Fiscal Policy & Economic Growth From Problem to Solution

Syed Shabbar Zaidi
Senior Partner - A.F.Ferguson & Co.

Lahore School of Economics

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Objectives of Fiscal Policy

Fiscal policies for developing countries should aim to achieve the following conflicting objectives:

- Availability of adequate resources for the governments for **developmental expenditure** on education, health, infrastructure and security;
- **Competitive rate** of taxation for corporates and non-corporate sectors for effective **mobilization** of **savings** for **growth** and to stop outflow of investment to other countries;
- Reasonable proportion of collection through **direct taxation measures** in order to provide **equity** in **allocation** of **wealth**;
- **Equity** in **incidence** between citizens; and
- Economic policies to **override** all other considerations.

Universal Fiscal Policy

Economic policy is the subject of the west (except China); Our role is of an implementer only.

Summary of universal policy; in the ‘pre’ Trump Era:

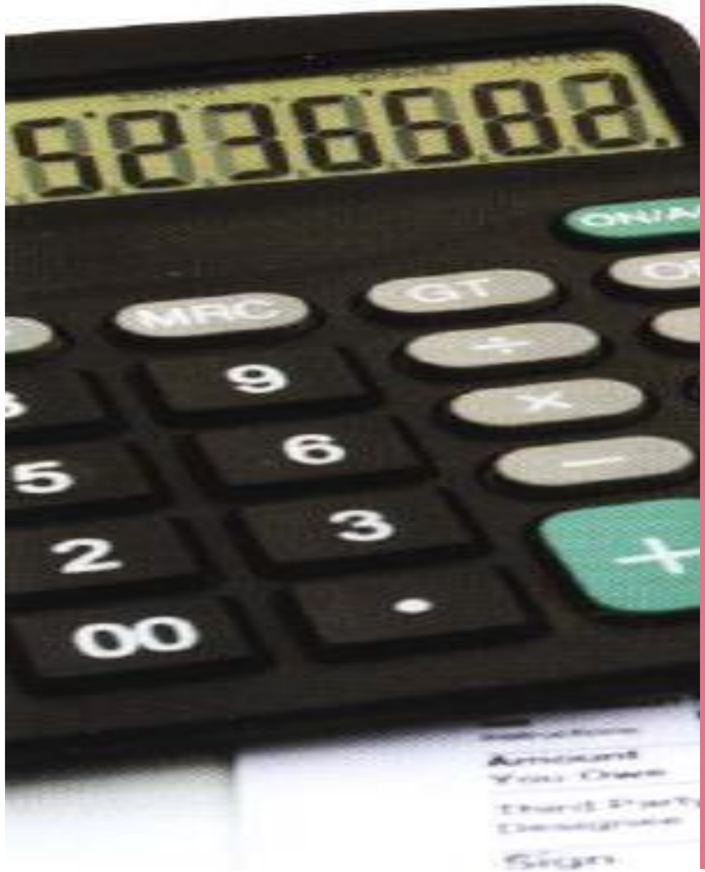
(a) Smaller governments

(b) Universal tax rate of around 25-30 percent on corporate income and personal income;

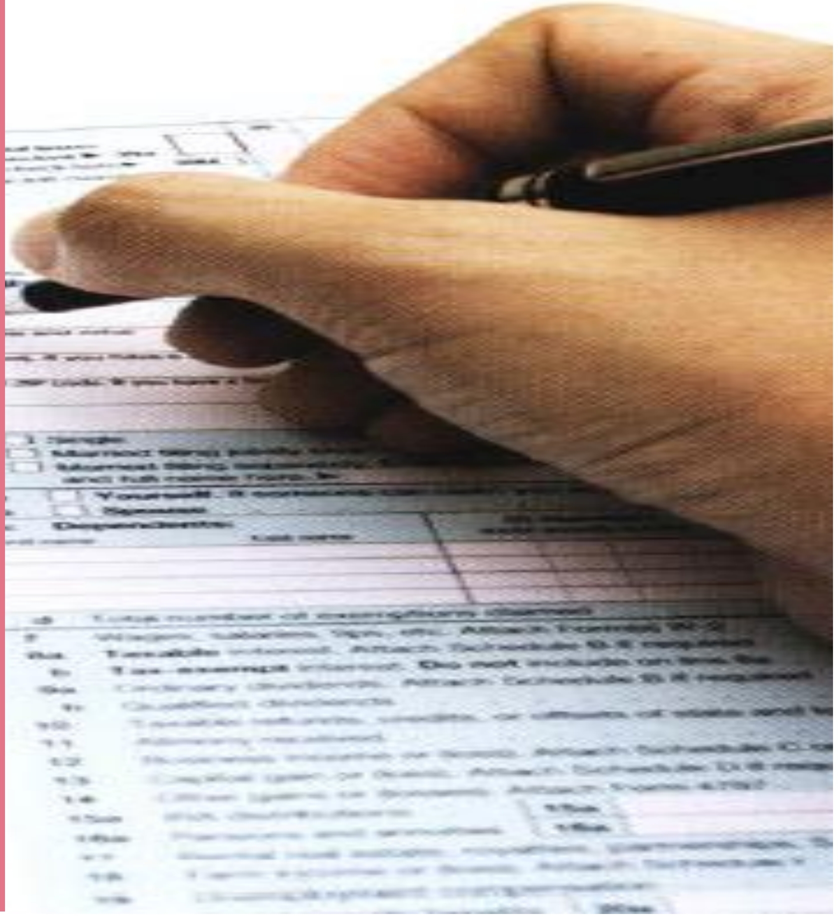
(c) Lower tariff to promote global trade;

