



**Webinar**  
**Brief 80:2021**

# **Fiscal Policy for Sustainable Growth and Accountable Governance : Can Pakistan Learn from China or Mexico**

---

**Pakistan Institute of Development Economics (PIDE),**  
Quaid-i-Azam University Campus,  
P.O. Box. 1091, Islamabad,  
Tel: +92-51-9248074  
Fax: +92-51-9248065





PAKISTAN INSTITUTE OF DEVELOPMENT  
ECONOMICS, ISLAMABAD

# Fiscal Policy for Sustainable Growth & Accountable Governance

“Can Pakistan learn from China or Mexico?”



**DISCUSSANT**  
**DR. MUSHARAF CYAN**

Member National Finance  
Commission representing Khyber  
Pukhtoonkhwa



**SPEAKER**  
**PROF. EHTISHAM AHMAD**

Director of a project on  
Sustainable Transitions in  
China and Mexico,  
Grantham Research Institute,  
LSE



**CHIEF GUEST**  
**SHAUKAT TARIN**

Federal Minister for Finance  
and Revenue  
Government of Pakistan

20

September, 2021

**MONDAY**

7:00 PM (PST)



To join the conversation, please visit <https://bit.ly/2Pwskh3>  
Meeting ID: **986 3023 1695** | Passcode: **381153**



PIDEIslamabad



PIDEpk



PIDEpk



PIDE Official



PIDEIslamabad

## Preamble

The Pakistan Institute of Development Economics has organized a webinar titled "Fiscal Policy for Sustainable Growth and Accountable Governance: Can Pakistan Learn from China or Mexico?" The purpose of the webinar is to discuss how Pakistan can learn from fiscal policy initiatives of China or Mexico for long-term growth and accountable governance. A distinguished set of panelists include Mr. Sahuakt Tarin, Federal Minister of Finance and Revenue, was the keynote speaker at the Webinar; Prof. Ehtisham Ahmed, Director of project on Sustainable Transitions in China and Mexico, Grantham Research Institute was the invited speaker and Dr. Musharraf Cyan, Member National Finance Commission, Representing Khyber Pukhtoonkhwa was the discussant of the webinar.

### Key Points by Shaukat Tarin:

- Pakistan need an inclusive and sustainable growth over a long period of time. The economic advisory council proposed that certain structural imbalances must be corrected if we are to grow in a sustainable manner.
- One of the structural deficiencies is a lower tax to GDP ratio, which is due to the fact that we only have three million taxpayers in a country with a population of 220 million. Aside from that, the government has inherited a slew of challenges, both on the fiscal and external fronts. The very fact is that the growth which was 5.5% was not on solid foundations.
- Government is focusing on growth on solid footings and unless we do not increase the revenues, we do not bring in fiscal discipline and will not be able to oil our economy towards growth.
- The revenue targets for this year have been increased quite steeply from around 4.7 trillion rupees to around 5.88 trillion rupees by using all kind of technology, progressive instruments, broaden the tax base and also increase penetration into the retail market. In the first two months the revenues are around 45% better than last year so we basically believe that we are on our way to achieving the 5.8 trillion rupees of revenues.
- There should be two taxes; income tax and consumption tax and then this should be done gradually over a period of time and we should remove all the other kind of taxes like withholding taxes etc.
- Government has set a target of achieving 20% tax to GDP ratio within the next seven to eight years. To achieve this target, fiscal discipline will be the key. Developmental expenditure needs to be increased and reduce our current expenditure. We need to give space to productive sectors of our economy and focus on consolidation of different sectors such as agriculture, export industry, technology.
- Government is also trying to uplift the lower strata of the society by social protection initiatives.

### Views of Invited Speaker Professor Ehtisham Ahmed

- Value added taxes are important. China and Mexico integrated value-added tax on goods and services in 2015 which reduced the cost of doing business and increase their tax to GDP ratios in fairly short period of time.
- Pakistan had faced major revenue problems at the time of independence due to lack central revenue tax collection capabilities. Tax reform is not just about revenues. It is about incentive to producers and investors. It's about distribution of income, about incorporating effects on environment and externalities and has to be consistent with investment decision and a growth strategy to create a basis for sustainable private investment.

