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

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Introduction

By 2050, Pakistan is projected to become the 3rd most-populous country in the world, with a total population of 389 million people, surpassing the United States, Nigeria and Indonesia (United Nations, 2024). Most of these will be young people below the age of 30, and they will require education, employment, and healthcare. However, at present, there seems to be no hope on the horizon for the country's rapidly expanding population. In the last two decades, real GDP per capita has only grown at a rate of 2pc, which is half of the regional average (World Bank, 2025). The national literacy rate is a paltry 60.65pc, not accounting for the vast gender and regional disparity (Pakistan Bureau of Statistics, 2023). Unemployment in Pakistan today is at 7.1pc. As of June 2025, the country's external debt stands at 26.046 trillion rupees, which amounts to 23pc of the GDP (Debt Management Office, 2025). Most concerning is the trend in poverty rates. After two decades of consistent poverty reduction, Pakistan is backtracking. From 2000 to 2019, it reduced poverty from 60pc to 22pc (according to the national poverty line), but since then, the rate has ticked up. According to the World Bank, Pakistan's poverty headcount rate in 2024 is 25.3pc (World Bank, 2025). Despite this, the country's development expenditure, a percentage of GDP, is under 3pc, far below the regional average.

If one were to summarise the Pakistani economy's biggest issues, it would be something like this: historically, the Pakistani government has struggled to raise sufficient revenue to finance government expenditure. To finance this fiscal gap, the government has taken on huge amounts of internal and external debt, which require large interest payments. A significant percentage of annual government revenue is then used to make the repayments. When nearly half of the revenue you generate is spent on repaying debt taken to finance previous spending, as was the case in 2019, very little is left to tackle the country's growing poverty, educational and healthcare crisis, and provide employment for the youth (Husain, 2025).

To further complicate the country's woes, foreign debt financing forces it to turn to the International Monetary Fund (IMF) every 3-4 years. The IMF program comes attached with strict edicts on taxation. For example, after the most recent agreement in 2024, the government unveiled a budget which aimed to increase tax collection by 38pc. However, it was not by creating more equitable tax policies or expanding the tax base, but by increasing direct and indirect taxes, by 48pc and 35 pc respectively (Salman, 2024). For many decades, Pakistan's tax policy has been ad-hoc and short-term, focused only on achieving "elusive targets of tax-to-GDP ratio and reducing fiscal deficit" (Khalid & Nasir, 2020), in order to satisfy international bodies, like the IMF and the World Bank. These foreign bodies are oblivious to each country's specific issues (Stiglitz, 2003), and in an attempt to create short-term fixes, they often pressurise countries to adopt higher taxation regimes, which, "without growth, equity and delivery of social services to the citizens is a lethal pill, based on a diagnosis by a quack rather than by a qualified physician." (Bukhari & Haq, 2020).

The issues in the current tax system are many, but three are the most pressing. The first is that the system disproportionately targets specific classes, and lets entire industries go scot-free. For example, in the fiscal year 2022-23, the agriculture sector accounted for 23pc of Pakistan's GDP, services 58.4pc and industry 18.4pc (Pakistan Bureau of Statistics, n.d). However, the top two sectors, forming 81.4pc of the GDP, made up a combined 30pc share in the tax revenue. The industry sector, by far the smallest of the three, paid the remaining 70pc (Khan & Umar, 2024). Most egregiously, the agricultural sector has contributed less than 1pc in tax for many years (Ali, 2025).

The second problem is that a very large percentage of the total tax revenue comes from indirect taxes, like the General Sales Tax (GST), custom taxes and duties. In FY19, for instance, indirect taxes made up four-fifth of all tax revenue. That is higher compared to other lower middle-income countries, which average a ratio of two-third. Indirect taxes are regressive in nature and contribute to higher inequality, because they disproportionately affect lower-income households (World Bank, 2025). The justification for such high indirect taxes is that due to vested interests, the government is unable to persuade powerful groups, like landlords or retailers, to come under the tax umbrella and contribute their fair share to the national treasury. However, if such a significant part of the GDP goes untaxed, the tax-to-GDP ratio will worsen further and the government will struggle to finance its different expenditures more. Therefore, the indirect tax is used as a corrective measure.

There is a consensus that the Pakistani tax system needs to change. Most policymakers, commentators and economists, emphasise the expansion of the tax base and the reduction in indirect taxes. Moreover, there is still the belief that a more progressive income tax can eradicate Pakistan's issues. However, many scholars underplay the importance of where the tax revenue is getting spent. Due to the pressure of the IMF and interest payments, every year, the Federal Board of Revenue (FBR) unveils an overly ambitious revenue target and the federal budget, which includes spending on loan repayments, defense, exorbitant government salaries, subsidies, and development, is made under the assumption that the revenue target will be met. Then, due to systemic faults, the FBR falls much short and the government is forced to make cuts to its spending. The first item of business to get reduced is not the payouts to bureaucrats or defense cuts; rather it is the development spending. In a country where nearly 45pc people live in poverty (World Bank, 2025), that should be the last thing getting cut. However, due to "elite" interest groups (Khan, 2024), foreign pressure and misaligned priorities, developmental projects and poverty reduction programs are the state's first target.

As an alternative to this regressive and outdated system, this research explores the feasibility of an alternate system of taxation in Pakistan: a state-administered Zakat tax. By definition, Zakat is an annual proportional tax on wealth, not on income. It is also, by definition, reserved for spending on the poor, and cannot be used for other purposes, like interest payments. The motivation for this research is that Pakistan is a heavily Muslim-majority country where a significant number of people already give Zakat privately, as part of their religious obligation. In 2024, according to a study done by Umair Javed and Max Gallien, nearly 50 million Pakistanis gave an average of Rs. 15,000 in Zakat. However, so far, it is a voluntary contribution, so many high net-worth individuals choose not to give it. By formalising Zakat as a tax to the state, Pakistan can tap into the large amounts of wealth which remains untaxed. It can also generate significant revenue, exclusively for poverty reduction.

