

Presentation on

Federal Taxation: Opportunities and Risks

By

Ather Maqsood Ahmed, PhD
Professor (Economics)

School of Social Sciences and Humanities
National University of Sciences & Technology (NUST)

THE ECONOMY OF PAKISTAN

IN THE LIGHT OF MACROECONOMIC POLICIES

Pakistan's growth performance is typical of an underperforming economy. It has recorded only three episodes of growth acceleration since 1960 when GDP per capita exceeded 3% per annum (1963-66, 1980-83, 2004-07);

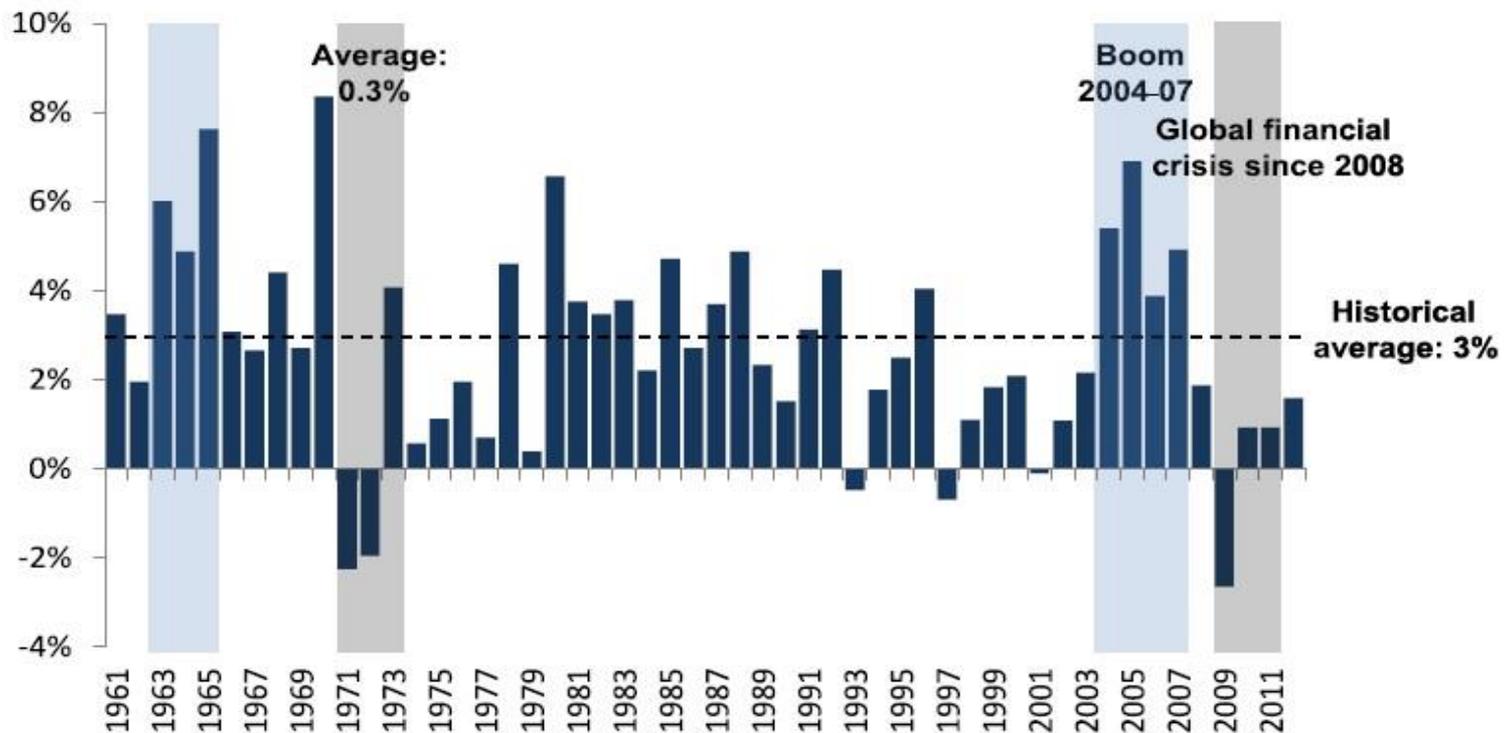
Its long-term 'structural' growth trend is declining from 6-7% in 1960s to less than 3% in late 2000;

