Fiscal Policy for Sustainable Growth and accountable governance:
Can Pakistan learn from China or Mexico?

Ehtisham Ahmad

PIDE

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Based on the author's on-going LSE Program on Financing Sustainable Urban Transitions in Developing Countries—with a focus on China and Mexico, and direct policy advice to China and Mexico since the 1990s. Work on Pakistan was initiated in 1980, with a project on Optimal taxation in Developing Countries, directed jointly with Lord Stern. Recommendations were made to the Qamar-ul Islam Tax Reform Commission in 1985. The author also was Senior Advisor for Pakistan on the IMF board in 2008-9, and the domestic resource mobilization agenda was the crux of the government's plan presented to the Friends of Pakistan and IMF in 2008.

Issues and Outline

- **Long-standing political-economy conundrums have historical roots**
  - seeds of failure in the post-independence centralization of final point sales tax and Raisman revenue-sharing award
  - Issues of assignments and financing are linked, but US-based models (e.g, underlying 18^{th} Amendment) are not adequate, especially in the post-pandemic era
- **Some theory—<u>tax reforms not just about revenues!!</u>**
  - but **incentives facing producers**, **distribution of income**, **effects on the environment/externalities**; and needs **to be <u>consistent with investment decisions and growth strategy</u>** (Ahmad and Stern, *Theory and Practice of Tax Reforms in Developing Countries,* Cambridge 1991)
  - **<u>Political economy of multilevel finance-</u>–apply positive second-generation political economy theory, not US-centric normative models** (Ahmad and Brosio, *Handbook of Fiscal Federalism*, Elgar 2006 and *Handbook of Multilevel Finance*, Elgar 2015)
  - **Own-source revenues critical for sustainable access to credit** for provincial governments and cities—essential element in building back better
- **Political economy aspects critical** (China 1993/4 and Mexico 2013—both countries had tax/GDP ratios of 10% in early 90s: different political systems but used similar instruments)
- **Options for Pakistan** within the constraints of the 18^{th} Amendment

The Pakistan context:

need for a coordinated approach to tax reforms with political economy and sustainable growth objectives

Applications of Theory of Reform (Ahmad and Stern, 1991), and Political Economy of Multilevel Finance and "Geografiscal" Federalism (Ahmad and Brosio, 2006, 2015)

Increasing Risks for Pakistan

- **Sustained failure of tax reforms over 30 years**—tax/GDP ratio fell from 14% in 1984 to under 10% in 2014, despite a VAT introduced in 1990
  - Badly-designed VAT, non-integration of goods and services adds to the cost of doing business and does not provide information on cheating and weak revenue performance (one of the lowest C-efficiency coefficients in the world)
  - **Split VAT base adds to the cost of doing business and does not facilitate overall increase in tax/GDP ratio needed for financing assigned provincial assignments**
- **Decline in basic public services and outcomes, increasing inequalities** (both inter-personal and across regions
- **Overall fiscal constraints a major problem and risk**
  - **Decentralizing full functional responsibility for education and health care without accountable financing is hugely problematic**
  - **Inadequate own-source revenues for sub-nationals reduced accountability** (limited scope of rate adjustments in GST makes it more like a shared revenue/transfer, hence not own-source for accessing credit
  - **Risks not alleviated by PPPs or private sector operations with CPEC and may magnify the problems**
  - **Global financial markets will be turbulent post-COVID, risk of increasing interest rates can be catastrophic for a country teetering on the edge of a debt-spiral**

Revenue pressures let to plenty of mistakes since Independence

- Post independence fiscal crisis—central government lacked tax functions (apart from customs) and administration
  - **Centralization of pre-independence 100% provincial final point sales tax**
    - <u>**No incentive to give up revenue base for less than what was being collected**</u>
  - **And Raisman award sowed seeds of disintegration <u>inadequate sharing/compensation:</u>**
    - 50% of net proceeds of income tax, but only 45% of shared tax to more populous East
    - 50% of net sales tax collection of sales tax on origin basis to originating province
    - 50% of excise duty on tobacco, betel nuts and tea (grown entirely in the East)
    - 62.5% share in duty on jute to the East (grown entirely in "East")
  - **Lop-sided allocation of investments to the West** (Indus basin, defense excluded) as well as definition of investments
- **Huge focus on tariffs and QR protection** for now 75-year old infant industries (Nadeem ul-Haque emphasis), mainly in the West—increasing reliance on customs revenues
- **QRs and exemptions sought by powerful interest groups, including in the GST (in excise mode, weakened by capacity schemes to raise revenues)**

When a GST/VAT has the opposite effect to what it is designed for….

- **VAT introduced in Europe is designed to reduce costs of doing business and addressing competitive disadvantages**
  - replaced mainly the turnover tax, that cascaded and to the cost of doing business and discouraged exports, and a myriad of other nuisance taxes
  - Coordinated rate structure and base made it a precondition for membership of the common market—ensuring free flow of goods and services
- **But GST/VAT never really understood by Pakistani policy makers, operated like an excise**
  - Introduced under duress by PMLN—and **implemented like an excise tax, with incidence on producers, exacerbated by capacity tax schemes** to raise revenues
  - Thus, the tendency remained to **ask for exemptions by friends and relatives of the influential, and 75-year old infants**
  - But **exemptions break the information flows in the value chain, and destroy the logic of the VAT**—which also begins to cascade
- **Tax decimated by the 2008-11 administration**—
  - **Disastrous split of the base and administration across levels of government (18th Amendment), adding to the cost of doing business**
    - Made it harder for businesses, and also did not provide an own-source revenue handle where the rate structure can be adjusted without serious effects on firms
  - **Exemptions galore**: SRO283 (2011) #185—provided blanket coverage for anything that FBR could think of in the future, destroying primacy of Parliament
  - Had no impact on revenue generation, or investment

Lots of bad advice, and political economy constraints

- **Centralizing, after Independence, a final point sales tax best managed at provincial and local levels—with inadequate and unfair "compensation"**
  - Laid the foundations for the grouse of the less influential provinces, especially the more populous East Pakistan
- **Attempting to incorporate distributional and investment "goals" in the VAT or applying "fixed or capacity pricing" to meet IMF targets in the 1990s** a huge mistake
- **2010 split of the GST worse than the 1949 centralization base hugely problematic**
  - contrary to best practice
  - China, Mexico are going in the opposite direction in order to reduce the cost of doing business, facilitate export refunds and generate a unified economic space (changing nature of the SEZs in both)
- **The FBR is incompetent, so move back to "turnover taxes**" especially for Pakistan ("third best" recommendations, Best et al., supported by IGC!!)
- **Should one fix FBR before attempting tax reforms**?? The best tax administration in the world would not do better than FBR with the policy regime currently in place
- Should GOP **pay officials according to the amount of money that each collects?**
  - *Not consistent with a functional* administration structure **institutionalizes corruption and rent seeking?**

What revenue target is needed to meet obligations and avoid a debt spiral?

