

***Nurturing Minds***  
***A Weekly Seminar Series to give impetus to development  
discourse and stimulate intellectual thought***

**PAKISTAN INSTITUTE OF DEVELOPMENT  
ECONOMICS**



**Topic: "Taxation Policy in Pakistan"**

**DR MUSHTAQ AHMED**

Dr Mushtaq Ahmed, during his talk on the Taxation Policy in Pakistan, will be reviewing the past and the evolutionary process of the taxation regime in Pakistan. The talk will then look at the current situation in light of the new policies; assess where we stand at the moment and what our future appears to be.

**About the Speaker...**

Dr Mushtaq Ahmed obtained his PhD degree from Indian University in the US. He worked at the IDRC, USA, as a Research Fellow. He has held prized positions in the Government of Pakistan some of which are that of Chief Economist; Economic Advisor; and Member National Tariff Commissions. Additionally he has worked as an independent consultant with many international organization such as the FAO and the World Bank.

**Date: November 23, 2006**  
**Thursday**

**Time: 11:00 am**

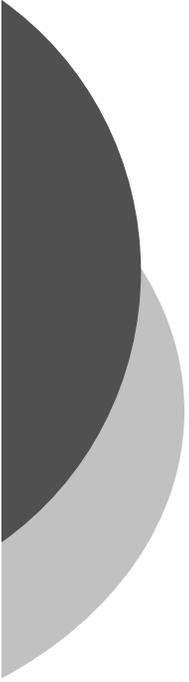
**Location Details**  
**Seminar Hall**  
**Pakistan Institute of**  
**Development Economics**  
**Quaid-e-Azam University**  
**Campus**  
**Islamabad.**

**Contact person:**  
**Amara Saeed**  
**amara@pide.org.pk**  
**amara\_saeed@yahoo.com**  
**(051) 9209393/ 9216949**

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**Your active participation will make this effort a turning point in  
the importance of intellectual contribution to our development  
processes!**

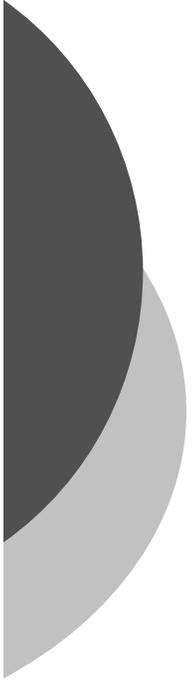
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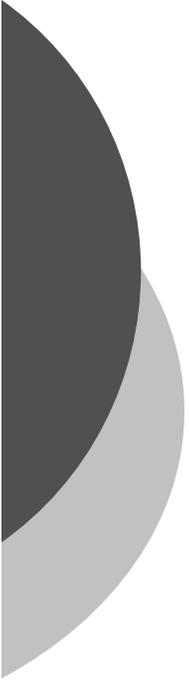


# SL-1. Current Taxation Policy In Pakistan

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- Background.
- Features of The Then Taxation Policy.
- Areas of Orientation of The Policy.
- Assessment of The Policy In Terms of:
  - The Officially Set Goal Posts.
  - Responses of the Economy To The Reformed Policy.
  - The General Norms of A Canonical Taxation Policy.





## SI-3. Domestic Economic Compulsion

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- Over Fiscal Deficit – 8.8% GDP in 1990-91.
- Low tax elasticity / buoyancy.
- High GDP Exp Elasticity.
- Snowballing Impact on Debt-Liability.
- Debt Servicing – Eat up Revenues.
- Monetary Policy.
  - Hostage to Fiscal Policy.
  - Deficit Financing – Inflation.
  - Crowding out of Private Sector.

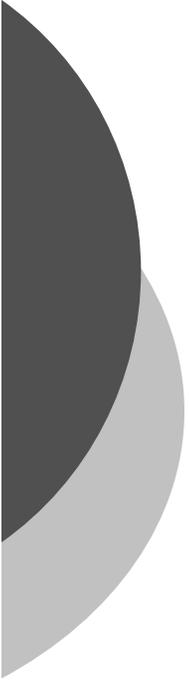
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## **SI-4. Domestic Economic Compulsion**

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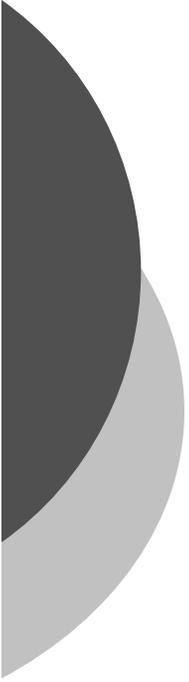
- Relative Size of Public – Private Sector.
- Intergenerational Equity in Public Borrowing Suffered.