The Basis for Zakat: Economic and Religious

Before 1945, Europe and the United States were countries with small governments and large amounts of private wealth, in 1910, aggregate private wealth in the UK was six times greater than British national income. After the shock of World War II, however, most Western countries moved toward what economist Thomas Piketty calls a "social state," spending far more on public health, education and transfer payments, which resulted in a steep drop in wealth and income inequality accompanied by the introduction of progressive income taxes. In the United States, the top rate reached an all-time high of 90pc during the 1960s. Since 1980, there has been a sharp reversal, and wealth concentration is now reaching levels last seen in nineteenth-century Europe. To put it in concrete terms, the world's top 1pc own more wealth than 95pc of humanity.

This is why some economists have argued for a progressive wealth tax to replace or supplement the income tax. The difference between these two taxes is straightforward: an income tax applies to the flow of earnings within a time period, including wages, capital gains and dividends, but ignores what people already possess. A wealth tax, in contrast, applies to the stock of accumulated assets at a particular point in time, real estate, financial securities, business equity and other holdings, regardless of whether these assets generate income.

Piketty, Saez and Zucman argue that income taxes fail to tax billionaires because the ultra-wealthy often have little "taxable income," accumulating wealth instead through unrealized capital gains which are not taxed until sold. Their research found that currently, the effective tax rate on the top 0.1pc is lower than the working class. A billionaire whose stock portfolio grows by $1 billion in a year has $1 billion in "economic income" but can report $0 in "taxable income" if they don't sell shares, and they may simply borrow against their assets to fund consumption rather than selling them, so a wealth tax hits the asset itself, closing this loophole. At a moderate rate of 2pc on wealth above $50 million and 3pc above $1 billion, the US could raise $175 billion annually, almost 1pc of GDP. Moreover, in his seminal work *Capital in the Twenty-First Century*, Piketty explains that historically, the return on capital exceeds the rate of economic growth, meaning inherited wealth grows faster than income from labor, leading to an inevitable concentration of wealth in the hands of a few, which is undemocratic and non-egalitarian. So, for Piketty, the wealth tax is not primarily a mechanism for governments to raise revenue but rather counteracts growing inequality and prevents billionaires from consolidating power.

Critics of the wealth tax point to France's failed "solidarity tax on wealth," which since 2011 has generated limited revenue while triggering €200 billion in capital flight, and argue that valuation is administratively impossible since private businesses, real estate and intellectual property lack clear market values, forcing annual disputes between taxpayers incentivized to undervalue and authorities incentivized to overvalue. Economic efficiency suffers, they claim, because taxing capital discourages entrepreneurial risk-taking, particularly for early-stage ventures that generate zero returns, penalizing innovators with full tax obligations absent offsetting income and pushing capital toward low-risk, established sectors. However, Switzerland maintains a 0.3-0.9pc wealth tax that raises 3.9pc of total tax revenue, the highest globally, with success stemming from decentralization where cantons (provinces) set rates, preventing a race-to-the-bottom, broad asset coverage with minimal exemptions, and the absence of competing capital gains taxes.

This debate matters particularly for Pakistan, where 60pc of total wealth is owned by one-tenth of the population. Pakistan's economic, political and social malaise can be traced back to this inequality and the power it grants some groups of people. The manifestation of this power is apparent in the large subsidies and tax exemptions the government provides to powerful interest groups like the agricultural sector, in the multiple bailouts that "private" companies established to provide for retired senior military personnel have received from the state since 1997, and in budgets like the one unveiled in 2025 which increased defense spending by 20pc and tax exemptions by 50pc while the World Bank warned that Pakistani society is regressing in terms of health, education and employment that the state provides for its citizens.

It is in the global context of this debate over wealth taxation, and Pakistan's Muslim majority population, that Zakat becomes a relevant topic of consideration. In Islam, Zakat is third only to the declaration of faith to God and the five daily prayers, and it is the pillar concerning social and financial matters, an annual tax on wealth held by an individual for at least one lunar year which exceeds the nisab amount, the minimum threshold. There are two ways to ascertain whether a person meets the nisab requirement: the gold standard, where the person must possess 85 grams of gold or equivalent assets, and the silver standard, where the person must own 595 grams of silver or equivalent.

Literally, the word "zakat" translates to "purification" and "growth," as by reserving a fixed percentage of the wealthy's assets for the poor, Islam wants to purify the soul of the giver from greed and selfishness, while purifying the heart of the receiver from envy and hatred toward the wealthy. Dr. Umer Chapra takes this reasoning even further by arguing that Zakat purifies the economy itself, transferring purchasing power from those with a low marginal propensity to consume, the rich, to those with a high marginal propensity, the poor, thereby stimulating aggregate demand for basic necessities and steering the economy toward producing essential goods rather than luxuries. He further identifies

Zakat as the first institutionalized social security system in history, and unlike modern welfare states which often rely on taxing income and thus penalizing work, Zakat taxes idle wealth, encouraging capital holders to invest and circulate their money rather than hoard it, aligning with the Islamic economic goal of preventing wealth from becoming "a commodity circulated only among the rich."