Pakistan's current growth rate is below its potential level and significantly diverging from its most competitive neighbors, China and India;

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BOOMS AND BUSTS IN GROWTH

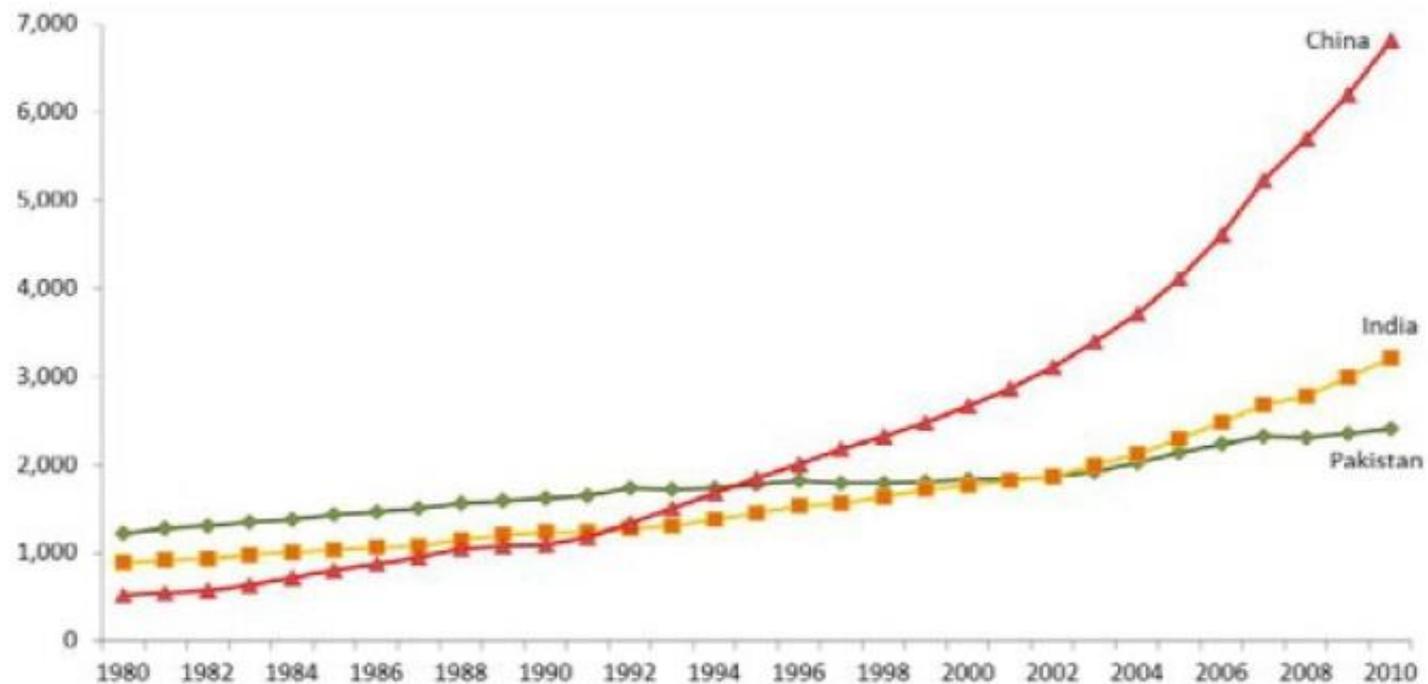
Figure 1 Pakistan: booms and busts in growth, 1961-2012
(GDP per capita growth, percent)



Source: The World Bank 2013

DIVERGENCE!

