

# Revenue Collection & Sustenance of State and Economy of Pakistan

Comments on Federal Budget 2011-2012

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## CONCENTRATION ON NON ISSUE (1)

- In his recent book *Pakistan-The Hard Country*, King's College, London's Professor Anatol Lieven observed that Pakistan is:

*“Divided, disorganised, economically backward, corrupt, violent, unjust, often savagely oppressive towards the poor and women, and home to extremely dangerous forms of extremism and terrorism”.*

- It is easy to conclude, as many have, from this roll call of infirmities that Pakistan is basically Afghanistan or Somalia with nuclear weapons. Or is this a dangerously false perception, a product of wholly defective assumptions.
- Prof. Lieven has very rightly concluded that present Pakistan is a geographical entity and it is very unlikely that such a geographical entity would ever be split. What we need to decide is to determine the basis of economic sustenance of 190 million people living in this area. The theory of disintegration is promoted to demoralize the nation and to let them concentrate on non-issue.
- Do we Pakistanis acknowledge this reality? Are we dealing with the main issue i.e. Economic welfare of common man?

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## CONCENTRATION ON NON ISSUE (2)

### REASONS AND BASIS OF ANTI IMPERIALISM

- Lieven shows that, as in Latin America, anti-Americanism in Pakistan is characterised less by racial or religious supermacism than by a political bitterness about a supposed 'ally' that is perceived to be ruthlessly pursuing its own interests while claiming virtue for its blackest deeds. **And if many Pakistanis seem to prefer Islamic or tribal legal codes, it is not because they love stoning women to death but because the modern institutions of the police and judiciary inherited from the British are shockingly corrupt, not to mention profoundly ill-suited to a poor country.**

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## CONCENTRATION ON NON ISSUE (3)

### VICIOUS CIRCLE

- Dr Ishrat Hussain explained the matter in his book “**Pakistan the Economy of an Elitist State**”.
- Our problem is very simple. **Unless we collect tax, we cannot provide services; however, unless we provide services we can not build trust in a nation to pay equitable taxes. Who will break this vicious circle?**
- Let us go back to our history and accept that economic equality and welfare of common man has never been our subject.
- As Prof. Leiven said let us not digress or demoralize the nation that our ills are incurable. **Country and the state is not in danger; people’s well being and their future is in danger.**



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## ECONOMIC INEQUALITY AND REBELLION

- Nobel Laureate Dr Amartya Sen in his book “On Economic Inequality” observed:

*“The relation between inequality and rebellion is indeed a close one, and it runs both ways. That a perceived sense of inequity is a common ingredient of rebellion in societies is clear enough, but it is also important to recognize that the perception of inequity, and indeed the content of that elusive concept, depend substantially on ‘possibilities of actual rebellion’. The Athenian intellectuals discussing equality did not find it particularly obnoxious to leave out the slaves from the orbit of discourse, and one reason why they could do it was because they could get away with it. The concepts of equity and justice have changed remarkably over history, and as the intolerance of stratification and differentiation has grown, the very concept of inequality has gone through radical transformation.”*

- Are we not like Athenian Intellectuals? The common man of Pakistan is treated like an Athenian slave not to be taken into account whilst deciding the course of country’s future in every sense. There could be a ‘Tehrir Square’ in Pakistan. However, let us hope it is there once we appreciate the main issue.



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## MISNOMERS ABOUT IMF/WTO FREE MARKETS (1)

- An ordinary Pakistani has been made to believe that system is not working because Americans and imperialist powers do not want it to be so. He may be right in one sense; but totally wrong in other manner. This sense of 'National Complacency' is to be removed. Most of the problems and solutions are homegrown and solution is also local and domestic.
- In 2011, a realistic situation has emerged. We are effectively, at least temporarily not short of US\$. We are short of Rupees, let us appreciate that inspite of all issues of globalisation, economy is a sovereign subject and each country has to take care of its economic interests.
- There is national misconception about the role of IMF and other lending agencies with regard to Pakistan economy. This matter is highly politicized.
- Free market notion has a different meaning for countries around the world. Almost at the G8 countries are not compliant. For us, it means free for all favouring pressure groups and vested interests. Our foremost priority should be employment, poverty alleviation and creation of wealth within the country.

