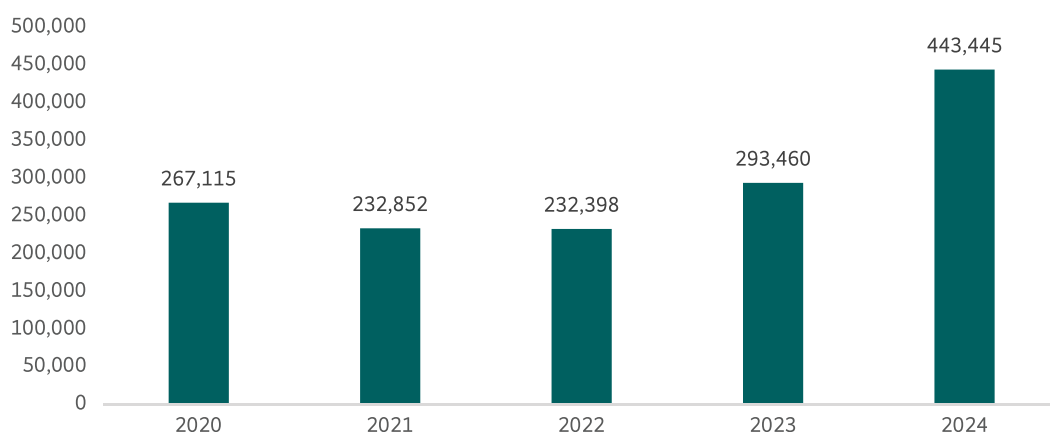
PDL highlights a growing reliance on regressive means to meet fiscal targets. The petroleum levy is classified as non-tax revenue and is not shared with the provinces under the National Finance Commission (NFC) Award. This makes it a particularly attractive tool for the federal government to raise revenue autonomously, especially under the constraints of IMF programs and fiscal adjustment requirements.

In 2020, the collection from petroleum levy stood at Rs. 260 billion, which nearly doubled to Rs. 500 billion in 2021. However, there was a sharp drop in 2022, to just Rs. 135 billion, likely due to government decisions to suppress fuel prices for political and inflation management reasons. This decline came at the expense of significant revenue loss. From 2023 onward, the levy surged again, Rs. 542 billion in 2023 and reaching an unprecedented Rs. 960 billion in 2024. A whopping target of 1479 billion for 2025-26 reflects a deliberate policy shift to use petroleum levy as a core-revenue-generating instrument.

While effective in boosting federal revenues, this strategy reflects a deeper issue, which is the increasing dependence on regressive fiscal tools. While it may bring easy revenues for the government, it shifts the burden disproportionately on poor segments of society already struggling with high cost-of-living crisis. Such measures may help the government fulfill IMF targets and stabilize fiscal indicators in the short term, but they amplify inequality and social discontent in the longer run.

This is further amplified by tax exemptions. Taxation in Pakistan is a double edge sword for poor and a classic example of elite capture. On one hand, the poor are burdened through indirect taxation for the tax that the rich either avoid by remaining outside the tax net or evade altogether—tax evasion and avoidance. On the other hand, rich are given income tax exemptions. Figure 6 suggests that tax exemptions have increased from 267 billion to 443 billion, a growth of 66% over five years

Income tax exemptions (Rs. Million)



Source: Economic Survey of Pakistan

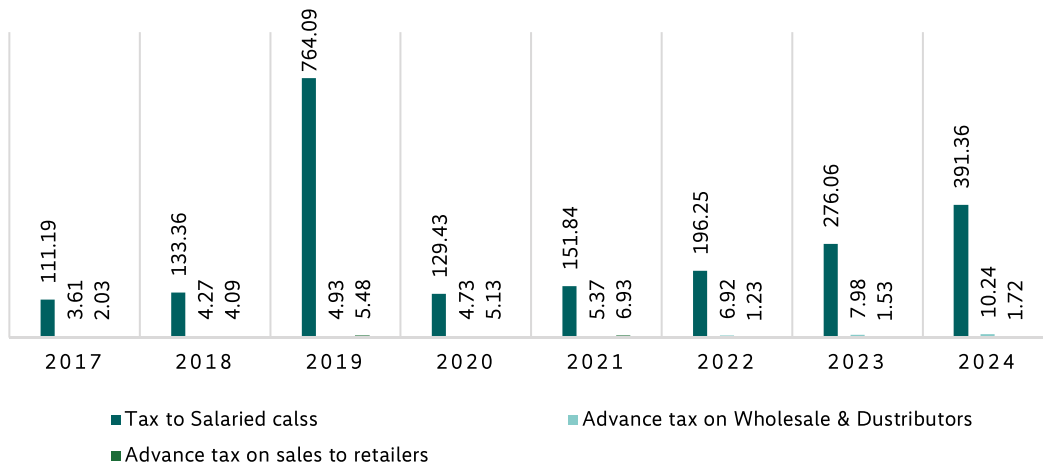
Figure 6 reveals a concerning and persistent trend in the country's fiscal policy, significant and rising revenue losses due to exemptions, even during times of economic distress and fiscal tightening. Despite pressure to broaden the tax base, these exemptions were not meaningfully reduced, they continue to increase. This trend reflects how deeply embedded tax privileges remain within Pakistan's political economy.

Despite ongoing commitments under IMF programs to reduce tax expenditures and enhance direct tax collection, the government has continued to extend or preserve generous income tax exemptions, effectively shielding certain sectors and interest groups from contributing their fair share. These exemptions overwhelmingly benefit powerful constituencies, including large businesses, politically connected individuals, and entire economic sectors that remain largely outside the formal tax net, such as agriculture, wholesale, and retail trade.

Third and most critical hall of taxation in Pakistan are sectors which are either out of the tax net or significantly undertaxed. The agriculture sector, which constitutes a significant share of GDP, remains undertaxed, despite being highly profitable for large landowners. This leads not only to loss of revenue from the sector but also allows landlords to disguise taxable income as agricultural income. Similarly, wholesalers and retailers, a vast and dynamic part of the domestic economy, continue to operate largely outside the documented tax system, often paying negligible or no income tax.

During last five years (2020-25), the total tax paid by the salaried class was 1144.94 billion PKR whereas the contribution from retailers was around 16.54 billion PKR and the share of wholesalers and distributors 35.23 billion PKR. This is pure case of elite-driven policymaking on the one hand and the inability of taxation system to track and trace those who do not pay taxes on the other. According to SBP, out of 5 million Micro, Small and Medium businesses, only 179,383 retailers have installed point of sale (POS) that was around 151,646 in FY2024 (SBP, 2025).

Share of salaried class viz a viz retailers, wholesale & distributor



Data Source: FBR Annual Book

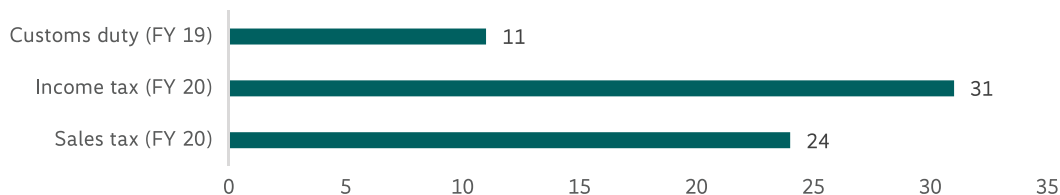
These groups, which wield significant political influence, have consistently resisted documentation and formalization, and successive governments have lacked the political will to bring them fully into the tax net. Resultantly, the burden of taxation falls disproportionately on salaried individuals and formal businesses, those who are already within the tax system and easier to tax.