- **Roughly 18% of GDP** needed for Sustainable Development Goals and anchoring Public investment for recovery from the Pandemic
  - More needed for ***security requirements*** in rough neighborhoods
  - Pakistan spending in excess of 20% of GDP (1985 target when tax/GDP ratio was almost 14%, Qamar-ul Islam, National Tax Reform Commission)
  - ***<u>10 % tax/GDP over the past three decades just not enough, leads to repeated calls on the IMF</u>***
- Going after 99% of population that does not pay income tax (PIT), **laudable, but ineffective**
  - Unrealistic to expect PIT to be main source of government revenues in emerging market economies (1.5% in China; with 21% tax GDP ratio)
  - May get 2-3% of GDP in long- run
    - with the danger of "rounding up the usual suspects",
    - destroying incentives to invest ,
    - encourage possible capital flight

- Lessons from China 1993/4 and México 2013/14 in **moving out of 10% tax/GDP trap: focus on the VAT to stop cheating, raise revenues and improve business climate**

Policy issues linked to financing sustainable growth

Consistency of tax and investment choices – key conclusions of theory of reform

- **Public investment and tax decisions, from theory of reform** (Drèze and Stern, 1987, Ahmad and Stern, 1991):
  - Impacts on firms and households in different circumstances (backward regions, women, informal settlements)
  - **Appropriate weights** on
    - Skills and labour supply **(human and social capital**), and on **natural capital-**-environment, carbon use and emissions
  - **Appropriate discount rate** (Stern and Stiglitz, 2018, 2021)
  - **Minimization of fiscal risks**, especially at the sub-national level, given political economy considerations and incentives to shift liabilities to higher levels, or future generations
- Economy wide-shadow prices (Ahmad, Coady Stern, PDR 1988)
  - with appropriate discount rate for consistent national decision making for both **investment and tax design** (basis for say national carbon tax and subnational piggy backs)
- But has to be linked to **a long-term growth strategy,** and a focus on **risk management**, including the **provision of key services at different levels of government**
  - for **basic health care, education and human capital, and typical local functions** such as clean water and sanitation; tracking tracing and support
  - Supporting **private investment and sustainable employment** in clean “hubs”, including in lagging regions,

Integration of investment and taxation strategy at different levels of government for sustainable growth

Coordinated Investment strategy:

- Appropriate weights for social, natural capital and labour
- Income distribution and employment focus
- Environmental and pollution impact
- Appropriate cost of public funds choice of discount rate

- Tax and spending assignments
- Public investment for sustainable employment
- Transparency and governance requirements
- Financial sustainability in medium-term

Improvement of local public service delivery and infrastructure

- Accountability through local own-source revenues and equalization transfers
- Full information/balance sheets to access private capital/ municipal bond systems

Sustainable urban employment hubs

- National investment requires local infrastructure and public services
- Urban design and regulations matter
- Attracting private investment to ensure employment generation
- Requires a solid public fiscal basis

Coordination of policies across levels of governments and economic sectors

Multilevel finance implications

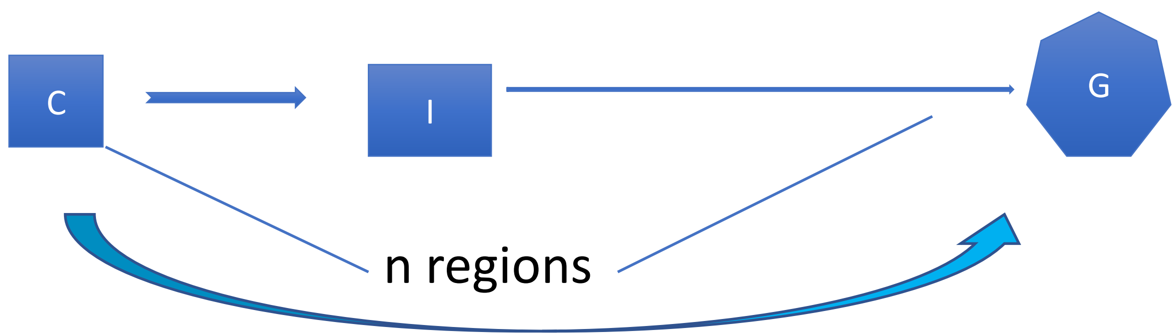
- **In light of COVID-19 (and climate change, or pandemic in slow motion)—need to reconsider assignments under different governance models:** (US, Germany, China)
  - In all cases, need for coordination of policies, including for preventive care and support, but especially financing (applies equally to education)
  - Complete separation neither feasible, nor desirable
- **Own-source revenues are critical for accountable sub-national actions**
  - This includes some control over rates at the margin, to ensure local accountability and access to private finance (Ambrosanio and Bordignon 2015, in Ahmad and Brosio (2015, *op cit*)
  - Separate subnational tax administrations are not needed (abolished in China, and do not exist in the US)
  - **Failure of US-style property taxes** in the Sub-Continent, Mexico, China—proposed alternative is a simple banding system linked to service delivery—UK examples (simulations for China and Mexico)
  - **Land value capture leads to land grabs and urban sprawl, congestion, inequality and informality**
- **Fiscal rules straight-jacket at sub-national level is problematic**, **especially with economic shocks**,
  - Can prevent desired structural change (clean cities) and addressing spatial imbalances
  - Importance of aligning both finance and incentives facing sub-national entities to prevent debt spirals and poor investment choices
- **Spatial mechanisms of urban transition come into play,**
  - Generating clean employment "hubs"—
  - Link reforming metro areas, with new compact and connected cities in lagging regions
  - to address congestion and urban sprawl in metropolitan areas, with distributional and employment concerns in lagging regions
- **Full information on transactions and buildup of liabilities;** GFSM2014-compatible balance sheets to prevent "game play" (Ahmad, Bordignon and Brosio, 2018 for the EU), especially at subnational levels

How to restructure cities for sustainable growth?

- **Reforming cities in light of the pandemic involves reversing migrant flows to major metropolitan areas, and building sustainable "employment hubs"**
- **Large metropolitan areas** need to be restructured—
  - innovative work patterns, within city transport, restructuring buildings and communal spaces,
  - Innovation zones linked to high-tech research labs and research centers, financing, support for startups and new value chains
  - preventive health clusters within metropolitan areas
  - These investments need to be financed in sustainable manner (e.g., beneficial property taxes)
  - **But sole focus on Jakarta or Mexico City, or Karachi, is self defeating—cannot absorb more migrants**
- **Regional and cross-border connectivity** necessary to reorient domestic and external value chains, but not sufficient for "leveling up"
- **Compact, clean and connected (CCC) cities strategically located outside metro areas** (Khorgos, Gwadar?) as "sustainable employment hubs", to
    - absorb workers from restructuring metropolitan areas, and
    - Generating more labour-intensive activities

Rebalancing and new BRI/CPEC value-chains

- **Effectively shortens economic distance** (G representing CPEC export hub, Gwadar)
  - Reduces economic costs in Chinese interior regions (i) (Chengdu, Urumchi, Khorgos –to EC)
  - To the benefit of both rebalanced Chinese coastal (C) and interior (I) regions
- Generates **shifts in production structure**—closer to both domestic markets/exports—but more than connectivity is needed.....