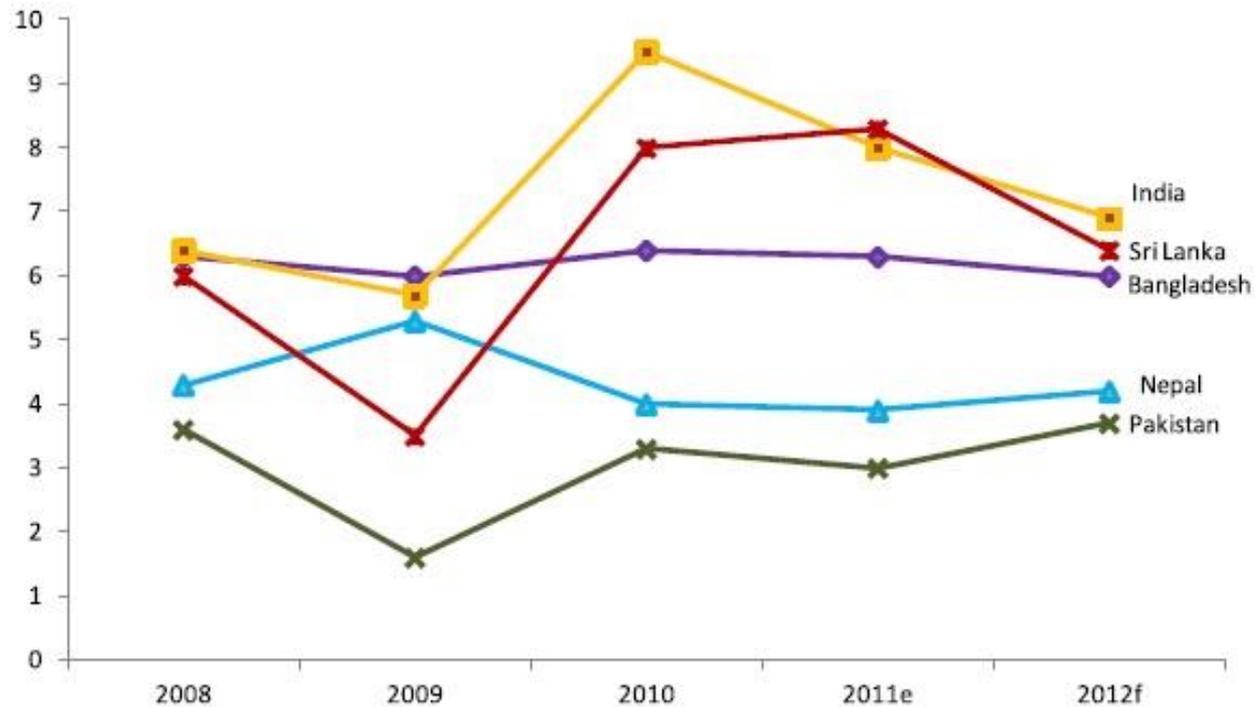
Figure 2: Diverging GDP per capita between Pakistan and world's fast-growing economies (purchasing power parity, 2005 \$)



Source: World Bank 2012e.

LAGGING BEHIND THY NEIGHBORS!

Figure 3: GDP growth in Pakistan and other South Asian countries, 2008–12
(2005 \$)



Source: World Bank 2012b.

THE ECONOMY OF PAKISTAN

IN THE LIGHT OF MACROECONOMIC POLICIES

There is marked deterioration in many structural areas such as revenue collection, energy sector, social protection, and overall environment for private investment,

The backbone of the economy, i.e., the industrial sector is performing dismally, it has shown only a modest recovery after serious slide in recent years;

Macroeconomic instability in the shape of fiscal and trade deficits, and unemployment has reached an disturbing stage;

