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Improving Pakistan's Fiscal Policy: A Blueprint for Sustainable Development and Economic Growth

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Abstract

Historically, the fiscal policy of Pakistan has confronted with the challenges like structural inefficiencies, recurring fiscal deficit, and narrow tax base that has impede the sustainable development. Pakistan's economic performance has experienced upheaval due to the 2022's flash flooding and consumption-led growth model. However, following the successful completion of International Monetary Fund (IMF) standby agreement have contributed to the early signs of recovery that has improved cash inflows, robust agricultural growth rate of 6.5%, and exchange rate stabilization have collectively promoted economic stability in the FY2024. Nevertheless, primary challenges still persist; this paper through mixed method approach critically analyzes structural inefficiencies and provides findings for policymakers to bolster the Pakistan's economy. Thus, the Policy recommendations suggest comprehensive measures to achieve economic sustainability.

Keywords: Tax reform, Expenditure efficiency, Macro-economic stability, Debt management, Revenue generation

Information

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1 Introduction

Pakistan's fiscal policy plays a significant role in determining its trajectory towards economic growth. Over the years the country has grappled with persistently low tax-to-GDP ratios, structural fiscal deficits and inefficient public spending which have hindered its economic potential. Therefore, this paper seeks to address these issues by developing a comprehensive blueprint for policy reforms, efficient expenditure allocation, the integration of progressive taxation, and sustainability-focused initiatives. Furthermore, this study aims to present actionable recommendations within a growth-oriented fiscal framework.

The pursuit of sustainable development in Pakistan's economy is deeply intertwined with the formulation and implementation of effective fiscal policy. This involves the use of government spending and taxation to influence the country's economic conditions, especially on a macroeconomic scale emphasizing that fiscal policy plays a crucial role in reducing unemployment and stabilizing the economy. (Fatás & Mihov, 2012). Depending on economic conditions, fiscal policy can be either expansionary or contractionary. Expansionary fiscal policy, typically used during economic downturns, aims to stimulate growth by increasing government spending or cutting taxes. Conversely, contractionary fiscal policy seeks to reduce economic overheating or inflation by decreasing expenditures or raising taxes. The primary goal is to stabilize prices and maintain long-term economic stability. Historically, Pakistan's fiscal policy has remained expansionary fiscal contraction. Government revenue and expenditure are two major instruments of any fiscal policy. Taxes generate revenue for government expenditures that are essential for sustainable development. However, Pakistan faces significant challenges, including a low tax-to-GDP ratio, high tax evasion, and weak tax institutions. Similarly, Pakistan's expenditure surpasses the revenue, resulting in a fiscal deficit that directly affects the development portfolio of the country. Addressing these challenges requires comprehensive fiscal reforms to strengthen tax institutions, effective debt management, and rationalize public spending that can lead to sustainable economic growth and development (Khan, 2022).

Pakistan's economy showed signs of moderate recovery in FY24 primarily due to a surge in agriculture growth, reduced inflation, and an improved current account balance. The agriculture sector showed a robust 6.25% growth, driven by increased cotton, rice, and wheat production that offset the weaker growth of the manufacturing and services sectors. However, inflation in the country dropped from an average of 28% last year to 11.7% by May 2024, aided by decreased food inflation and a stable currency exchange rate. Similarly, higher exports and restricted imports contributed to a reduction in the current account deficit. Foreign exchange reserves rose from $9 billion in June 2023 to $14 billion, supported by $2 billion from the Naya Pakistan Certificate and $2.2 billion from the World Bank and IMF (Economic Survey of Pakistan, 2024). The completion of a $3 billion Standby Agreement program with the IMF further stabilized the economy (Economic Survey of Pakistan, 2024). The following table shows the Key indicators for FY2024 from July to March.

Table 1: Key Indicators (July to March of Fiscal Year 2024)

Macroeconomic Indicator	Status
Tax Revenue	7.26 trillion PKR
Non-Tax Revenue	2.52 trillion PKR
Total Expenditure	13.68 trillion PKR
Current Expenditure	12.33 trillion PKR
Development Expenditure	1.16 trillion PKR
Fiscal Deficit	3.7 percent of GDP

Source: Economic Survey of Pakistan, 2023-24

However, the challenges facing Pakistan's economy, including circular debt, high debt servicing costs, and climate change, pose major challenges for sustainable development. Pakistan's energy sector struggles with rising circular debt that reached PKR 2,635 billion (2.4% of GDP) in the power sector and PKR 2,866 billion (2.7% of GDP) in the gas sector by January 2024. This debt surge is mainly due to "take-or-pay" contracts, tariff adjustment delays, structural inefficiencies, high subsidies, and expensive RLNG diversion. Although electricity prices increased from 3.95-25.98/unit in 2021 to 5.95-35.54/unit in 2024, and gas prices rose from PKR 300-4,000 to PKR 500-4,200 for different levels (consumption-wise) still circular debt remains a big trap for Pakistan's economic stability (World Bank, 2023).