Connectivity infrastructure is necessary for reduced costs, but not sufficient to attract firms, and skills—relevant for BRI/CPEC

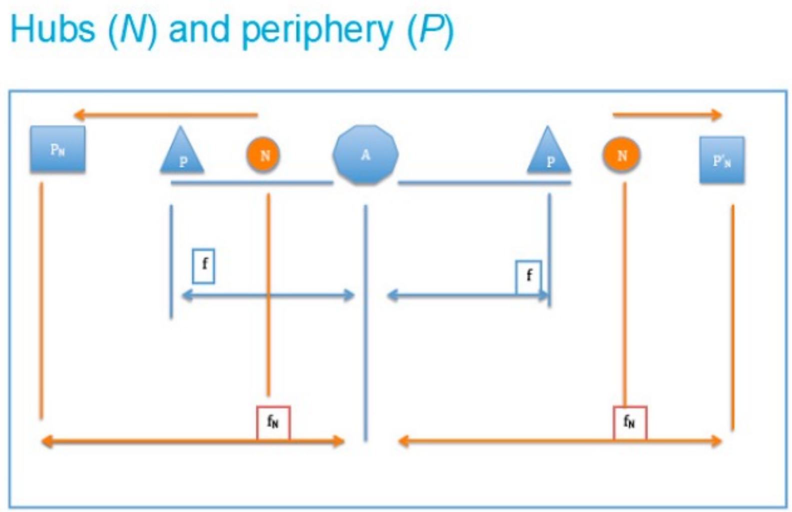


Figure 1. Sustainable hubs and "rebalancing" to the interior and the periphery.

Note: The blue figures represent the existing market structure, with A as the metropolitan areas (mainly along the coast), for production and export. P is the maximum reach with pre-reform connectivity. Infrastructure connectivity investments may create new hubs, N, that bring the excluded periphery P_N into play.

A—existing coastal hubs; new innovation zones (GBA, YRD)
P—interior hubs/ rebalancing
N—new hubs in the interior, domestic consumption and BRI—dual circulation
 # critical importance of local public services in P and N

Source: Ahmad, E., 2021. *Journal of Investment, Policy and Development.*

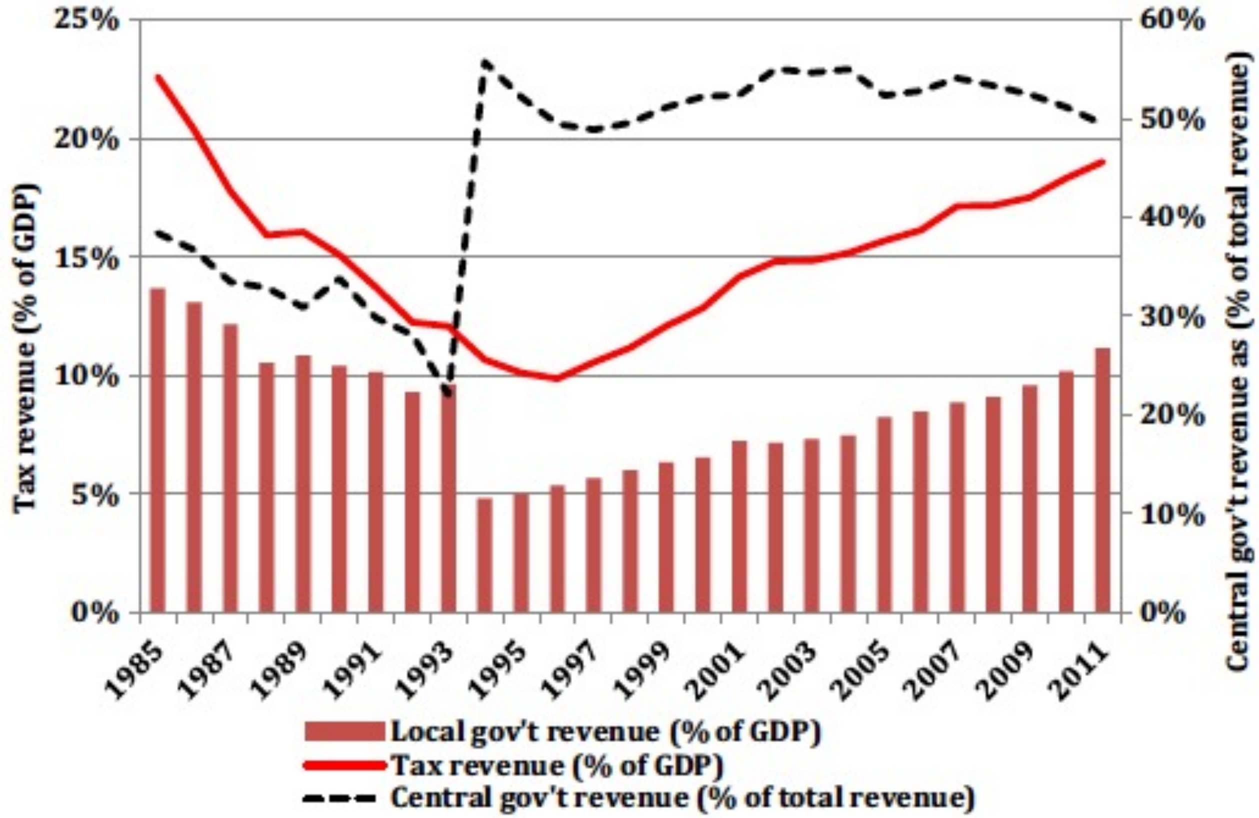
What is there to learn from China?