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THE ECONOMY OF PAKISTAN

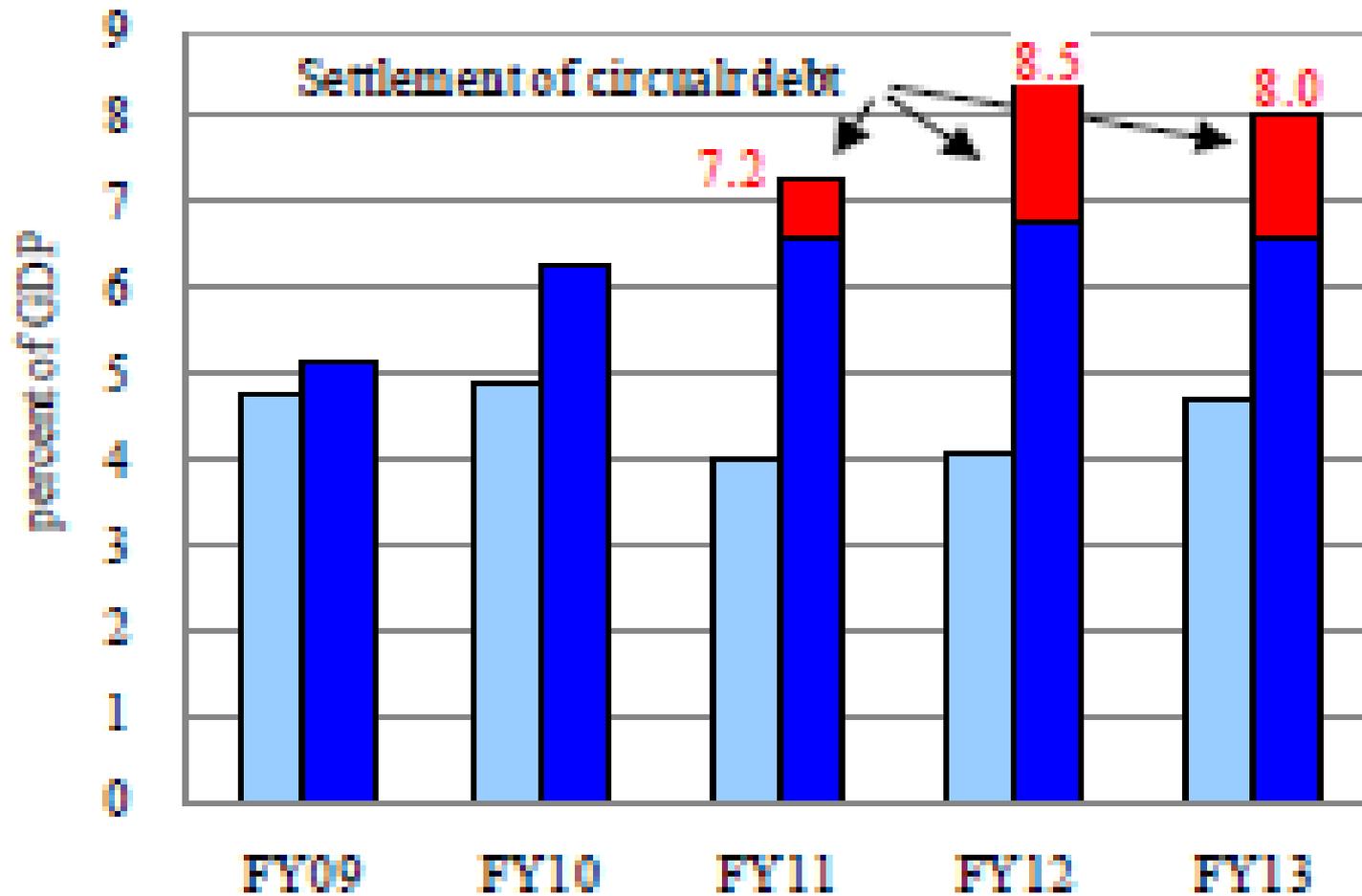
Constraints on fiscal space and continuous security risk have put the economy on the brink of degeneration;

Increasing debt burden reflects serious flaws in economic management. Not to mention that there is gross violation of Fiscal Responsibility and Debt Limitation Act; and most importantly

There are worrying signs of rising levels of poverty and worsening of income distribution across regions.

