The ‘Elite capture’

EDITORIAL: Former Governor State Bank of Pakistan, Salim Raza, while addressing a seminar held by the Pakistan Institute of Development Economics (PIDE) accused the private sector of living off massive subsidies, the cause of an inefficient private sector and ‘pocket of industrialisation with big gaps.

Mollycoddling the productive sectors through monetary and fiscal policies has been the hallmark of nearly all Pakistani governments which, over time, has contributed to ‘elite capture’ of all lucrative productive sectors/subsectors in industry and agriculture reflected by two elements.

First, the pervasive influence of the elite on government’s decision-making and, in the rare case of a government taking a policy decision at odds with the interests of the elite, massive protests and shutdowns that are followed by capitulation. And second, by a sustained heavy reliance on indirect taxes, whose incidence on the poor is greater than on the rich, rather than direct taxes that are based on the ability to pay principle.

The Pakistan Tehreek-e-Insaf (PTI) administration did not deviate from this basic flaw in the tax structure though an attempt was made to widen the tax base through plugging loopholes by appointing Shabbar Zaidi, a chartered accountant and senior partner of a leading firm of auditors operating in the country as Chairman Federal Board of Revenue (FBR) with firsthand knowledge of the means to avoid and/or evade taxes.

He failed to bring about reforms with explanations ranging from his ill health, to resistance of the FBR staff to reforms that he wished to undertake and lumping of these reforms with the overall reform exercise being proposed by an advisor to the prime minister. However, without doubt, another reason for his failure or his inability to override entrenched interest groups that possess the so-called ‘shutterdown power’ before which the governments buckle under.

And at the end of his short tenure, as Chairman he, like his predecessors, was compelled to focus on raising revenue, no doubt as a consequence of the agreement forged with the International Monetary Fund by the then economic team leaders, and he too began to focus on revenue generation rather than instituting the direly needed corrections through reforms in the tax structure to make it equitable, fair and non-anomalous. This resulted in the continuing reliance on the low hanging fruit.

Zaidi’s successors too have had little success and while former Prime Minister Imran Khan is on record as having stated that tax collections this year have risen markedly, yet 52 percent of all collections in the current year were from import levies, rather than domestic production where the actual value-addition takes place.

During the previous Pakistan Muslim League-Nawaz (PML-N) tenure, the then government raised direct tax collections but unfortunately from withholding taxes in the sales tax mode through widening the tax differential payable between filers and non-filers on mainly consumer items and services. One would hope that the Shehbaz Sharif-led government makes the effort to reform the tax structure.

In this context, it is relevant to note that petroleum levy is a regressive tax (as is the sales tax on petroleum and products as well as on electricity tariff) — a tax that the previous government had budgeted at 610 billion rupees for the current year but which, as per Finance Minister Miftah Ismail and his predecessor Shaukat Tarin, is simply not achievable subsequent to the 28 February relief package.

Given the serious resource constraints facing the country, it would be fair to assume that the petroleum levy is likely to be imposed again though by how much and whether the other pledges made by the previous government are likely to be phased out and therefore more acceptable to the public would depend on the technical level talks with the IMF scheduled after Eid holidays.

Pakistan needs empirical studies to determine whether the cost of the policies that has consolidated 'elite capture' in our economy in terms of subsidies and/or cheap credit and/or tax relief/exemptions has led to any significant rise in output.

Any attempt to change the existing set of incentives leads to a hue and cry followed by violent protests spearheaded by rich and powerful pressure groups. Raza during the seminar also criticised the utilisation of the otherwise laudable Temporary Economic Refinancing Facility of the State Bank of Pakistan by pointing out that bulk of it (500 billion rupees) has gone into spinning, a little less into weaving.

"So we're back to yarn and cloth…into anything that can give an edge to our textiles so they can compete against the rest of the world. Was this useful? What are we going to do with big businesses which have such an influence on how policies are made?"

One can only hope that a serious and sustained effort is made to end 'elite capture' of all major productive sectors — a time-consuming project that maybe extremely challenging during a ten plus-party coalition government. However, that is where the solution of all our major economic problems lies.