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## MISNOMERS ABOUT IMF/WTO FREE MARKETS (2)

- This problem is not new.
- We supported feudalistic and elitist culture since inception and even before we could not bring about any meaningful change in that system. No meaningful land reform has been introduced and implemented.
- Our economic policy is ruled by pro-imperialist forces supporting the elitist mindset. An ordinary man is not relevant, it is not only IMF it is an ingrained elitist, pressure group, security state mindset. **A poet has rightly said:**

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## WHO IS DRIVING THE ECONOMY: A LONE VOICE?

معیشت دوسروں کے ہاتھ میں ہے، میرے قبضے میں  
جزاک ذہن رسا کچھ بھی نہیں، پھر بھی، مگر مجھ کو  
خروشِ عمر کے اتمام تک اک بار اٹھانا ہے  
عناصر منتشر ہو جانے، نبضیں ڈوب جانے تک  
نوائے صبح ہو یا نالہ شب، کچھ بھی گانا ہے

اختر الایمان



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## NOTHING HAS REALLY CHANGED!

کہ اب تک!  
پاؤں تنگے ہیں بے نظیروں کے



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## DUTY DIFFERENTIAL RAJ

- Pakistan has disturbed its economic base and industrial competitiveness by amending the duty and tariff structure on ad-hoc basis since inception without proper economic studies, blind following of WTO requirements and pressure from vested interests. Under invoicing, Afghan Transit Trade, Smuggling and present exchange regulation has effectively crippled out the industrial base.
- ‘Licence Raj’ has been replaced by ‘Duty Differential Raj’.
- We move the pendulum wrongly on both sides. At times we provide excessive protection, apparently and discretely and in various situations kill our local industry on the argument that any facilitative duty structure will be prone to smuggling and abuse of Afghan Transit Trade. This side of our fiscal policy is in a mess.
- Recent tariff study conducted by the Planning Commission led by a world renowned expert has raised certain fundamental issues in this regard. This requires:
  - Complete reexamination of present duty structure;
  - Providing ‘facilitation’ to local industry;
  - Not to be taken on a ride by the slogan of ‘free market economy’.
  - Reviewing ‘Chinese’ trade in realistic manner.
- In the budget for the year 2011-2012, there are minor amendments in the duty structure, however, substantial changes have not been introduced.

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## ESTIMATED COLLECTION & EXPECTED / ACTUAL SHORTFALL (1)

	<i>Rs in Billion</i>
Overall Budget Collection	
Projected collection for 2010-2011	1,588
Less: Expected short fall	38
Expected Collection	<u>1,550</u>
Effect due to reduction in overall rate of sales tax and abolition of SED	50
	<u>1,500</u>
Base for next budget	
Expected growth 4%	58
Estimated inflation 12%	<u>174</u>
	<u>232</u>
Estimated Collection	1,732
Collection expected from broadening the tax base	<u>220</u>
	<u>1,952</u>

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## ESTIMATED COLLECTION & EXPECTED / ACTUAL SHORTFALL (2)

- I am not very concerned about this Rs 220 billion. Even if we achieve the same, this collection of revenues cannot bring any incremental improvement in economic well being of the people.
- This effectively means that purchasing power of common man will diminish by 12 percent without any corresponding improvement in state facilities for education, health, security and infrastructure.
- We need Rs 700 billion incremental funds to get out of vicious trap. The ground reality is that we can do that. This is not a big amount. Let us look at the advertisement in the popular daily newspaper of Pakistan. Do we realize the problem is on both sides of the picture?



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پاکستان کی معیشت کا 50 فیصد انحصار سروسز سیکٹر پر ہے اور اس سے حاصل ہونے والے ٹیکس کی مالیت صرف 17 فیصد!

