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Pakistan Affairs

Test - 4

Q No. 1

Topic:

Reforms to Pakistan's tax System for Improved Revenue Collection, Reduced External Borrowing, and Enhanced Economic Equity

1. Introduction

Pakistan's tax system faces significant challenges including a low-to-GDP ratio, inadequate revenue collection and high reliance on external borrowing. This has resulted in fiscal deficits limited government spending on development and growing economic inequality. To address these issues, comprehensive tax reforms are essential. By broadening the tax base, improving

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compliance and introducing a more progressive and efficient tax structure, Pakistan can generate more revenue, reduce its borrowing dependency and foster a more equitable economic environment. Such reforms are vital for achieving long-term economic stability and reducing disparities within the country.

2. Broadening the tax base

I. Formalizing the informal economy

A significant portion of Pakistan's economy remains informal with a large number of small businesses and traders operating outside the tax system. The informal economy is estimated to account for more than 30% of GDP. Formalizing this sector through incentives, technology and simplification of the tax process could sustantially increase revenue. Digital tools such as mobile apps, payment systems and electronic invoicing could help track informal transactions, ensuring better tax compliance and widening the tax base.

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II. Strengthening taxpayer identification

Pakistan's tax system suffers from a limited number of registered taxpayers. As of 2020, only about 3 million people were actively paying taxes while the actual potential taxpayer base is much larger. Expanding the taxpayer Identification Number (TIN) system to cover a wider portion of the population would help in identifying untapped taxpayers. Additionally, campaigns to raise awareness about the benefits of being a registered taxpayer could encourage more people to enter the tax net.

3. Improving tax compliance and enforcement

I. Strengthening tax authorities

A key challenge to tax compliance is the capacity of tax authorities. FBR in Pakistan has been criticized for inefficiency and corruption. Investment in training tax officials and equipping them with modern auditing tools would enhance enforcement.

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Risk-based audits and data analytics could help identify high-risk taxpayers, reducing evasion and increasing collections.

II. Simplifying the tax filling process

Pakistan's tax filling process is often cumbersome, discouraging voluntary compliance. As of 2020, the World Bank reported that Pakistan's Paying taxes ranking stood at 141 out of 190 countries largely due to complex procedures. Simplifying this process, moving towards a fully digital platform and reducing bureaucratic hurdles would make tax filling easier and encourage timely payments.

III. Incentivizing Compliance

Pakistan could benefit from implementing a more robust system of incentives for tax compliance. Introducing tax amnesty programs for instance could encourage businesses and individuals to disclose their income and assets. Furthermore, offering reduced penalties

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for small businesses or individuals in lower income brackets could motivate them to enter the tax system.

Reforming the tax Structure

I. Progressive Taxation

A progressive taxation system ensures that individuals with higher incomes contribute more to the public coffers. Pakistan currently has a flat income tax rate for a large portion of its population, but high-income earners could face higher rates. Implementing progressive Income tax rates for those earning above certain thresholds could generate more revenue from wealthier citizens and help reduce income inequality.

II. GST and Sales tax reforms

The Goods and Services Tax (GST) system in Pakistan is complex, with ~~of~~ many exemptions and a high incidence of

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evasion. As of 2021, Pakistan's GST revenue stood at only 4% of GDP which is relatively low. Simplifying GST rates removing unnecessary exemptions and extending the tax to more goods and services would increase the efficiency of the system and broaden the tax base.

III. Corporate tax reforms

Corporate taxation in Pakistan also needs reform. Large corporations often benefit from tax exemptions and loopholes, allowing them to avoid paying their fair share. In 2020, corporate tax collection in Pakistan was just 3.5% of GDP. Closing these loopholes and implementing stricter tax regulations for large corporations could increase corporate tax revenue which currently lags behind regional peers.

5. Reducing Reliance on external Borrowing

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I. Domestic resource mobilization

Pakistan's dependency on external borrowing has escalated in recent years, reaching approximately $120 billion in foreign debt by 2023. This reliance hampers long-term financial sustainability. By boosting domestic resource mobilization through expanded tax collection, the government could reduce its reliance on borrowing. Introducing new tax sources, such as wealth tax or a carbon tax could further diversify the revenue base.

II. Improving public financial management

Improving the management and allocation of public finances is key to reducing external borrowing. Pakistan's public financial management system is often criticized for inefficiency and a lack of transparency. Strengthening public financial reporting ensuring the efficient use of resources and making budgetary processes more transparent could

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help build investor confidence and reduce borrowing costs.

6- Strengthening Social Safety nets and redistribution

I. Targeted transfers and social protection Programs

One of the main goals of tax reform should be to promote equity. Pakistan's social protection system, although expanding is still insufficient. In 2020, Pakistan allocated just 1.4% of GDP to social protection programs. Expanding targeted transfers and social welfare programs such as Benazir Income Support Program (BISP) would improve the livelihoods of the country's most vulnerable populations.

II. Progressive Social welfare funding

Redirecting tax revenues toward social infrastructure such as healthcare,

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education and housing for marginalized communities would foster long-term economic equity. Investing in rural areas and underdeveloped regions could help address regional disparities and ensure that all citizens benefit from the country's economic growth.

7. Fostering a tax culture

I- Public awareness campaigns

A fundamental challenge for Pakistan is the low level of tax awareness. Many citizens do not understand how taxes are used or why they are important. Public awareness campaigns could help citizens recognize the benefits of tax contributions and encourage them to comply. Information campaigns about the positive impact of taxes on infrastructure, social programs and development would increase voluntary compliance.

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II. Transparency and accountability

Transparency in how tax revenues are spent is crucial for building trust in the tax system. The government should regularly publish reports on how tax revenues are utilized, ensuring that funds are directed toward essential services like education, health and infrastructure development. Establishing mechanisms for public scrutiny such as citizen oversight committees would hold government officials accountable for the use of taxpayer money.

8- Critical Analysis

Pakistan's system struggles with a low-tax to G.DP ratio, widespread evasion and inefficiencies leading to heavy reliance on external borrowing and worsening income inequality. The lack of a progressive tax structure and uneven tax burdens exacerbate economic disparities. While reforms like broadening the tax base, improving compliance and progressive

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taxation are vital their success hinges on strong political will structural changes and enhanced tax authority capacity. Without addressing these systemic issues, the desired goals of revenue generation reduced borrowing and economic equity remain unttainable.

9. Conclusion

Reforming Pakistan's tax system is a multifaceted endeavor that requires coordinated efforts across various sectors. By broadening the tax base improving compliance and reworking the tax structure, Pakistan can enhance its revenue collection, reduce dependence on foreign borrowing and promote a more equitable economic environment. However, these reforms require political will, investment in capacity-building and a long term commitment to transparency and accountability. The proposed reforms can lay the foundation for sustainable fiscal health and reduced inequality ensuring

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that future generations benefit from a more resilient and inclusive economy.