During FY 23-24, Pakistan's budget deficit reached 3.7% of its GDP which is the same as the previous year. The Federal Board of Revenue (FBR) exceeded its tax collection target of PKR 6.7 trillion in the first three quarters, with the intent to further expand the tax base through digitalization and improved tax compliance. Non-tax revenues also improved, with the State Bank of Pakistan's (SBP) surplus profit reaching PKR 972 billion, up from PKR 371 billion in 9MFY23, contributing 39% of total non-tax revenue (Economic Survey of Pakistan, 2024). Similarly, the petroleum levy and customs tax revenue increased significantly. However, Pakistan's debt servicing consumed 56% of total revenue due to higher interest rates. Total expenditure climbed by 37%, driven by increased interest on domestic and external debt, leading to an additional PKR 8 trillion in domestic borrowing between March 2023 and March 2024. According to the Economic Survey of Pakistan 2023-24, total public debt stood at Rs. 67.5 trillion by March 24 with domestic debt recorded at Rs. 43.4 trillion and external debt at Rs. 24.1 trillion. The situation is quite worrisome as Pakistan's growing debt stock is not only putting pressure on its budget FY 24-25 but is also pushing it into a debt trap where it is borrowing more to pay its debt (Al-Kasasbeh, 2023).

Thus, Pakistan's fiscal policy requires a strategic revamp to address the long-standing inefficiencies. By adopting the global best practices and learning from past policy failures, Pakistan has the opportunity to create a resilient fiscal framework. However, this study offers short-term, medium-term, and long-term measures through which fiscal sustainability can be achieved and pave the way for an inclusive growth.

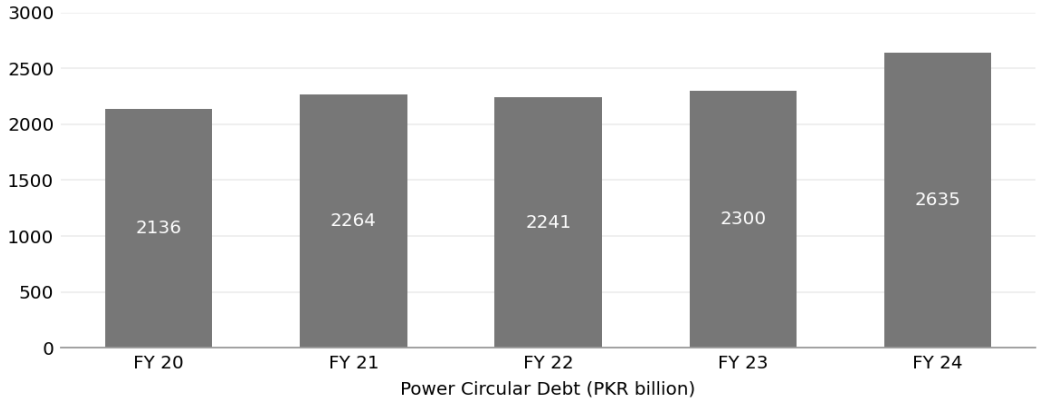


Figure 1: The Past Trends in Power Circular Debt

Source: PACRA, World Bank, 2023

2 Literature Review

The literature on fiscal policy and its contribution to the economic development of Pakistan is extensive; however, challenges also persist. Fiscal policy, through government revenue collection and expenditure, directly influences macroeconomic stability, long-term economic growth, and poverty alleviation. The fiscal policy of Pakistan is criticized for its imbalances, inefficiencies, and lack of robust mechanisms (Rajan, 2018). In this connection, scholars have offered diverse perspectives and solutions to improve the fiscal policy of Pakistan and achieve comprehensive economic growth. However, the comparison with past literature on Pakistan's fiscal policy discloses significant shifts in focus, leaving room for further improvements in fiscal policy.

The literature review delves into key studies while highlighting reform proposals, broader implications for improved fiscal policy in Pakistan, and current challenges. However, empirical literature and extensive theoretical frameworks link fiscal policy with economic performance. Barro (1990) argues that sound fiscal policy supports economic growth by stabilizing the economy, fostering a conducive environment for investment, and providing public goods. However, poor fiscal management is characterized by insufficient spending and high deficits, which can lead to economic stagnation. In the context of Pakistan's economy, fiscal reforms are a necessary requirement for addressing the socio-economic disparities and unlocking the country's growth potential. However, fiscal discipline, better public expenditure management, and improved tax revenue are critical components for sustainable development.

Pakistan's fiscal policy challenges are well documented, with the literature emphasizing problems such as over-reliance on indirect taxes, a narrow tax base, inefficient public spending, and high fiscal deficits. Malik (2019) provides an analysis of the taxation system of Pakistan, noting that structural deficiencies have led to sub-optimal tax revenue collection. He further mentions that only 1% of the total population pays income tax, and informal economic activities remain largely untaxed, which exacerbates fiscal imbalances. Moreover, excessive spending on non-developmental projects and public expenditure inefficiencies hamper Pakistan's growth trajectory and crowd out investment in the crucial sectors of education and health.

