Q: There are two options with the state to increase tax collection; one, install business would result in more taxes. It would also help grow the economy. Second, increase tax ratio in order to meet the expenditures. But it would hit the business and growth badly. The government of Pakistan has opted for the latter option. Critically evaluate the budget of Pakistan in the light of above statement.

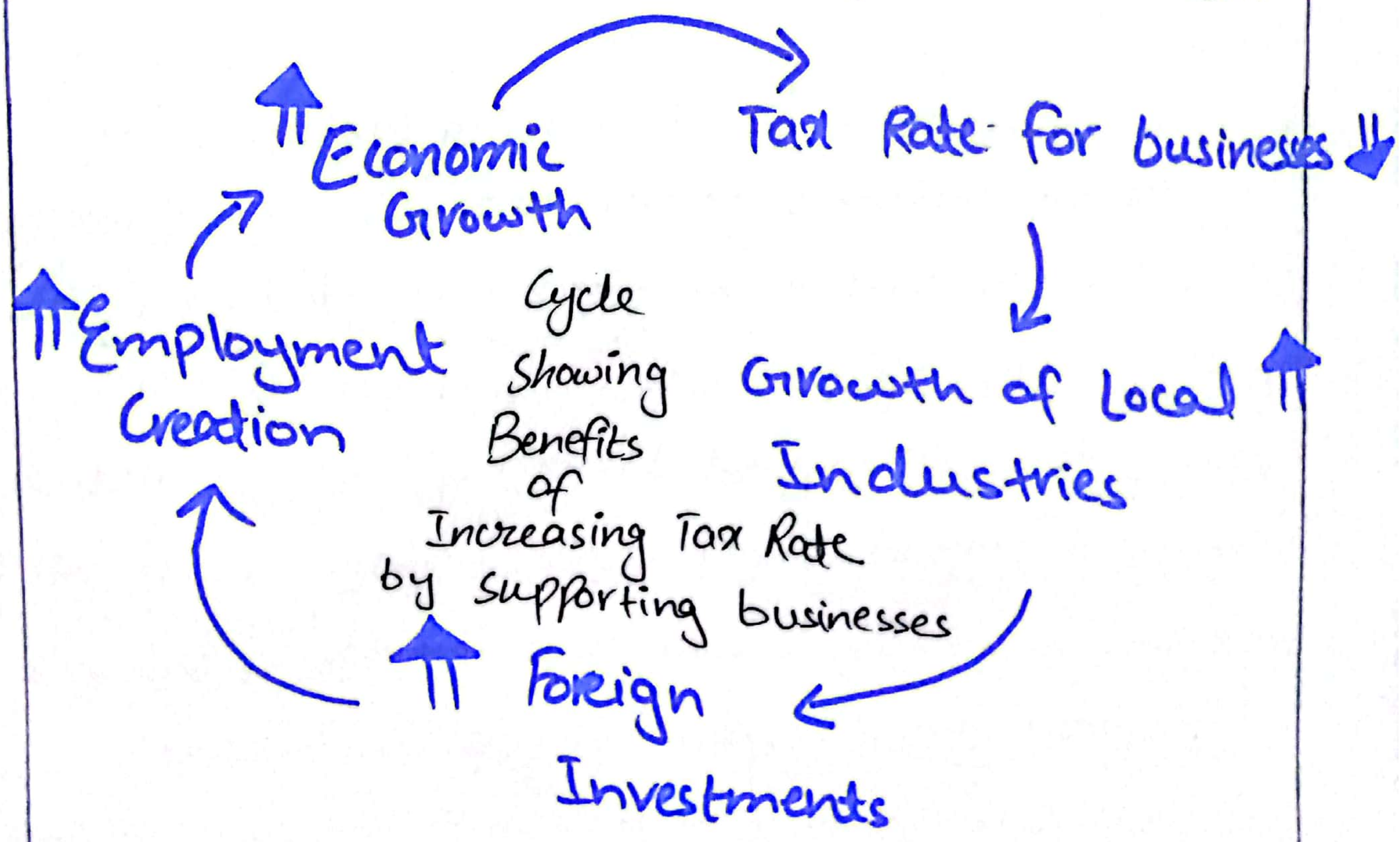
Explicating the Two Approaches for Increasing Tax Revenues

There are two approaches for increasing tax revenues which include increasing tax base by supporting business development and by increasing tax rates for meeting the expenditures. Pakistan has opted for the second option in the budget of 2024-2025 which has led the country toward devastating implications including increased poverty, increased inflation, fall of domestic businesses and local industries, balance of payment crisis, capital flight and reduction in exports. However, these repercussions can be mitigated by taking effective measures.