## SI-5. International Environment

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- Launching of the Uruguay Round in 1986.
- Collapse of the Soviet Union.
- Emergence of Unipolar World.
- Shift in the Donors Attitude.
  - Tax Payers' Demand in Donor Countries.
  - Changes in Conditionalities of External Assistance.
- New Economic Philosophy – Free Market Economy.

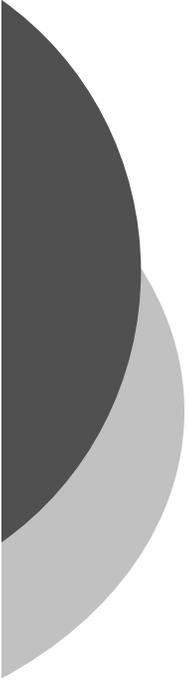


## SI-6. Features of The Then Taxation Policy

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- Heavy Reliance on Foreign Trade Based Taxes.
  - Convenience in Collections.
  - Receipts Susceptible to Fluctuations.
- So on Indirect Taxes
- Narrow Tax base- Both Direct and Indirect Taxes.
  - High Elasticity of Demand == High Chances of Tax Evasion.

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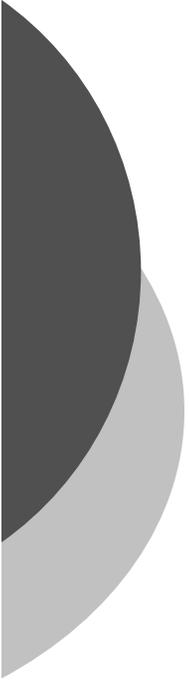


# SI-7. Features of The Then Taxation Policy

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- Multiple Tax Rate Structure => Complexity.
- High Tax Rates.
  - Smuggling.
  - Black Marketing.
- Many Exemptions and Deductions.
  - Further Erosions in Tax Base.
  - Efficiency Losses through Distortions of Deductions.
- High Compliance Cost.

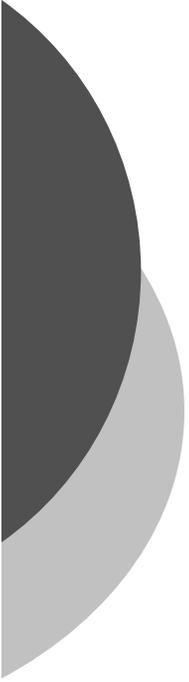


# SI-8. Features of The Then Taxation Policy

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- Large Scale Tax Evasion.
- Corruption and Inefficiency of Tax Machinery.
- Lack of Political Will to Tax.
- Excessive Centralization in Tax Collection.
- Growth of Inefficient Industries Under High Protection.

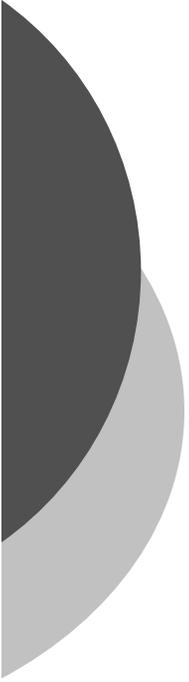


## SI-9. Areas of Orientation of Tax Policy.

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- Shift in Tax Base from Foreign Trade to Domestic Consumption (Besides the said goals, Absorption Capacity => Alexander Hypothesis).
- Expansion in Tax base.
- Lower Tax rates => The Laffer Curve.
- Simplicity in Tax Rules.

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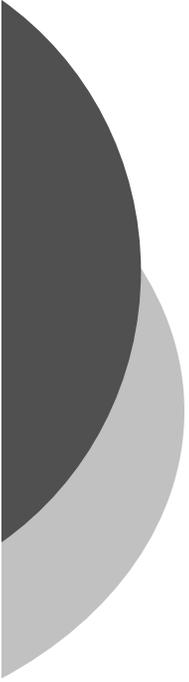


# SI-10. Areas of Orientation of Tax Policy.

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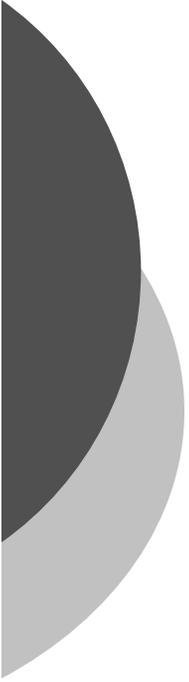
- Number of Tax Rates Reduced.
- Rationalization of Import Duties => Cascading for V.Added.
- Reduction in Exemptions and Deductions.
- Survey to Document the Economy.
- Decentralization in taxation.
- User's Charges.