The strategies and reform proposals have been advanced by numerous scholars aimed at strengthening the economic stability of Pakistan. To increase tax revenue, the World Bank (2021) advocates improving tax compliance, broadening the tax base, and reducing exemptions. Further, it is emphasized that the essential requirement for comprehensive expenditure reform is to advocate a transformation from current expenditure to development-oriented spending. It is also argued that investment in education, infrastructure, and healthcare can yield high returns concerning economic productivity and human capital development (Hussain & Ahmed, 2020). Policy suggestions also underscore the significance of the decentralization of fiscal powers. The contribution of fiscal decentralization to the promotion of governance efficiency and regional economic equity is also explored by previous studies. Their research suggests that empowering provincial governments to manage and generate revenues could lead to more effective and tailored developmental policies. The comparison of Malaysia's fiscal policy strategies emphasized how efficient resource allocation and targeted subsidies can drive economic growth while ensuring fiscal discipline. The alignment of fiscal strategies with the sustainable development needs a focus on green finance mechanisms and environmental taxation. In addition, gender-responsive budgeting is crucial to reduce poverty and ensure equitable economic opportunities. The Asian Development Bank (2020) and International Monetary Fund (IMF) have also provided frameworks for fiscal consolidation and debt management. The structural reforms provided by the IMF (2023) include reducing fiscal deficits and sustainably managing debt. Similarly, the Asian Development Bank (ADB) outlines strategies emphasizing the requirement for economic diversification, enhancing fiscal resilience against external shocks, and efficient mobilization of resources.

Empirical studies have highlighted mixed outcomes of previous fiscal policies in Pakistan. Javaid and Raza (2017) conducted a time-series analysis of fiscal policy impacts on economic growth in Pakistan from 1980 to 2015. Their findings recommend that while public investment positively correlates with Gross Domestic Product (GDP) growth, high fiscal deficits undermine macroeconomic stability. Further, they also argued that it is insufficient to only initiate tax reforms without improvements in expenditures. However, the comparable developing economies case studies offers lessons for Pakistan, such as India's fiscal reform policies illustrate that potential benefits of implementing GST-Goods and Services Tax (GST) to to streamline revenue collection and curb the tax evasion. Thus, if such frameworks are applied, it could reform Pakistan's fragmented taxation system in terms of supporting social development initiatives and increasing fiscal space.

Pakistan's fiscal policy, which encompasses taxation (government revenue collection) and spending, plays a crucial role in shaping the economic landscape of Pakistan. However, due to the persistent debts, budget deficits, and socio-political challenges, fiscal policy has often confronted several challenges in achieving sustainable growth. In recent years, Pakistan's fiscal policy has focused on stabilizing the economy amid challenges such as public debt, high deficits, and low foreign reserves. The government of Pakistan has collaborated with the IMF by implementing a series of fiscal reforms aimed at spurring growth, achieving economic stability, and tackling structural issues (Fatima, 2021). The following section analyses Pakistan's fiscal policy. The constitution of the Islamic Republic of Pakistan, through Articles 79 to 88, provides the basis for fiscal policymaking and public financial management. The government of Pakistan presents a fiscal policy statement before the National Assembly by the end of January each year, under Section 6 of the Fiscal Responsibility and Debt Limitation Act, 2005 (FRDA, 2005). The fiscal policy statement analyzes key macroeconomic indicators such as total fiscal deficit, total revenue receipts, total expenditure, total debt, and debt per capita, and provides a rationale for any deviation from the approved benchmarks. Furthermore, the Public Financial Management Act promulgated in 2019 provides an enabling environment for a sound fiscal policy through improved macroeconomic management (Aslam, 2021).

Moreover, Pakistan's tax-to-GDP ratio remains low not only by global standards (at least 15pc) but also among the lowest in the region. Although FBR's tax collection remained at 7 trillion during the financial year 2023-24, its tax-to-GDP ratio remained at an average of 8pc which is much below the international standard and Pakistan's

potential. Over the last two years, the situation has not been encouraging, and Pakistan's tax-to-GDP ratio remained at 10.3% of GDP, again much lower than the international standard and below the standard set for the South Asian region for FY 2021-22 (World Bank, 2023). According to FBR's tax gap report 2022, Pakistan is unable to collect its 26 potential collectible taxes, which mainly adds to its low tax-to-GDP ratio, thus resulting in reduced revenue generation and a growing fiscal deficit. However, In terms of composition, indirect taxes (sales tax, customs duty, federal excise duty) have always dominated the total FBR collection share From FY2006-23, on average, indirect taxes have contributed 63%, while direct taxes contributed only 37% of total FBR taxes, which discourages progressive taxation in the country (Ahmed & Mangla, 2024).

