

The Problem of Agricultural Taxation in West Pakistan and an Alternative Solution : A Comment

by

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In the Summer 1973 issue of the *Pakistan Development Review*, Mr. Mohammad Ghaffar Chaudhry wrote on "The Problem of Agricultural Taxation in West Pakistan and an Alternative Solution". I find myself in substantial disagreement with a lot of what Mr. Chaudhry has written. First, I would like to clarify some misconceptions that seem to exist regarding the finding of my paper "A Suggested Approach to Agricultural Taxation Policy in West Pakistan", published in the Winter 1970 issue of the *Pakistan Development Review*. Second, I would comment on Mr Chaudhry's conclusions regarding the scope for additional taxation in the agriculture sector. Finally, I would question the efficacy of the tax policy he has suggested for the future.

In his paper Mr. Chaudhry writes "this differs from Hamid's general conclusion. Depending solely on direct taxes in the two sectors [15, Pp. 422-47] he had concluded that agriculture during the sixties was undertaxed. His conclusion is inconsistent as the data (in his own Table No. 4-III) does not allow for a general statement of this kind for West Pakistan. According to his estimates during 1969-70 tax income ratio for West Pakistan agriculture was 2.3 per cent whereas the non-agricultural sector contributed 2.6 per cent of its income for the same year. With these ratios under taxation of agriculture can only be claimed under the assumption of flat tax rates but, with considerations to equity, agriculture might be over-taxed. "(1, p. 106) From this paragraph it seems that not only has Mr. Chaudhry mis-read some of the figures in my paper but has completely missed the essence of my argument. First of all, my estimates did show that, during 1969-70, the tax income ratio for West Pakistan agriculture was 2.3 per cent. However, they did not show that this ratio for the non-agricultural sector in West Pakistan was 2.6 per cent for all Pakistan (including East Pakistan) while it was 4.1 per cent for West Pakistan. Secondly, and this is the more important point, the argument that agriculture was undertaxed was not made simply on the basis of these ratios. Direct taxes were only one of three types of taxes that I discussed in some detail and my conclusions were:

- (a) "the incidence of taxation (direct, indirect and disguised) on agricultural incomes is substantially less than on non-agricultural incomes in West Pakistan";

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- (b) "In West Pakistan the ratio of agricultural taxes to agricultural income has almost halved during the last decade. Agricultural income has almost doubled while the tax receipts from direct taxes on agriculture have shown virtually no increase. This fact, coupled with the finding that the net effect of disguised taxes is negligible, if not negative, in West Pakistan, clearly indicates considerable tax potential."

"Undertaxation of agriculture sector as a whole, however, does not mean the undertaxation of those who are at or near the bottom of the income scale (or land holding). Unlike the non-agricultural income where an annual income of 6,000 rupees is exempted from income tax, there is no exemption limit for land revenue. Land revenue per cropped acre is roughly 4.2 rupees in West Pakistan (Appendix Table A-VIII). This land revenue is assessed irrespective of the size of the farm. A small holding of 5 acres pays about the same land revenue per acre as a large holding of 500 acres. In addition to this, since there is no exemption limit for small farms, the subsistence farmers have also to deal with revenue officials who make many undue exactions from them."

"It is apparent that the small farmers are in a sense overtaxed and it is the large farmers who are grossly undertaxed. From the point of view of social justice and horizontal equity, it is felt that small farmers should be exempted from paying taxes and the larger farmers should bear a progressively higher burden of taxation. The proposals developed in the subsequent section of this paper are based on this principle." [2, Pp. 430-31].

From this it can be seen that what is important in a discussion on agriculture taxation is not so much the relative burden of tax on agriculture and non-agriculture, but the inequalities within agriculture as well as elsewhere. The basic problem is to tax inequalities in income and, in my paper, I had attempted to show that a graduated land tax in the long run, comes closest to doing this. If Mr. Chaudhry had identified the problem in these terms, he would have been able to avoid the indecision reflected in his statement "Two conclusions can be drawn from the ratios in the two sectors. On the basis of a flat tax rate, agriculture was undertaxed. But if equity is to be considered where proportional or increasing progression in tax rates becomes desirable, agriculture perhaps was overtaxed relative to the non-agricultural sector". [1, p. 105]. This confusing conclusion is reached because, after skillfully dividing direct and indirect taxes on the basis of their likely incidence between the agricultural and non-agricultural sectors, Mr. Chaudhry shies away from attempting to estimate the impact of disguised taxes and the magnitude of resource transfers into or out of agriculture. The result is that the analysis is incomplete and the reader is left in a state of ambivalence regarding the conclusions to be drawn. The question remains unanswered whether agriculture is taxed more or less than the non-agricultural sector. In fact, Mr. Chaudhry himself is not clear about the inference to be drawn from his empirical analysis.