Figure 5.1: Fiscal Deficit

□ Budgeted ■ Actual



Source: Ministry of Finance

IDENTIFYING THE PROBLEM AREAS

A cursory look at the projected and realized budgets of previous years shows that revenues fall short of target whereas expenses exceed their budgetary allocations. The deviation from initial estimates is largely on account of three factors:

- i. Under-estimation of subsidies and transfer payments (power, railways, PSEs);
- ii. Underestimation of interest payments on debt; and
- iii. Over-estimation of FBR tax revenue.

□ The sole objective is to present a manageable Fiscal Deficit position.

ADDING INSULT TO INJURY!

It has been shown in the literature that if fiscal policy is imprudent and if central bank does not finance that fiscal imprudence initially, the end-result could still be inflationary as the public Debt/GDP ratio would turn unsustainable over time.

In our case, unfortunately rather than ensuring coordination between monetary and fiscal policies, Pakistan's MP has been subservient to FP which itself has been a total flop.

RESTRUCTURING THE FEDERAL TAX STRUCTURE

It is now well recognized that Pakistan has a flawed tax structure since ages;

It is generally perceived that the TARP was ill-designed as it did not deliver.

Just to remind ourselves that the two components of tax reform program are:

- Tax Policy Reforms focusing on tax rates and tax bases; and**
- Tax Administration Reforms focusing on all other issues.**

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RESTRUCTURING THE FEDERAL TAX STRUCTURE

Historically, the reform process on the first component started in late 1980s and continued till 2002.

- **Revision of Rates of Customs Duties**
- **From Sales Tax to GST (Sales Tax Law in 1990)**
- **Overhauling of WHT in 1995**
- **Less reliance on CED (now FED), and**
- **Revised rate structure of Companies and new Income Tax Act 2001.**

The work on second component continued in the second half of 1990s and its implementation from 2002 onwards. [SAS, ITC, HR initiatives etc]

FBR REVENUE COLLECTION VS BUDGETED TARGETS

(AMOUNT IN BILLION RS.)

Fiscal Year	Budgeted Target	Actual Collection	Deviation (-) and (+)	Deviation (%)
1999-2000	352	347	-5	-1.4
2000-01	407	392	-15	-3.7
2001-02	414	404	-10	-2.4
2002-03	459	461	2	0.4
2003-04	510	521	11	2.2
2004-05	590	590	0	0.0
2005-06	690	713	23	3.3
2006-07	835	847	12	1.4
2007-08	1,000	1,008	8	0.8
2008-09	1,250	1,157	-93	-7.4
2009-10	1,380	1,329	-51	-3.7
2010-11	1,667	1,558	-109	-6.5
2011-12	1,952	1,881	-71	-3.6
2012-13	2,381	1,946	-435	-18.3
2013-14	2,475	2,266	-209	-8.4
2014-15	2,691	2,610*	-81	-3.0

* Estimate

UNDERSTANDING THE ISSUE

It will be seventh consecutive year since 2007-08 that the revenue target will be missed;

One of the critical factors is that the FBR has reversed the Reform Process;

Today the tax policy is as ad hoc and growth retarding as it was in the 1980s and 1990s.

Emphasis on high rates, imposition of regulatory and special duties, and furthering regressivity through WHTs;

The legislative approval through Parliament is not being sought;

FBR RELATED ISSUES

Despite obvious structural problems in the taxation system in Pakistan, there appears to be a lack of willingness on the part of the authorities to take decisive action to resolve long standing issues.

General reluctance to improve compliance and take up measures to broaden the tax-base through audit and enforcement, the two vital elements of reform program, resulting in substantial growth of the informal (undocumented) economy.

FBR RELATED ISSUES

Successive governments have conceded to pressure groups, and instead of trying to tax the untaxed, have opted either for regressive indirect taxation or taking on more debt. This situation has resulted in unsustainability of deficit and debt.

My final observation. FBR has been unable to sell the reform program to its employees. They are too happy with double salaries but their mindset of taxpayers' harassment has not changed a bit, lip-service notwithstanding. Let us see how they react to new reform initiative.

THANK YOU

FOR YOUR ATTENTION

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