

Agenda for tax reforms – II

Though many authors, including ourselves, have presented suggestions for reforming the existing tax system and raising taxes to the level of Rs 8 trillion at federal level and Rs 4 trillion at the provincial level - New tax model - *Business Recorder* August 28, 2015, our more-loyal-than-the-king stalwarts sitting in Ministry of Finance and FBR want "advice" and "assistance" from the IMF and the World Bank that miserably failed in the past. Their predicament can well be explained in the following couplet of great Urdu poet Mir Taqi Mir:

Mir kya sada hein beemar howe jis key sabab

usi attar key londey sey dawa letey hein

(What a simple soul is Mir; he seeks medication from the healer's boy who is the cause of his ailment).

The present tax system and policies are detrimental for economy, social justice, business and industry. Those who possess more economic power (income and wealth) should contribute more to the public exchequer and vice versa. The ability-to-pay principle is regarded as the most equitable and just method of taxation and emphasized upon primarily for its redistributive role. In Pakistan, our rulers have completely deviated from this principle, which is in fact, a constitutional obligation of the government. Political economy of tax reforms must be studied from this fundamental perspective, if some meaningful change in nation's life is desired.

Tax reforms with borrowed funds: The World Bank extended to Pakistan a \$125.9 million grant, including IDA credit of \$102.9 million, and a UK DFID grant of \$23 million, for the tax administration reform project (TARP, many sarcastically called it TRAP). The objective of the project, according to official quarters, was to improve the integrity and fairness of tax administration by improving organizational efficiency and effectiveness of the revenue administration. TARP was aimed at promoting compliance through strengthened audit and enforcement capacity and transparent as well as high quality tax services. The project was also to focus on improving trade facilitation through modern and internationally acceptable customs procedure', says an official handout.

It was a national shame that for improving the integrity and fairness of tax administration we needed such a heavy borrowing from the World Bank and other donors. Although a part of revenue collection by the FBR could have been earmarked on annual basis for this purpose, but the government was bent upon borrowing funds. It is obvious that the actual aim behind this project was to make us subservient to the agenda of foreign donors. In the name of tax reforms project, certain forces wanted to have control over our revenues and tax

machinery readily obliged them just for few tours and chances to meet the old colonial masters. This was like the re-emergence of East India Company's operations during the British raj in the subcontinent. On the one hand, our imported Prime Minister [who also retained the portfolio of Ministry of Finance] was claiming to free this nation from the clutches of IMF, and on the other was negotiating fresh loans/grants even for projects like tax reforms.

The World Bank successfully convinced the government of Pakistan that it needed substantial loan for its tax reform agenda. This reform agenda was prepared by the IMF and World Bank, and they wanted to give money to their "experts" (sic) by lending us money. The main chunk of loan went to their handpicked consultants! This modus operandi was not new; all the subjugated nations underwent this kind of exploitation at the hands of international donors. Responsibility for this kind of maltreatment and exploitation of a nation lies with its inept, incompetent and anti-people leadership that succumb before donors.

Our history of economic subjugation commenced in the 1960s when our rulers set themselves on large intakes of foreign loans. With every loan comes a host of conditions. These conditions ostensibly aim at reforms, in fact meant to subjugate a nation in complete terms, i.e., economically, politically and mentally. In recent years, our economic managers have started claiming that they are severing all ties with the IMF and other foreign donors, whereas the reality is that new loans for reforming (sic) tax, banking and justice systems-just to mention a few-are still being negotiated with unprecedented vigour to please the foreign masters.

The process of so-called tax reforms was initiated in 2000. Way back in 2001 promising "a big change of culture" in the FBR in the next 12 months, the then prime minister as a finance minister, toeing the IMF conditionalities, announced that massive tax reforms were on the cards.

He specified the following outline for intended tax reform agenda:

- Heavy investment in Information Technology (IT) to facilitate collectors.
- Massive surgery in tax system through human resource development and use of computers, which would increase efficiency and image of the department.
- Good officers would get compensation on the achievements of targets.

