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Recommendation for upcoming budget



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Prepared by:

**Yasir Riaz
YP12-ICT-02**

Budget is not only an account of revenue and expenditure but it provides government's policy to address economic challenges. Main objectives of budget should be restoration of economic stability, reduction in inflation, employment generation, protection of poor and vulnerable sects of society and making Pakistan attractive for foreign investors.

Pakistan is facing severe economic crises in these days. Per capita income and investment rate is falling consistently whereas inflation is constantly in double digit. Tax to GDP ratio is quite low and remain 9% only. In addition, current energy crises fortifying the effects of economic crises. **Upcoming budget should address the current challenges faced by our country.**

Few recommendations are presented in this report for upcoming budget. Although, a comprehensive analysis of the situation and detailed investigations of public spending are not possible, few recommendations to increase the revenue including increase in tax net and decrease in tax evasion are presented.

1. Increase in tax net: Agriculture Income Tax:

Agriculture sector in Pakistan accounts for a quarter of the Gross Domestic Product (GDP) and provide employment to 45% of the population. But, it contributes to tax revenue hovers is only one percent.

Historically, according to Govt. of India Act 1935, tax on agriculture income was levied to provinces. Same system was adopted in Pakistan after independence. A tax on agriculture income was introduced in Finance Act 1977, but was reverted by military regime of Gen. Zia-ul-Haq. In 90s all four provinces introduced their own Agriculture Income Tax Ordinances. Following table shows different rates of agriculture land tax.

Punjab		Sindh		KP		Balochistan	
Categories	Tax in PKR	Categories	Tax in PKR	Categories	Tax in PKR	Categories	Tax in PKR
Less than 12.5 acres	Nil	Irrigated land	500	Less than 5 acres	50	Irrigated land	50
Exceeding 12.5 but less than 25 acres	150	Un-irrigated	250	Exceeding 5 but less than 12.5	72	Un-irrigated	Exempted
Exceeding 25 acres	250			Exceeding 12.5 acres	100		

Similarly tax on agriculture income also varies from province to province.

Rationales of Agriculture Income tax:

As stated earlier, tax to GDP ratio in Pakistan is minimal, and it is necessary to increase the tax net by bringing un-taxed sectors in tax net. Most important among these is agriculture sector. Secondly, rural

income in Pakistan is gradually growing and capital is transforming from urban to rural areas¹, it become necessary to bring rural income in tax net. Thirdly, exemption of agriculture income from tax is against the ground of equity. A person earning from either source, agriculture or non-agriculture, should be treated in a similar way. Fourthly, tax payers engaged in non-agriculture sectors declare their income as earned from agriculture just to avoid taxes, which increase an additional loss to economy. Last but not least, Pakistani society is highly polarized with unequal wealth distribution. 24% of the people are living below poverty line (\$1.25/day), whereas 5% people earning more than 15 million Rupees. Rich having control over 95% of the resources but contribute only 2% in tax². Most of them are landlord, who do not pay taxes and report their income as an agriculture income. Imposing progressive agriculture income tax will be a cause of reducing this gap.

Problems with proposed tax: There are many issues related to collection of Agriculture Income tax. First of all, there are already multiple taxes imposed on agriculture including taxes on land and indirect taxes on agriculture sectors. Introducing another tax will create distortion in sector. Second important issue is related to complexities in computing agriculture income. In rural economy, it is very less likely to make transaction through banks. Formulation of specific, measureable and acceptable formula to compute agriculture income is vital. Thirdly, land record is not centralized and it is easy for landlord to hide their actual landholding due to localized record. Forth, mismanagement, corruption and lack of capacity in related institutions are also a major problem.