The Quran specifies eight rigid categories of beneficiaries and does not leave anything to the whims of the giver. According to Chapter 9 of the Quran, the eight categories are: the destitute, those with no assets; the needy, those whose earnings do not cover basic needs; administrators who collect and distribute Zakat; those whose hearts are being reconciled, meaning new Muslims or allies; those in bondage, with modern application including freeing people from trafficking; debtors overwhelmed by legitimate debt; those in the path of Allah, historically defense but broadly interpreted to include Islamic education and general welfare; and the stranded traveler. Therefore, Zakat, whether state-collected or privately distributed, cannot be given to anyone other than the above eight categories, and it can be thought of as a source of government revenue meant specifically for social development, which would be a solution to Pakistan's development crisis where the state will not be able to spend the Zakat amount on anything other than social development projects.

Zakat rates mandated by the Quran are similar to what economists recommend for wealth taxes. On cash, savings, gold, silver and business merchandise applied to the current market value of stock-in-trade, the rate is 2.5pc. On irrigated agricultural produce, the rate is 5pc, which is lower than the 10pc mandated for rain-fed agricultural produce. The rate on income, which is a modern invention, is 2.5pc, and scholars argue that high-income earners like doctors and lawyers should pay

Zakat on net income on receipt, the way Zakat has to be paid on harvest for agricultural products, rather than waiting a year.

The Implementation Issue

There are two aspects to the practicality of Zakat as a state-administered tax: will people pay it, and will the government be able to distribute it to those who need it the most? On the first issue, recent research estimates that in 2024, 50 million self-identified Sunnis in Pakistan paid over Rs. 619 billion in Zakat, an amount that exceeds all state-led social systems. For example, Pakistan's state-led cash transfer programme, the Benazir Income Support Programme, distributed Rs. 592 billion in 2024, and more money is being distributed in Zakat payments than Pakistan received in official aid, despite the country being the largest aid recipient in South Asia. However, less than 5pc of these 50 million Zakat payers gave it through the national Zakat Fund, with most preferring either to give to schools, mosques, NGOs, or most overwhelmingly, directly to individuals the payer deemed Zakat-eligible. Therefore, we can conclude that people are already paying a significant amount as Zakat, but just not to the state.

The origins of the current mistrust lies in the Zakat and Ushr Ordinance of 1980 by General Zia-ul-Haq. While ostensibly an attempt to Islamize the economy, many citizens viewed the move as a political tool to legitimize a military dictatorship rather than a genuine effort at socio-economic justice. The Ordinance mandated the compulsory deduction of 2.5pc Zakat from savings accounts on the first day of Ramadan, but this coercive, top-down approach immediately fractured along sectarian lines when the Shia minority, adhering to Fiqh Jafria, successfully argued that their jurisprudence mandated Zakat payments be made to their religious leaders rather than the state. Consequently, the government was forced to grant an exemption, which created a massive regulatory loophole: Sunni Muslims, mistrustful of how the government would utilize the funds, began filing affidavits claiming to be Shia to avoid the deduction. Furthermore, the days leading up to the 1st of Ramadan witnessed, and continue to witness, massive capital flight from the banking sector, as depositors withdraw cash to escape the state's net, and this annual "bank run" undermines the stability of the financial sector and demonstrates the public's vote of no confidence in the state's Zakat management.

Beyond the collection mechanism, the distribution side of the state Zakat system has been equally disastrous. The current system relies on local Zakat Committees meant to identify the deserving poor, but multiple reports and audits have revealed that these committees are often captured by local political elites, so rather than reaching the destitute, funds are often distributed to political supporters, relatives of chairpersons, or used to grease patronage networks. For a donor whose primary motivation is religious obligation, the risk that their Zakat might be embezzled or given to an undeserving political worker makes their act of worship invalid.

The Way Forward

It is against this backdrop that the proposed model rethinks zakat collection by separating regulatory authority from operational management, so that Pakistan's civil society is a part of the process, and not alienated from it. I draw lessons from Malaysia's corporatized state institutions, Indonesia's dual BAZNAS-LAZ structure, and Pakistan's own successful Securities and Exchange Commission framework to design this model. At the top sits the National Zakat Regulation Authority (NZRA), an independent statutory body governed by a seven-member board nominated by the Supreme Court, professional accounting bodies, and civil society, deliberately excluding political appointees. The NZRA's mandate is just regulatory: licensing organizations, setting standards, enforcing transparency, and protecting beneficiaries. Most importantly, it never touches zakat funds.

Approved Zakat Organizations (AZOs) form the operational branch. These are existing, trusted civil society institutions, like The Edhi Foundation, Shaukat Khanum Memorial Trust, Al-Khidmat Foundation, The Citizen Foundation, among more, that have already collected billions of rupees through donations over decades. To qualify for licensing, organizations must show a ten-year track record, keep administrative costs below 15pc, maintain Shariah advisory boards, and submit to annual forensic audits by independent accounting firms. This is to ensure that only institutions with proven competence and public trust manage zakat collection and distribution. Even existing government zakat councils could apply for AZO licenses if they meet these standards, creating competitive pressure for performance rather than protecting our current bureaucratic monopolies.

This infrastructure abandons the current compulsory bank deduction system that has led to widespread evasion and resentment. Instead, it proposes voluntary participation through multiple channels, designed for maximum convenience and transparency. The main mechanism is a unified national zakat application. Citizens can access a comprehensive zakat calculator covering wealth, income, gold, agriculture, and business assets. The app displays all licensed AZOs with performance ratings, including administrative expense ratios, distribution effectiveness scores, Zakat-beneficiary demographics, and impact metrics drawn from NADRA records. Donors can select their preferred

AZO, make instant payments via JazzCash, Easypaisa, or bank transfer, and receive digital certificates which are linked to their tax filing accounts.