In addition, tax expenditures are special provisions in a tax code/law that benefit specific sectors or groups of taxpayers through exclusions, concessions, deferrals, credits, and tax rates for socioeconomic reasons. The global average tax expenditure for 2010-2022 is 4.16%, whereas the average for OECD countries for the same period is 5.15%. In comparison, Pakistan's average tax expenditure for this period remained at 1.61%. Pakistan also ranks below the average tax expenditure among its regional peers. The South Asia regional average tax expenditure is 3.22%, which is much higher than Pakistan's average. This means Pakistan is losing its potential revenue due to its tax expenditure policy (Federal Board of Revenue [FBR], 2024). Further, Pakistan's narrow tax base and low compliance cause revenue losses to the government and promote tax evasion. The number of active taxpayers in Pakistan is 5.3 million people, despite 11.4 million people being registered (World Bank, 2023). This shows that not only fewer people have been registered with FBR but those registered and having valid NTN numbers are not submitting annual income tax returns. In 2024, only 2.4% of Pakistanis filed income tax returns, of whom almost 56% filed nil returns, shifting the burden onto compliant segments (Rana, 2024). This happens because the tax administration has not ensured punitive actions or effectiveness. In addition, sectors like Agriculture and Real estate are exempted from tax, which is causing a huge revenue loss of up to 69.5 billion to the exchequer.

On non-sustainable pension expenditure, the Finance Division has long been cognizant of the ever-growing pension liability. The pension liability, recorded at Rs 250 billion in 2016-17, has grown to Rs 801 billion in CFY 2023-24 (more than 200%). This is expected to reach Rs. 927 billion in the next 02 years, which will be a huge challenge. However, pension reforms are still at the draft stage. The federal government provides a range of products and services to the general public, including passports, ID cards, etc. The Cost Organization, Finance Division is the institutional mechanism for determining the cost of services; however, it has been dysfunctional for the last 07-08 years (Finance Division, 2023). This directly affects the federation's non-tax revenue, which is non-divisible. Moreover, under Public Financial Management (PFM), one of the prime objectives was to promulgate the PFM Act 2019 to ensure that all Federal receipts are credited to the Federal Consolidated Fund. Unfortunately, this objective has not been achieved to date. Most of the earnings of SOEs and public authorities like NADRA, CDA, HEC, and NHA are not credited in FCF. Further, the PFM Act 2019 has not been implemented in Defense organizations to date. This complex situation increases net borrowing and contributes to fiscal mismanagement (Finance Division, 2023). Despite devolution and the 7th NFC Award, the overburdened federal government spends two-thirds of its consolidated expenditure on some of the already devolved areas. After the 18th Amendment and the 7th NFC Award, provinces receive approximately 3/5th of consolidated revenues (FY-2022). Expenditure for these devolved subjects, including health and education, amounted to Rs.328 billion (0.5% of GDP) in FY2022 alone. Similarly, expenditure on HEC and BISP amounted to approximately 0.10% of GDP (Rs.70 billion) and 0.36 percent of GDP in FY22. Additionally, in FY22, Rs. 315 billion (0.5% of GDP) was spent on development in devolved areas. This vertical fiscal imbalance, along with expenditure on devolved subjects, has contributed to ongoing federal fiscal deficits and will continue to pose future fiscal challenges.

Pakistan has an extensive informal economy that is contributing to its economic woes. This extensive sector includes small-scale agricultural businesses, small enterprises, retail shops, etc. According to the World Bank, Pakistan's informal economy contributes to one-third of its GDP, where approximately 61% of its population is employed. Several federal SOEs made net losses averaging around 0.5% of GDP from FY2016 to FY2020, with accumulated losses amounting to 3.1%. (World Bank, 2023). The federal government provides fiscal support to aid these SOEs through loans, subsidies, and equity injections. These amounted to 1.4% of GDP in FY2021 alone. This practice also crowds out private-sector lending and puts significant pressure on the fiscal balance. Over the past decade, these SOEs have consistently experienced losses, placing significant strain on fiscal resources. Remarkably, SOEs' overall profitability has sharply declined since FY14, shifting from a profit of 0.8% of GDP to a loss of 0.2% of GDP in FY22 (Ahmed & Tola, 2024). While analyzing Pakistan's fiscal policy, the country's per capita debt increased 36pc from

2011 to 2023 compared with its regional peers, whereas Pakistan's GDP per capita declined by 6% during this period. This disparity between growth and debt service has led to additional borrowing, making the debt profile unsustainable. According to the State Bank of Pakistan, Pakistan's total external debt amounts to 24.3 bn, with 3.9 bn allocated for interest payments and 20.4 bn for principal repayments. For the next financial year, Pakistan's estimated debt payments are alarmingly high and push the country into debt vulnerability (World Bank, 2023).

Moreover, Pakistan's Human Capital Index (HCI) is 0.41, below the South Asian average of 0.48, highlighting major educational challenges. A two-decade-long wave of terrorism in the country has badly affected its education system. Destroyed schools and interrupted education have resulted in limited skill development. Additionally, climate change poses a growing threat, as empirical evidence suggests a negative relationship between climate change and human development; rising temperatures, increased floods, and drought can further lower Pakistan's HCI ranking, with serious implications for economic growth (Batool & Khan, 2023). This literature underscores that, because fiscal policy is a powerful tool for economic development, Pakistan's current fiscal framework needs significant reform. This requires addressing the structural weaknesses in tax collection, adopting sustainable fiscal practices, and improving public expenditure efficiency to foster long-term economic growth. However, scholars agree that development goals can be achieved by integrating fiscal procedures to transform Pakistan's economic landscape, but successful implementation will require institutional capacity, sustained political commitment, and international cooperation.