In 2000, while commenting on the tax reform drive (sic) launched by the Finance Minister, we made the following remarks, which are relevant even today: The tall claims made by the government about six months back that by 1st January 2001, it would introduce major tax reforms and even a new Income Tax law proved to be yet another promise not kept. The deadline has now been extended to the budget time when the Finance Ordinance will be announced. This was not something that came as a surprise to many, including myself, as most of the claims by our government are wo wada hi kya jo wafa ho gaya (promises are made not to be fulfilled). We would have been much happier if the hasty attempts to further

destroy the existing enactments and tax structures were abandoned, but it seems that some vested interests are bent upon to do so in the hope that they will get enormous money (for this poor nation it will be a loan of \$100m) from the World Bank for this vandalism. This is the most painful part of the whole exercise.

Since 2001, in the name of simplification of tax laws, the FBR is imposing more and more obligations on the citizens of Pakistan without corresponding tax rights in tax codes. The nation has been burdened with a number of more cumbersome tax terms and new enhanced obligations of withholding taxes without any compensation. This is the sordid story of tax reform in Pakistan so far. With every new round of reform comes foreign loan. More money to handpicked consultants, who hardly know anything about a pragmatic tax policy and its administration. More workshops to mercilessly squander public money. At the end of every reform programme, the nation faced more well-equipped tax dacoits who play havoc with its peace and tranquility.

The great failure of all reforms programmes is now well-documented in *The Role of Taxation in Pakistan's Revival*, edited by Jorge Martinez-Vazquez and Musharraf Rasool Cyan, and published by Oxford University Press.

Real dilemma of tax system The real dilemma of our tax system is that it is not equitable. The burden of taxes is less on the rich and more on the poor. In the face of this stark reality, the government since 1991 has been resorting to regressive taxation like presumptive taxes in income tax and turnover taxes in the shape of multi-point sales tax. Over the period of time our tax system has become rotten, oppressive, unjust and target-oriented. There is a dire need to discuss philosophical framework, principles of equity and justice that should be the main concern of our tax policy; not mere achieving of targets set out by the foreign donors. Our worthy tax managers are more concerned with meeting budget targets through presumptive tax regime which is a distortion under the direct tax legislation shifting tax incidence on consumers rather than the actual income earners.

The gulf between the poor and the rich will further widen if the present tax policies continue. We may manage to collect higher taxes but it will not serve the real purpose of redistribution of wealth which is at the core of any direct tax philosophy. On the one hand, we are not collecting taxes according to capacity to pay, and on the other, annual targets are fixed to further squeeze the already dried tax base. During the colonial era when salt tax was imposed, the visionary leaders of that time staged a revolt against such high-handedness. But now in the so-called post-independence age the IMF/World Bank imposed rulers are playing havoc with the life of the common man by levying exorbitant tax on salt and many other every-day items. It is tragic that neither the politicians nor any public-spirited NGO have agitated against this injustice.

We can collect much higher taxes if the present tax laws are rationalised and incompetent, inefficient and corrupt tax machinery is overhauled. We should liberate ourselves from the reform game of the World Bank and other foreign

donors. The tax policies implemented by us on the dictates of foreign donors have led to abject poverty for vast majority of people. These policies are not making us self-reliant but on the contrary are destroying our industry and business. If we manage to formulate a rational tax policy through public debate and parliamentary process and implement it through consensus and not coercive measures, there is every possibility to get rid of World Bank and IMF in a short span of time. However, if we continue following their prescription, we will neither realise real tax potential, nor achieve the cherished goal of self-reliance through rapid industrial growth.

Our tax revenue potential is not less than Rs 8 trillion provided that the existing tax base is made wider and equitable, tax machinery is completely overhauled and exemptions and concessions available to the privileged sections of society are withdrawn. To achieve these goals we do not need any loan from anyone. If we take money from World Bank or any other lender then we are bound to follow their conditions because beggars cannot be choosers. Many local experts can do the reform work either voluntarily or at much less cost than what may be wasted on foreign consultants at the commands of World Bank and others.

Fiscal decentralisation and municipal self-rule Taxation should essentially be linked with a social policy based on the principle of universal entitlements for all residents in terms of access to social benefits and social services. Taxation without representation also means denial of spending for the essential entitlements guaranteed in the Constitution. The principle of universal entitlements seeks to prevent the formation of inequalities and the foundation of the poor as a separate social group, whereas residualism/marginalism takes the form assisting the poor and the needy, and thus implicitly defining them as certain types of social groups.

