Ending Exploitative Taxation – A zakat-based system for justice, economic growth, and welfare for all.

Introdution

Exploitation in taxation occurs when the burden of taxes is disproportionately placed on vulnerable segments of society, when powerful sectors evade their obligations, and when collected revenue is not translated into public welfare. Common examples include indirect taxes, consumption taxes, or poorly structured income taxes, which disproportionately affect the economically vulnerable.

The taxation framework in Pakistan Regressive nature and relies heavily on indirect taxes such as sales tax, federal excise duty, and withholding taxes. These taxes are applied uniformly on consumption, regardless of income level, which means poorer households spend a larger share of their income on taxes than wealthier households. Pakistan's tax structure had over 60% of FBR revenues from indirect taxes in recent years, despite attempts to increase direct taxation. In addition, tax evasion by affluent individuals and powerful sectors has narrowed the tax base, shifting the burden onto compliant taxpayers. This has weakened public trust in the system and reduced voluntary compliance.

Historical Roots of Exploitative Taxation in Pakistan

Pakistan's current taxation structure is not accidental. It is the product of historical patterns that reinforced inequality.

Colonial Fiscal Legacy

Much of the modern taxation framework traces its roots to colonial systems designed to extract revenue rather than promote welfare. The British introduced indirect taxes and land revenue systems primarily to finance administrative and military expenses not to empower citizens.

Post-Independence Political Economy

After independence, Pakistan inherited an economy controlled by a small elite. Over time, this elite influence expanded, shaping fiscal policies in ways that protected privileged groups. The military, bureaucracy, industrialists, and feudal classes enjoyed concessions that later became entrenched in law and political culture.

Inconsistent Reform Efforts

Though many governments attempted reforms, political instability, short-term policymaking, and resistance from powerful lobbies prevented long-term structural changes. Tax authorities were never fully depoliticized or modernized, limiting progress.

Failures of the Current Tax System in Pakistan

Regressive Nature of Taxation

Pakistan's tax system is largely regressive due to its heavy dependence on indirect taxes. In the fiscal year 2024–25, indirect taxes accounted for approximately **51.3 percent of total tax revenue**, making them the primary source of government income. These taxes are imposed on consumption rather than income or wealth, which means they affect all consumers equally regardless of their financial capacity. As a result, low-income households spend a larger share of their earnings on taxes compared to wealthier groups. International assessments have shown that the poorest ten percent of the population contribute a higher proportion of their income in taxes than the richest ten percent, reinforcing income inequality and worsening living standards for vulnerable groups.

Tax Evasion and Elite Privilege

Another major weakness of Pakistan's tax system is extensive tax evasion, particularly among affluent individuals and powerful economic sectors. Tax evasion is estimated at around **PKR 5.8 trillion annually**, representing nearly **6.9 percent of GDP** in the 2022–23 fiscal year. Weak enforcement mechanisms, legal exemptions, and political influence allow many high-income earners to remain outside the formal tax net. Consequently, the burden of taxation shifts to a small group of compliant taxpayers, especially salaried individuals, creating perceptions of injustice and reducing public trust in the system.

Impact on Business Activity and Informality

The complexity and instability of Pakistan's tax framework have also discouraged formal economic participation. Frequent policy changes, multiple tax rates, and cumbersome compliance requirements increase the cost of doing business. Small and medium enterprises, in particular, often choose to operate informally to avoid regulatory pressure. As a result, the informal economy is estimated to account for nearly **60 percent of GDP**, limiting productivity, restricting investment, and reducing the government's ability to mobilize revenue effectively.

Low Tax-to-GDP Ratio

These structural weaknesses are reflected in Pakistan's persistently low **tax-to-GDP ratio**, which stood at approximately **9% in FY 2023–24**. This figure is significantly below the **15% to 20% range** typically observed in emerging market economies and considered necessary for sustainable economic growth. A low tax-to-GDP ratio constrains public spending on essential services such as education, healthcare, and infrastructure, increasing reliance on borrowing and external assistance. Overall, the current tax system has failed to provide an equitable, efficient, and sustainable fiscal foundation for Pakistan's development.

