TEST-2

The Challenge of Tax Evasion and the Informal Economy in Pakistan

The outline

(1) Introduction

Thesis: Tax evasion and the informal economy perpetuates in Pakistan due to structural flaws in the institutions and reluctance of the majority to pay tax. It impedes self-sustainance and development of Pakistan that seeks multi-faceted solution through institutional reforms, digitization, and civic education.

(2) Understanding the terms "Tax Evasion" and "Informal Economy"

(3) Causes of tax evasion and the informal economy in Pakistan

(a) Fragile institutional frameworks to formalize all sectors in Pakistan

(b) Weak mechanism of tax culture in Pakistan encourages informal sector development

(c) Lack of political will to address the challenge of tax evasion and the informal economy

(d) Elite businesses and informal networks ~~control~~ manipulate policies to avoid tax in Pakistan

Case study:

According to Islamabad policy of Research institute (IPRI) report (2024-2025), as of Pakistan labour force survey and Pakistan Economic survey, informal economy constitute almost 59% of GDP of Pakistan.

(4) **Implications of Tax evasion and the informal economy of Pakistan**

(a) Narrow fiscal space and viscious cycle of dependency on foreign lenders

Case in point:

In year 2025, Pakistan acquired $7 billion loan from International Monetary Fund (IMF) as Extended Fund Fascility (EFF)

(b) Widening poor-rich divide in Pakistan owing to unfair competition in the market

(c) Inadequate investment on public development programs in Pakistan

Case study:

According to World Bank Report (W.B), Pakistan's informal economy could generate $700 million if it is formalized.

(5) ~~(d)~~ **Policy Recommendations to address the challenge of tax evasion and the informal economy in Pakistan**

(a) Introducing institutional reforms

to ensure autonomy

Case in point:

Federal Board of Revenue (FBR) must be an independent body devoid of political influence

(b) Simplifying tax collection process to encourage tax compliance

(c) Transforming the system from cash-based economy to digitized one to bring transparency

Case study:

Turkey, malaysia and Indunesia successfully reduced informal sector through digitization

(d) Stringent accountability policies for tax evadors and informal sectors

(e) The government should introduce incentives to encourage formalization of economy in Pakistan

(f) Inculcating awareness of tax culture and responsive citizenship in people of Pakistan

(6) Conclusion

The Essay

The crippling economy of Pakistan struggles with mammoth of challenges that are deeply entrenched in it. Various sectors are documented like an ice-berg where small portions are formalized, and large part of certain businesses, real estate sectors, and small and medium enterprizes (SMEs) remain hidden from the government. In modern economic system, taxation is a responsibility of state's citizens. ~~and~~ On the other hand, the country is bound to spend these taxes for welfare of its citizens. This creates an integrated system where citizen-state trust builds up. Through taxation, inequality gap between haves and haven not are bridged, thereby pledging progress in the future. Tax evasion and the informal economy perpetuates in Pakistan due to structural flaws ~~and~~ in the institutions and reluctance of the majority to pay tax. It impedes self-sustainance and development of Pakistan that seeks multi-faceted solution through institutional reforms, digitization, and civic education. The causes of huge tax evasion and the informal economy in Pakistan include weak institutions and fragile tax culture in Pakistan. Additionally, lack of political will and elite capture further complicates the situation. The ramifications unfold in the form of narrow fiscal space, widening inequality between rich and poor, and stunted investment on education, healthcare, and infrastructure. This ~~menace~~ challenge can be controlled through institutional autonomy, and reduction of complex hurdes. Apart from this, digitization of economy ensures accountability and transparency to reduce chances of corruption. Furthermore, civic education and incentives for formalization can reduce evasion. In this way, ~~this complex challenge can be addressed~~ Pakistan can address this complex challenge.

Before heading towards the challenge ~~of~~ of tax evasion and informal economy, the terms are explained. Tax evasion is process of avoidance of tax. ~~It~~ It may also include payment of small part of tax and avoiding huge portion through under-invoicing and fake documentation. Similarly, informal economy is a huge part of economy in Pakistan. It is undocumented, unreported, and untaxed economy.

According to Pakistan Institute of Development Economics (PIDE), almost 35%-50% of GDP constitute informal economy in Pakistan. It include various sectors, such as Real estate, small and medium enterprises (SMEs), agriculture, street vendors, domestic workers, and retail trade.

The first and foremost cause of tax evasion and the informal economy in Pakistan is fragile institution with structural flaws. Federal Bureau of Revenue (FBR) is the central institute for tax collection and documentation in Pakistan. The tax is collected through outdated, complex system. Most of the sectors still practise ~~po~~ cash-based system. Additionally, it is more focused on indirect taxes that burden salaried class of Pakistan. The narrow tax base of FBR creates unequal burden. Furthermost, the institution lack autonomy to formalize elite businesses. Hence, old, traditional framework along with manipulation by the elite creates vacuum for tax evasion and informal businesses to survive in Pakistan.