Expenditures in Pakistan

Tax policy plays a vital role in the economic

development of any country. All countries

PI-22-23

a <u>recent tax expenditure report</u>, the FBR has

estimated federal tax expenditures to amount

to PKR 1,482.3 billion, or 31.2 percent of the

support economic activity through the use of tax policies. Through the judicious use of taxes, governments can promote specific sectors of the economy, limit others, and redistribute wealth. Tax policy includes how taxes are imposed, in what amounts, and on whom. Typically, a tax policy specifies a tax code that applies to all economic activities along with deviations from the standard code. These deviations are called "tax expenditures" and include provisions for preferential tax rates, exemptions, deductions, allowances, rebates, deferrals, and credits. Tax expenditures are used to grant differential tax treatment to various economic activities. By their very nature, tax expenditures introduce distortions in the tax system. Preferential tax treatment for one sector

encourages investors to invest in that sector when they may not have done so without the tax incentive. For example, the real estate sector in Pakistan has attracted massive capital due to low statutory taxes (and high evasion opportunities). Tax expenditures are of importance not only for their effect on economic activity but also for their revenue implications. For Pakistan, in

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to another third on defense). The total debt is

close to 90 percent of GDP. The only

sustainable way for the government to reduce

and revenues. Pakistan's tax-to-GDP ratio

federal tax revenues in the fiscal year 2020-21, which are distributed among sales taxes (49.9 percent), income taxes (27.0 percent), and customs duties (23.1 percent). It is important to note that these estimates capture only the mechanical effect of the tax changes, i.e., they assume the economic activity or the reporting behavior of taxpayers does not change in response to the tax policy. Accounting for the behavioral effects, such as changes in economic activity or differential reporting by taxpayers, may substantially change the magnitude of the estimates. Additionally, these estimates do not consider the above-mentioned preferential treatment of capital gain taxes from real estate as expenditures. Nevertheless, these estimates highlight the importance of tax expenditures and their role in determining overall tax revenues in Pakistan. The significant revenue impact of tax expenditures requires that they be carefully evaluated and rationalized. Pakistan's government has historically lived beyond its

interest payments. Every year, the government spends more than one-third of the budget on interest payments (in addition

Pakistan consistently lies near the bottom in

terms of tax-to-GDP ratio compared to Asian

and Pacific countries. Since tax expenditures

are responsible for the loss of almost one-

third of federal revenues, it warrants that they

be rationalized for maximum economic impact

with minimal revenue loss.

1

means, leading to ballooning debts and hefty

its obligations is to reduce the size of the fiscal deficit, i.e., bridge the gap between spending

compares dismally to other countries at a similar level of development. Figure 1 shows Range Asia and Pacific % 50 -45 40 35 30

Figure 1: Tax to GDP ratios: Pakistan versus Asia-Pacific average -●- Pakisran

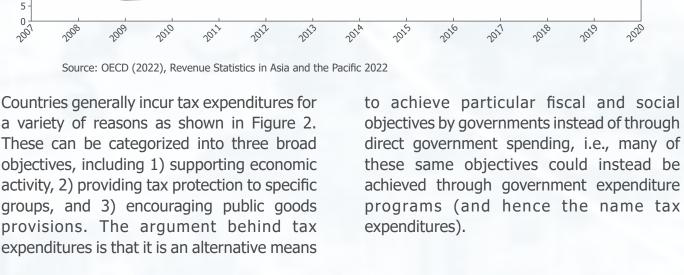
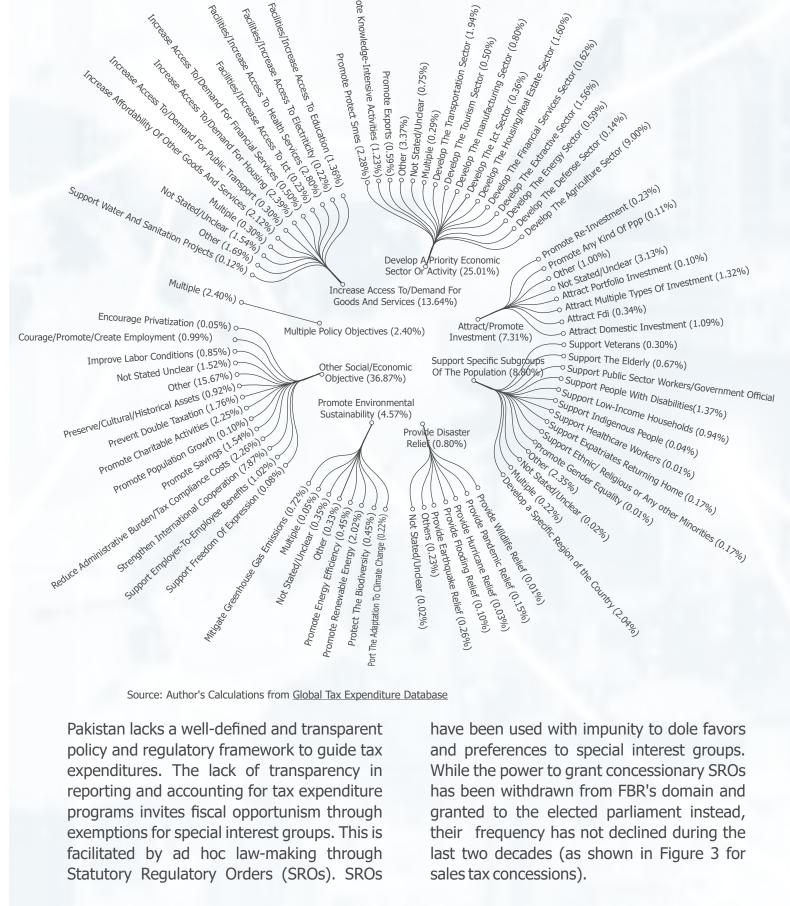