Principles of Zakat as a Fiscally Just Alternative

1. Defining Zakat and Its Economic Role

Zakat is an Islamic obligatory levy traditionally set at **2.5% of qualifying accumulated wealth and assets**, including cash savings, precious metals, business inventory, and certain financial holdings, provided these exceed a minimum threshold known as the *nisab*. Unlike income tax, which is based on periodic earnings irrespective of wealth accumulation, zakat targets surplus wealth and directs funds to those in need according to defined categories. This mechanism is fundamentally tied to the ethical redistribution of resources.

2. Equity and Progressive Contribution

One of zakat's core strengths is its inherent progressivity. Only those above a minimum property threshold are obligated to contribute, shielding low-income individuals from punitive fiscal pressure. Zakat's distribution targets specified categories, such as the poor, the needy, debtors, and others who lack adequate means. This ensures that fiscal resources flow directly to the most vulnerable segments, supporting social justice and reducing income gaps.

3. Promoting Economic Circulation and Reducing Hoarding

Islamic economic principles underlying zakat discourage wealth hoarding and encourage productive investment and consumption. By requiring periodic distribution of surplus wealth, zakat naturally promotes the circulation of capital within the broader economy. This can stimulate economic activity by increasing the spending power of lower-income households and channeling resources into productive use.

Designing a Comprehensive State-Managed Zakat System in Pakistan

Institutional Framework

For a state-managed zakat system to function effectively in Pakistan, it must be supported by strong institutional mechanisms. A dedicated **Zakat Authority** should be established working with existing fiscal institutions to oversee assessment, collection, and transparent distribution. Digital technologies, including banking system integration and beneficiary verification through national identity systems, can help reduce leakage and improve targeting.

Scope and Asset Coverage

The zakat base should include wealth categories traditionally recognized under Islamic law, adapted for contemporary financial contexts: monetary assets, financial securities, business inventories, and non-productive real estate holdings above essential needs. This bottom-up wealth assessment differs from existing tax classifications and can capture previously untaxed assets, broadening the revenue base.

Inclusivity for All Citizens

A modern fiscal system must be inclusive of all citizens regardless of religion. While zakat is a religious obligation for Muslims, the welfare framework should ensure **equitable social support for non-Muslim citizens**. This can be achieved through complementary secular welfare programs funded through designated wealth levies or property tax revenues, ensuring no group is excluded from social safety nets.

Transparency and Accountability

Given historical challenges with public trust and institutional credibility, maintaining transparent governance is essential. Public disclosure of collection and disbursement figures, regular independent audits, and community participation in oversight can strengthen trust and enhance compliance.

Economic Growth and Welfare Outcomes

A well-implemented zakat system has the potential to directly reduce poverty and inequality. By redistributing wealth to those in greatest need, motorcycle households can achieve more stable consumption patterns, improving access to food, education, and health services. Evidence from social giving practices suggests that private zakat contributions in Pakistan exceed PKR 619 billion annually, often surpassing the budgets of major state-led cash transfer programs.

Simplifying the fiscal regime by balancing and reducing regressive indirect taxes while introducing a structured wealth-based zakat mechanism may also encourage investment and formal economic participation. By aligning fiscal contribution with ability to pay, such a system can support higher growth while preserving fairness.

Comparison with Conventional Taxation

While conventional taxes often aim to maximize state revenue, they do not always prioritize fairness or social welfare. Zakat, on the other hand, explicitly integrates equity as a core principle. It is **progressive by design**, as only surplus wealth beyond a prescribed threshold is subject to contribution. Integrating zakat within modern fiscal systems can complement tax revenue collection while reducing regressive burdens on the poor (IJIFER, 2022).

Conclusion

Pakistan's current taxation system has struggled to generate equitable, efficient, and socially sustainable revenue. Its heavy dependence on indirect taxation and a narrow direct tax base burdens lower income groups while allowing affluent entities to avoid proportional contribution. In contrast, a state managed zakat-based fiscal framework structured around principles of equity, wealth circulation, and targeted redistribution offers a viable alternative that aligns with social justice and inclusive economic growth. By adopting such a model and ensuring welfare provisions for all citizens, Pakistan can move toward a fairer, more resilient economic future that truly serves the needs of all its people.

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