



TAX AND SUBSIDY POLICY ON INDUSTRY

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OBJECTIVES OF RESEARCH

- ❖ **Quantify and Derive Implications of Varying Incidence of Taxes/Subsidies on Industry**
- ❖ **Determine the Levels of Effective Protection to different Industries**
- ❖ **Quantify the value of export incentives**
- ❖ **Make recommendations for the rationalization of the tax regime and fiscal incentives**



SHARE OF INDUSTRY* IN GDP

(%)

Years	Industry	Share of Large-Scale Manufacturing
1980-81	22.6	49.0
1990-91	25.8	47.9
2000-01	24.0	43.6
2010-11	21.2**	57.2**
2013-14	21.3	66.0

*including mining and quarrying, manufacturing, slaughtering, construction, electricity and gas

** following the rebasing

Source: SBP | PEC

GROWTH RATE OF LARGE-SCALE MANUFACTURING

Decades / Period	(%)
80s	8.2
90s	4.8
2000s	7.1
2010-11 to 2013-14	3.7
Currently*	2.5

*July to December 2014-15

Source: PES | PBS



STRUCTURE OF LARGE-SCALE MANUFACTURING

(%)

	Share of	
	Value Added	Employment
Textiles	31.0	53.2
Food Products & Tobacco	20.2	14.1
Chemicals & Products	16.0	7.6
Non-Metallic Minerals Products	6.5	4.6
Petroleum Refining	4.7	0.4
Automobiles	4.5	2.1
Machinery	3.9	4.0
Others	13.2	14.0
Total	100.0	100.0

Source: Census of Manufacturing, 2005-06, PBS



FAST AND SLOW GROWING INDUSTRIES 2002-03 TO 2012-13

(ACGR, %)

Fast Growing (> 5%)	Slow Growing (< 5%)
Cotton Cloth (6.0%)	Cotton Yarn (4.7%)
Cement (11.1%)	Fertilizer (-0.4%)
Motor Cycles (25.4%)	Vegetable Ghee (4.0%)
Cars (6.8%)	Sugar (3.2%)
Tractors (6.7%)	Cigarettes (3.2%)
	Beverages (-1.1%)
	Chemicals (2.4%)

Source: PES



STRUCTURE OF DIFFERENT TAXES

(Rs in Billion)

	Revenue	Share (%)
Federal	2375	92.6
Direct Taxes	884	34.4
Sales Tax	1002	39.1
Excise Duty	145	5.7
Customs Duty	241	9.4
Petroleum Levy	103	4.0
Provincial	190	7.4
Total	2565	100.0

Source: MOF

INCIDENCE OF TAXES BY SECTOR

2012-13

- ❖ Incidence of all Federal and Provincial Taxes, both Direct Taxes and Indirect Taxes (%)

	Share of Tax Incidence	Share of Value Added	Tax-to-Value Added Ratio
Industry	76.4	21.3	36.7
Agriculture	2.6	25.1	1.2
Services	21.0	53.6	4.6
Total	100.0	100.0	9.60

Source: Derived

- ❖ Need to distribute the tax incidence/burden more uniformly among the sectors



STRUCTURE OF IMPORT DUTIES IN PAKISTAN

- ❖ **Maximum Normal Duty is 25%, six slabs with gap of 5%**
- ❖ **Some zero duty items subject to 1% duty in 2014-15**
- ❖ **Specific duties on edible oil**
- ❖ **Tariff Peaks: alcohol (90%); Auto parts (35%), Motor Vehicles, upto 100%**
- ❖ **Number of Import Duty SROs active is 95**
- ❖ **Regulatory Duties of 5% to 15% introduced on 313 tariff lines**
- ❖ **Number of SROs withdrawn in Budget of 2014-15**

Source: FBR



ERP OF MAJOR INDUSTRIES

(%)

Industry	ERP	Industry	ERP
Vegetable Oils	151.8	Wood Products	19.3
Food Products	121.5	Iron and Steel	11.6
Motor Vehicles	115.0	Chemicals	11.5
Dairy Products	75.0	Rubber & Plastic Products	11.3
Leather Products	68.0	Machinery	11.0
Wearing Apparel	66.7	Electrical Equipment	10.0
Textiles	57.1		
Mineral Products	26.6		
Petroleum Products	24.6		
Paper and Products	21.0		

Source: FBR



RECOMMENDATIONS ON ERP

- ❖ Reduce ERPs on Motor Vehicles, Vegetable Oils and Food Products
- ❖ Reduce ERPs on Export Oriented Industries like Textiles, Wearing Apparel and Leather
- ❖ Raise ERPs to minimum of 20%, except for machinery (to promote investment)
- ❖ Introduce Minimum Import Prices on products vulnerable to under invoicing (especially from China)



STRUCTURE OF SALES TAX ON GOODS

- ❖ **Standard rate of 17% since 2013-14**
- ❖ **Collection Efficiency is low at 32%**
- ❖ **Higher rates on telecom & POL products (recent)**
- ❖ **Exempt items from import or domestic supply include basic food items, books, stationary, medical supplies and equipment, solar energy equipment, etc.**
- ❖ **5% sales tax on imports of cotton**
- ❖ **22 items in the Third Schedule taxed on retail price. This raises the rate to between 19% and 21% on ex-factory price**



STRUCTURE OF EXCISE DUTIES

- ❖ Limited Tax Base with high tax rates
- ❖ Industries taxed include Vegetable Ghee, Concentrates for Aerated Waters, Cigarettes, Cement and LNG
- ❖ Highest Rate of 65% on cigarettes.