اس سیکٹر میں وہ بازار بھی شامل ہیں جہاں آپ اور ہم روزانہ خریداری کرتے ہیں۔ پچھلے سال پاکستان بھر کی تمام دکانوں سے دس کروڑ روپے سے بھی کم رقم ٹیکس کی مد میں حاصل ہوئی جبکہ اصل صورت حال کچھ یوں ہے کہ لاہور میں موجود لبرٹی مارکیٹ کی دکانوں کی یومیہ فروخت بھی اس سے گہیں زیادہ ہے۔

**ذرا سوچئے!**



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## INEQUITABLE DISTRIBUTION OF TAXES (1)

- Out of total collection of Rs 1.588 (2010-2011) trillion around 70 percent [directly and impliedly] represent indirect taxes. Projected collection for the year 2011-2012 of 1.952 trillion reflects the same trend. This nation effectively pays only Rs 350 – 300 billion in direct taxes and that too by banks, big companies and salaried people.
  - Indirect taxes in Pakistan are levied on all products including petroleum, electricity and gas. This creates inequity between affluent and poor segments of the society;
  - Indirect tax in the guise of direct tax. Six main segments of ‘business activities’ are subject to presumptive tax:
    - Income of commercial importers;
    - Income of exporters;
    - Income from property;
    - Income from interest on securities and dividend;
    - Income of contractors;
    - Income on local supplies, other than listed companies.

This means that there is effectively no direct tax on almost all business activities.

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## INEQUITABLE DISTRIBUTION OF TAXES (2)

- In the Finance Act 2011, one positive step has been undertaken by way of reducing the rate of Sales Tax from 17 to 16 percent and a proposition to eliminate Excise Duty on all non-luxury goods. However, the other step being gradual switch to non-presumptive taxation has not been done. This means that the issue of equity is not being introduced.
- This system suits **non-documentation** and **lack of asset records**.
- No meaningful tax reform on the policy side can be placed, unless this vicious circle is broken.
- Taxation on net income basis with documentation of asset is the only solution. There will never be a “Messiah”. We are our owns Messiahs.

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## SALES TAX (1)

- Reforms in sales tax regimes proposed in 2010 were for:
  - a) Removing Exemptions;
  - b) Dealing with Export Oriented Sector;
  - c) Extending VAT to Retailers; and
  - d) Extending VAT to service sector.
- All these amendments and changes could have been introduced without bringing in a new law and having parliamentary approval. However, as a matter of transparency and **'political ownership'** that course was suggested. It failed.
- In March 2010, SRO's were issued for removing the exemption for:
  - Fertilizer, Plant & Machinery, Agricultural Inputs; and
  - Export Oriented Sector were brought into a different regime.
- However, for obvious reasons 'Retailers' and 'Service Sector' were not taken up. Now in the Finance Bill 2011 the position remains the same.

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## SALES TAX (2)

- Let us admit that our system for this tax is not working in the manner we want. The system could not be extended to 'Retailers' and 'Service Sector', where value addition is almost 50 percent of total GDP. If we relate this issue with other aspects referred earlier practically there are serious problems not of implementation but fractures in structures.
- We have to accept that our mode of implementation of Sales Tax, being 'Top to Bottom', has not worked well. Top to Bottom' approach means:
  - 1) Manufacturers
  - 2) Importers
  - 3) Wholesalers
  - 4) Retailers
- In the present position the system has effectively stopped at Manufacturers and Importers. This is not an effective Consumption Tax, it is Production Tax.
- We would have to examine the possibility of other measures, whereby, 'Retailers and Wholesalers' issue needs to be independently examined.

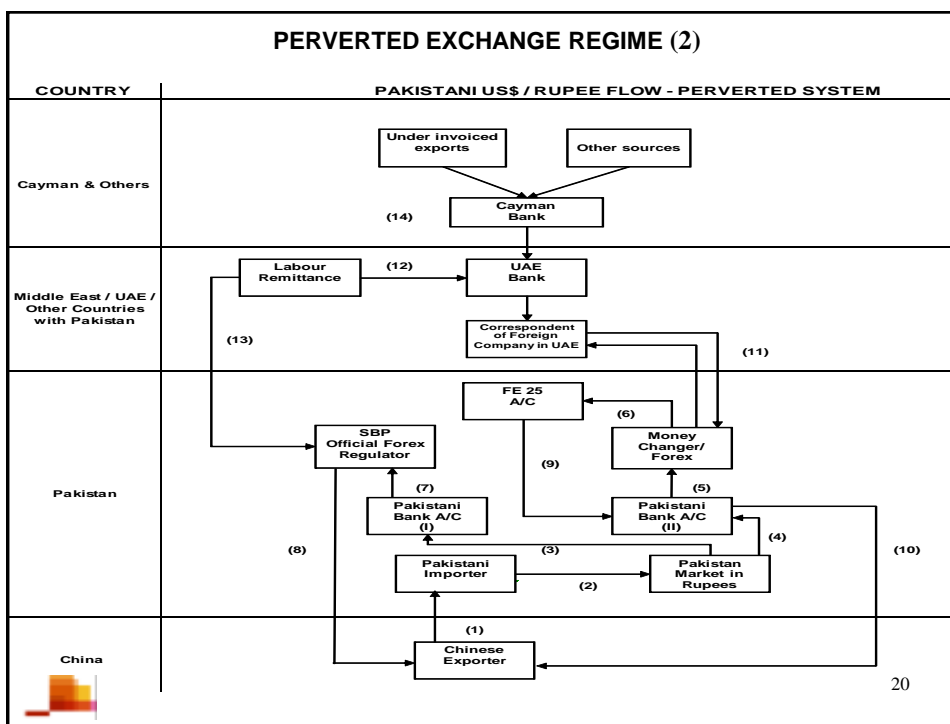
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## PERVERTED EXCHANGE REGIME (1)