Political economy masterpiece in 1993/4 based on the introduction of the VAT: “hold harmless principle” to bring provinces on board and ensure that no province would lose as a result of the reforms

China: Political economy of sustained growth with 1993/4 reforms

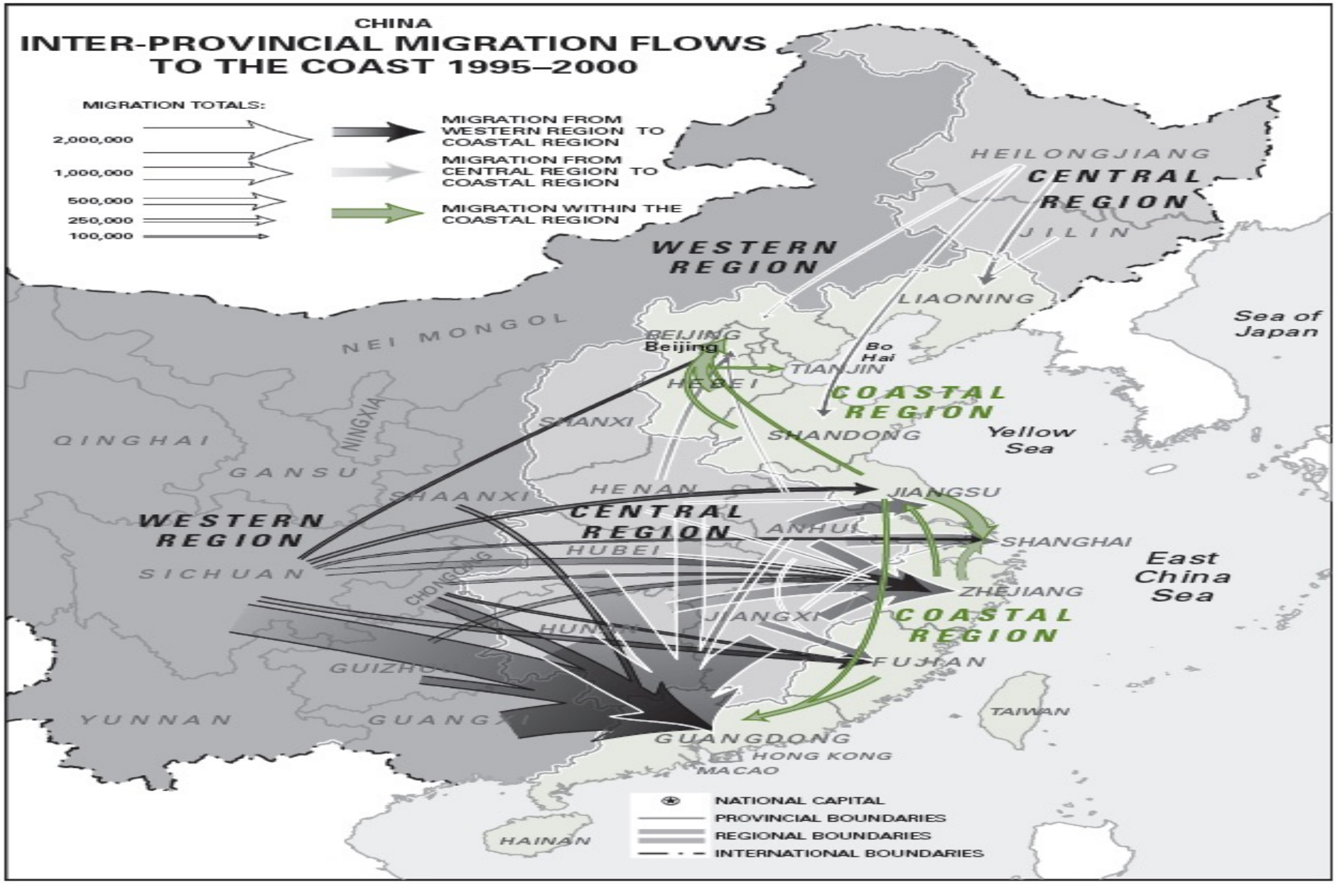
- **<u>Fiscal responsibility system entailed reducing the effective taxs to induce growth (100% on profits of SOEs)</u>**
  - **Tax/GDP ratio dropped sharply** from 25% in 1980 to 10% by 1992
  - And central share from 50% to 25%, as local governments prioritized their own spending before sharing revenues upward
  - By 1992/3 central government ability to conduct macroeconomic policy, redistribution or investment severely curtailed
- **1993/4 reforms: based on**
  - **creating a central tax administration (STA) from scratch**
  - **Functional basis and "Golden tax project" to match invoices**
  - **a new VAT, shared with provinces, and augmented by equalization transfers**
- **<u>Political economy: ensured that no province loses : stop-loss provision</u>**
  - VAT on goods to be shared with provinces on origin basis
  - Lump sum guaranteed transfer to ensure no province lost (stop-loss provision, used in Mexico's 2007 reform)
  - Revenue-share from VAT and income taxes benefitted rich provinces
  - Equalization system, provided an inducement for the poor provinces
  - **Revenue returned**: created space for investment for coastal "hubs", critical for sustained growth over the next two decades
- **Effects:**
  - No individual compensation—but maintenance of full employment
  - Major reduction in poverty (over 750m; as 150m migrated to coastal hubs)

China: 1993/4 VAT reforms—increase in tax/GDP and central share as basis for rapid growth



Source: Ahmad, Rydge and Stern, China Development Forum 2013.

China: 1993/4 reforms created the basis for major structural transformation



- 10% + growth for over two decades
- Over 750 m taken out of poverty
- But increasing congestion and pollution in coastal cities

2015 Reforms: Provincial business tax on services integrated into national VAT

- **Designed to reduce cost of doing business, offset increasing wage costs and exchange rate appreciation**
  - Remove the distortions to "enhance business climate"
  - Make it easier to remove all taxes on exports
  - Also facilitate better integration of SEZs into rest of the economy (see Shenzhen discussion below)
- Was expected to lose revenues on account of greater offsets and refunds on exports, but
- **More than compensated by reductions in leakages in other taxes** (reflecting the Mexican experience from the 2013 reforms)
- **India has tried to do the same** with the Constitutional Amendment, to maintain competitive position
  - but with 32 administrations the benefits have not materialized!!

Innovation “hubs”—Shenzhen and the GBA Silicon Valley—transforming the SEZ

- Shenzhen was created as a SEZ, given <u>an imperfect tax and institutional framework on the mainland in the 1990s</u>
  - From a small fishing village, the city has become one of the prime export regions of the world
  - But the mega metropolis has led to huge influx of workers, congestion and pollution
- **Clean growth strategy and response to the trade shocks involves**:
  - Moving the heavy and polluting industries inland to smaller and clean cities (part of the rebalancing effort) also to shift from exports to domestic consumption,
  - **Transforming Shenzhen into an innovation hub**, building on first-rate universities and highly skilled workers and the service sector
- **Changing nature of SEZ—removal of tax borders with VAT, role of BEPS Pillar 2**
  - **Facilitated by the integration of the business tax into the VAT, permitting the removal of the borders around Shenzhen to further develop linkages with other “hubs” and cities**
  - **Tax holidays to attract investment in SEZs will have to be phased out, with global minimum CIT**
- But further development of the high-tech zone (e.g., Greater Bay Area) will require a shift to a more sustainable financing model,
  - based on **effective property taxes and possibilities for additional financing** instruments, for
  - The additional **local infrastructure investments and strengthening of public services**