Salary deduction operates on a voluntary opt-in basis, fundamentally reversing the current system's tyrannical approach. Employers integrate zakat payment into their payroll systems, which allows employees to automatically transfer a percentage of their annual Zakat to an AZO of their choosing. This is similar to voluntary pension contributions rather than a mandatory tax, respecting individual agency while providing convenience. The critical difference from the existing system is employee choice: they decide whether to participate, how much to give, and which organization receives their zakat. This addresses the cultural resistance to government-imposed religious obligations.

A third mechanism in this system is wakalah, adapted from Malaysia's Pusat Pungutan Zakat system. Many people like to directly pay Zakat. So, under the wakalah system, donors paying through licensed AZOs have the right to direct 30-40pc of their zakat to specific beneficiaries: relatives experiencing hardship, neighbors in poverty, or individuals they personally know. The AZO's role then becomes supervisory: it verifies beneficiary eligibility through the NADRA database, documents the transfer, issues the tax certificates, and monitors the outcomes. This approach acknowledges that 95pc of Pakistanis currently prefer giving directly to relatives or local poor, and offers a pathway to formalize these transactions without eliminating the personal dimension that donors value.

The tax deduction mechanism creates powerful incentives for citizens to channel Zakat through licensed Approved Zakat Organizations rather than informal direct giving, and we can see how this works through a concrete example. Consider a professional earning PKR 2.5 million annually, a doctor, lawyer, or accountant who currently gives PKR 60,000 in Zakat informally to relatives or local poor, receiving no documentation, and pays approximately PKR 180,000 in income tax separately, viewing these as unrelated obligations with a combined annual cost of PKR 240,000.

Under the proposed system, channeling his PKR 60,000 Zakat through a licensed AZO makes it fully deductible from taxable income, dropping his taxable income from PKR 2.5 million to PKR 2.44 million and reducing his tax liability by approximately PKR 12,000 at his 20% marginal rate. While his total cost remains similar at PKR 168,000 in tax plus PKR 60,000 in Zakat, he now receives substantial additional benefits: a digital tax certificate documenting religious compliance, real-time tracking showing exactly how his contribution is allocated across education scholarships, entrepreneurship programs and emergency relief, confidence that funds reach verified beneficiaries through NADRA-authenticated distribution rather than uncertain informal recipients, and participation in productive programs achieving 40-60% income increases for mustahiq, vastly superior outcomes to ad hoc personal giving.

The incentive strengthens considerably for higher earners, as a business owner paying PKR 500,000 in Zakat saves PKR 125,000-175,000 in taxes depending on bracket, making formal channels economically compelling. More importantly, the system addresses Pakistan's fundamental trust problem, which is that citizens avoid government Zakat not because they oppose Zakat itself, but because they distrust opaque bureaucracies that have historically mismanaged and embezzled these funds. By offering transparency, professionalism through civil society management, and tangible tax benefits, the model converts the existing PKR 619 billion informal charitable flow into accountable, efficient formal channels, transforming Pakistan's vast generosity from scattered individual acts into systematic poverty alleviation.

Conclusion

The proposed model does not ask Pakistanis to pay more Zakat, nor does it demand they surrender their religious obligations to a government they distrust. Instead, it offers a third way: regulatory oversight without operational control, civil society management without government interference, voluntary participation with powerful financial incentives, and above all, transparency through technology that makes embezzlement functionally impossible.

By separating the regulatory authority from operational management and licensing trusted civil society institutions as Approved Zakat Organizations, this model transforms Zakat from a sporadic act of individual piety into systematic poverty reduction. The infrastructure already exists: institutions have decades-long track records, the technology is available, and most importantly, the money is already being paid. What remains is the political will to acknowledge that the state's method of Zakat collection has failed, and that Pakistan's path forward requires not more government control, but smarter governance that uses the country's deep-rooted generosity through institutions our citizens actually trust.

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Can a Zakat-based tax system reduce inequality and create economic growth in Pakistan?

Introduction

By 2050, Pakistan is projected to become the 3rd most-populous country in the world, with a total population of 389 million people, surpassing the United States, Nigeria and Indonesia (United Nations, 2024). Most of these will be young people below the age of 30, and they will require education, employment, and healthcare. However, at present, there seems to be no hope on the horizon for the country's rapidly expanding population. In the last two decades, real GDP per capita has only grown at a rate of 2pc, which is half of the regional average (World Bank, 2025). The national literacy rate is a paltry 60.65pc, not accounting for the vast gender and regional disparity (Pakistan Bureau of Statistics, 2023). Unemployment in Pakistan today is at 7.1pc**.** As of June 2025, the country's external debt stands at 26.046 trillion rupees, which amounts to 23pc of the GDP (Debt Management Office, 2025). Most concerning is the trend in poverty rates. After two decades of consistent poverty reduction, Pakistan is backtracking. From 2000 to 2019, it reduced poverty from 60pc to 22pc (according to the national poverty line), but since then, the rate has ticked up. According to the World Bank, Pakistan's poverty headcount rate in 2024 is 25.3pc (World Bank, 2025). Despite this, the country's development expenditure, a percentage of GDP, is under 3pc, far below the regional average.

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To further complicate the country's woes, foreign debt financing forces it to turn to the International Monetary Fund (IMF) every 3-4 years. The IMF program comes attached with strict edicts on taxation. For example, after the most recent agreement in 2024, the government unveiled a budget which aimed to increase tax collection by 38pc. However, it was not by creating more equitable tax policies or expanding the tax base, but by increasing direct and indirect taxes, by 48pc and 35 pc respectively (Salman, 2024). For many decades, Pakistan's tax policy has been ad-hoc and short-term, focused only on achieving "elusive targets of tax-to-GDP ratio and reducing fiscal deficit" (Khalid & Nasir, 2020), in order to satisfy international bodies, like the IMF and the World Bank. These foreign bodies are oblivious to each country's specific issues (Stiglitz, 2003), and in an attempt to create short-term fixes, they often pressurise countries to adopt higher taxation regimes, which, "without growth, equity and delivery of social services to the citizens is a lethal pill, based on a diagnosis by a quack rather than by a qualified physician." (Bukhari & Haq, 2020).