CamScanner

Expounding the First Approach: Increasing Tax Base By supporting Business Development

In this approach, the government reduce ~~corporate~~ tax rates for supporting business development. For instance, the government of India has reduced tax rate for domestic companies from 30% to 22% in 2023. For new manufacturing companies, this rate was set at even lower than 15% (UPSC, Tax rate of India, December 2023). This has increased India's tax revenues, for instance: in the FY 2023-24 India's gross tax collection was approximately $136.39 billion which is 13.6% increase from that of previous year collection.



Explicating the Second Approach of Increasing Tax Revenues : Increase in Tax Ratio

This approach is focussed on increasing tax rates to meet current expenditures. However, this method can stifle economic growth.

Illucidating the Increase in Tax Ratio in Pakistan in the Light of Budget of 2024–2025

The 2024-2025 budget of Pakistan has introduced several reforms showing the increase in tax ratio across various sectors.

1- **Sales Tax Reforms:**

These reforms include increase in sales tax on certain items like branded clothes and shoes are now taxed at 18% (Dawn, Sales Tax Reforms in Pakistan, July 2024).

2- **Increased FED (Federal Excise Duty) on Airline Tickets:**

The federal government has hiked the excise duty on business and club class tickets upto Rs. 350,000. (Tribune, Increased Federal Excise Duty, July 2024).

3- **Increased Petroleum Development Levy:**

The government has decided to increase the Petroleum Development Levy (PDL) by Rs. 10 per

CamScanner

liter on MS petrol and High-Speed-Diesel (HSD).

iv- **10% Surcharge on High Earners:**
The Federal government has imposed a 10% surcharge on the tax liability of high earners.

v- **Increased GST on Consumer goods:** General sales tax on consumer goods has seen a rapid surge like GST on LPG has increased from 10% to 18% (Dawn, Increased General Sales Tax (GST), July 2024).

vi- **Income Tax reforms:**
Individuals earning Rs. 600,000 annually are exempt from income tax. Others are taxed in following way.

Annual Income of Tax Payer	Tax Rate for Tax Payers
Rs. 600,000 to Rs. 1.2 million	5% of the amount exceeding Rs600,000
Rs. 1.2 million to 2.2 million	Rs. 30,000 + 15% of the amount exceeding 1.2 million
Rs. 2.2 million to 3.2 million	Rs. 180,000 + 25% of the amount exceeding 2.2 million

CamScanner

Rs. 3.2million to 4.1million	Rs4,30,000 + 30% of the amount exceeding Rs 2.2million
Above Rs 4.1million	Rs. 700,000 + 35% of amount exceeding 4.1 million

vii. Increased taxes on real estate

According to 2024-2025 budget, the filers will face 15% tax rate on the purchase and sale of property. While non-filers will be taxed at 45% tax rate (Business Recorder, Increased Taxes on real estate, July 2024). The government is aimed at generating Rs 77.11 billion after taking these measures.

IMPLICATIONS OF INCREASING TAX RATIO ON BUSINESS AND ECONOMIC GROWTH

Following are the implications of increasing tax ratio on business and economic growth of Pakistan.

CamScanner

i- Prevalence of Shell Companies

Due to increased tax ratio, number of shell companies is increasing rapidly. For instance, the Federal Board of Revenue (FBR) has reported that four shell companies accused of laundering Rs.16 billion are involving influential figures from business and political realms (Dawn, Prevalence of Shell Companies, Jan 2024).

ii- Increase in Foreign Debt

Due to increased tax ratio, the economic growth of Pakistan has slowed down rapidly. This has increased the volume of foreign debt upto $131 billion by the end of December 2023 (SBP, Pakistan's Foreign Debt, Jan 2024). Moreover, Pakistan's debt has risen by 27.2% in the first half of FY2024.

iii- Capital Flight

Increased tax rates of Pakistan has led toward capital flight. Real estate experts, tax lawyers say that poor governance, rapid currency depriciation and increased tax rates are driving Pakistanis to invest in Dubai. Dubai Unlocked Investigative Project has revealed that Pakistanis owned residential properties in Dubai worth $11 billion (Al-Jazeera, Pakistanis' Properties in Dubai, May 2024).