Need to rethink local financing model

- **Land sales/land value capture, was the main source of local finance post** 1993/4
  - Played a role in development of SEZs, Shenzhen, but
  - Has led to increasing **urban sprawl, congestion, pollution, informality** pushed to more remote areas
  - **Off-budget financing** and access to credit—**corruption and generation of liabilities of unknown magnitude**
    - As in Mexico and Spain, problems are emerging in the financial sector—is Everglade too big to fail?
- 14th Five Year Plan **endorses development of local own-source revenues to anchor sustainable growth**
- **US-type property tax experiments in Shanghai and Chongqing failed** to raise revenues
- Proposal to **develop "Marshallian" beneficial property tax system**, based on location, size, and cost of service delivery
  - Simulations for six cities to raise 2% of GDP, replace land sales—
  - also reduce inequality and provide a basis for sustainable access to private finance, including municipal bonds and PPPs
  - See Ahmad,E., M. Niu, L. Wang and M. Wang, (2020), *Beneficial Property Tax to Finance Sustainable Transitions in Chinese cities,* LSE Program on Sustainable Transitions in China

Simulations of the 2% of GDP beneficial property tax for six metropolitan areas in China

Distributional impacts Atkinson index Aj, and Gini Coefficient Gj

City	Property tax 2% GDP (Y bn)	Current Education Spending (Y bn)	Property Tax (Y)/ m^2	Initial A_1	Tax Only A_2	Tax/ Benefit Education A_3	Initial G_1	Tax Only G_2	Tax/Benefit Education G_3
Guangzhou	39.2	32.12	121.4	.60	.76	.75	**.39**	**.40**	**.39**
Shanghai	54.9	84.10	90.81	.71	.51	.50	**.40**	**.41**	**.40**
Shenyang	10.9	11.51	52.68	.63	.49	.47	**.33**	**.34**	**.33**
Wuhan	23.8	23.11	85.11	.52	.47	.46	**.33**	**.35**	**.33**
Xian	12.5	11.96	48.8	.47	.57	.49	**.35**	**.36**	**.34**
Fuzhou	12.4	15.31	54.6	.51	.89	.55	**.36**	**.37**	**.36**

Note: Gini coefficient (G) and Atkinson index (A) are two different measures of interpersonal inequality. Atkinson index is more sensitive to lower-income groups.
Source: Ahmad et al. (2020)

For decades, Mexican tax/GDP ratio stuck at 10%,

Rent-seeking and inability to fix VAT or income taxes

Political economy of 2013 reforms—offsetting gainers and losers, as in China in 1993/4—both focusing on a more effective VAT

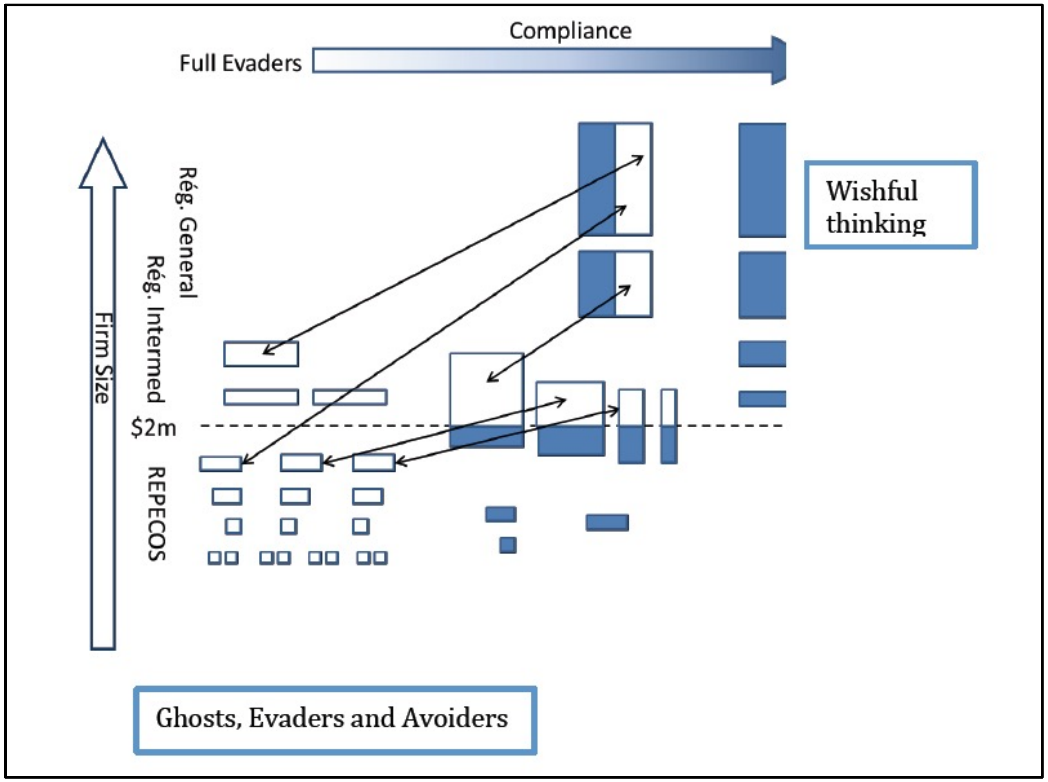
As in Pakistan, creeping erosion of tax bases in Mexico…

- As in Pakistan, a **non-competitive trading regime in Mexico was the cause for preferences and exemptions both for the income taxes and the VAT**
- And prior to NAFTA, there was considerable **emphasis on the creation of SEZs** (the maquiladoras in the border zone with the US)
  - Designed to attract US investment and provide cheap labour
  - And for the US firms to make higher profits, and keep Mexican workers in Mexico
  - Firms exempt from income tax and VAT
- **Lower VAT rates in the border regions** adjacent to the maquiladora
- Subsequent to NAFTA, Mexico lifted trade restrictions, and **the exchange rate was market-determined**
- But the preferences remained—very hard to remove once bestowed
- Successive Finance Ministers (since the late 1990s) tried to initiate reforms to fix the income tax, or others to fix the VAT
  - Because of strong vested interests, none of the reform attempts worked
  - **The non-oil tax/GDP ratio stagnated at around 10%, VAT efficiency of 25%,**
  - **Close parallels with Pakistan**

Incentives to cheat, plus ability to get away with it—gaps in information

- **Split bases for VAT and Income taxes**
- *REPECOS* (small taxpayers regime (below ~US$ 250k administered by states) provided a convenient shelter from SAT audit
  - No incentive for states to chase taxpayers, given transfer design (year end gap-filling exercise);
    - Evidence: bunching at lower end—minimum required to keep SAT at bay
    - 90% + evasion (SAT assessment)
  - convenient mechanism even for larger firms to "hide" production
- *Made worse by Maquiladoras* (Special economic zones); and lower border rates
- Progressive deductions and exemptions continue to nibble away at the "Swiss cheese" of tax base:
  1. ***Temptation effect*** (generates incentives to cheat)
  2. ***Information gaps*** (limits possibilities of offsetting cheating?)