## **SI-11. Evaluation of The Outcome of Orientation.**

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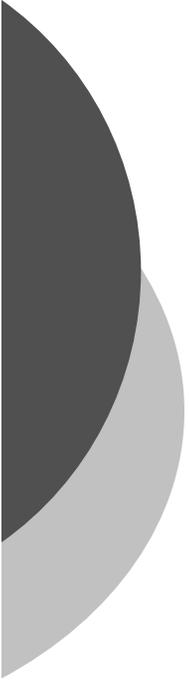
- The Planned Orientation Mostly Implemented.
  - Tax–GDP Ratio Stationary.
  - Import Duties Loss Uncompensated.
  - Tax Evasion Not Checked.
  - Political Interference Continues.
  - Lack of Interest by Admin. Machinery Due to Wage Dichotomy and Service Insecurity.
- Contd.



## **SI-12. Evaluation of The Outcome of Orientation. Contd.**

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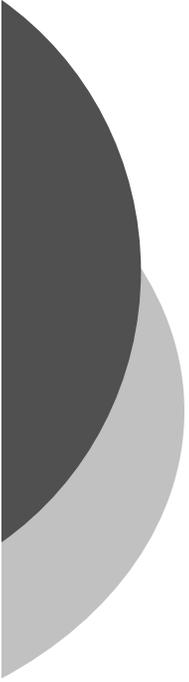
- Poor Computer Literacy.
- Concomitant Changes in the Economy.
  - L.S.Manuf. Growth Suffered and So GDP Growth.
  - Poverty Incidence Doubled.
- Why With-Holding Tax – Not Part of Planned Orientation=>Distortionary and Regressive.
- High Budgetary Borrowings=>Monetary Policy Still Hostage. Cont....



## SI-13. Evaluation of The Outcome of Orientation. Contd

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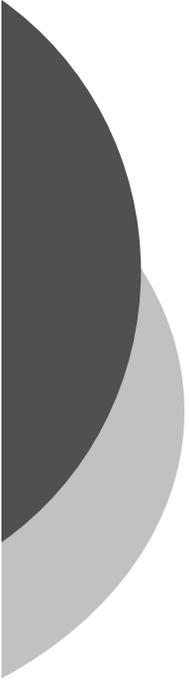
- Negation of the Norms of Canonical Tax Policy.
  - Substantial Efficiency / Welfare Loss due to Distortionary Taxes.
    - **The Ramsey Rule = Tax rates in reverse proportion to price elasticities of demand. Efficiency gains but equity loss.**
    - **The Musgrave Rule= Narrow tax base makes both demand and supply more elastic.**
    - **In partial equilibrium, efficiency loss=  $\frac{1}{2}epqt^2$ . Even when  $e$  is very small, high value of expenditure,  $pq$  matters and so  $t^2$ .**



## SI-14. Evaluation of The Outcome of Orientation. Contd

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- Why High Protection to Auto Mobile Industry While Other Industries Also Generate Employment.
- Why So High Duty on Edible Oil.
- Inequitable Sharing of Tax Burden, Vast Majority of the Poor with Inelastic Demand while Relatively Elastic Supplies.
- Equity Principle Ignored  $\leq$  Taxes Duplicated-Factors of Production and Outputs Simultaneously Taxed.
- Admin. Cost Increased.
- Public Perception of Compliance Cost Unchanged.



## SI-15. Conclusion

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- The Tax Policy Driven By High Revenue Consideration.
- Equity and Efficiency Considerations Seem ignored But Equally Important.
- Some Social Welfare Function Needs to be Defined to Determine Trade Offs Between Conflicting Implications.
- Social Welfare Function Will Help to Set a Desired Pattern of Effective Tax Rates. Tax Instruments Be Accordingly Designed.
- Why Not to Follow the Taxation Pattern of the Developed Countries-Higher Income Taxes Share and Lower That of Consumption Taxes.