The issues in the current tax system are many, but three are the most pressing. The first is that the system disproportionately targets specific classes, and lets entire industries go scot-free. For example, in the fiscal year 2022-23, the agriculture sector accounted for 23pc of Pakistan's GDP, services 58.4pc and industry 18.4pc (Pakistan Bureau of Statistics, n.d). However, the top two sectors, forming 81.4pc of the GDP, made up a combined 30pc share in the tax revenue. The industry sector, by far the smallest of the three, paid the remaining 70pc (Khan & Umar, 2024). Most egregiously, the agricultural sector has contributed less than 1pc in tax for many years (Ali, 2025).

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There is a consensus that the Pakistani tax system needs to change. Most policymakers, commentators and economists, emphasise the expansion of the tax base and the reduction in indirect taxes. Moreover, there is still the belief that a more progressive income tax can eradicate Pakistan's issues. However, many scholars underplay the importance of where the tax revenue is getting spent. Due to the pressure of the IMF and interest payments, every year, the Federal Board of Revenue (FBR) unveils an overly ambitious revenue target and the federal budget, which includes spending on loan repayments, defense, exorbitant government salaries, subsidies, and development, is made under the assumption that the revenue target will be met. Then, due to systemic faults, the FBR falls much short and the government is forced to make cuts to its spending. The first item of business to get reduced is not the payouts to bureaucrats or defense cuts; rather it is the development spending. In a country where nearly 45pc people live in poverty (World Bank, 2025), that should be the last thing getting cut. However, due to "elite" interest groups (Khan, 2024), foreign pressure and misaligned priorities, developmental projects and poverty reduction programs are the state's first target.

As an alternative to this regressive and outdated system, this research explores the feasibility of an alternate system of taxation in Pakistan: a state-administered Zakat tax. By definition, Zakat is an annual proportional tax on wealth, not on income. It is also, by definition, reserved for spending on the poor, and cannot be used for other purposes, like interest payments. The motivation for this research is that Pakistan is a heavily Muslim-majority country where a significant number of people already give Zakat privately, as part of their religious obligation. In 2024, according to a study done by Umair Javed and Max Gallien, nearly 50 million Pakistanis gave an average of Rs. 15,000 in Zakat. However, so far, it is a voluntary contribution, so many high net-worth individuals choose not to give it. By formalising

Zakat as a tax to the state, Pakistan can tap into the large amounts of wealth which remains untaxed. It can also generate significant revenue, exclusively for poverty reduction.

This paper is organised as follows: In the first section, I explore the existing literature on wealth taxes and their feasibility in the twenty-first century. Then, in the second section, I discuss the religious and economic literature on Zakat. I also examine attempts at institutionalising Zakat in various Islamic countries, including Pakistan. In the third section, I explain how a Zakat tax can actually be implemented in Pakistan.

LITERATURE REVIEW

Section I

Before 1945, Europe and the United States were countries with small governments and large amounts of private wealth (for example, in 1910, the aggregate private wealth in the UK was six times greater than the British national income). After the shock that was World War II, however, most Western countries moved away from a small, regalian system of government towards what the economist Thomas Piketty calls, a "social state". Governments started to spend a lot more on public health, education and transfer payments, which resulted in a steep drop in wealth and income inequality in these countries. This was accompanied by the introduction of the progressive income tax, especially in the United States where the top rate reached an all-time high of 90pc, during the 1960s. Since 1980, however, there has been a sharp reversal. In this time period, the decrease in the top marginal rate of income tax throughout the developed world is "closely related to the size of increase in the top centile's share of national income". Wealth concentration is now reaching levels last seen in nineteenth-century Europe (Piketty, 2015). To put it in more concrete terms, the world's top 1pc own more wealth than 95pc of humanity (Oxfam, 2024).

This is why some economists have argued for a progressive wealth tax to replace or supplement the income tax. Before we discuss their arguments, it is important to clarify the difference between these two taxes. An income tax applies to the *flow* of earnings within a time period. It includes wages, capital gains, dividends, and other forms of annual compensation. It is applicable on what people earn but ignores what they already possess. A wealth tax, in contrast, applies to the *stock* of accumulated assets at a particular point in time. Some examples of such assets are real estate, financial securities, business equity, and other holdings. The wealth tax does not take into account if these assets generate an income.

This is why Picketty, Saez and Zucman (2023) argue that income taxes fail to tax billionaires because the ultra-wealthy often have little "taxable income." Their research found that currently, the effective tax rate on the top 0.1% is lower than the working class. This is because the ultra-wealthy accumulate wealth through unrealized capital gains, which are not taxed as income until sold. They may borrow against their assets to fund consumption rather than selling them so a wealth tax hits the asset itself, closing this loophole. To put it in concrete terms, a billionaire whose stock portfolio grows by $1 billion in a year has $1 billion in "economic income" but can report $0 in "taxable income" if they don't sell shares. The researchers also estimated the revenue a theoretical wealth tax could generate. At a moderate rate of 2pc on wealth more than $50 million, and 3pc on wealth exceeding $1 billion, the US could raise $175 billion annually (which is almost 1pc of its GDP).

Moreover, in his seminal work, *Capital in the Twenty-First Century* (2014), Picketty explains that historically, the return on capital (r) exceeds the rate of economic growth (g). When r > g, inherited wealth grows faster than income from labor, leading to an inevitable concentration of wealth in the hands of a few, which is undemocratic and non-egalitarian. For Picketty, the wealth tax is not primarily a mechanism for governments to raise revenue; rather, it counteracts growing inequality and prevents billionaires from consolidating power.