Stopping incentives to cheat in Mexico

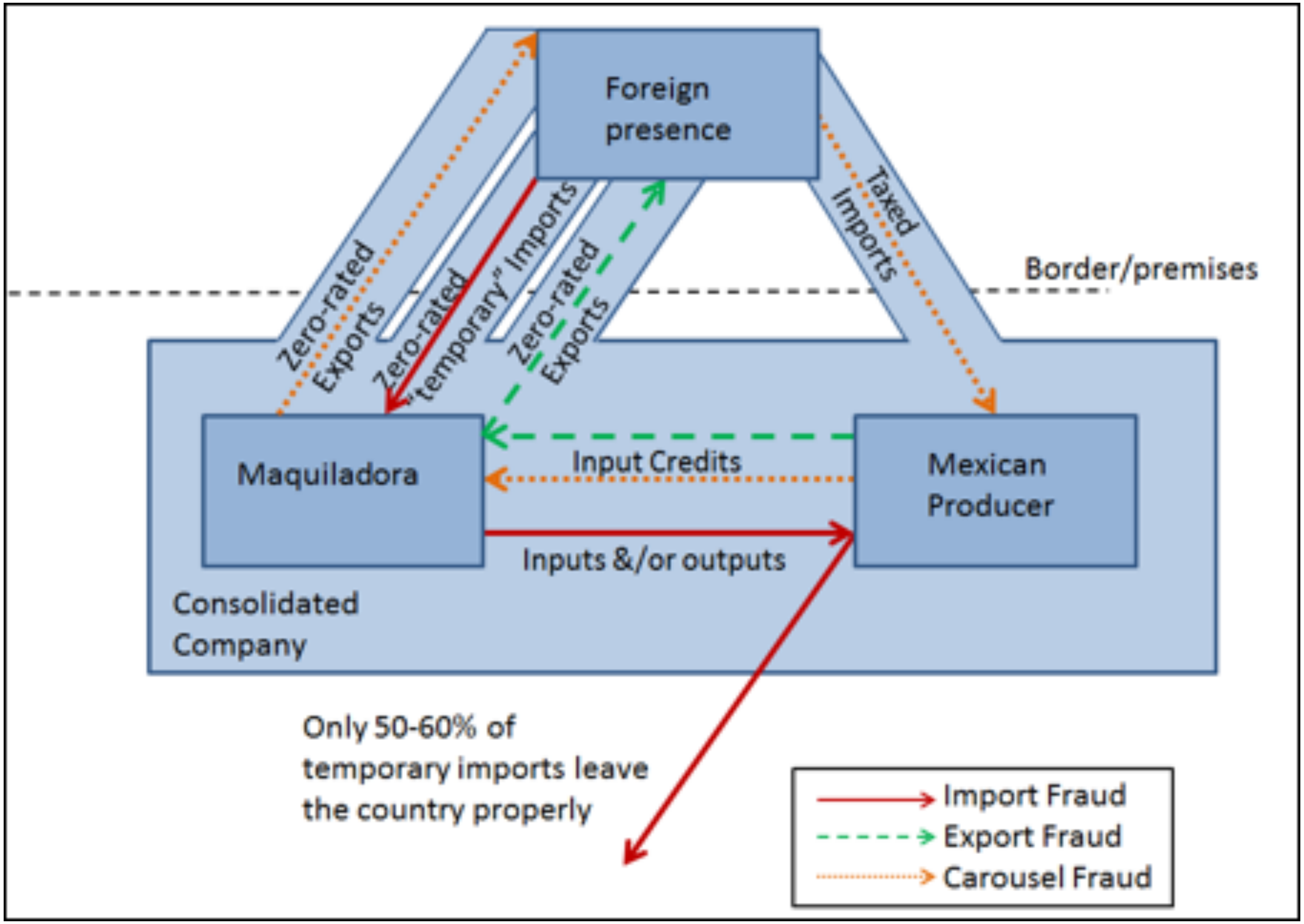


Source: Ahmad, E., 2021, "National and subnational tax reform to address informality, in *The Global Informal Workforce: Priorities for Inclusive Growth,* IMF.

Special Economic Zones add to cheating---Maquiladora sink-hole

- Firms shifted income tax liability to maquiladora subsidiary
- Carousel fraud
- Import fraud
  - VAT free goods smuggled into Mexico creating problems for domestic manufacturers
- Only lost revenues and create distortions

SEZ’s (Maquiladoras) play a role in this



VAT integration was the key to the reforms—raising the tax/GDP ratio by 4% of GDP in three years

- **Tax policy**, all the main taxes that were impossible to touch previously
  - Eliminated the special provisions in the VAT, dropped the threshold and integrated state level taxes
  - Rationalized the CIT
  - Minimum asset tax (IETU) abolished
  - Carbon tax, above a petroleum price set at world prices
  - Excises on "bads"
- **Administration:** Blocked the ability to cheat by integration the small taxpayer regime (RIF)
  - Simple cash-based accounting packages issued by SAT to taxpayers—praised by Walmart CFO in June Seminar with EC/OECD as providing linkages with US value chains
  - Must issue electronic invoices
  - Reverses the segmentation of the tax base, all firms subject to SAT audit
- **Compensation as part of "package":**
  - Reliance only on basic (social) pension (*65 y mas*) for those without occupational pension
  - CCT: *Oportunidad* not used, replaced in 2014 by *Prospera*, a program to encourage small businesses and encourage employment, **abolished in 2018 by Left wing government as it has become a poverty trap**

Turning the whole of Mexico into a Free Trade Zone.... (automotive examples)

Creation of ***new clean "hubs"*** for sustainable development

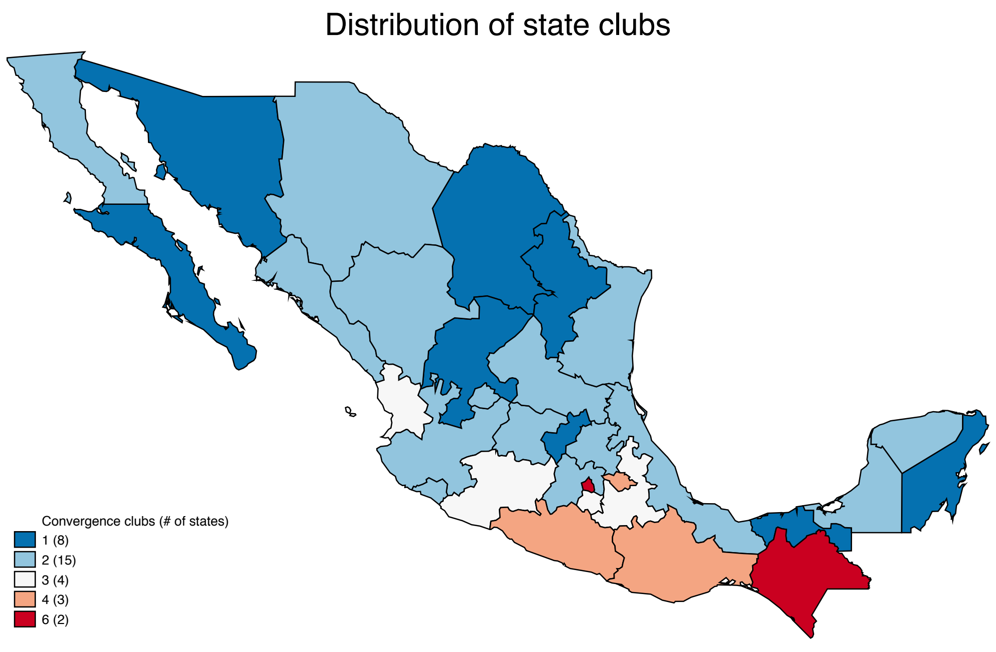
- Public investment : new airport at Querétaro
  - Small university town, attractive environment
  - Attracted Aerospace ($1.5 bn) and BMW ($1.3 bn)
  - Good local infrastructure
- **The national tax reforms leave Mexico much better prepared to take on the challenges in international trade** that it is facing
- But additional urban hubs require **state and local investment in services and smaller investments** to link to national grids
  - New government's "Tren Maya" for lagging southern provinces facing "poverty trap"
  - Abolished "Oportunidades" in 2018 (model for BISP) as it did not prevent increase in poverty (e.g., in Chiapas) and reduced work incentives
- State and local incentives remain a problem