To compensate for these large-scale exemptions and tax collection loops, every government has increasingly relied on regressive taxation tools, such as GST and petroleum levies, which place a heavier burden on poor and middle class. This dynamic further widens economic inequality and undermines the progressive intent of income taxation.

Figure 9 shows tax gap for 2019 and 2020, reflecting deep structural flaws in Pakistan’s taxation system. The figure shows that the income tax gap alone stood at Rs. 730 billion, accounting for 31% of the collectable income tax, while the sales tax gap was Rs 519 billion (24%), and the customs duty gap was Rs. 40 billion (11%). These gaps, representing revenue that should be collected but not, highlight the staggering scale of tax evasion and leakage that continues to undermine the country’s fiscal capacity. According to Auditor General’s Report, tax gap in 2024 reached to above Rs. 7 trillion (Sarfraz & Azad, 2025).

Tax gap (% of tax collectable)

Figure 8



Source: FBR Tax Gap Report 2022⁵

At the heart of this problem is the entrenched role of undocumented wealth and widespread tax evasion, which have become systemic features of Pakistan's economy. A significant portion of wealth remains unregistered, untaxed, and parked in sectors that operate outside the formal economy, evading detection and contributing nothing to the tax base. The informal economy facilitates large-scale non-compliance, particularly among small businesses, wholesalers, retailers, and self-employed professionals, many of whom do not file returns or pay any meaningful tax.

Furthermore, the agriculture sector, contributing around one fifth (20%) to GDP, contributes less than 1% to tax revenue. Not only has it remained outside the tax net, but it also continues to serve as a parking ground for income from other taxable sectors, owing to political protection and constitutional exemptions. Similarly, the real estate sector has evolved into one of the most significant avenues for concealing wealth. Repeated amnesties, property valuations significantly lower than market and under-regulation due to predominantly informal nature of sector act as incentive for those seeking to park untaxed money.

Overall, the scale of tax evasion in Pakistan is shaped by this interplay of weak documentation, powerful vested interest, and deliberate policy choices, such as the repeated ranting of amnesty schemes, which signal to taxpayers that evasion carries little risk and can always be regularized at minimal cost. This perpetuates a culture of non-compliance, undermines tax morale, and shifts the burden onto a shrinking pool of compliant taxpayers, mostly salaried individuals and industry.

⁵ This is last report available on the website of Federal board of Revenue (FBR)

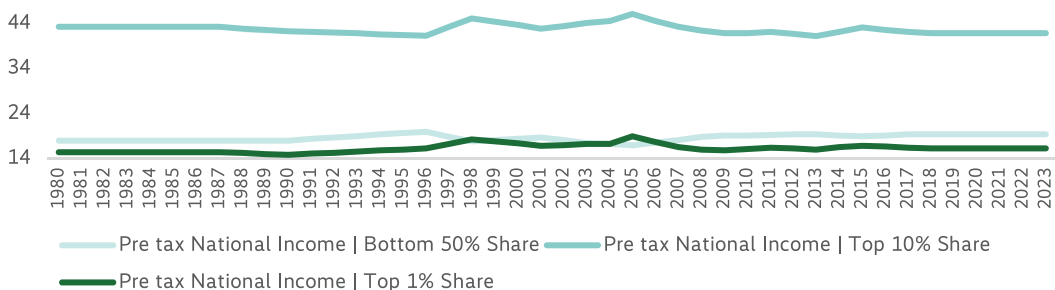
Wealth and Income Inequality

Inequality is one of the most adverse outcomes of regressive taxation. When a tax system fails to bring people into tax net, tax the income progressively, and redistribute wealth, it catalyzes the production of inequality, a condition that remains rampant in Pakistan. The rich continue to generate and capture major share of income and wealth, with no major distribution improvements over the last half century. Top 1% adult population holds roughly 15% of countries total income. The top 10% hold a staggering 42-43% of country's total income every year, since 1980 (WID, 2025, figure 7).

Largely remaining untaxed, this capture of income by rich has led to accumulation of wealth. Let's make a comparison by class to understand the scale of this inequality. Half of the bottom population of country own net wealth of 4% compared to 60% of top 10% (figure 11). In other words, if total wealth of country is Rs. 100, half of the bottom population, the poor, has a total wealth of only Rs. 4 out of it while the top 10% own Rs. 60 which is 15 times, 1500%, higher than half of the bottom population. The share of bottom 50% is 600% less than the only 1% richest population which owns Rs. 25 out of 100.

Share of top 1%, 10% and bottom 50% in total income of Pakistan

Figure 9

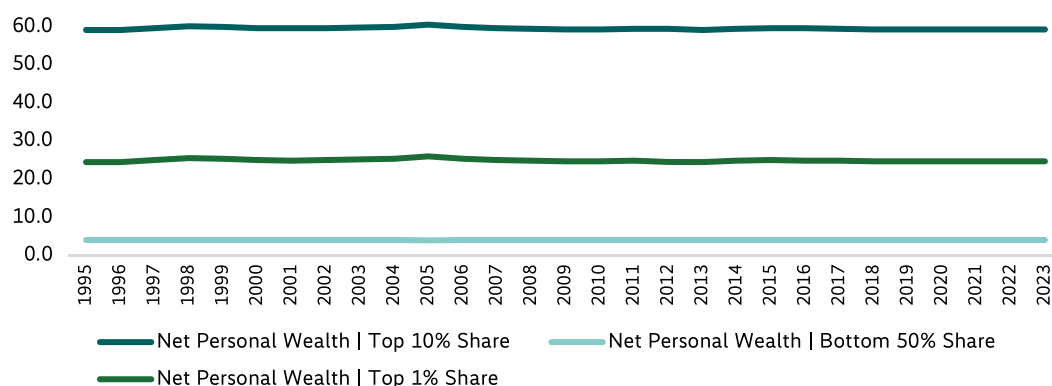


Source: World Inequality Database (WID)⁶

In a regressive taxation system, income inequality translates into deeper structural wealth inequality. Top 1% adult population on average owns one fourth (25%) of total wealth of the country, while the wealth controlled by top 10% is 60% of the total wealth of the country, without any improvements in last three four decades.

⁶ https://wid.world/world/#sptinc_p99p100_z/PK/last/eu/k/p/yearly/s/false/14.6045/20/curve/false/country

Share of top 1%, 10% and bottom 50% in total wealth of Pakistan



Source: World Inequality Database (WID)

Inequality of income and wealth is persistent and structural in Pakistan, driven by three primary forces which reinforce each other namely i) elite capture on productive resources, lower intergenerational social mobility which limits opportunities for poor to participate into productive jobs, earn higher income and accumulate wealth and iii) a regressive tax system which fails to redistribute the income and wealth.

Elite capture on policymaking, denoted by ability to influence reforms agenda and power to extract productive resources coupled with tax exemptions, favourable subsidies and ability to avoid tax, enables the wealthy to accumulate income and wealth at rates far higher and faster than the poor. (Assad, n.d.), (Zulfiqar & Moosvi, 2022). The untaxed income accumulates, leading to a sharp rise in wealth. This control over assets, coupled with more access to productive resources, such as modern technology and finance, creates a feedback loop that generates higher returns on investments, leading to further rise in income and wealth inequality.