Along with the work of Picketty, et al., the other major theoretical argument for a wealth tax comes from Guvenen, et al. (2023). In their influential paper “Use It or Lose It: Efficiency Gains from Wealth Taxation”, they depart from traditional tax models, which assume that all investors earn the same “normal” rate of return (e.g. 4pc). In that simplified world, a wealth tax and a capital income tax are mathematically equivalent. However, they incorporate heterogeneity in returns, which is empirically observed in the real world, and show that the real economy consists of “super-productive” entrepreneurs and “unproductive” wealth holders (e.g., heirs, passive rentiers). The wealth tax, according to their research, creates a specific selection pressure that they have termed the "Use It or Lose It" effect. Currently, the capital income tax targets results. The more productive you are (higher return), the more tax you pay. This disproportionately penalizes the most efficient allocators of capital. Conversely, a wealth tax (say, of 3pc) will act as a fixed cost of holding capital, so unproductive owners (who cannot generate >3pc) will see their wealth shrink ("lose it"). Therefore, they will be incentivized to sell assets to productive entrepreneurs who can generate high returns (>3pc) and thus afford the tax ("use it"). According to their sophisticated "Overlapping Generations" (OLG) model calibrated to match US data on wealth concentration and return dispersion, the authors ran a simulation where they replaced the existing US capital income tax with a revenue-neutral wealth tax. The result was a 6pc increase in GDP and a significant boost to aggregate productivity. This is a massive gain in macroeconomic terms, far larger than typical tax reform estimates. Their optimal taxation analysis suggests a positive wealth tax rate of around 3pc is welfare-maximizing. In contrast, the optimal capital income tax in their model is often negative (a subsidy), because you want to encourage high returns, not tax them.

Critics of the wealth tax point out issues in its practicality. First, valuation is administratively impossible: unlike income or public stock prices, private businesses, real estate, and intellectual property lack clear market values, forcing annual disputes between taxpayers (incentivized to undervalue) and authorities (incentivized to overvalue). There is a recent case study of France to illustrate this: Since 2011, France imposed a 'solidarity tax on wealth', which has generated limited revenue while triggering €200 billion in capital flight from the country. Second, according to Gregory Mankiw (2015), economic efficiency suffers: taxing capital discourages entrepreneurial risk-taking, particularly for early-stage ventures that generate zero returns. A wealth tax penalizes these innovators with full tax obligations absent offsetting income, pushing capital toward low-risk, established sectors. However, real-world empirical data, like the one used by Nguyen (2020) shows a global wealth tax *would* reduce inequality, but only if consumption growth exceeds output growth, the r−g spread sufficiently exceeds a threshold increasing in wage inequality, and the tax rate stays below a cap decreasing in inequality. High-inequality economies face the tightest constraints, creating a paradox:

where wealth taxation is most desired, permissible rates are lowest. To counter the French example, one can look at the Swiss success story. Switzerland maintains a 0.3–0.9% wealth tax, raising ~3.9pc of total tax revenue, which is the highest globally. Success stems from decentralization (division set rates, preventing race-to-bottom), broad asset coverage with minimal exemptions, and absence of competing capital gains taxes.

Section 2

The previous section demonstrates that given a low rate of a wealth tax (between 1 and 5pc), inequality will decrease. This is an important finding in the context of Pakistan where 60pc of total wealth is owned by one-tenth of the population (World Inequality Lab, 2024). Pakistan's malaise, economic, political and social (represented by the abysmal figures I cited in the Introduction) can be traced back to this inequality, and the power it grants some groups of people. The manifestation of this power is apparent by the large subsidies and tax exemptions the government provides to powerful interest groups, like the agricultural sector (Davies et al., 2016). It is apparent in the multiple bail-outs "private" companies established to provide for retired senior military personnel, have received from the state since 1997 (Siddiqa, 2007). It is apparent when the government unveils a budget which increases defense spending by 20pc and tax exemptions by 50pc, as it did in 2025, *while* the World Bank warns that Pakistani society is regressing in terms of health, education and employment that the state provides for its citizens.

It is in the global context of the debate over a wealth tax and Pakistan's Muslim majority population that Zakat is a relevant topic of consideration. In Islam, Zakat is third only to the declaration of faith to God and the five daily prayers, and it is the pillar concerning social and financial matters. It is an annual tax on wealth held by an individual for at least one lunar year which exceeds the *nisab* amount, which is the minimum threshold amount. There are two ways to ascertain whether a person meets the nisab requirement: the gold standard (the person must possess 85 grams of gold, or equivalent assets) and the silver standard (the person must own 595 grams of silver, or equivalent).

Literally, the word "zakat" translates to "purification" and "growth", as by reserving a fixed percentage of the wealthy's assets for the poor, Islam wants to purify the soul of the giver from greed and selfishness, while purifying the heart of the receiver from envy and hatred toward the wealthy (Qardawi & Monzer, 2000).

Dr. Umer Chapra (1992) takes this reasoning even further by arguing that Zakat purifies the economy itself. By transferring purchasing power from those with a low marginal propensity to consume (the rich) to those with a high marginal propensity (the poor), Zakat stimulates aggregate demand for basic necessities, steering the economy toward producing essential goods rather than luxuries. He further identifies Zakat as the first institutionalized social security system in history. Unlike modern welfare states which often rely on taxing income (penalizing work), Zakat taxes idle wealth, encouraging capital holders to invest and circulate their money rather than hoard it. This aligns with the Islamic economic goal of preventing wealth from becoming “a commodity circulated only among the rich” (Quran 59:7).