Thus, the literature review offers a comprehensive understanding of the academic discourse on fiscal policy in Pakistan and its implications for sustainable development. Furthermore, policy experiments and research is necessary for addressing the emerging challenges and optimizing the fiscal strategies for Pakistan's future prosperity. Moreover, long-term sustainability depends on addressing low productivity, climate vulnerability, and resource allocation. Fiscal policy should support private-sector-led growth, human capital investment, and climate adaptation. These insights emphasize the significance of comprehensive fiscal reforms in Pakistan.

2.1 Integrated Fiscal Reform Framework

The proposed analytical framework links four policy domains with the study's aims. First, tax-base expansion and improved compliance can support more predictable domestic revenue. Second, expenditure reprioritization and reduced losses in state-owned enterprises can preserve resources for productive and social investment. Third, transparent debt management and cash administration can address financing risks and borrowing costs. Fourth, institutional coordination across federal and provincial authorities can support implementation and accountability. These channels are expected to interact; for example, stronger revenue administration may create fiscal space, but development outcomes still depend on effective expenditure selection and implementation (Barro, 1990; World Bank, 2023).

2.2 Theoretical Foundations and Research Gap

Endogenous growth theory provides a useful basis for examining how public investment and fiscal institutions influence long-term productive capacity (Barro, 1990). Similarly, the stabilization perspective explains how taxation and public spending can moderate economic fluctuations when fiscal decisions remain responsive to economic conditions (Fatás & Mihov, 2012). However, growth-oriented expenditure can be constrained when rising debt-service obligations and weak revenue collection reduce the fiscal space available for infrastructure, education, health, and climate adaptation (World Bank, 2023). These perspectives are complementary rather than competing: fiscal stability may support growth only when the composition, financing, and implementation of spending are also considered.

The literature identifies important reform instruments, including a broader tax base, improved compliance, expenditure rationalization, and stronger debt governance (World Bank, 2021, 2023; International Monetary Fund [IMF], 2023). Nevertheless, the reviewed studies and policy reports tend to address these instruments separately or emphasise particular fiscal pressures. Accordingly, this study contributes by bringing the instruments together in a sequenced, Pakistan-specific policy blueprint. The study does not claim to establish causal effects; instead, it identifies complementary policy channels and implementation requirements that can inform later empirical testing.

3 Research Methodology

Further methodological constraints arise from reliance on published secondary data, changes in fiscal definitions, the lack of uniform comparative series, and the absence of an independent counterfactual. Therefore, the descriptive figures alone cannot infer either the direction or the magnitude of long-term growth effects. Future research could validate the proposed relationships using consistent annual or provincial data and an explicitly specified econometric design. This research paper aims to develop actionable strategies to improve Pakistan's fiscal policy for sustainable development and economic growth. This research uses a qualitative approach to provide a comprehensive understanding of Pakistan's fiscal policy. The steps below outline the methodology.

3.1 Research Design

The study draws on qualitative evidence to analyze Pakistan's fiscal policy landscape. The qualitative aspect focuses on comprehending the structural and policy challenges through literature reviews and other secondary sources. However, where needed, a Quantitative analysis has also been incorporated, involving economic data analysis to assess fiscal policy impacts on growth indicators.

3.2 Mixed Method Approach

A mixed-method approach combines both qualitative and quantitative research for comprehensive analysis. Quantitatively, the statistical data has been informed by government reports and the Pakistan Bureau of Statistics to analyze fiscal trends, expenditure allocations, and revenue patterns. Qualitatively, previous literature, academic journals, government publications, and policy papers were reviewed to provide a theoretical foundation and historical context on Pakistan's fiscal policy.

3.3 Data Analysis

The evidence obtained through a qualitative approach was analyzed using thematic analysis to identify recurring challenges, recommendations, and perspectives on fiscal policy. In addition, the statistical data analysis of fiscal indicators, i.e., GDP growth, tax-to-GDP ratio, and debt levels, was analyzed to measure the current state and impacts of fiscal policies.

3.4 Limitations

The themes are organized around revenue mobilization, expenditure efficiency, public debt, institutional governance, and development resilience. The reported values in the source materials are retained with their original units and periods where possible. However, indicators drawn from different fiscal years or accounting definitions are not treated as directly comparable without qualification. The proposed fiscal savings in the recommendations are therefore presented as indicative policy estimates, not as independently verified results or additive forecasts. Limited access to government data and time constraints in collecting comprehensive data were possible limitations of the research. The quantitative component is descriptive: reported fiscal indicators are compared across the periods available in the cited secondary publications rather than estimated through a new econometric model. Consequently, the analysis should be interpreted as a policy diagnosis, not as a causal evaluation of individual reforms. In addition, the qualitative component draws together the institutional and structural explanations reported in the literature, budget documents, and policy reviews (Economic Survey of Pakistan, 2024; World Bank, 2023).