Figure 2: Stated Policy Objectives of Tax Expenditures in the World

Jnclear (0.75%)

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Source: Author's calculations using data from FBR's Sales Tax SROs

80

60

The discretionary award of tax concessions

creates an uneven playing field. However, the

overall impact on the competitive

environment, specific industries, exports, tax

revenues, and national output has not been

studied systematically. The author of this blog

Number of SROs

Figure 3: Use of Concessionary SROs by FBR for Sales Tax Sales Tax Concessionary SROs by FBR

2012 2013 2014 2015 2016 2017 2018 2019 2020

(one-third of federal tax revenues) in the

fiscal year 2020-21. Almost half of these

concessions were targeted toward sales taxes

(Figure 4), and the primary beneficiaries of

these exemptions were businesses, followed

by households (Figure 5). There is no

systematic data on the policy objectives of the

concessions. Although the publicly available

data is limited, it appears that, other than the non-profit sector, the primary beneficiaries of Examination of Pakistan's reported tax tax expenditures in Pakistan include the expenditure reveals that around 1500 automotive, retail, agriculture, telecom, and provisions in the law enabled various textile sectors. concessions amounting to PKR 1.27 trillion Figure 4: Distribution of Tax Expenditures by Taxes Tax Expenditures (in billion PKR) **Personal income** Tax, 9 Corporate income Tax,290 Sales Tax, 642

2006 2007 2008 2009 2010 2011

(with his colleagues) is already undertaking such analysis due to the support of the International Growth Center.

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Source: Author's calculations using data from Global Tax Expenditure Database

8%

Custom duties, 253

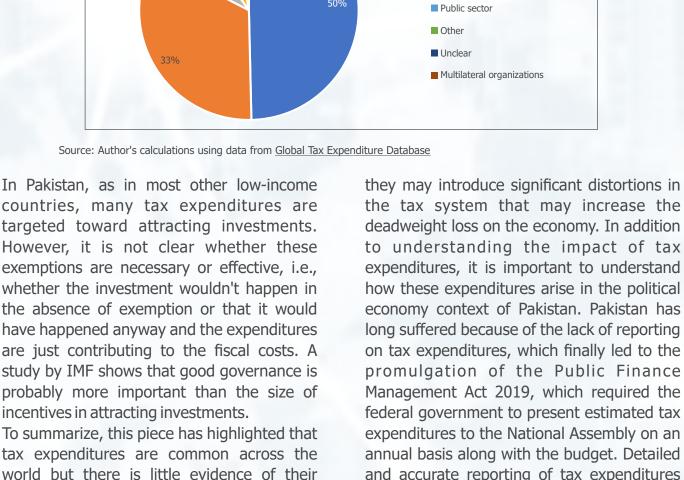
■ Businesses/Households

Non-profit organizations

Businesses

Households

Figure 5: Distribution of Tax Expenditures by Beneficiaries Tax Expenditures (in billion PKR) 2% 0% 0%



effectiveness. On the one hand, tax

expenditures can help achieve some

efficiency or distributional goals. On the other,

and accurate reporting of tax expenditures will go a long way towards ecouraging debate and improving the efficacy of these expenditures.

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