The Quran further specifies eight rigid categories of beneficiaries, and does not leave anything to the whims of the giver. According to Chapter 9 of the Quran, the eight categories are as follow:

1. Al-Fuqara: The destitute (those with no assets).
2. Al-Masakin: The needy (those whose earnings do not cover basic needs).
3. Al-Amiluna Alayha: Administrators who collect and distribute Zakat (wages).
4. Al-Muallafati Qulubuhum: Reconciliation of hearts (new Muslims or allies).
5. Fir-Riqab: Freeing slaves or captives (modern application: freeing people from bondage/trafficking).
6. Al-Gharimun: Debtors (those overwhelmed by legitimate debt).
7. Fi Sabilillah: In the path of Allah (historically defense, broadly interpreted by Qardawi (2000) to include Islamic education, da'wah, and general welfare).
8. Ibn al-Sabil: The stranded traveler.

Therefore, Zakat, state-collected or privately-distributed, cannot be given to anyone other than the above eight. It can be thought of as a source of government revenue, meant specifically for social development. This would be a solution to Pakistan’s development crisis, where the state will not be able to spend the Zakat amount on anything other than social development projects.

Zakat rates, mandated by the Quran, are similar to what economists recommend for wealth taxes (as mentioned in Section 1). On cash, savings, gold, silver, and business merchandise (applied to the current market value of stock-in-trade), the rate is 2.5pc. On irrigated agricultural produce, the rate is 5pc, which is lower than the 10pc mandated rain-fed agricultural produce. The rate on income, which is a modern invention, is 2.5 pc and Qardawi (2000) argues that high-income earners like doctors and lawyers should pay Zakat on net income on receipt, the way Zakat has to be paid on harvest on agricultural products on harvest, rather than waiting a year.

There are two aspects to the practicality of Zakat as a state-administered tax: will people pay it, and will the government be able to distribute it to those who need it the most? On the first issue, Umair, Gallien and van den Boogaard (2025) estimate that in 2024, 50 million self-identified Sunnis in Pakistan paid over Rs. 619 billion (£1.7 billion) in Zakat. This amount exceeds all state-led social systems. For example, Pakistan's state-led cash transfer programme, the Benazir Income Support Programme (BISP), distributed 592 billion rupees in 2024. Similarly, more money is being distributed in Zakat payments than Pakistan received in official aid, despite the country being the largest aid recipient in South Asia. However, less than 5pc of 50 million Zakat payers gave it through the national Zakat Fund, most preferring either to give to schools, mosques, NGOs, or most overwhelmingly, directly to individuals the payer deemed Zakat-eligible. Therefore, we can conclude that people are already paying a significant amount as Zakat, but just not to the state.

The chasm between the willingness to pay Zakat and the refusal to pay it to the state highlights the fundamental crisis of governance in Pakistan: a trust deficit. To understand why Pakistanis hoard their wealth from the government while generously donating to private individuals, we must analyze the systemic failures of the state's previous attempts to institutionalize Zakat. The skepticism is not unfounded; it is rooted in a history of political exploitation, administrative incompetence, and the sectarian issues that have plagued the country's official Zakat system since its inception.

The genesis of this mistrust lies in the promulgation of the Zakat and Ushr Ordinance of 1980 by General Zia-ul-Haq. While ostensibly an attempt to Islamize the economy, many citizens viewed the move as a political tool to legitimize a military dictatorship rather than a genuine effort at socio-economic justice (Lau, 2006). The Ordinance mandated the compulsory deduction of 2.5pc Zakat from savings accounts on the first day of Ramadan. However, this coercive, top-down approach immediately fractured along sectarian lines. The Shia minority, adhering to Fiqh Jafria, successfully argued that their jurisprudence mandated Zakat payments be made to their religious leaders (Mujtahids) rather than the state. Consequently, the government was forced to grant an exemption. This created a massive regulatory loophole: Sunni Muslims, mistrustful of how the government would utilize the funds, began filing affidavits claiming to be Shia to avoid the deduction. Furthermore, the days leading up to the 1st of Ramadan witnessed, and continue to witness, massive capital flight from the banking sector, as depositors withdraw cash to escape the state's net (Toor, 2013). This annual "bank run" undermines the stability of the financial sector and demonstrates the public's vote of no confidence in the state's Zakat management.

Beyond the collection mechanism, the distribution side of the state Zakat system has been equally disastrous. The current system relies on local Zakat Committees meant to identify the deserving poor (*mustahiqeen*). However, widespread reports and audits have revealed that these committees are frequently captured by local political elites. Rather than reaching the destitute, funds are often distributed to political supporters, relatives of chairpersons, or used to grease patronage networks (Khan, 2018). For a donor whose primary motivation is religious obligation, the risk that their Zakat might be embezzled or given to an undeserving political worker renders their act of worship invalid (*batil*). Thus, the hesitation to use the state fund is not just economic; it is a spiritual precaution. The state has failed to provide the transparency required to assure the donor that the "purification" of their wealth has actually taken place.

DISCUSSION

Section 3

While Pakistan offers a cautionary tale, other Muslim-majority nations demonstrate that a state-led Zakat system can be both efficient and trusted. By analyzing the frameworks of Malaysia and Saudi Arabia, we can identify the structural reforms necessary to revitalize Pakistan's approach.

Malaysia presents the most sophisticated model of Zakat management in the modern world, characterized by the corporatization and privatization of Zakat collection. Recognizing that government bureaucracy is often inefficient, Malaysian states (such as Selangor and Kuala Lumpur) established semi-autonomous corporate entities to manage Zakat. For instance, the Lembaga Zakat Selangor operates with the professionalism of a private wealth management firm rather than a government department. They have used marketing professionals to raise awareness, offer user-friendly digital payment platforms, and, crucially, separate the collection body from the distribution body to ensure checks and balances (Wahab & Rahman, 2011).