- No economy can sustain an equitable and facilitative structure if it is faced with the problems which Pakistan has created for itself in the past decades. The salient features of our system are:
  - A perverted exchange regime that effectively promotes under invoicing and creates a parallel exchange system;
  - An organized structure for ‘**Under invoicing**’ of imported Products at the cost of local industry and national exchequer by way of taxes and duties and documentation;
  - Open border specially on the western side effectively disturbing the whole tariff structure;
  - A perennial problem of Afghan Transit Trade
- On the following page a chart has been presented to depict the mechanism of this whole system. No taxation system can be promoted if this collaborative corruption, being infused into our system, is allowed to be perpetuated.



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### PERVERTED EXCHANGE REGIME (3)

- (1) Supply of goods at US\$ 10- /invoice US\$ 5.
- (2) Sale of goods in Pakistan market in Rupees US\$ 10 & margin  
[10+2]= 12 x 85 = Rs 1,020
- (3) Inflow of white money in Pakistani bank account no. (I)
- (4) Inflow of grey money in Pakistani bank account no. (II)
- (5) & (6) Using forex company / FE 25 in obtaining US\$ of 5.
- (7) Payment of L/C by SBP.
- (8) Receipt of cash by Chinese.
- (9) & (10) Payment of US\$ 5 by using FE 25.
- (11) Maintaining Parallel reserves - Inflow from sources identified, outflow as described.
- (12) & (13) Labour remittance is diverted to unorganised sector where the money forms part of FE 25 inflow and available for exemption under section 111(4).
- (14) Other sources of inflow are: Under invoiced exports and other sources.

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### EXPORT ORIENTED SECTORS (1)

- Five Export Oriented Sectors being textile, leather, sports, carpets and surgical were zero-rated. This effectively meant that even 'Local Supplies' were not subject to Sales Tax. This was totally unfair.
- The zero-rating was abolished in March 2011, however, after protracted negotiation with the stakeholders an intermediary system of sales tax was instituted through SRO 283.
- Under that system, sales tax without input adjustment was levied on supplies to unregistered person at the rate of 4 and 6 percent for yarn and other products respectively. This was a practical arrangement; there are certain shortcomings in the SRO which need to be corrected.
- In the budget documents, it has been stated that sales tax at the rate of 5% (without adjustment of input tax) may be introduced on certain products. In the budget document, there is no reference to that issue which effectively means that SRO 283 is still applicable.

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## **EXPORT ORIENTED SECTORS (2)**

- It is recommended that:
  - a) Extra-cautious approach be adopted with regards to sales tax on export oriented sectors;
  - b) It has been observed that the objective of SRO 283 being recovery of taxes on local supplies is not being made. That inefficiency needs to be removed otherwise system will fail.
  - c) The objective of the scheme was to ensure 'Registration' of persons involved in this sector. That objective has to be assured.