4 Results and Discussion

Because of the low tax-to-GDP ratio, Pakistan relies more on foreign loans and pledges. Consequently, the public sector development fund has been curtailed in recent years, badly affecting the country's development portfolio and its commitment to achieving the SDGs by 2030. Second, Taxation in the country relies heavily on indirect taxes. Indirect taxes, which can be regressive, are a burden on consumers they discourage consumption, savings, and investment (potentially slowing down economic growth) and promote tax evasion. Moreover, the Government is losing a sizeable share of potential sales tax, income tax, and customs duty revenue (26%, 18%, and 30%, respectively) due to tax exemptions given to various sectors (Naqvi, 2024). In addition, Pakistan's growing pension bill is emerging as a major threat to the country's fiscal sustainability, largely due to the absence of contributory arrangements from the pensioners. As compared to civil servants, military pensioners' numbers increase more

rapidly due to early retirement, which surges the pension bill and leads to a fiscal deficit. However, the lack of rationalization of service charges and subsidies for government services also affects revenue generation in the country, which is vital for the development work being conducted by the government.

4.1 Illustrative Reform Scenarios and Evidence Requirements

Several recommendations in the original analysis contain monetary estimates of potential savings. However, the available material does not fully document the underlying estimation procedures, baseline years, and implementation assumptions. Consequently, these values should be viewed as illustrative claims that require verification against fiscal accounts, institutional coverage, implementation costs, and potential overlap before using them for planning. Table 3 distinguishes the proposed intervention from the evidence necessary to assess its actual fiscal effect.

4.2 Interpretation of the Fiscal Policy Evidence

The evidence indicates that Pakistan's fiscal challenges should not be analysed exclusively as a revenue shortfall or exclusively as an expenditure problem. Rather, weaknesses in tax compliance, the distribution of tax burdens, debt-servicing pressures, losses in public enterprises, and uneven implementation of public-finance reforms reinforce one another (Economic Survey of Pakistan, 2024; World Bank, 2023). Therefore, the proposed framework places equal emphasis on the quality of revenue mobilization and the productive use of public resources. Similarly, expenditure rationalisation should distinguish efficiency gains from indiscriminate reductions that may undermine social protection, human capital, or climate resilience (Hussain & Ahmed, 2020; Batool & Khan, 2023).

The PFM Act 2019 also lacks an effective mechanism to meet the operational needs of autonomous bodies and public entities in the country. Currently, organizations keep their money in commercial banks (approx. 4000 accounts), which is public money, yet the finance division borrows from the same commercial banks, creating a fiscal burden from interest on borrowed funds. While other countries are privatizing SOEs, Pakistan still debates for disinvestment of these SOEs. Meanwhile, the government injects significant funds annually through subsidies and grants to sustain these 204 unprofitable entities. The size of Pakistan's informal sector highlights the vast number of businesses and individuals outside the tax net, potentially costing the national exchequer hundreds of billions in tax revenue. Further, the government's dependence on domestic banks to finance its fiscal deficit has surged as foreign direct investment (FDI) and remittances decline. This increasing reliance on banks is often considered to pose a "systemic risk" to the country's financial system (World Bank, 2023). However, given the country's current economic situation and the fiscal policy challenges discussed in the preceding sections, this section proposes improvements to fiscal policy to achieve inclusive and sustainable development. The main focus will be on both components of fiscal policy, such as revenue and expenditure, with proposed changes for improvement that could lead to several positive outcomes.

Empirical evidence shows that although revenue collection has shown an upward trend during the last five years, the persistent fiscal deficit poses a serious challenge to the country's economic stability. This fiscal challenge is because the improved revenues are mainly the result of excessive policy handles and not from a robust tax system. Therefore, it is vital to create an enabling environment for a robust tax system through the following policy alternatives. The existing taxation system is uniquely regressive as it puts an equal burden on wealthier and poorer people through income-based taxes and consumption-based indirect taxes. Although Pakistan has adopted some measures for progressive taxation, there is still a long way to go to embrace progressive taxation in letter and spirit. This involves restructuring the tax system to ensure higher-income individuals and corporations contribute proportionally more to government revenue (Hasan & Khan, 2020). This can be achieved by closing corporate tax exemptions, improving federal-provincial coordination, increasing provincial revenue through logical agricultural taxation, raising excise duties on socially harmful goods, reducing energy-sector tax expenditure, eliminating loopholes, and reducing tax evasion through stricter enforcement and better compliance mechanisms.