The success of the Malaysian model lies in its emphasis on trust-building through transparency. These institutions publish detailed annual reports, audited by independent firms, showing exactly where every ringgit was collected and spent. Furthermore, they have framed Zakat payment not as a tax but as a social service, offering salary deduction schemes that integrate with the national tax system to provide income tax rebates. This incentivizes compliance; paying Zakat reduces one's income tax liability dollar-for-dollar in some jurisdictions, aligning religious duty with fiscal prudence. The result is a high compliance rate and a robust social safety net that funds scholarships, housing, and micro-financing for entrepreneurs, thereby fulfilling Chapra's vision of Zakat as a tool for economic circulation.

Saudi Arabia offers a different, yet equally relevant, model through its General Authority of Zakat and Tax (GAZT), now ZATCA. In the Kingdom, Zakat is mandatory for all Saudi and GCC nationals conducting business. The system is fully integrated with the state's financial infrastructure; companies cannot renew their commercial licenses or bid for government contracts without a Zakat certificate. This integration ensures that Zakat is not a voluntary charity (as is the case in Pakistan) but an essential cost of doing business, treated with the same legal weight as a corporate tax. The revenue generated is ring-fenced for social security, directly funding the beneficiaries of the Ministry of Human Resources and Social Development.

The convergence of the theoretical economic efficiency of wealth taxes (Guvenen et al., 2023), the religious mandate of Zakat (Qardawi, 2000), and the empirical success of peers like Malaysia provides a clear roadmap. However, implementing this in Pakistan requires overcoming the "trust deficit" identified in Section 2. The solution lies in removing the human element of corruption through technology.

Pakistan possesses a digital infrastructure that arguably rivals, and in some aspects surpasses, that of many developed nations: the National Database and Registration Authority (NADRA). The state can leverage this, alongside the existing data from the Benazir Income Support Programme (BISP), to create a transparent, end-to-end digital Zakat ecosystem. This approach would mirror the success of India's Aadhaar system, which revolutionized welfare delivery by utilizing Direct Benefit Transfers (DBT).

In India, the linkage of biometric identity (Aadhaar) with bank accounts allowed the government to bypass layers of corrupt bureaucracy. Previously, a rupee sent from Delhi would ultimately result in only 15 paisas reaching the villager due to leakages and "ghost beneficiaries" (according to Indian Prime Minister Rajiv Ghandi in 1985). With DBT, the transfer is instantaneous and verifiable. Pakistan has already experimented with this through the BISP, which uses the National Socio-Economic Registry (NSER) to identify the poorest households.

To institutionalize Zakat effectively, Pakistan should abolish the politicized local Zakat Committees and replace them with a centralized, algorithm-driven disbursement system linked to CNICs. A new "National Digital Zakat Authority" could operate as follows:

1. Collection: Zakat is collected via a mandatory wealth tax on specific asset classes (real estate, stock portfolios, and idle bank deposits above the Nisab), integrated with the FBR's filing system but deposited into a ring-fenced "Social Protection Fund" separate from the national treasury. This separation is essential to assure citizens their religious dues are not being used to pay foreign debt or government salaries.

2. Identification: Beneficiaries are identified through the NSER dynamic survey, which uses proxy means testing (PMT) to grade poverty levels. This creates a data-driven definition of Al-Fuqara and Al-Masakin.

3. Disbursement: Funds are transferred directly to the biometric mobile wallets or bank accounts of the women heads of eligible households. This eliminates the current issue of the "local chairman" who demands a cut.

This digital verification system addresses the primary objection of the Pakistani donor: "My money will probably not reach the poor." By creating a portal where a Zakat payer can see the aggregate data the progress of his or her payment, the state can rebuild trust.

Furthermore, this system aligns with the "Use It or Lose It" efficiency argument. By transferring wealth from the rich (who hoard it in real estate plots and gold) to the poor (who spend it immediately on food, medicine, and shelter), the state triggers a consumption multiplier effect. The poor have a marginal propensity to consume of nearly 100pc. An injection of Rs. 600 billion (the estimated private Zakat potential) into the rural economy would stimulate demand for agricultural produce and basic goods, and revitalise the very sectors that sustain the poor.

Conclusion

The economic trajectory of Pakistan, characterized by stagnating growth, crippling debt, and rising poverty, is unsustainable. The current tax regime, reliant on regressive indirect taxation and punitive income taxes on the salaried class, has failed to widen the fiscal base or reduce inequality. In this context, the Zakat tax is not merely a religious issue; rather, it is a pragmatic economic necessity.

The literature reviewed establishes that wealth taxes are the most efficient tool for reducing inequality in the twenty-first century (Piketty, 2014; Guvenen et al., 2023). For Pakistan, Zakat offers a culturally relevant and theoretically robust version of such a tax. While historical attempts at implementation failed due to political interference and a lack of transparency, the examples of Malaysia and Saudi Arabia prove that these hurdles are surmountable through disgitalisation and strict governance.

By using the power of digital identity (like NADRA) and direct transfers, Pakistan can bypass the corrupt intermediaries that have historically disgusted the public. A state-administered Zakat system, insulated from the federal treasury and dedicated exclusively to the Quranic heads of expenditure, would fulfill the constitutional and religious promise of social justice, transforming the "paltry 60.65pc" literacy rate and the "25.3pc" poverty rate not through foreign loans, but through the circulated wealth of our own people. The mechanism for salvation exists; we only require the political will to modernize it.

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