The provincial parliaments in Pakistan should enact laws for establishment of local governments as ordained under Article 140A of the Constitution on the basis of social policy-they have so far just copied the previous outdated ones with patchwork here and there. The bureaucrats do not want to empower people through self-governance. They want to enjoy total control over resources. The local governments will not be meaningful unless entitled, within national economic policy, to have adequate financial resources of their own, of which they may dispose freely within the framework of their powers and for public welfare.

Taxes and self-reliance For achieving the goal of fiscal decentralisation, local governments' financial resources must commensurate with the responsibilities provided for by the constitution and the law to ensure welfare of the people and ensure sustainable growth at grass root level. Part of the financial resources of local authorities should derive from local taxes and spent for providing universal entitlements and development. Pakistan must follow the model of welfare states where resources available to local governments are based on a sufficiently diversified and buoyant nature to enable them to keep pace with the real evolution of the cost of carrying out their tasks.

There is no political will to implementing any rational fiscal reform agenda, though

general consensus on it exists in society. Addiction to borrowed money and lust for wasteful spending are the main stumbling blocks for achieving the cherished goal of self-reliance that can pave way for rapid growth, employment generation and substantial spending for social sectors.

The ever-widening fiscal deficit amongst many other reasons has its roots in wasteful funding of a monstrous government machinery, especially corruption-ridden-inefficient public sector enterprises (PSEs), and extending of tax-free perks and perquisites to elites. These profusely bleed the already scarce resources-both tax and non-tax.

The story of persistent failure of implementing a prudent fiscal policy in Pakistan and poor management of economic affairs is thus, not unknown or untold-it is even candidly admitted in all official documents, released from time to time, relating to taxation, public expenditures and public borrowing.

Expropriatory taxation The yearning for "more and more taxes" by successive governments-civilian and military alike-has become a source of irritation for the citizens. They argue as why to pay taxes when in return they do not even get basic amenities of life. In a true social democracy people pay taxes as their collective responsibility while the state looks after their needs. Pakistanis are subjected to exorbitant taxes as the country is caught in debt enslavement. The major reason for tax defiant behaviour is lack of trust in the government-abuse of taxpayers' money for personal comforts and luxuries by the rulers. The State has failed to protect the life and property of the people, what to talk of providing them basic needs eg health, education and civic amenities. The populist argument against paying taxes is 'why we should pay when the government cannot even ensure safety of our lives.' This scenario and narrative is paving the way for radicalisation of society. Our so-called experts have never thought of analysing this as a significant internal security threat.

Over-taxation to the extent of expropriation is Pakistan's real dilemma. Collection of unjust taxes is no answer to resolving existing maladies. Rather they add to them. Rise in internal and external debts is a security threat as economic destabilisation can lead to dismemberment of the State-as was proved in the case of erstwhile USSR. We cannot overcome challenges on political fronts, including the menaces of terrorism and militancy, unless we restructure our economy for social democracy. For this we need an all-out reforms in all institutions.

All of us should focus our attention to jobs and growth if we are to have any peace here. Yet our policymakers are tailing donors into thinking that all economics revolves around increasing tax/GDP. As if tax alone will solve all our problems."

Level of taxation in a country is traditionally judged in terms of the ratio, which taxes bear to some measure of national income. The study of tax-GDP ratio is considered important because trends in taxation in a country or group of countries are analysed mainly in terms of this ratio, and the composition of tax revenues. Are inter country comparisons of taxation levels meaningful? Some fiscal experts

have sharply criticized these attempts. According to critics, the economic, political, and institutional characteristics of individual countries are so different that neither theoretical nor empirical studies provide useful information of policy relevance. Tax-GDP ratios do not consider the fact that some countries are more favourably placed to levy and collect taxes than others. For example, Lotz and Morssan analysed a sample of 72 developed and developing countries to examine the relationship between tax ratio variations and differences in per capita income and degree of openness. The sample included a wide spectrum of dissimilar economies ranging from Nepal to Singapore. It is prima facie erroneous to compare Nepal's high rural and agricultural economy with a high commercial and industrial city-state of Singapore. Generally the tax revenue to GDP ratio in developed countries has been high and in the less developed countries low.