Structural Causes and Social Impacts of Inequality

But the most critical question is what shapes this unapparelled access of the rich to all productive resources and better jobs, compared to the poor. What keeps the poor from accessing all these resources. The answer lies in literature on equality of opportunities. In country where everyone has equal, equitable, access to opportunities of education and entry to labour market, the inequality of income and wealth tends to fall (Aiyar & Ebeke, 2020). Despite starting from a lower rung, people can rise to higher levels through their potential and abilities. In other words, individuals are not necessarily constrained by their initial socioeconomic status. This is called higher social mobility.

However, when socioeconomic status of person, parents or family background drives access to resources, such as good health, quality education, the poor have lower chances to access these opportunities. They are most likely to end up in the same ladder. Take example of a boy child born to a dishwasher and a bank manager in Pakistan on same day. A scrutiny of data of Pakistan Social and Living Standard Measurements (PSLM,) suggests that the son born to dishwasher has 71.6% chances

of remaining a dishwasher on very days of birth (Javed and Irfan, 2014). This can also be interpreted that out of 100 sons born to dishwashers, 72 will end up being dishwashers in their working age. In contrast, out of 100 sons born to bank managers, 84 will become bank managers or attain even higher position (figure 12B).

In addition to other factors, this is mainly from barriers to education mobility. There is 42% chance that son will never attend schools if his father never attended school while only 9% chance that he will graduate (figure 12A). In other words, out of 100 sons born to fathers who never attended school, 42 will never attend school, 75 will not complete matriculation and only 9 will graduate. Corresponding, the son born to graduate father has 58% probability that he will graduate (Javed and Irfan, 2014), 58 out of 100 will do graduation.

Education and Income Mobility Index

Figure 11

A) Education of Sons

Education of Father	Never Attended School	Up to Primary	Middle	Matric	Graduation	Post Graduation	% (N)
Never Attended School	42.4	17.3	14.6	16.5	8.2	0.8	100 (1650)
Up to Primary	23.6	31.3	15.9	16.7	12.3	0.3	100 (390)
Middle	14.1	14.6	27.0	26.5	14.6	3.2	100 (185)
Matriculation	9.2	9.2	21.1	25.9	31.4	3.2	100 (185)
Graduation	12.0	2.7	6.7	24.0	36.0	18.7	100 (75)
Post Graduation	7.1	0.0	0.0	14.3	42.9	35.7	100 (14)

B) Occupation of Sons

Occupation of Father	Elementary	Services/ Agriculture	Technicians/ Associate Professionals	Managers/ Professionals	% (N)
Elementary	71.6	25.8	1.1	1.5	100 (465)
Services/Agriculture	37.4	56.9	3.7	2.0	100 (860)
Technicians/Associate Professionals	47.1	38.2	14.7	0.0	100 (34)
Mangers/Professionals	15.6	40.6	28.1	15.6	100 (32)

C) Quintiles of Annual Income of Sons

Quintiles of Annual Income of Father/Son	1 st Quintile	2 nd Quintile	3 rd Quintile	4 th Quintile	5 th Quintile	% (N)
1 st Quintile	43.5	25.3	16.6	8.1	6.5	100 (308)
2 nd Quintile	31.3	33.8	17.9	11.7	5.4	100 (240)
3 rd Quintile	20.7	30.4	22.1	16.7	10.1	100 (276)
4 th Quintile	21.3	24.5	23.1	20.2	10.8	100 (277)
5 th Quintile	18.5	14.0	18.5	26.0	23.0	100 (265)

Source: (Javed & Irfan, 2014)

This influence of socioeconomic status on access to education and job opportunities lays the foundations for structural inequality of income and wealth. The son born to bank manager can access good quality education from top schools, take good care of health from private hospitals and invest in other skills development simply because his family can afford. In contrast, a son born to dishwasher cannot get any of it as his family cannot afford. This unequal access to opportunities—determined solely by the ability to pay—places these two on different life trajectories; low paid, elementary jobs for one and high paid, more professional jobs for the other.

This applies exactly to entire class of poor and rich in society. Out of 100 sons born to poorest fathers, 1st quintile, 44 (43.5) will remain the poorest in their generation and only 8 will reach rich (4th Quintile) (figure 12C). In contrast majority of sons born to rich and richest fathers, 4th and fifth quintile, will be rich/richest in their generation (figure 12C) only because they were born to rich fathers. In other words, their progress in education, job market and income, is mainly driven by socioeconomic status of their fathers.

This distribution of economic opportunities shaped by socioeconomic status violates right of equitable access to opportunities produced in different sectors of economy and has intergenerational effect. This is particularly true for education and employment opportunities. Inequitable access to education opportunities translates to unequal distribution of job opportunities in labour market. Households with limited access to education or access only poor-quality education, often end up at the bottom of the labour market ladder, elementary jobs—setting a vicious circle of *less earnings, lower savings, poor human capital investments in next generation*.

This is where the role of tax policies becomes very critical, going far beyond revenue collection. In addition to generating resources to finance social investments which directly impact public service delivery, taxation also provides conducive environment for equitable access to public services through income and wealth distribution. It shapes the future of generations by enabling greater intergenerational social and economic mobility—more equitable access to education, health and job opportunities.

Without aiming to assess the role of taxation in shaping these opportunities, this section looks into the distribution of opportunities themselves. Building on the Social Opportunity Function and using data from four rounds of the Pakistan Social and Living Standards Measurement (PSLM) survey (2004, 2010, 2015, and 2019), I constructed Opportunity Curve (OC) to assess the distribution of education and employment opportunities across six domains: paid employment, employment with above-median income, primary education, secondary education, and adult literacy.

The population is divided into percentiles from 1 to 100 on horizontal axis, representing the range from the poorest to the richest. Share of opportunities taken by each group of population is shown on vertical axis. An upward shift in the curve indicates that more opportunities were created overall, while the slope of the curve reflects how these opportunities were distributed. A downward-sloping curve suggests that a greater share of newly created opportunities benefited the lower percentiles (the poor), whereas an upward-sloping curve indicates concentration among higher-income percentiles (the rich).