But problems persist....increasing inequalities

- **Lagging southern states**—conditional cash transfers did not help Chiapas (negative growth) celebrated *Oportunidades* became a "poverty trap"
- Focus on improving Mexico City (CDMX)—land value capture to renovate Historical Center—merely **pushed informal sector into the periphery** (State of Mexico)
  - Dual economy models still work—people come to CDMX in search of a better life—now too big, and sinking (like Jakarta)
  - Congestion and pollution
  - Greater pressure on infrastructure and financing (collapse of line 12 in May in poor southern district
- **Focus on connectivity investment (Trèn Maya), but is that enough?**
  - Absence of own-source revenues makes it unlikely that public services can be improved in the South
  - Failure of US-type property tax: 0.2% of GDP—or not that different from Pakistan

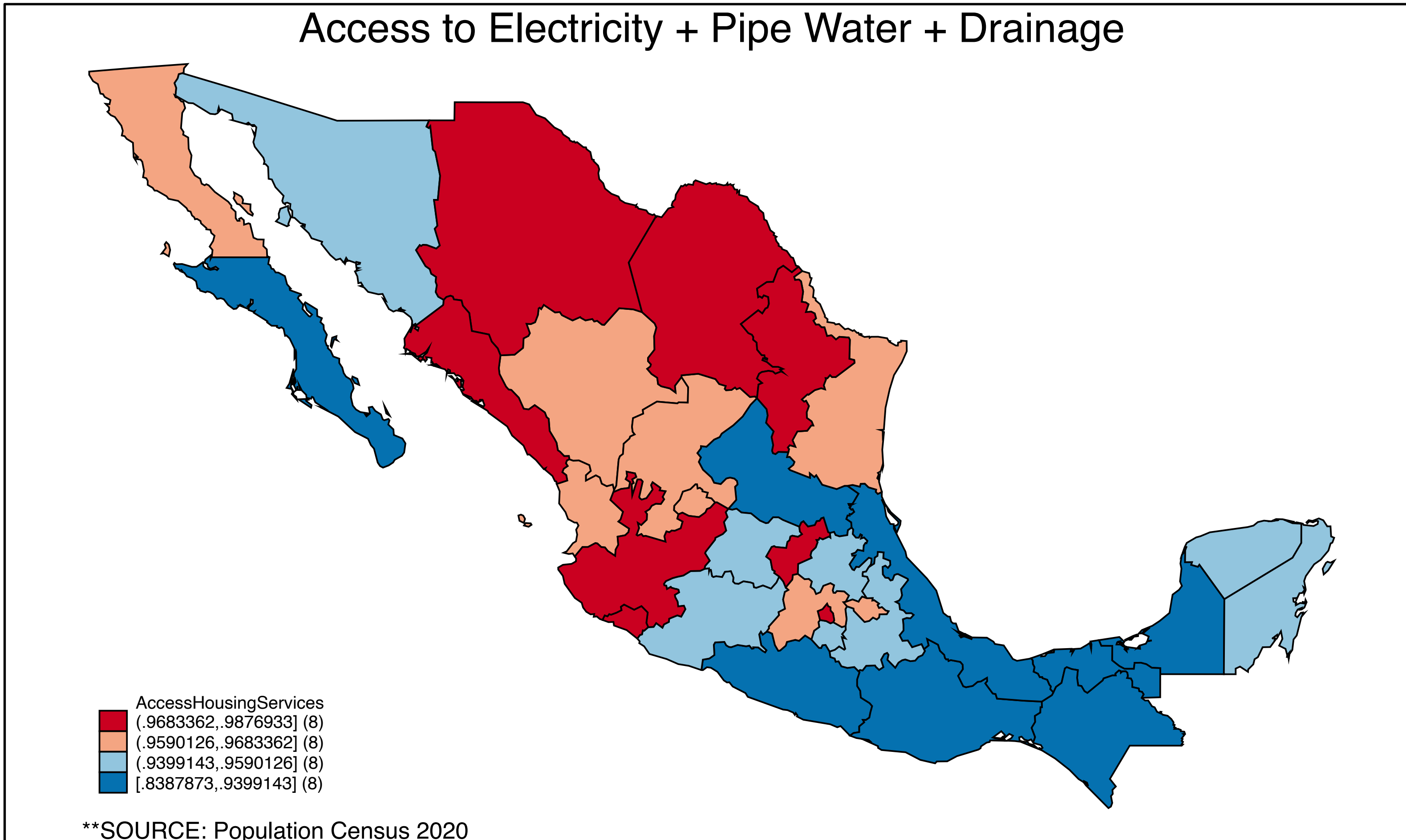
Market based growth created inequalities, with convergence in the center but South falling behind

- Finance Minister, Hererra (2019), stressed divergent trends, but robust growth in the North and around Mexico City, with negative growth in the poorest southern states
- Ahmad and Viscarra (2021) apply Phillips and Sul (2007) convergence tests
- Mexican states do not converge in the long run:
  - 4 clubs, roughly following the Northern, Central and Southern states.
- But Chiapas and Mexico City (CDMX) represent extreme inequality:
  - CDMX remains the richest part of the country by far
  - And Chiapas is the poorest, with an increasing share of the poor.