- Models that are followed by US cannot be applied to the issues of Pakistan and China since the way institutions function in Pakistan or the way institutions function in China are very different from the way institutions function in the United States. So one has to be very careful about US centric models, they don't even work in Europe since their institutions function differently.
- What China did in 1993-94 and 2015 and what Mexico did in 2013, they used the same instruments despite the fact that their political systems were different. So, the lesson here for Pakistan is the instruments used in emerging market countries were similar despite political systems differences.
- The imposition of VAT/reformed GST was not a willing decision. It was badly designed and therefore adds to the cost of doing business and does not facilitate automatic increases in revenues.
- The tax system in Pakistan is evolved in the form of tax breaks and protection. After independence, the revenue instrument was made centralized though it was best managed and implemented at provincial and local level. This centralization laid foundation for the separation of East Pakistan.
- Under the 18<sup>th</sup> amendment, GST was split which was absolutely terrible contrary to the best practices. China and Mexico have tried to integrate VAT to provide a uniform economic base.
- Turnover tax is like shooting oneself in the foot because turnover tax has been abandoned by every country in the world and it increase the cost of doing business.
- Going after the 99% of population that does not pay the personal income tax is laudable but ineffective because most of the people in the income tax net are wage earners. It will make the system more unequal. It is best to bring into net the non-wage income people like agriculture and real estate sector which can only be done if you have data.

### **Lessons from China and Mexico**

- China started off with a pretty high tax to GDP ratio and at the end of the 1970s, it had a tax GDP ratio of 30 percent. After that China realized high taxes killed initiatives so it reduced the taxes that boosted growth. In 1980, China's Tax to GDP was 25% which dropped to 10% by 1992.
- In 1992, the Chinese government had no capability of redistribution macro policy or investment. They did not even have a tax administration and the major aim of the 1993 reforms was to create a central tax administration. A new value-added tax shared with provinces and an equalization transfer system was developed and they made sure no province lost as a result of this transformation.
- There was no individual compensation but China maintained full employment by allowing people to move as a result 800 million people came out of poverty. They integrated the business tax on services with the national VAT and they did that to reduce the cost of doing business and reduce the burden on firms. They expected the revenues would go down but it did not due to less cheating from the income taxes.
- Mexico is similar to Pakistan, there's a federal system, tax GDP ratio stuck at 10 percent since the 1990s. It was largely due to tax exemptions to attract investment.
- Mexico split the base between the income tax and the VAT. It enabled large taxpayers to hide their transactions, hide their value added which is wages and profits, hide their output and basically reduce efficiency and of course also the tax GDP ratio remained stagnant.
- To fix the problem, Mexico's government just dropped the threshold effectively to zero. The VAT integration was critical, they dropped the threshold, rationalize the corporate income tax, and abolish the minimum taxes. This situation blocked the ability to cheat.



## **Views of Dr. Musharraf Cyan**

- The splitting of the income tax and sales tax bases is an issue that must be addressed. Unless we integrate the sales tax and assign it cleanly to the federal level as we have done with the income tax, the kind of revenue measures and tax reform that we have tried will always be elusive.
- This dialogue can only take place in an environment of trust between provinces and the federal government.
- Another critical point is that detailed designs for some of our institutions have yet to be developed. NFC is one such example. NFC secretariat has no idea what technical work entails. It doesn't provide much technical support to the NFC discussions even at the provincial level. To move the discussions forward, there is a lot of political posturing and very little technical work.
- There is no need for multiple tax agencies because it adds unnecessary complexity. Instead of a federal tax agency, we can establish a national tax agency but this again would necessitate trust between provinces and the federal government.



**Prepared by**  
*Aneesa Chaudhry and Aisha Irum*

**Edited by**  
*Saima Bashir*

**Design by**  
*Afzal Balti*

🌐 [www.pide.org.pk](http://www.pide.org.pk)  
✉ [policy@pide.org.pk](mailto:policy@pide.org.pk)  
☎ 92-51-924 8051  
📠 92-51-942 8065