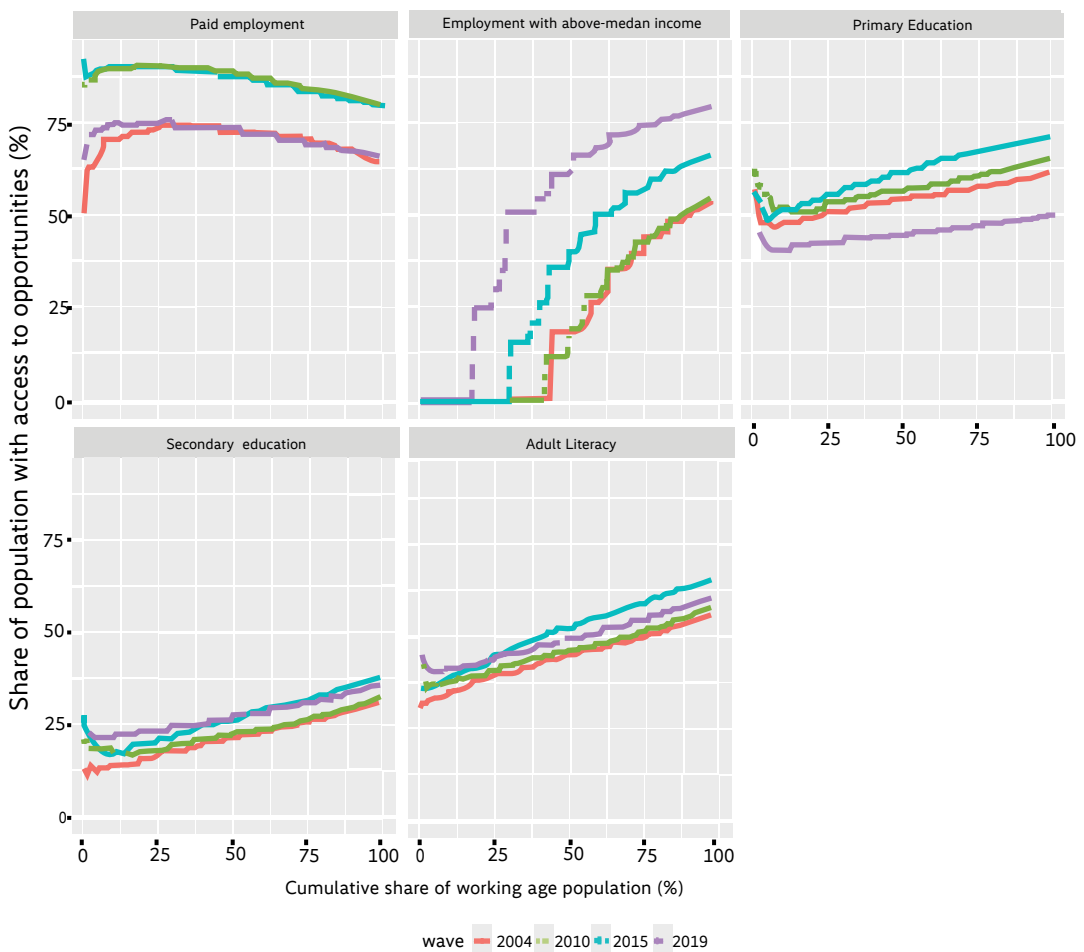
As shown in Figure 3, opportunity curves for paid employment are consistently downward sloping across all waves. It means the poor segments of society benefited from these opportunities more than the rich—the top percentiles—indicating a pro-poor distribution of employment opportunities. The period 2004–2010 is marked by a substantial outward shift in the curve, reflecting significant

increase in job . However, from 2010 to 2019 only a marginal number of job opportunities were created.

But important question at our hands is who gets high paying jobs? The distribution of employment yielding higher income—denoted as jobs with above-median income-- remains highly unequal, as shown by a steep rise of opportunity curves, suggesting that these jobs were concentrated among the upper percentiles (figure 13). In other words, the rich, with higher social economic status are more likely to secure well-paying jobs, while elementary and low-skilled positions are predominantly filled by those with poor backgrounds.

Figure 12

Distribution of education and employment opportunities to population (2024-2019)



Apparently, what looked “equitable distribution” is trap of intergenerational immobility--Poor are getting elementary jobs only in one generation and the next (figure 13).

Education is primary tool of international social mobility (Li, et al., 2025). Access to quality education without one’s socioeconomic status is critical to produce equitable society. Access to education remains inequitable—while poor get some opportunities, more education opportunities go to the rich. Particularly opportunities of higher education, above intermediate, have sharper upward slope indicating that most of the opportunities are accessible to rich—those who can afford.

Consequently, the rich get good high-paid jobs because they can afford good education at higher level. The poor mostly end up slightly benefiting from primary education, limiting their ability to participate in good jobs. Taken together, these findings highlight a pattern of structural inequality in access to education and labour market. The slowdown in equity gains over the latter period suggests structural constraints that disproportionately affect the poorest and most marginalized groups, continuing to prevail.

Progressive taxation, progressive by definition, breaks these barriers of social mobility. It redistributes wealth, generates revenues from direct taxation to lower the burden of indirect taxes on poor, and provides a fiscal space for direct transfers through special protection and other social safety nets and investments in public education to enhance the access of those who cannot afford privileges, bridging the education divide. This, in turn, improves the entry of poor into good jobs, raising their income, narrowing the gap between rich and poor, reducing the structural inequalities of access to education, job and income.

Scandinavian countries like Sweden, Norway, and Denmark—often praised for low inequality and high quality of life— present and excellent case study of central role of progressive tax systems in reducing inequality (Abbasove, 2025). In the first round, higher top marginal tax rates reduce post tax income gap between the rich and poor. In the second round, they provide resources to enhance ability of poor people to participate in decent jobs and increase their earnings by strong public investment in education, healthcare, and childcare. The result? More upward mobility, less poverty, and a stronger middle class.

Who Gains and Who Loses from Tax Reforms

While the communication on tax in Pakistan actively and consistently communicates a narrative centered on fair and progressive taxation, deliberately employing terms like “fair,” “equitable,” and “just” in its official messaging (IRS, 2024); however, it largely fails to embed this principle in practice, as the structural over-reliance on indirect taxation overwhelmingly coming from GST, withholding taxes, immense system complexity, frequent tax exemptions and amnesties for elite class such as real estate sector and perceptions of arbitrary enforcement create a system that a significant portion of the population experiences as fundamentally unfair and unjust.

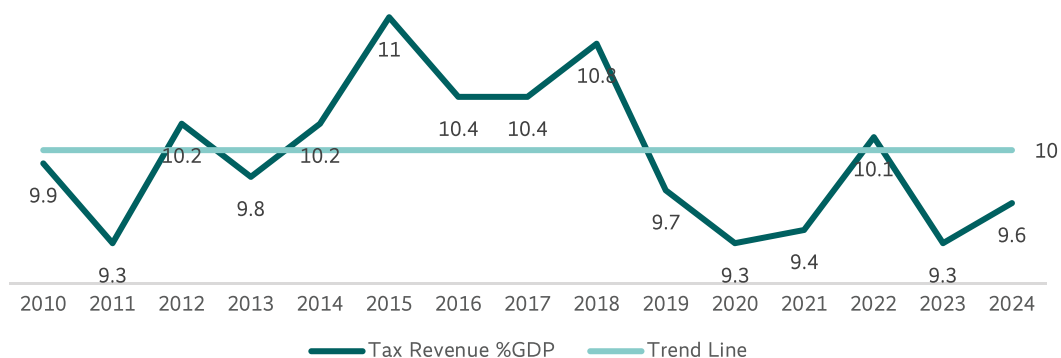
The accountability drives of taxation, often run in the name of improving tax culture, are mainly to control residual tax evasions and avoidance and do not descend to deep rooted accountability where fundamentals of tax structure are corrected. For example, repeated tax amnesties suggest contradictions in policy and practices⁷. The recurring use of tax amnesties creates a perverse incentive: it rewards non-compliance by fostering the belief that another amnesty will always be available, which in turn promotes tax avoidance and discourages participation in amnesty itself.