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## **INDIRECT TAXES ON CAPITAL GOODS – PLANT AND MACHINERY (1)**

- Sales Tax on Capital Goods is an important subject that needs to be examined in its complete context. Under the complete VAT regime, in principle, tax on capital goods is not against investment as all tax paid on capital goods is claimable against output tax. By virtue of this provision input tax for capital goods industries' effectively becomes admissible. This proposition, in practical sense, becomes impracticable for the following reasons:
  - A substantial part of our industries including major export sectors are not subject to full VAT regime, therefore, input tax on capital goods is not adjustable. It effectively becomes a cost;
  - A substantial portion of service sector industries are not subject to VAT, therefore, input becomes unadjustable;
  - Notwithstanding the same, even if input tax on capital goods becomes refundable, because of defects in the system, substantial amount of funds are struck up;



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## **INDIRECT TAXES ON CAPITAL GOODS – PLANT AND MACHINERY (2)**

- In the interim measures announced in March, 2011 exemption of tax on capital goods was removed. In the Finance Act, 2011 amendments have been made in Section 8B of the Act to facilitate the immediate allowability of input tax or refund.
- There is a need to examine the issue in totality. At the moment, this measure is inflationary in nature. In the meantime, it is suggested that exemption for capital goods be retained after proper evaluation of the case.



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## **FEDERAL EXCISE DUTY**

- In concept, excise are levied to curb consumption. In Pakistan, this tax is used for revenue collection. The policy to remove all Excise Duty over a period of time is a step in right direction.
- The second abuse of excise duty was encroachments in the right of taxation of the Provinces. This was excessively being done in the case of services like telecommunication, banking, insurance etc. Once excises will be abolished, the possibility of abuse will be minimized.



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## Transit Fee

- One of the great action undertaken in this budget is the introduction of a Transit Fee under the Custom Act. It will generate revenue and also provide some control over abuse of transit trade.
- The nation should accept the people living on the eastern side of the Durand line can not perennially suffer on account of issues on western side.

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### **SALES TAX – COERCIVE PROVISION, BLACKLISTING AND SUSPENSION OF REGISTRATION**

- A new provision has been introduced, whereby, during the period of suspension of registration, the invoices issued by such person shall not be entertained for the purposes of sales tax refund or input tax credit, and once such person is blacklisted, the refund or input tax credit claimed against the invoices issued by him, **whether prior or after such blacklisting**, shall be rejected.
- The validity of this provision with regards to retrospective application is challengeable. Such provisions effectively create an environment of harassment and coercion.

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### MAJOR STEPS NOT UNDERTAKEN (1)

- Fiscal Policy requires immediate or medium term plan for the following actions. Federal Budget does not provide road map for the same. These are:
  - a) Gradual abolition of Presumptive Tax (Direct Taxes). (*In fact the situation is reverse, whereby, companies have been placed under FTR in case of services rendered*).
  - b) Abolition of ways for whiten the Grey Money [section 111(4) of the Income Tax Ordinance, 2001].
  - c) Alignment of taxing right between Provinces and Federation with regard to sales tax and Federal Excise Duty.
  - d) Extension of sales tax to wholesalers and retailers and suppliers of services.

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### MAJOR STEPS NOT UNDERTAKEN (2)

- e) Recording and documentation of 'Assets' including agricultural assets.
- f) Taxation of trading activities in agricultural sector (Arthis etc.).
- g) Taxation of agricultural income and income from real estate trading and capital gain.

All these actions are 'inevitable' for increasing the tax base.

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## CONCLUSION AND WAY FORWARD

- There should not be 'demoralization';
- Problems are identified and curable;
- External support will not resolve the issue;
- There is no solution without increasing revenue collection by Rs 700 billion from 'Direct Taxes' from elitist and people not paying any form of direct taxes;
- Complete overhaul of Exchange Regulation, Duty Structure, Afghan Transit Trade, Under Invoicing; and
- Taxation of agricultural activities and traders, retailers and real estates.


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## WHAT DO OUR RULERS WANT! WHO IS THE RULER?


یہ راہبر  
یہ راہبر ہیں کسی کو باخبر ہونے نہیں دیں گے  
گزر جائے گی شب، لیکن سحر ہونے نہیں دیں گے  
مجھے مجبوس رکھیں گے وہ وعدوں کی فصیلوں میں  
کسی دیوار میں تعمیر در ہونے نہیں دیں گے

احمد ندیم قاسمی

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Is the beauty of this country yet to be explored?



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Thank you



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