Pakistan focuses primarily on income tax as the sole criterion for tax liability and has been criticized for its fairness and for its insufficient fiscal base. Developed countries have included collecting wealth, inheritance, capital gains, and gift taxes into their comprehensive tax systems. Due to inadequate tax administration capacity, these taxes have not yet been added, leading to fragmentation of the fiscal base. By incorporating these taxes, Pakistan can significantly expand its fiscal base. Persistent reliance on amnesties as policy tools, coupled with unresolved issues

from the Tax Amnesty Scheme of 2018 and increasing challenges from offshore tax evasion, is projected to exacerbate fiscal deficits beyond current estimates (Mehmood & Shahid, 2019). Therefore, it is important to target all beneficiaries of these amnesties and formulate policy to tax the export and import sectors to discourage them from retaining surpluses abroad. Pakistan's fiscal deficit is primarily due to its growing expenditure; therefore, efficient expenditure management is crucial for fiscal discipline. To achieve this, the following policy measures are proposed. By right-sizing the government, public expenditure can be saved. Unnecessary hierarchy strains salaries and pensions; therefore, the government should promote digitization in the public sector, which can improve efficiency and accountability while reducing public spending. Nevertheless, regarding subsidy rationalization and elimination, targeted subsidies are required to benefit low-income households while phasing out subsidies that primarily benefit inefficient sectors such as state-owned enterprises (Shah, 2016).

Furthermore, Pakistan's lack of investment in human capital has reduced labor productivity, leading to overreliance on friendly countries. Thus, it is significant to reduce poverty, inequality, and prioritize labor productivity. Inclusive growth and improved human capital can be promoted through annual increases in healthcare, education, and social protection programs. Long-term fiscal sustainability can be achieved by addressing both internal and external debt and by considering measures such as negotiating with international creditors, particularly China, to restructure debt terms and conditions. This includes repayment schedules and interest rates to ease immediate financial burdens (Ahmad et al., 2018). Moreover, exploring opportunities to refinance debt on more reliable and favorable terms through mutual agreements in international markets can support long-term sustainability. Moreover, to ensure borrowing remains within manageable limits, regular assessments of debt are essential to improve transparency in debt management practices. This will also provide stakeholders with regular updates on repayment strategies, obligations, and debt levels. In this connection, the government can engage the development sector to provide technical assistance. Below are the anticipated policy benefits of implementing the alternative policies.

1. First, the progressive taxation policy will generate additional revenue from those most able to pay, broaden the tax base, and will reduce dependence on regressive taxes.
2. Second, subsidy rationalization and efficient spending would lower overall government expenditure, improving fiscal balance and reducing borrowing needs.
3. Third, lower fiscal deficit through reduced expenditure and increased revenue will enhance the confidence of investors.
4. Fourth, efficient debt management policies will mitigate risks associated with debt servicing and may free up resources for economic development and productive investments.

In the context of Pakistan's economy, implementing the outlined fiscal policy model may face various considerations and challenges that require critical evaluation. However, progressive taxation aims at increasing revenue from corporations and higher-income individuals. Pakistan faces notable problems concerning tax enforcement and compliance. Loopholes and Tax evasion are rampant, which reduces the effectiveness of higher tax rates. There is a large informal economy that is untaxed, limiting the potential revenue from wealth taxes and income. Administrative capacity constraints and political resistance from influential groups further hinder the effective implementation of reform policies; efficient expenditure management is crucial given Pakistan's history of fiscal deficits driven by inefficient public spending and extensive subsidies. Pakistan has faced persistent internal and external debt issues that have led to high debt-servicing costs, straining fiscal resources. Debt restructuring and refinancing initiatives require collaboration with foreign creditors, shaped by Pakistan's geopolitical relationships and global economic conditions. Effective debt sustainability analysis is crucial but often lacks transparency, impacting investor confidence and Sovereign Credit Ratings.

5 Policy Recommendations

To improve Pakistan's fiscal policy for sustainable growth, the policy recommendations can be divided into short-, medium-, and long-term goals as follows.

Short-Term

1. Pakistan's currency swap arrangements with the Kingdom of Saudi Arabia (KSA) and Iran for fuel imports can be designed to facilitate trade by allowing transactions to be conducted directly in their respective national currencies, rather than relying on a third-party currency like the US dollar.
2. Simplify tax procedures and enforcement for filing and refunds. Increase public awareness of online services, such as the national sales tax return and FBR Tax Maloomat, along with other FBR initiatives, to boost tax compliance and reduce the tax gap.
3. To reduce circular debt and fuel consumption, close markets in the evening and reduce school days to three days a week.
4. Strictly enforce the PFM Act, 2019, and fully implement the Treasury Single Account (TSA) to enhance cash management and ensure proper monitoring and accounting of the federal government's cash balances.
5. Implementing the TSA alone will help reduce public borrowing needs and could potentially save Rs. 444 billion (0.53% of GDP) annually, thereby lowering debt servicing costs. Privatize or divest underperforming SOEs, and improve financial reporting and governance for retained SOEs to potentially achieve annual savings of Rs. 458 billion (0.55% of GDP)

Medium Term:

1. Streamline and phase out preferential tax rates (e.g., on cigarettes), zero ratings, and tax exemptions, aiming for potential annual savings of Rs. 670 billion (1% of GDP).
2. Simplify the structure of personal income tax and reduce the tax-free threshold to potentially save Rs. 67 billion (0.1% of GDP) annually.
3. State Bank of Pakistan (SBP) should be engaged to work with banks and companies with mutual funds to formulate pension plans and encourage new recruitment on market wages. It will provide employees with financial security and encourage long-term savings among the working population.
4. SMEs and startups in Pakistan should strengthen domestic sourcing and international supply-chain connections to procure raw materials more efficiently, reducing dependence on expensive imports. This strategy aims to enhance economic resilience, lower production costs, and conserve foreign exchange, supporting sustainable growth and competitiveness in domestic industries.
5. The federation should cease spending on current and development expenditures for devolved subjects. For federally entrusted responsibilities like climate change risk management under Article 144, deduct a matching grant from provincial shares post-legislative amendment. Additionally, restructure federal entities to align with devolution plans, including ministries and attached departments.