While the complexities exist, it does not mean no efforts have been made to improve taxation in Pakistan. Many tax reforms commissions have been constituted in this regard. The first National Tax Reform Commission to present recommendations to improve tax system in the country was constituted in 1985 (Ahmed, S., & Sheikh, S. A. (2011). The commission focused on three main areas, namely direct taxes, indirect taxes and administrative reforms. Tax reforms introduced then majorly targeted the reduction of indirect taxes and broadening of direct taxes. These efforts to improve tax structure were somewhat successful and the share of direct taxes increased more than double from 18% in 1990 to 40% share in GDP of 2010. (Ahmed & Sheikh, 2011). It has been almost stagnant since then (Figure A).

It also aimed to shift the tax structure from GST to VAT taxation and to broaden the personal income tax base which could not be achieved and reliance on indirect taxes increased regardless of the tax reforms. A modern VAT system resolves the structural flaws of cascading sales taxes by taxing only the value added at each stage. Unlike turnover-style taxes that inflate consumer prices by taxing already-taxed inputs, VAT provides credits for input taxes, avoids tax-on-tax effects, and creates compliance incentives through invoice verification. Lastly, the aim of efficient administrative system, through transparency, training, auditing and upgradation of information gathering and processing system, did not show any significant improvement. Pakistan has one of the lowest total revenues generated by the government from taxes hovering around 10% (figure 14).

⁷ Pakistan has announced 11 tax amnesties schemes. https://www.researchgate.net/publication/322354024_Tax_Amnesty_Implementation_in_Selected_Countries_and_Its_Effectivity

Tax to GDP ratio; 2010-2025



Source: Economic Survey of Pakistan

In 2005 the government presented one of the main tax reforms known as Tax Administrative Reform Project (SDPI, 2013). It mainly focused on fairness of tax administration and effectiveness, tax compliance and broadening the tax base and lastly promoting trade facilitation. Overall, the performance of this reform initiative was unsatisfactory and could not generate gains.

Since the 18th amendment revenue collection became even more complex as each province devised its system and came up with a revenue authority where in each province the indirect taxes collected were always greater than the direct taxes. In fiscal year 2024-25, FBR collected 60.41 percent indirect tax against 39.51 percent direct tax, Punjab collected 87.88 percent indirect against 12.11 percent direct tax, Sindh collected 1.33% direct taxes against 98.66 percent and Balochistan collected 95.60 percent indirect against 4.40 percent direct tax and Khyber Pakhtunkhwa collected 88.91 percent indirect against 11.09 percent direct tax.

Tax reforms offer tax exemptions and many other incentives which deter tax collection. Such as the exemptions offered in 2013-14 amounted for Rs477 billion (SDPI, 2015)⁸. Agriculture sector benefitted by Rs115 billion, and sales tax exemptions and custom duty exemptions amounted to RS 211 billion and Rs131 billion, respectively. In a country where the vast amount of wealth and income remains out of the tax net, it becomes incredibly difficult to achieve the objectives and to shift the societal attitudes toward tax compliance.

Most recent tax reforms offered in 2019 cater 3 main concerns which include i) broadening of tax base and documentation of the economy ii) advance tax system iii) independent tax justice system. The government introduced business friendly tax and administrative packages, reducing the corporate tax to less than 30% over the period of next 2 to 3 years to promote economic growth. The results for the government's efforts around this are yet to be seen but history shows that even the large number of tax reform commissions could not achieve its objectives fully. (Hafiz, 1996)

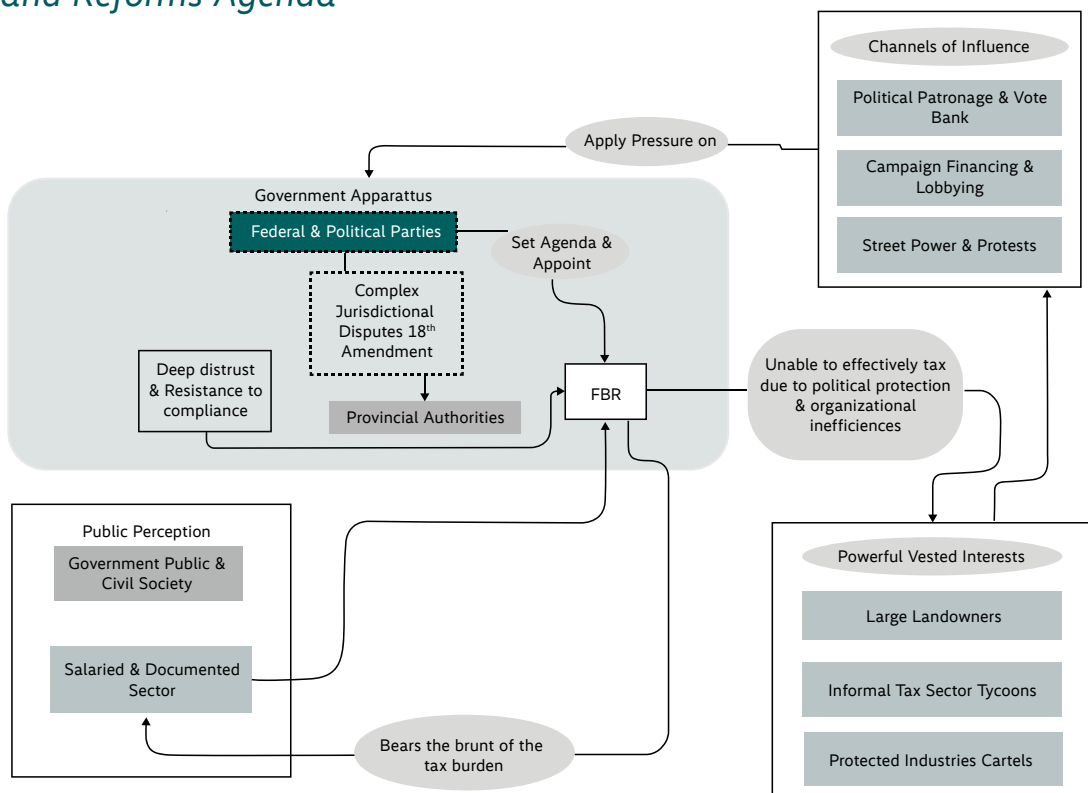
⁸ For details refer to study of SDPI on "Rationale for Tax Reforms in Pakistan" conducted in 2015. It is available on

As tax administration in Pakistan suffers from many institutional and structural weaknesses, tax evasion continues to be a serious issue and elite class of the country continues to amass wealth without penalties and tax morale (Ansari, 2025⁹). Furthermore, the size of informal economy has increased to a great extent. There is a need for strong political ownership and administrative efficiency to improve tax structure, tax culture and policy effectiveness.

The preceding summary of tax reforms shows that these reforms focused more on technical side, whereas the underlying problems of tax governance are power, politics and incentives. The elite influence begins from the very power of setting tax reforms agenda. The elite control instruments include a) political patronage, b) the power of lobby and c) street power (figure 15). The business cartels, big landlords and the tycoons working in formal sectors have largely been the primary custodian of these elite control instruments and the largest beneficiaries of the system.