Recommendation for enforcement and Collection:

- Imposition of indirect taxes on agriculture like tax on agriculture machinery and agriculture inputs directly affects prices of agriculture commodities and consequently affect situation of food security in the country. So it is recommended that such indirect taxes should be reduced and replaced with direct tax on agriculture income.
- A formula to compute agriculture income based upon cultivated land and average yield of the area may be adopted.
[Total yield=average yield/acre*acreage planted, taxable yield=total yield-expected HH consumption-seed for next planting, agriculture income=taxable yield*market price]
- Agriculture tax should be made progressive with exclusion of small farmers
- Land record should be centralized and computerized to ensure effectiveness of the system

2. Decrease in tax evasion:

Tax evasion by elite class of Pakistan, corruption and discrepancies in tax collection system are leading causes of budget deficit. Chairman Federal Board of Revenue admitted that in fiscal year 2011-12, tax gap (difference between potential and actual tax collection) is 69%³ whereas study of World Bank claims that it hits 79% this year which is ever highest figure in the history. Most of the politicians, landlords and

¹ Taxing Agriculture Income in Pakistan, Pildat briefing paper no. 42, 2011

² Tax on Agriculture Income, Pildat briefing paper no. 43, 2011

³ Daily Dawn, June 7, 2011.

bureaucratise are culprits of tax evasion. FBR estimated that some 0.23 million rich persons are not paying taxes. It deemed necessary to make strict laws to reduce tax evasion from Pakistan.

3. Debt servicing:

External and domestic debt burden on Pakistan is extremely onerous. Debt to GDP ratio which is an important indicator of debt management was 55.4% in fiscal year 2007 is now increased up to 60%⁴. Proportion of foreign loans and interest payment in current budget of Pakistan was fixed at 37% of total expenditure. In past, high debts were borrowed while ignoring debt servicing capacity of the country, i.e. minimal export earning and inadequate revenue generation. This results in negative tendencies in macroeconomic indicators and call for large budgetary resources for debt servicing.

A long term policy should be formulated based on debt rescheduling

4. Expenditure on Power Sector Projects

In expenditure side, priority should be given to such power sector projects which provide solution on long term basis. In past, short term and costly projects badly affect the situation, whereas delay in long run projects caused increase in cost of project.

Neelum Jhelum hydro project, which is one of the mega projects of WAPDA with 969 MW installed capacity was supposed to complete in 2012. Now cost of the project increased from Rs. 130 billion to 333 billion which is 156% increase only due to delay. In addition, government has to pay high subsidies for electricity generation. In budget 2010-11, proposed share of electricity related subsidies to total subsidies was 68% which was increased up to 86% in revised budget. In budget 2011-12, total proposed share was 89% of the total subsidies. These subsidies can be avoided in long-run by focusing on cost-effective power generation project.

5. Military Enterprises:

Almost 20% of the total budget in Pakistan is reserved for defense purpose. In addition to the defense budget, military in Pakistan is involved in business which does not recorded in defense budget and not follow the normal accountability procedures of the state. Rationales of engaging military in such business activities are to provide a system of social security for retired and serving personals and to contribute in socio-economic development of country. Four military enterprises, Fauji Foundation, Army Welfare Trust, Shaheen Foundation and Bahria Foundation, are prominent in this category. These enterprises are registered under Act 1890 and hence not audited by government prime accountability agency, Auditor General of Pakistan. Therefore, very few information regarding actual economic volume of these enterprises are available.

Involvement of military in business is rather common in modern world but its mechanics vary from country to country. In many countries like US, UK, France and South Africa, military enterprises works with the partnership of government and civilian corporate sector. But in some other countries like

⁴ Pakistan Debt Policy Statement 2011-12

Pakistan, Turkey, Myanmar and Indonesia, these enterprises work independently. The mechanism adopted in former countries is more efficient and economically proficient; it is proposed to bring these military corporations under national accountability procedures and gradually convert into government-military joint ventures.

Rationales of bringing military enterprises into national network:

- Direct involvement of military in business causes a hidden flow of public funds to private sector, which pose a burden on defense budget and to a larger extent on national budget. (Few examples: AWT leased the land transferred from GHQ to overcome the deficit. This was a public land and cannot be transferred to private firm. Similarly, it was reported that Askari Aviation used resources of Army Aviation Wing which were public property⁵)
- These enterprises get financial help and bail-out packages from military budget and government in case of facing deficit. These bail-out packages not only create a burden on national budget but also violate the rule of open market and give an extra advantage to military enterprises over other private players. (For example: AWT got bail-out packages of worth RS. 2 billion in 1997 then again a guarantee from federal government of worth RS. 2.5 billion⁶)
- Finally, lack of accountability and economic independence increase political power of military which coincide with the military's involvement into countries politics.

⁵ Auditor General of Pakistan, 2003, pp. 5-6

⁶ Inside Pakistan Military Economy, Ayesha Siddiq