Source Ahmad and Viscarra, LSE Program on Financing Sustainable Transition in Mexico, (2021)

Disparities in public services influencing the disparities in growth and adequate employment



Policy option: Distributional impact of beneficial property tax with linkage to benefit structure

(Atkinson indices with varying inequality aversion

	ε=0.5			ε=1			ε=2		
Estados	Y1 (Y0-property tax 1,5% PIB)	Y2 (targeted)	Y2 (equal)	Y1 (Y0-predial 1,5% PIB)	Y2 (targeted)	Y2 (equal)	Y1 (Y0-property tax 1,5% PIB)	Y2 (targeted)	Y2 (equal)
Aguas Calientes	0,160	0,090	0,134	0,308	0,176	0,261	0,550	0,338	0,477
Baja California	0,215	0,154	0,188	0,373	0,255	0,325	0,598	0,375	0,515
Baja California Sur	0,219	0,132	0,208	0,382	0,244	0,367	0,590	0,420	0,576
Campeche	0,219	0,085	0,166	0,379	0,158	0,289	0,585	0,281	0,458
Coahuila	0,135	0,066	0,121	0,264	0,125	0,242	0,484	0,225	0,464
Colima	0,172	0,081	0,148	0,313	0,154	0,269	0,520	0,282	0,448
Chiapas	0,246	0,080	0,140	0,450	0,155	0,261	0,720	0,287	0,456
Chihuahua	0,158	0,078	0,133	0,301	0,142	0,250	0,531	0,241	0,437
CDMX	0,151	0,144	0,151	0,277	0,263	0,275	0,467	0,436	0,461
Durango	0,166	0,063	0,129	0,322	0,125	0,252	0,584	0,244	0,464
Guanajuato	0,154	0,091	0,116	0,289	0,162	0,219	0,517	0,271	0,395
Guerrero	0,177	0,068	0,131	0,354	0,130	0,262	0,634	0,234	0,485
Hidalgo	0,283	0,099	0,203	0,490	0,172	0,346	0,761	0,278	0,528
Jalisco	0,172	0,141	0,144	0,315	0,248	0,265	0,554	0,395	0,469
Mexico	0,182	0,157	0,139	0,344	0,289	0,265	0,604	0,480	0,476
Michoacan	0,226	0,109	0,171	0,404	0,192	0,309	0,635	0,308	0,508
Morelos	0,254	0,132	0,206	0,456	0,234	0,369	0,717	0,379	0,594
Nayarit	0,221	0,113	0,186	0,403	0,215	0,340	0,684	0,417	0,597
Nuevo Leon	0,154	0,126	0,139	0,284	0,226	0,257	0,475	0,362	0,442
Oaxaca	0,221	0,089	0,158	0,421	0,178	0,307	0,723	0,364	0,573
Puebla	0,225	0,121	0,171	0,403	0,211	0,312	0,656	0,336	0,527
Queretaro	0,203	0,104	0,166	0,374	0,193	0,307	0,657	0,350	0,546
Quintana Roo	0,149	0,070	0,132	0,278	0,138	0,250	0,472	0,269	0,441
Potosí	0,247	0,130	0,205	0,449	0,230	0,370	0,720	0,378	0,602
Sinaloa	0,188	0,075	0,155	0,351	0,140	0,292	0,583	0,246	0,494
Sonora	0,188	0,120	0,168	0,327	0,202	0,293	0,536	0,311	0,480
Tabasco	0,206	0,106	0,172	0,391	0,206	0,333	0,677	0,407	0,607
Tamaulipas	0,191	0,122	0,168	0,354	0,222	0,311	0,590	0,363	0,517
Tlaxcala	0,182	0,084	0,134	0,349	0,166	0,256	0,643	0,323	0,466
Veracruz	0,217	0,152	0,174	0,390	0,259	0,315	0,648	0,399	0,528
Yucatan	0,241	0,106	0,191	0,422	0,189	0,338	0,650	0,310	0,531

Source: Ahmad and Viscarra (2020).

Developing reform options for Pakistan

Coherent policy framework to finance sustainable growth

- **Need sustainable growth strategy,**
  - **with consistent and appropriate weights** on income distribution (across provinces as well as interpersonal) and social and human capital (workers), environment (natural capital), efficiency (firms and investors)
  - **for both public investment and tax reforms**
- **Tax breaks and fuel/energy subsidies for the rich to finance land grab and gated communities and golf courses** not sustainable over longer term
- **Ahmad-Stern recommendations on directions of tax reform**, and economy-wide shadow prices for investment, to 1985 Qamar-ul Islam National Tax Reforms Commission still largely relevant (see also Ahmad and Stern, 1991)
- **Avoid exacerbating regional tensions—ensure "stop loss provisions"**
  - Political economy of a fair sharing of resources
  - Need to be augmented by multi-level consideration of sustainable employment generation, including new "new clean, compact, hubs"
- **Rethink SEZ design** with BEPS Pillar 2 (minimum corporate income tax)—focus on agglomeration and linkages and
  - Avoid tax exemptions (provided the VAT is reformed)
  - Replace tax holidays with indefinite loss carry forward to create a level playing field over the project life cycle

Create a level playing field for investors while stopping rent-seeking and cheating in tax design

- **Steps to create single portal for GST step in right direction but**
  - Converts GST into a shared tax
  - Requires action on other taxes, in Pakistan, generate provincial "fiscal autonomy"
- **Consolidate split PIT base**
  - Plug holes and eliminate exemptions and special privileges
  - Use integrated GST information to plug holes in the income taxes
  - Piggy-back on consolidated base sufficient for provincial autonomy—do not need sub-national administration
- **Create arms-length national tax administration on agency basis, working for federation and provinces**
  - SBP model/ independent agency for all levels of government
    - Provinces represented with Federation on board of governors
  - Reporting to CCI?
- **Accountability at SNG level, through better incentive structures and information generation**
  - New **tax sharing on origin basis of whole VAT** (as in China) for provincial revenues
    - **Should yield more than just the tax on services** and enhance the ease of doing business
  - Piggy-back on the consolidated income tax for accountability,

  plus
  - **Beneficial property tax for sustainable cities** (Ahmad, 2020 Mahbub ul Haq lecture, LUMS)

Summary of tax recommendations Fiscal instruments for sustainable growth and creating an accountable local governance

- **Focus on the PIT and "rounding up the usual suspects" likely counterproductive**
- Better to **generate full information on the value chain**,
  - eliminate possibilities for cheating,
  - while reducing costs of doing business, and creating a strong economic space
- **VAT integration plays a major role, as seen in Mexico and China**
  - Take current revenues to ***16% of GDP*** (as in Mexico) if not the 20% of GDP as in China
  - Can be accommodated while respecting the 18^{th} Amendment distribution of resources
- **Piggy-back on PIT and a possible Carbon Tax desirabl**e
- In addition, the main **elements to finance the SDGs include**
  - a "land tax", and can be credited towards ***ushr*** **(+ 1% GDP, Ahmad and Stern 1991)**
  - "beneficial area-based property tax", can be credited towards ***zakat*** **(+1% to 1.5% GDP)**
  - Avoid "land grab" and unproductive enclaves
- **Create sustainable employment "hubs"**
  - Revisit SEZ design in generating employment and growth in **new urban "hubs**", and
  - better social services and income distribution in **transformed rural communities**