Figure 14

Process and Channels of Influencing Tax and Reforms Agenda



Source: Author's elaboration

⁹ <https://file.pide.org.pk/pdfpideresearch/discourse-2025-02-01-tax-reforms-in-pakistan-progress-made-pitfalls-ahead-and-the-road-forward.pdf>

Each political party in Pakistan tends to have a particular stronghold among specific voter blocs and party members—such as rural communities, traders, or business groups. When in power, these parties often prioritize protecting their electoral base, not only as a form of political compensation but also to secure future votes. As a result, tax policy is frequently shaped by electoral interests rather than economic logic. This leads to widespread tax exemptions, under-enforcement, and even rollbacks of existing tax measures for favored sectors.

Agriculture, real estate, and wholesale and retail trade serve as illustrative case studies. Until recently, large segments of these sectors, particularly agricultural traders and the real estate market, remained outside the formal tax net. Different political parties, seeking to appease their core constituencies, shielded these sectors from taxation. Meanwhile, the tax burden has increasingly fallen on salaried workers and other easily taxed groups, deepening perceptions of unfairness in the system.

Third most effective tool is the street power-- ability of certain economic or social groups to collectively mobilize and exert pressure-- of different economic actors and sectors. Several factors influencing how much street power a certain group of society has included i) level of organization ii) economic importance iii) political influence and iv) ability to disrupt daily life. These factors are often mutually reinforced. More organized sectors have a higher level of street power. Take example of retailers and traders in Pakistan. This is one of the most organized sectors and has repeatedly shown a very high street power. This strength is further catalyzed by the ability to disrupt life. Closing the markets and shops, with shutters down, disrupts the daily routine of everyone.

Real estate sector is one classic example of street power emanating for contributions to economy. A slowdown in real estate sector slows down economy, an unfavorable situation for any government. Pakistan have recently had a reversal on tax policies, exemptions and cutting tax rates down for this sector (Abbasi, 2025). Another major driver adding to the street power of this sector is its informal nature—no data and documentation which makes it difficult to impose tax on.

Poor enforcement capacity also forces tax authorities to step back. For face saving, the system opts for voluntary schemes such as amnesties and voluntary registration. Failure to bring retailer sector into tax net despite repeated rounds is another typical example of it. The government has been announcing Tajir Dost Scheme repeatedly, but it failed every time. Implemented in 42 cities of Pakistan including Karachi, Lahore, Islamabad, Rawalpindi, Quetta, Peshawar, Faisalabad, Sialkot, Multan, and Gwadar, the scheme has been able to register only 65000 retailers and traders since April 1, 2024, showing one of the biggest failures of tax reforms (Khan, 2024).

Contrary, the biggest losers are those who do not have tools to manipulate the tax reforms agenda, lack instruments and ability to lobby and fall short on street power. Salaried class and industry are best examples here. Bound by the contracts, lacking the ability to conceal income, and unable to stage protest or influence the FBR like powerful businesses in retail and trade sector and investors in real estate sector, this group is and has been most vulnerable to tax extraction in country. The industry contributes to roughly 20% to GDP but pays more than 85% of total tax collections in Pakistan. Contrary to it, agriculture and services sector with a share of 20% and 60% in GDP only contributes to 0.2% and 30% to tax revenues, respectively.

Preceding discussion presents worrying picture of a social contract between state and society which guarantees fair share in responsibilities and benefits. A tax system that relies heavily on consumption tax rather than income tax—and consistently fails to redistribute wealth—has created a systemic trap. As the preceding evidence suggests, the poor are bearing the brunt of the tax burden, while the

wealthy, who benefit disproportionately from state resources, continue to remain outside the tax net and enjoy widespread exemptions. The absence of economic and distributive justice in taxation has systematically excluded poorer segments of society from accessing meaningful economic and social opportunities.

This imbalance has eroded public trust—particularly among taxpayers—in the fairness of the tax system and the integrity of broader economic governance¹⁰. The state has not been able to demonstrate that taxpayers' money is spent on their welfare (SDPI, 2013). As a result, the social contract between the state and society has weakened, if not broken entirely. This must be urgently addressed. The only viable path forward for Pakistan is the construction of a new social contract—one grounded in progressive taxation, with equitable income and wealth distribution and ensuring that poor segments of society have equitable access to social and economic opportunities at its core.

¹⁰ According to (SDPI, 2013), a whopping 71% of eligible taxpayers did not pay tax as they do not trust that tax money will be used for welfare of society.

Progressive Taxation---Tax Equity-- as a Tool for Equitable Society

Economic and distributive justice makes the core of equitable society which builds on fair and share in responsibility of contributing to resources, noted as revenues here, distribution of resources, noted here as public spending, ensuring equitable access to public services. Given the scope of this paper, we focus more on the former. A progressive tax system takes its foundations from two social principles. Those who are liable to pay tax are required to do so. Second, the rich pay more as they earn more, particularly when higher earnings are from the result of elite-driven policy making. But more importantly, a fair tax system inherently protects the poor from bearing the tax burden¹¹.

Progressive taxation from a social perspective is about redistributing wealth and income in a way that reduces inequality and paves way for social mobility, along with generating much needed tax revenues. Technically speaking, a taxation system in this perspective is not guided by the “ability to collect revenues to meet annual targets”, instead it is guided by “ability to reduce inequalities” while collecting these revenues. It is in this context that tax equity sets the foundation of economic and distributive justice leading to social cohesion. The transmission mechanisms include both a) fiscal redistribution, and b) signaling of fairness (figure 16).

Progressive taxation not only brings more revenues for the government, but also contributes to people’s trust in policies, institutions and the overall governance system. On the one hand it mobilizes revenue which can be channeled towards financing quality public services in health, education and skill development. This, in turn, improves social mobility where everyone has equitable chances of achieving better education, quality health and decent jobs/employment.

In other words, it enhances capabilities of marginalized and poor and improves their economic security. Through a more direct channel, it provides space for direct transfer to those who cannot participated in market/opportunities through safety nets for poor, elderly, women and children, reducing the ga between haves and have nots (figure 16). Similarly, gender sensitive taxation, such as giving tax incentives to industries and SMEs employing women on priority, can not only increase female labour force participation in the country, but also reduce the gender employment and wage gap substantially. All these combined strengthen social institutions and contribute to trust in social and economic governance.