NOMINAL INCIDENCE OF SALES TAX + EXCISE DUTY ON CONSUMER GOODS INDUSTRIES (%)

Product	Incidence	Product	Incidence
Cigarettes	93	Pharmaceuticals	12
Sugar	7	Motor Cycles	17
Beverages	29	Biscuits	17
Tea	21	Electrical Goods	17
Food Products	17	Confectionary	17
Toilet Soap & Detergents	17	<i>POL Products*:</i>	
Processed Fabrics	3	• Motor Spirit	32
Readymade Garments	3	• HSD	47
Others Textile Products	4	• Kerosene Oil	24
		• LDO	25

❖ The incidence has become more regressive.

* Inclusive of Petroleum Levy

Source: Derived

PROBLEMS WITH SALES TAX

- ❖ There is evidence of significant over-invoicing of inputs, especially in zero-rated sectors.
- ❖ Refunds, especially to exports, not paid promptly. Currently, arrears of refunds at Rs 118 billion
- ❖ No system of audit of monthly returns. System of composite audit in IRS not introduced yet.
- ❖ Almost half of imports exempt from sales tax.
- ❖ Incomplete extension to wholesalers/distributors and retailers.
- ❖ Discussion on move to a Single-Stage Sales Tax without input tax invoicing.



SUPPORT TO INDUSTRY

- ❖ **On Consumption of electricity, subsidy of Rs 70 billion**
- ❖ **Consumption of gas, especially to the fertilizer industry, of Rs 200 billion**
- ❖ **Number of Fiscal Incentives for Investment in SEZs**
 - **Tax Holiday (10 years)**
 - **Duty Exemption on Machinery**
- ❖ **Exports Incentives**



EXPORT INCENTIVES FOR TEXTILES IN PAKISTAN

- ❖ Upto the early 90s there was a 30% export duty on cotton**
- ❖ Now, there is a low presumptive income tax of 1% on export receipts**
- ❖ Exports enjoy access to concessionary finance at 6% compared to the policy rate of 8.5%**
- ❖ Till recently, there was exemption on domestic sales, now concessionary rate**
- ❖ The Duty-Drawback rates have been raised in the Budget of 2014-15 to 1% -4%**

VALUE OF EXPORT INCENTIVES IN PAKISTAN - 2012

% Defacto Increase in the Exchange Rate

	Spinning & Weaving	Made-Up Textiles	Other Textiles
• Low Rate of PIT	7.6	9.1	13.1
• Concessionary Rate of Export Finance	1.2	1.5	1.3
• Concessionary rate on Domestic Sales	3.4	7.1	13.2
Total	12.2	17.7	27.6

Source: Derived



TOTAL VALUE OF EXPORT INCENTIVES IN SOUTH ASIAN COUNTRIES

% Defacto Increase in the Exchange Rate

	Spinning & Weaving	Made-Up Textiles	Other Textiles
• Pakistan	12.2	17.7	27.6
• India	21.7	23.6	32.8
• Bangladesh	26.3	30.0	48.5

Source: Derived



RECOMMENDATIONS FOR INDUSTRIAL DEVELOPMENT

- ❖ Reduce high ERPs to put pressure on industries to achieve higher levels of efficiency due to competition from imports and lower prices, especially, automotive sector
- ❖ ‘Infant Industry’ argument still applies for capital- and – technology industries, like the engineering goods industry. Raise ERPs in such industries by withdrawal of SROs

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RECOMMENDATIONS FOR INDUSTRIAL DEVELOPMENT

- ❖ **Need to broaden the sales tax regime, especially on intermediate imports, to ensure that the GST burden on value added is uniform across industries**
- ❖ **Case for withdrawal of excise duty on cement**



RECOMMENDATIONS FOR INDUSTRIAL DEVELOPMENT

- ❖ Rates are too high in some sectors like cigarettes which has led to high levels of tax evasion
- ❖ As an overall policy, the extraordinarily high burden on industry as a whole should be reduced and raised on services, especially on services in the formal sector of the economy. Also, need for higher income tax on agriculture

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RECOMMENDATIONS FOR INDUSTRIAL DEVELOPMENT

- ❖ **The exchange rate is significantly overvalued by about 19%. Therefore, need for adjustment of the value of the Rupee. Alternatively, more export incentives will have to be provided including higher duty drawback, reduction in rate of export finance and long-term finance, etc, to remove the competitive disadvantage of Pakistani exporters.**



Thank You