In evaluating the proposals made for improving the system of agriculture taxation, Mr. Chaudhry criticises my proposal for a progressive tax on the value of land. His first criticism is "Under the prescribed rates as suggested by Hamid [15, Pp. 422-47] a tenant cultivating 12.5 acres of land, of a land-lord

owning more than 150 acres, on a 50 per cent basis, will be subjected to more than double the rate of tax on owner operated holdings between 50-150 acres, 11 times the rate on 25-50 acre holdings and 22 times the tax on 12.5-25 acre holdings [1, Pp. 114-115]. A quotation from my proposal should clarify this issue "The owner of the land will have to pay the tax" since the tenant gets 50 per cent of the produce and the owner pays the tax on the basis of his total land values out of his share of the income [2, p. 432].

The other criticism Mr. Chaudhry makes is that "Like a proportional land tax, a graduated land tax will still be price and income inelastic" [1, p. 115]. What Mr. Chaudhry fails to appreciate is that it is desirable to make the tax income inelastic for a fixed number of years (between assessment periods) so that a strong incentive remains for farmers to improve their land and productivity though new investments and increased effort. As far as price elasticity is concerned, the problem can be tackled and I quote from my original proposal "In the period between assessments, it should be possible to adjust land values (to reflect price changes) for any area by an administrative decision based on information gathered through sample surveys. These revisions in land values could then be consolidated at the time of the decennial assessment." [2, p. 433].

Another consequence of a progressive land tax which seems to upset Mr. Chaudhry is that it would lead to a subdivision of holdings resulting in a loss of revenues. "This phenomenon is accelerated by the fact that a heavier tax on large holdings will result in the disposal of the holdings over and above the capacity of a farmer to till the land [1, p. 115]. In this connection, suffice it to say that from the point of view of income distribution and efficient utilization of land this will be most desirable.

Having brushed aside the proposals for a graduated land tax, Mr. Chaudhry suggests a proportional land tax coupled with a tax on the marketed produce. He admits that a proportional land tax would be inequitable and income and price inelastic. To make the tax system equitable, he proposes a tax on the marketed produce. An important reason for his preferring this dual system of taxes to a graduated land tax is that it will be much easier to administer.

In my opinion Mr. Chaudhry's proposal has serious defects. First of all, by coupling a marketing tax with proportional land taxes, some progression in the tax structure is introduced. The larger farmers are the ones who have a marketable surplus so they are subjected to an additional tax. But it does not make the system progressive between the different size of farmers who market their produce. Second, it may be a deterrent to the production of cash crops and an increase in the marketable surplus. Third, it is as difficult to administer a graduated land tax as a proportional land tax. The tax on marketed produce will add yet another tier to the administrative complexity surrounding agricultural taxation, create an additional source for corruption, and divert produce from the legal to the illegal markets. Fourth, it is likely to reduce the intensive margin of cultivation (i.e. increased use of labour, other inputs, and capital investments) which, incidentally, is more important than the extensive margin of cultivation. Finally, it is not clear who will bear this tax—the producer or the consumer or both. Excise duties and sales taxes are passed on the consumers;

the degree of shifting depending upon the nature of the market and the state of competition. A tax on marketed produce may well be shifted to the consumer.

REFERENCES

1. Chaudhry, M. Ghaffar, "The Problem of Agricultural Taxation in West Pakistan and an Alternative Solution" *The Pakistan Development Review* 12: 93-122 (Summer 1973).
2. Hamid, Javed, "Suggested Approach to Agricultural Taxation Policy in West Pakistan" *The Pakistan Development Review* 10: 422-447 (Winter 1970).