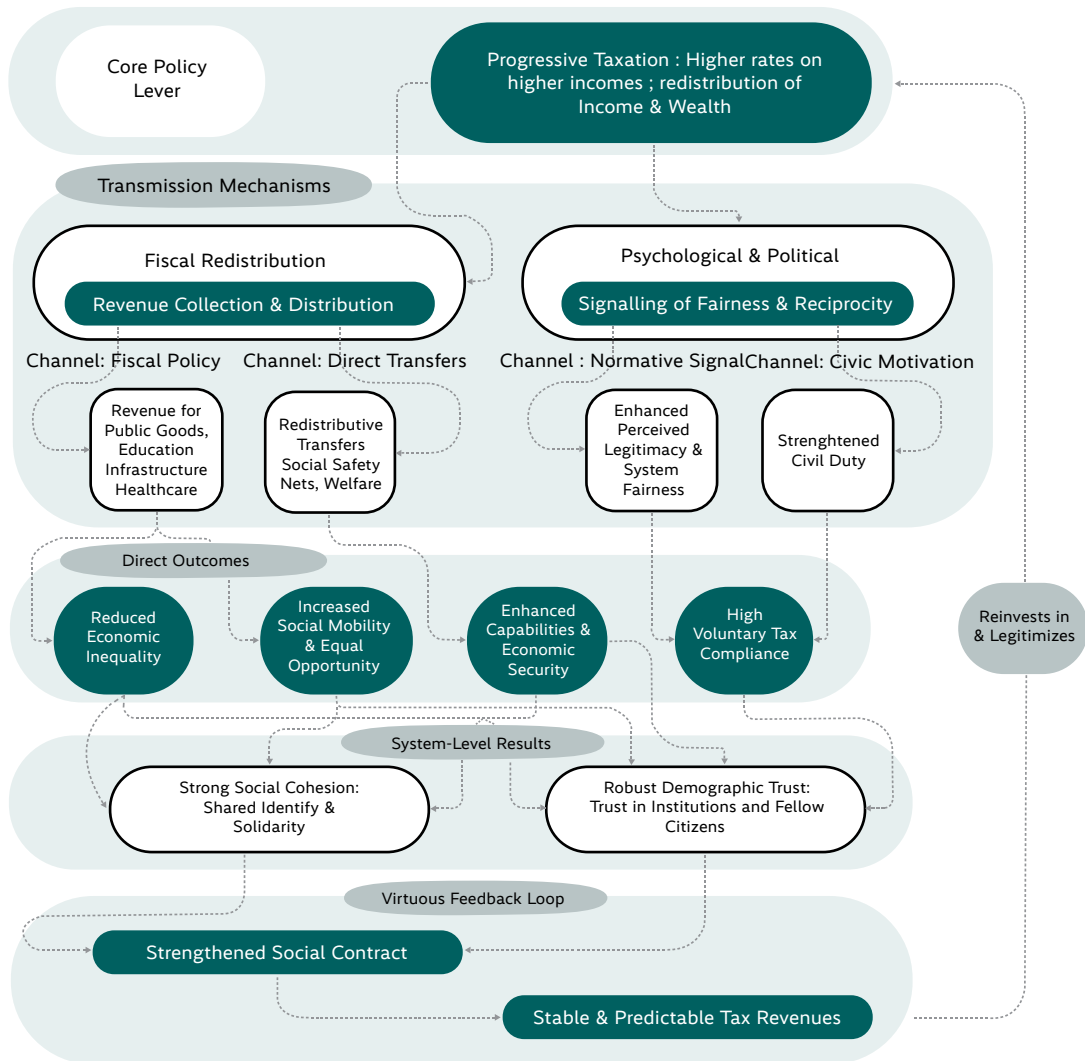
But the true contributions of progressive taxation come through normative and motivational channels. When government taxes its elite, irrespective of their power and class, the middle class takes it as a signal of fairness and reciprocity that those who made more money using state resources are contributing more. System’s legitimacy, the right to tax and decide who pays how much to state,

¹¹ The strategies may include bringing everyone and every sector in tax net without any systemic immunities and exemptions, progressive tax rates, and stronger penalties for those who evade ort avoid tax.

improves. The civic senses of responsibility and motivation to contribute towards state increases, leading to positive tax culture in the society. All this together adds to voluntary tax payments (figure 16). Overall, a taxation system based on principles of reducing inequality serves both the objectives of increasing revenue and social cohesion.

Figure 15

A Conceptual Framework on How progressive taxation leads to more revenues and equitable society simultaneously



Source: Author's elaborations

A Strategic Agenda for Taxation in Pakistan

Taxation in Pakistan requires fundamental shift and rethinking about purpose, objective and model of taxation. It needs to shift its focus from an economic tool of meeting revenue annual targets to a systemic policy reducing wealth and income inequality and creating a more inclusive, equitable and just society. Moving away from present model of revenue extraction to a model which generates revenues and reduces inequality by distributing resources to create new economically empowered groups will require critical policy changes. This shift requires a mix of strategic and procedural reforms.

Only a new social contract between state and society can regain trust of people, state must act and lead

While this may sound repetition, Pakistan needs a new social contact to establish trust of people on tax system of the country. This is the only way forward to strengthen tax culture. The distrust of people on tax policies and machinery is so deep rooted and widespread that no standard policy tweaks can restore it. We have seen points of Sales, Tajir Dost Schemes and other similar initiatives repeatedly failing and rate hikes and audits not delivering. Only explanation is broken social contract of state with society, its people. The people perceive current tax system as an extortionary trap.

Correcting this perception and regaining public trust will take concerted effort by the state. A new social contract is required to build legitimacy through fairness in the taxation, both policies and administration. This is something beyond the scope of the Federal Board of Revenue (FBR) and Ministry of Finance. The state has to step forward to clearly demonstrate its commitment for fair taxation through its actions delivering visible value in the exchange of tax compliance. This approach must extend from broader economic policy to fiscal and tax policies supported by long term planning, to establish trust of citizen in the overall economic governance and tax system. To begin with, the state must make its budget and spending transparent to the public. Strengthening citizen participation and oversight over budget and tax policy is essential. It has to let citizens see where their tax money is going.

The state has to ensure that elite of this country are made to pay tax, without any exemptions whatsoever. It also has to establish that taxes will be charged as per ability and that those in tax net shall not be penalized just to meet revenue targets. This is minimum start. This fear of falling in tax net, often considered as unending trap, is so high that overwhelming share of businesses, particularly SMEs, even of concessionary loans are available¹². They do not want loan as they believe entering in bank transaction will trap them in a never-ending cycle of taxation (Karandaaz, 2023). A new social

¹² According to Javed, S., A. (2021), Government's policy to document, unintentionally or intentionally, try to overnight formalization of centuries old informal businesses, which creates fear as the businesses perceive government will keep increasing the tax on them.

contract led by state and structured around equity, transparency, inclusive policy making, reciprocity and accountability is the only way forward for reforming taxation in Pakistan. Rest is residual and ad hoc. Accountability here denotes more protection of taxpayers' rights.

Ensure horizontal equity

Horizontal equity is building block of a fair tax system and tax moral of society. A system where salaried class pays multiple times higher than exporters, wholesalers, retailers, and distributors combined is a fractured tax system. It is in sheer contradiction of fairness principle. It not only compromises the revenue collections but also hits the legitimacy if the taxation system as a whole.

To ensure horizontal equity, all incomes, irrespective of the sources, must be taxed. The immediate step toward demonstrating a commitment for horizontal equity is to reduce salaried class burden. This class has been penalized far beyond its due share. The government must expand the tax base and bring every sector, every business and individual liable to pay tax, into tax net to show its commitment to horizontal equity. Nothing less than this will suffice.

First and foremost, the system has to address the unfairness where salaries are taxed at up to 35%, but capital gains (e.g., on stocks or property) are taxed at much lower rates (e.g., 15%). This different treatment must go--reduce the rate for salaried class and increase for the capital gains. Income from agriculture must be taxed under progressive taxation regime. Furthermore, all special tax regimes must come to an end, once and forever. All sectors must contribute as per their share in income. Preferential tax treatments, including effective rates and exemptions, must end.

Finally, horizontal equity cannot be achieved without bringing informal economy into tax net through documentation. This documentation however must not be for meeting revenue targets as it has been in the past, instead the state needs to clearly convey and demonstrate "documentation for development". This will essentially require a better planning and inclusive policy design avoiding the random announcements such as "compulsory CNIC for all market transactions".