Long-Term:

1. Steps should be taken to enhance product value addition before export, diversify the range of goods exported, increase their acceptability in International markets, and explore new international markets for sustained exports. These strategies aim to increase export revenue by offering higher-quality products. This will expand market reach, and reduce dependency on specific markets, thus increasing economic growth through diversifying trade opportunities.
2. New labor markets shall be explored, which can involve expanding the deployment of workers to additional countries or industries abroad. This strategy aims to increase remittances sent home by expatriate workers, boosting national income. It will enhance economic stability, diversify remittance sources, and build resilience against fluctuations in specific regions and labor markets.
3. Chinese industries are relocating due to higher labor costs; if they are incentivized to move to Pakistan, they can contribute to long-term growth initiatives. Such initiatives will attract foreign investors, transfer technology, and create job opportunities. Moreover, if offered favorable conditions such as strategic location and lower operating costs, Pakistan can boost economic growth and industrial development.
4. Implementing mitigation measures and climate adaptation strategies in Pakistan will reduce the demand for imports needed for post-disaster rehabilitation. However, Pakistan can lower its reliance on external aid by enhancing resilience to climate impacts, improving disaster preparedness, upgrading infrastructure, and adopting sustainable practices.

5. By using Information Technology (IT), the Federal Board of Revenue (FBR) can effectively identify tax evaders. By leveraging intelligence gathering and data analysis, FBR can efficiently detect violations of tax laws, non-compliance, and integrate evaders into the tax system.
6. To increase fairness and revenue collection, it is also suggested that input from provincial governments be incorporated, along with data from sectors with economic potential. This approach aims to support efficient assessment and agricultural land use for tax income, while considering provincial perspectives and regional variations to ensure equitable distribution of tax revenues and effective implementation.

6 Conclusion

Future empirical studies may test how improvements in tax administration interact with expenditure efficiency and public debt sustainability. Similarly, provincial comparisons could assess whether differences in fiscal capacity and federal–provincial coordination are associated with investment in education, health, and infrastructure. A further avenue is to examine whether climate-responsive expenditure and better-targeted subsidies influence resilience and distributional outcomes. These questions require consistent data, explicit identification strategies, and attention to the timing and institutional context of fiscal reforms.

The study suggests that fiscal sustainability and economic development are linked outcomes. Stable revenues and manageable debt obligations may support public investment, while the efficiency and distribution of expenditure determine whether fiscal resources build productive capacity and inclusion (Barro, 1990; Fatás & Mihov, 2012). In addition, the reform framework offers a structured basis for comparing Pakistan with other emerging economies, provided that future studies use harmonised fiscal indicators and clearly specified policy settings. Such comparisons are a prospective application of the framework, not an empirical comparison undertaken in this paper.

The analysis indicates that fiscal policy plays a significant role in transforming economic outcomes by influencing effective spending decisions and government revenue. It further stabilizes the economy, ensures resilience against economic shocks, and fosters growth. Therefore, targeted expenditures on social projects and programs, along with balanced revenue generation, are crucial for macroeconomic stability and sustainable development. Both challenges and potential are reflected in Pakistan's recent economic trajectory; despite setbacks from the 2022 flash floods and dependence on consumption-driven growth, the country has shown moderate signs of improvement. In addition, budget management, which allocates significant resources, has underscored the challenge of balancing fiscal sustainability with the need for development in education, infrastructure, social welfare, and healthcare. Addressing these challenges requires comprehensive reform. Therefore, enhancing revenue through curbing tax inefficiencies and progressive taxation is crucial. Moreover, reducing reliance on the informal economy and prudently managing debt, expenditure, and pension liabilities are crucial for long-term inclusive growth and economic sustainability. A well-designed fiscal framework that integrates these short-, medium-, and long-term measures will pave the way for a more self-reliant and resilient economy capable of addressing the challenges of the 21st century.

Implementing the proposed reforms requires sequencing and coordination rather than adopting every measure simultaneously. In the short term, improved tax administration, cash visibility, and transparent reporting can establish the institutional basis for later changes. In the medium term, subsidy targeting, pension arrangements, and reviewing preferential tax provisions can be assessed for both fiscal gains and distributional consequences. In the long term, export diversification, human-capital investment, and climate adaptation may strengthen productive capacity and resilience (World Bank, 2021, 2023; Batool & Khan, 2023).

Ethics Statement: This study is based on secondary documentary material and publicly reported macroeconomic indicators. No primary data collection involving human participants.

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