The root cause of our economic woes is the outlandish living style of the elites off taxpayers' money. Look at the residences of judges, generals and high-ranking civil officials with an army of servants and fleets of cars. Wasteful spending on elites and disinclination to tax the rich is playing havoc with the economy. Behind the present chaotic socio-economic and political situation in Pakistan, amongst other factors, is fiscal indiscipline.

A democratic tax system is one under which tax payments are based on the amount of benefits received from government services-the Scandinavian social democracy model is a good example to quote. In social democracies, the cost of government services are apportioned amongst individuals according to the relative benefits they enjoy. In economic terms, this is called "benefit principle" that presupposes determination of the incidence of public expenditure before deciding distribution of tax burden.

The existing tax system is a worst expression of manipulation and exploitation. A highly unjust and distorted tax base benefits the rich and mighty (exploitative elements having monopoly over economic resources) and fleeces the economically-deprived classes. There is no political will to tax the privileged classes in Pakistan. The common man is subjected to exorbitant sales tax (though standard rate is 17% but actual incidence is over 40% in many cases after applicable customs duty, regulatory duty, mandatory value addition and advance income tax). In return, a common citizen even does not get what is guaranteed by Constitution eg free education and health cover-what to speak of affordable shelter and transport. On the other hand, the mighty sections of society-monopolistic industrialists, absentee landowners, generals, judges and bureaucrats-get exemptions and concessions. The cost of tax free perks and perquisites to members of militro-judicial-civil and political elite alone is in billions-it is borne by taxpayers!

Determination of a tax base capable of measuring an individual's ability-to-pay is a major problem of our tax system. In all democracies, this rule is followed by adopting progressive rate schedule for personal income tax and property tax. In Pakistan, we have moved from this policy to unequal sacrificial rule where the mighty militro-judicial-civil complex (now an integral part of our landed

aristocracy by earning State lands as awards and rewards) and political elite are paying meagre taxes and actual incidence is shifted to the less-privileged. The businessmen are offered presumptive tax regime, even under income tax law, to pass on burden on the customers. The masses are overburdened with oppressive indirect taxes, ever rising costs of public utilities and petroleum products.

It was Louis XIV's finance minister, Jean-Baptiste Colbert, who claimed that the art of taxation was "to pluck the maximum amount of feathers from the goose with the least amount of hissing". Colbert's view was close to the truth, even in today's world, but taxation in his day was not used as an instrument to achieve a broad range of economic and social objectives. Rather, it was a tangle of practices and customs designed to finance wars, private and public works, as well as the pet schemes of the royal family-and their aristocratic hangers-on. In fact, until the 20th century, the notion of a progressive tax on income did not strike them as being virtuous. Our rulers are, however, still living in that state of mind.

In the second half of the 20th century, a number of governments in the West realised that taxation was indeed a multifaceted instrument which, if used sensibly, could help each society attain its economic and social goals. This required a delicate balance between rewarding entrepreneurship, innovation and risk-taking on the one hand, and the need to finance important public expenditures on the other, including education and social programmes, as well as the traditional public works which attracted Colbert. Not easy to do, and few countries, if any, can be fully satisfied with the balances they have struck. Pakistan, of course, is not among such countries.

There are only three main sources of tax revenue upon which government treasuries depend: income, capital and consumption. Too heavy a tax burden on any one of those will cause it to become unreliable as a source of revenue, as well as generating distortions and inequities. In some cases, it might spur tax evasion or drive part of the economy underground or in age of globalization flight of capital to tax havens. Any well-intentioned politician sees no limits to levels of taxation and redistribution. If an elected politician has the courage to tax and spend in a transparent way on his or her perceived worthy social objectives, then it must happen in the democratic way. The politician must be sanctioned or approved by the electorate to go for great revolution.

However, a government can be tempted to exercise a philosophy of social responsibility by penalising the productive sectors instead of introducing reforms which require greater political courage. Yet, in doing so, it runs the risk of undermining the economy's growth potential. Many do not believe that tax systems should be over-burdened with the social convictions of politicians. Have individuals and corporations pay their fair share of taxes, yes! Have social charges disrupt the good functioning of economies, no! Excessive and unbalanced taxation can prevent many individuals and businesses from taking full advantage of the opportunities of the new knowledge-based economies.