Blanket exemption must be discouraged and reduced. For necessary exceptions a robust and transparent process must be adopted. As suggested by Ahmed et al. (2016), *"The government may also decree through the Finance Act a requirement for any future exemption or concession to be comprehensively debated in parliament or in the relevant standing committee, with the overall aim to discourage exemptions. Their endorsement should be necessary for creating new tax exemptions, which themselves should only be enacted where there is evidence that they will reduce incidence of inequality and poverty. The standing committees should have the provision to consult economists and legal experts before a Statutory Regulatory Order (SRO) is endorsed."*

Following principles must guide reforms for horizontal equity:

- a. Same income, same tax
- b. Same tax rules for all
- c. Sectoral and regional neutrality

Promoting vertical equity

Vertically equity—people with higher income pay higher and more taxes—is core to tackle inequality and achieve a more equitable society through income and wealth distribution. In this regard, Pakistan’s tax system is structurally regressive. Even the direct taxation is overwhelmingly dependent on withholding tax, contributing 60.5% in direct tax collected in 2024-25. The reliance on withholding taxes has to be reduced as it results in higher commodity and services prices, passed on to the consumers (Ahmed et al. 2016). There must be a limit now on energy taxation as a quick fix to fill revenue gaps. This is distorting vertical equity. Further, state must make it a priority to bridge loopholes in the system and freeze all exemptions and special treatments. They did not deliver over decades and must go out now. Everyone should pay as per ability. This will require immediate steps for:

- a. Reducing tax rates on salaried class and introducing new top tiers, instead of treating all salaried income above PKR 6 million and above equal. Further, Raise Tax-Free Threshold: Significantly increase the Threshold (e.g., to PKR 1.2 million/year) to protect low-income earners from bracket creep due to higher commodity prices.
- b. implement Wealth and property tax to shake the foundations of structural inequality. Implement property tax at fair market-based values.
- c. Implementing Capital Gains Tax (CGT) at a rate equal to Personal Income Tax (PIT)
- d. Eliminate special tax regimes for some professionals/sectors, including SROs for exporters, real estate sector and big lands.
- e. Reduce GST by 1% in the next two to three years, bringing it back to 15% .

Parallel economy has been a stumbling block for tax base reforms. This has significantly led to shift of burden to those who are already paying tax. State must make its priority to bring this into tax net. Linking performance of tax collection machinery to non-withholding revenue and revenue from additional sectors added into tax net may act as driver for expanding tax base. A starting point in this direction may be implementing recommendations of *National Tax Commission, 2022*, constituted by the sitting government. The tax reforms must demonstrate to common man that state is taking tax from those who benefit most from state resources, protecting poor from tax burden and is investing these collections for improving public service delivery.

Simplifying tax regime to reduce compliance cost

Tax process is complex in Pakistan. Simplifying it is crucial for tax filing and controlling evasion. Some fundamental shifts are needed. Take example of GST. Provinces have their own GST which is increasing tax fragmentation. This can be replaced with value added taxes, helping curb duplication of tax imposed by GST on goods and services. This is essential for a harmonized compliance across the province facilitating businesses operating in different provinces. Similarly, a flat income tax rate, irrespective of sources, and filing through digital forms can substantially simplify the tax filing. In many countries there is one standard practice of prefilled returns for employees and simplified regimes for sectors like SMEs. A unified GST, structured as VAT, through platform/portal can simplify tax compliance. Overall, simplifying the tax structure is backbone to:

- Improve vertical and horizontal equity,
- Facilitate formalization of the informal economy,
- Enhance administrative efficiency,
- Restore taxpayer confidence,
- Increase sustainable revenue collection without overburdening existing filers.

Finally, there is a need to strengthen tax ombudsman to strengthen dispute resolution. This will primarily require two major steps of taking appeal right FBR and strengthen ombudsman. It must be noted that HR increase must not be parking lot of FBR retired, it must have its own hiring, technical experts.

Increasing women representation in tax policy decisions, design and administration

Given that female constitute half of the population. And good revenue mobilization, and broader taxation, must be gender inclusive. Existing evidence suggest two major areas of gender inclusive taxation namely i) tax administration and ii) widening tax base. In the context of former, tax enforcement needs to be more gender inclusive (Merium Hadi, 2022). Currently, the enforcing arrangements and structures are permanently dominated by male. The report recommends, and this study echoes with it, that a gender audit of existing structures and processes of tax enforcement must be conducted. A dialogue around gender inclusive taxation must be initiated both at federal and provincial level. Main actions in this regard may include:

- A gender focused HR policy
- Policy for maternity leave, flexible working hours for women working tax system
- Gender Audit of existing processes and structures of tax administration
- Development gender segregated database

More importantly, women must be given decision making role in design and conduct of tax policies and administration—presently lacking. Further, detailed analysis of gender impacts of the current taxation regimes need to be undertaken. In this regard following actions may be taken:

- a. A clear strategy and roadmap for proportionate gender representation in decision making bodies, such as National Tax Council
- b. Public discussion, such as seminars, webinars, conference, media campaigns, around enhanced role of women in tax policy design and administration decisions

Institutionalize role of civil society and academia in tax policy advisory

Civil society can contribute towards achieving equitable taxation through evidence-based advocacy, strengthening taxpayers' voice and capacity to participate in budget and tax policy making and

mobilizing people at grass route level to put pressure on policy makers for a more equitable taxation through national level campaigns. Civil society organizations can be the most effective tool to hold government and tax authorities accountable at one hand while enhancing public's trust in taxation through promoting inclusive budgeting and tax policy design and administration. The major strategies may include:

- a. A structured dialogue around taxation equity to foster public engagements for economic and distributive justice.
- b. A network of think tanks, on the patterns of Tax Justice Coalition, working on tax issues may be established.
- c. Establishing Tax Equity Chairs in policy think tanks and universities to support evidence-based tax policies.
- d. Organizing taxpayers' education workshops to build capacity to participate in citizen's budget making and tax policy forums and training workshops for media on tax equity/tax justice
- e. Publish annual "Tax Justice" report providing detailed analysis of tax policy changes, administration performance, revenue collection trends and their implications for income and wealth distribution
- f. Encourage academia to undertake demand driven research agenda to inform Pakistan's agenda for tax reforms at federal and provincial levels

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State, Society and Progressive Taxation in Pakistan

This paper frames tax policy as a foundational pillar of achieving economic and distributive justice. It seeks to broaden the discourse on taxation in Pakistan by arguing that progressive taxation, if implemented in its true construct, can serve as a powerful institution to fostering a more equitable, cohesive, and productive society with strong economic and social foundations. It emphasizes that regressive taxation—by failing to adequately tax the wealthy and redistribute income and wealth—has, over time, deprived the lower segments of society of equitable access to economic and social opportunities. This has contributed to widespread public distrust in governance, particularly in the fairness and legitimacy of the tax system. In this regard, the paper proposes a strategic agenda including i) a new state-society social contract for taxation ii) implementing wealth and inheritance tax to shake foundations of inequality, iii) reducing reliance on withholding taxes based on consumption, iv) increasing proportionate representation of women in tax policy decision making forums/bodies and v) developing a narrative around and political constituency for taxation for equitable society by public engagement. The message of this work is directed toward policymakers, civil society, development partners, academics, and the media, with the aim of stimulating a more inclusive research agenda and public policy dialogue on taxation in Pakistan.

Further information on this topic can be found here:

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