CS CamScanner

iv- Accumulation of Wealth in Few Hands

Poor administration of Pakistani government in increasing tax ratios has led toward accumulation of wealth in few hands. An inquiry conducted by Competition commission of Pakistan (CCP) reportedly revealed that fertilizer sector has secured a gas subsidy worth a whopping Rs.152 billion at the expense of voiceless consumers (Gas subsidy to fertilizer giants, May 2024).

v- Collapse of local Industries

Due to increasing tax ratios of Pakistan, the local industries are facing a collapse. For instance, cement sales dropped 6.81% as they remained at 3.010 million tons in July 2024 compared to 3.23 million tons in the same month of last year (Tribune, collapse of local cement industries, July 2024).

vi- Reduction in Exports

Due to collapse of local industries exports are reduced. According to PBS exports amounted to $2.56 billion in March, higher by just 8% compared to the same month of last year. On the other hand, imports saw a sharp jump to $4.7 billion in March 2024, higher by 26% compared to the same month of last year (Exports and Imports of Pakistan, April 2024).

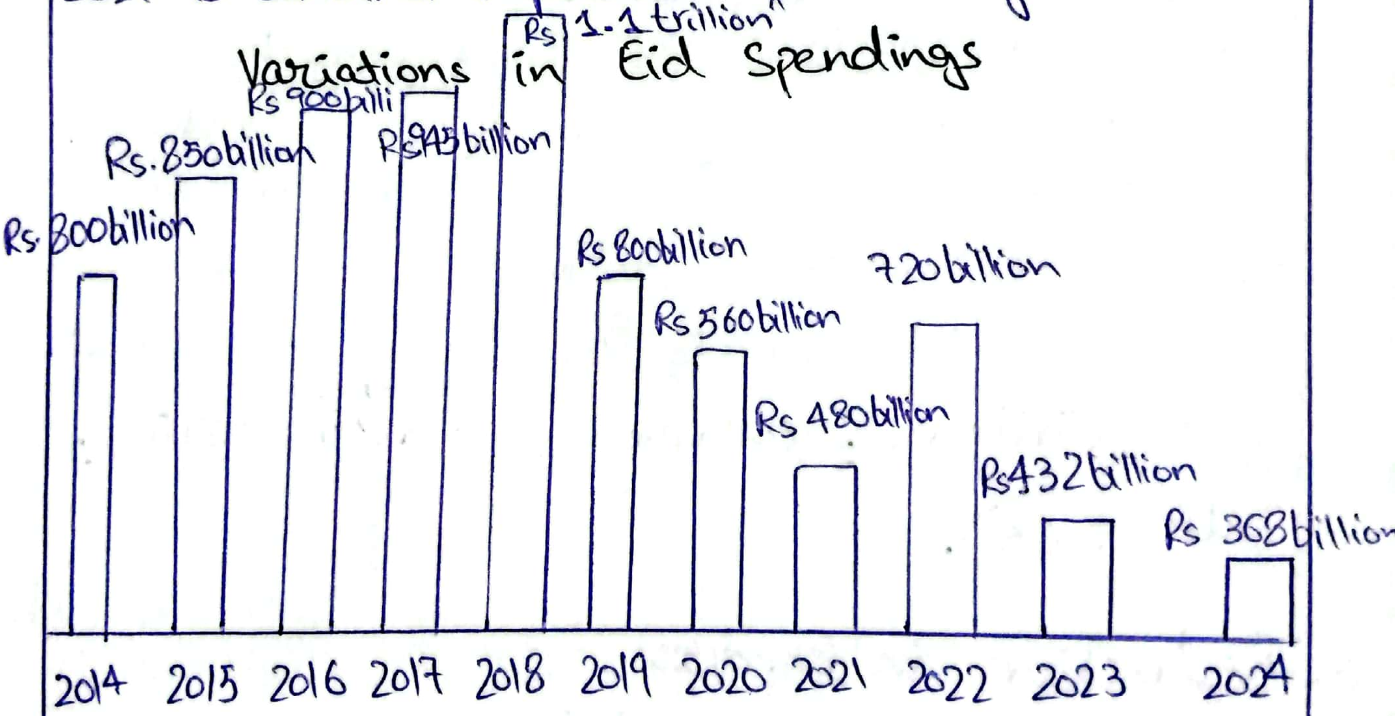
CamScanner

vii- Balance of Payment Crisis

Increased tax ratio is reducing exports and increasing imports, leading the country toward Balance of Payment crisis. For instance, steel sector saw 1.4% contraction in production during first half of FY2024 whereas imports of these goods have risen by 22% upto $2.062 billion (SBP, Balance of Payment Crisis, July 2024). This has caused "trade deficit" of $19.51 billion during FY2023-24