Taxpayers (including businesses) should share the burden of protecting those who

are vulnerable as a result of change, either through well-designed social protection measures or retraining, not through excessively rigid job protection measures and inflexible labour regimes that penalise productivity. That is why a fair and transparent tax system is so essential for maximising economic growth. In this regards, a detailed study [Towards Flat, Low-rate, Broad and Predictable Taxes, Islamabad: PRIME Institute, April 2016] is available that can be debated publically to find a workable tax model for Pakistan. Politicians must have the courage to achieve a sensible balance between income, capital and consumption taxes. And they must also have the courage to spend, not on ill-designed social programmes introduced more to collect votes than social returns, but on important investments in creating human capital, eg, education, training and health, and necessary public infrastructure to increase the productivity of the economy.

It is by no means an easy task in Pakistan. But one expects the public is increasingly suspicious of political motivations and better informed about the impacts of undisciplined public finance. At least, one hopes so! We must all do better. Independent observers should monitor tax data and survey the costs and benefits of various approaches to taxation that have been adopted, changed, abandoned and reinvented over many years; experts should give frank advice on reform and best practice, and help the government reach consensus on tax matters. Politicians listen to them. They should explore new challenges, such as the taxation of e-commerce, the problems of harmful tax competition and transfer pricing within large corporations. Simply put, the government must unshackle the constituent elements of economic growth by letting market forces play their respective roles. And governments must transfer the benefits of economic growth to enhance social well-being and cohesion through transparent and well-designed taxation. If the paradigm could be made to work, then Colbert's geese would barely hiss at all!!

Tax policy should be aimed at achieving the cherished goal of distributive justice. The government should launch programmes, financed mainly through taxes, to solve the twin problems of unemployment and poverty. These welfare-oriented schemes may also include subsidised/free medical and educational facilities, low-cost housing, and drinking water facilities in rural areas, land improvement schemes, and employment guarantee programmes. Once people see the tangible benefits of the taxes paid, there will be better response to tax compliance. Taxes cannot be collected through harsh measures and irrational policies. The government must demonstrate by its action to the taxpayers that money collected from them is being spent for collective welfare.

Taxes for growth and prosperity One of the main tools of tax policy is to increase the level of savings and capital formation in the private sector partly for borrowing by the government and partly for enhancing investment resources within the private sector for economic development. On the contrary, Pakistani economic managers have not only failed to achieve this goal, they are ruthlessly taxing capital gains arising out of immovable property and shares to destroy creation of capital and incentives for investment that can boost growth. Tax is a

byproduct of growth. With more growth we would have more taxes. The prevalent anti-growth taxes are the real cause of retarded economic growth, burgeoning fiscal deficit and insurmountable debt burden.

Recent years have experienced closure of large industries and stagnation in growth. Besides inefficiency, corruption and incompetence of Federal Board of Revenue (FBR), inconsistent, illogical, burdensome, complicated and expropriatory tax policies have forced the business community to search for safer havens abroad, depriving the country of invaluable capital. Similarly, foreign investors are reluctant to avail the tremendous Pakistani talent that goes to waste for lack of proper funding.

Economic challenges faced by Pakistan are multiple and grim-we are trapped in a deadly debt trap, but there is no will on the part of the rulers to come out of it. They are least pushed to accelerate growth, induce investment, stop wastage of resources and tap the real tax potential. Continuous surge in wasteful and unproductive expenses is no cause for concern. Rather, the entire emphasis on daily basis is on "more" (sic) taxes. Our total debt at present is about 68% of GDP which is increasing due to sheer callousness of our rulers. The last government during its tenure added Rs 6.3 trillion to our debt burden-an increase of 103% while the record of the present government is equally appalling. It has been borrowing heavily to pay earlier debts and bridging the fiscal gap-pushing debt servicing alone to Rs 1.5 trillion in 2015-16-nearly 68% of total revenue collection. The reckless borrowing to bridge burgeoning fiscal deficit is estimated to cross Rs 2 trillion this year. The position of balance of payment is also worsening. Current account deficit widened by 91% in the first five months (Jul-Nov) of 2016-17, increasing to \$2.6 billion from \$1.36 billion in the same period last year, according to data released by the State Bank of Pakistan (SBP). Inward remittances and Foreign Direct Investment are also showing negative trends.

(To be continued tomorrow)

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