viii- Shrinking Middle Class

The shrinking middle class of Pakistan during 2024 is another implication of increasing tax ratios.



These variations clearly indicate that the middle class of Pakistan is shrinking rapidly.

ix- Privatization of State-Owned Enterprises

The poor economic growth of Pakistan due to increasing tax ratios has led toward privatization of state-owned enterprises. For instance, PIA has sold six consortiums which include Air Blue, Arif Habib Corporation, Blue World City, Fly Jinnah, Ethanol Consortium and YB Holdings Consortium in June 2024.

Solutions to Implement Effective Tax System

1- Improving Tax Administration

For increasing tax revenues effectively, the capacity of tax administration to prevent tax evasion should be strengthened. For instance, due to lack of proper administration tax evasion estimated around Rs. 5.8 trillion annually on the basis of FY 2023 data (Al-Jazeera, Tax evasion in Pakistan, July 2024).

2- Implementing Tax Ratios Equitably

In Pakistan, for effective tax system the tax ratios should be implemented equitably. For instance, the income generated from agriculture sector is not taxed proportionately due to political influence of powerful land-owners. That is why in budget of 2024-25

CamScanner

"Punjab has budgeted only 0.07% and Sindh only 0.02% of their budgets as agricultural income tax."

iii- Strengthening local Industries rather than giving subsidies to business tycoons

In the budget of 2024-25, Pakistani government has set a target to increase tax revenue by 46% higher than the last year. However, these taxes are merely imposed at salaried class. The federal government has increased subsidy for power sector by an escalating 103.7% – from the revised estimates of Rs584 billion for FY 2023-24 to Rs 1.190 trillion for FY 2024-25. The tax system can be corrected by strengthening local industries rather than giving subsidies to business tycoons.

iv- Reducing the Influence of Business Giants in Policy-Making of Pakistan

The tax system can be strengthened by reducing the influence of business giants in policy-making of Pakistan. For instance, the government has budgeted Rs. 406 billion in addition to the regular subsidy for electricity bills for stemming the growth of circular debt.

CamScanner

But the primary beneficiaries of this policy are the owners of IPPs not the consumers of Pakistan who are struggling with electricity tariff rate of Rs 35.5 per unit (NEPRA, Electricity Tarriff Rate, July 2024).

v. Promoting Transparency in Tax Collection System

Despite being sixth most populous country in the world, Pakistan's tax to GDP ratio of 10.3% starkly contrasts with the South Asian average of over 19%. The primary reason is that Pakistan's tax collection system prominently relies on indirect taxation with almost 60% of the annual tax collection coming from Value Added Tax (VAT) which hits the salaried class only (World Bank, Poor Tax Collection System of Pakistan, 2024). Promoting transparency in tax collection system can make this system an effective one.

vi. Increasing the Accountability of Politicians

The tax collection system of Pakistan is poor mainly because of lack of accountability of politicians in Pakistan. Tax evasion is the most common practice among politicians.

CamScanner

According to Election Act of 2017, each year before Dec 31 every parliamentarian has to submit the records of his assets. But whether it is PANAMA leaks or Dubai leaks, the politicians have also been successful in evading taxes due to lack of accountability in Pakistan. Thus, tax system of Pakistan can be strengthened by ensuring the accountability of politicians before the state.

CONCLUSION

Pakistan is troubling to revive businesses and economy, but it is impossible to do so in the presence of a non-equitable tax system which is hitting the businesses harshly. For ravitalizing the business sector of Pakistan, it is important to build a Business-friendly environment in Pakistan. However, the escalating tax ratios which are targetting only the salaried class and giving escape routes to the elite class, are making it difficult for Pakistan to revive its economy. But still economic growth can be strengthened by taking effective measures to strengthen tax system.

CamScanner