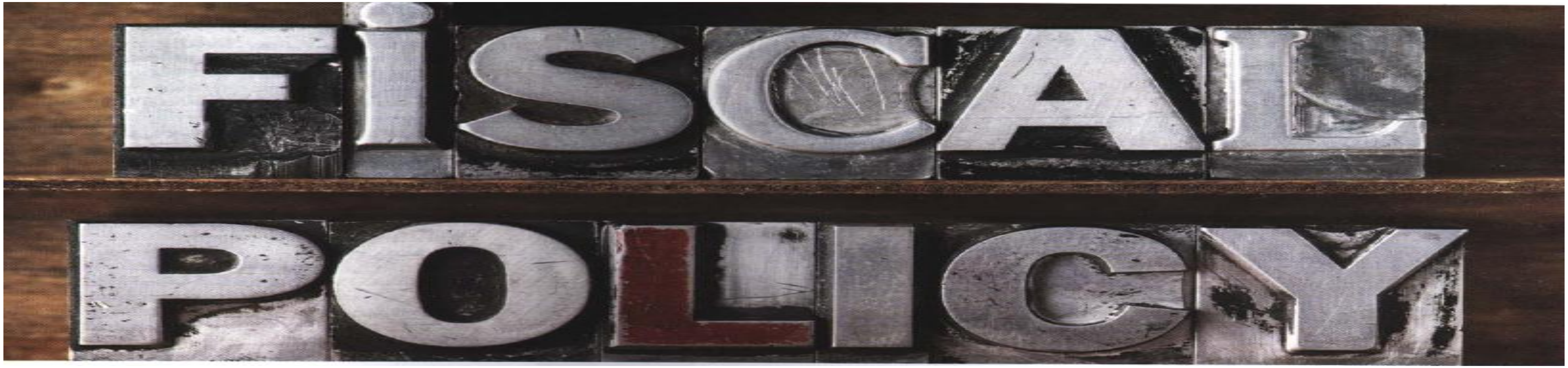
(d) Disguised protection for ‘tax havens’ for syphoning ‘wealth’ from east to west.

These policies have resulted in increasing ‘income disparities’ between states and people within the state, resulting in accumulation of huge reserves with MNCs on one hand and unsurmountable government debts on the other.



Less than one percent of the global population holds more than 80 percent of the world's wealth. Have our fiscal policies failed? Or are we in different phase of economic history?





Policy makers remain vague when questioned and inaccurately maintain that high disposable income in the hands of the traders will be reinvested and accelerate growth. This presumption is flawed for the reason that such savings are again invested in trading activities or investments in real estate and existing shares in stock exchanges. We are in a fiscal trap designed to promote trade.

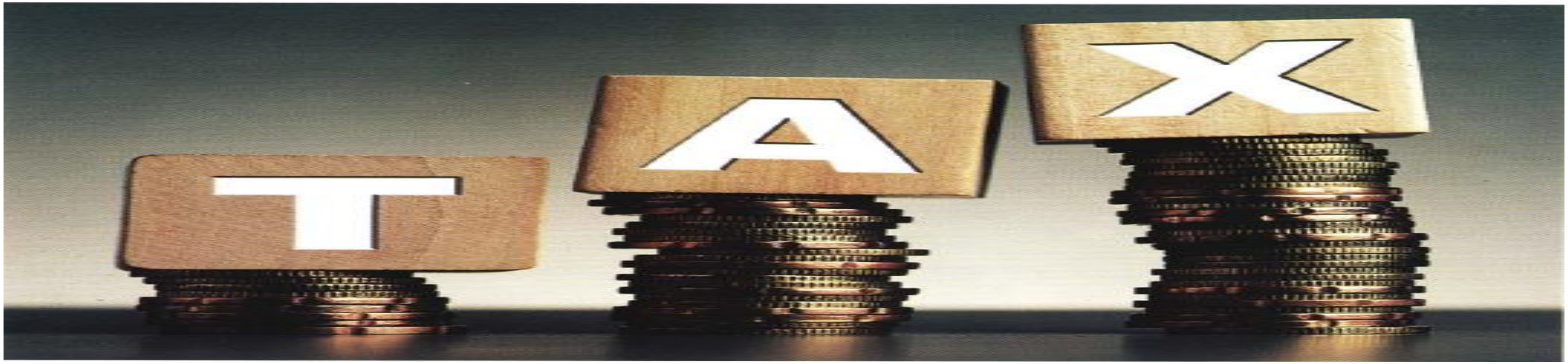
Impact of Fiscal Policy on Different Sectors

Present fiscal policies features divergent results for different sector of the economy:

Current fiscal policies are used as a tool to protect traders, evident from introduction of Presumptive Taxation for trading activities such as import/export.

Only taxable activity subject to normal tax regime is the 'industrial production' or documented service sector including banks. Hence, manufacturing activities were disbanded as being non-competitive.

This is a unique feature in Pakistan. There is a class, comprising around seven to eight percent of population, which is getting richer without any effective taxation whereas 90 percent of the population is provided neither adequate employment nor infrastructure by the government. So there are islands of prosperity within the sea of misery.

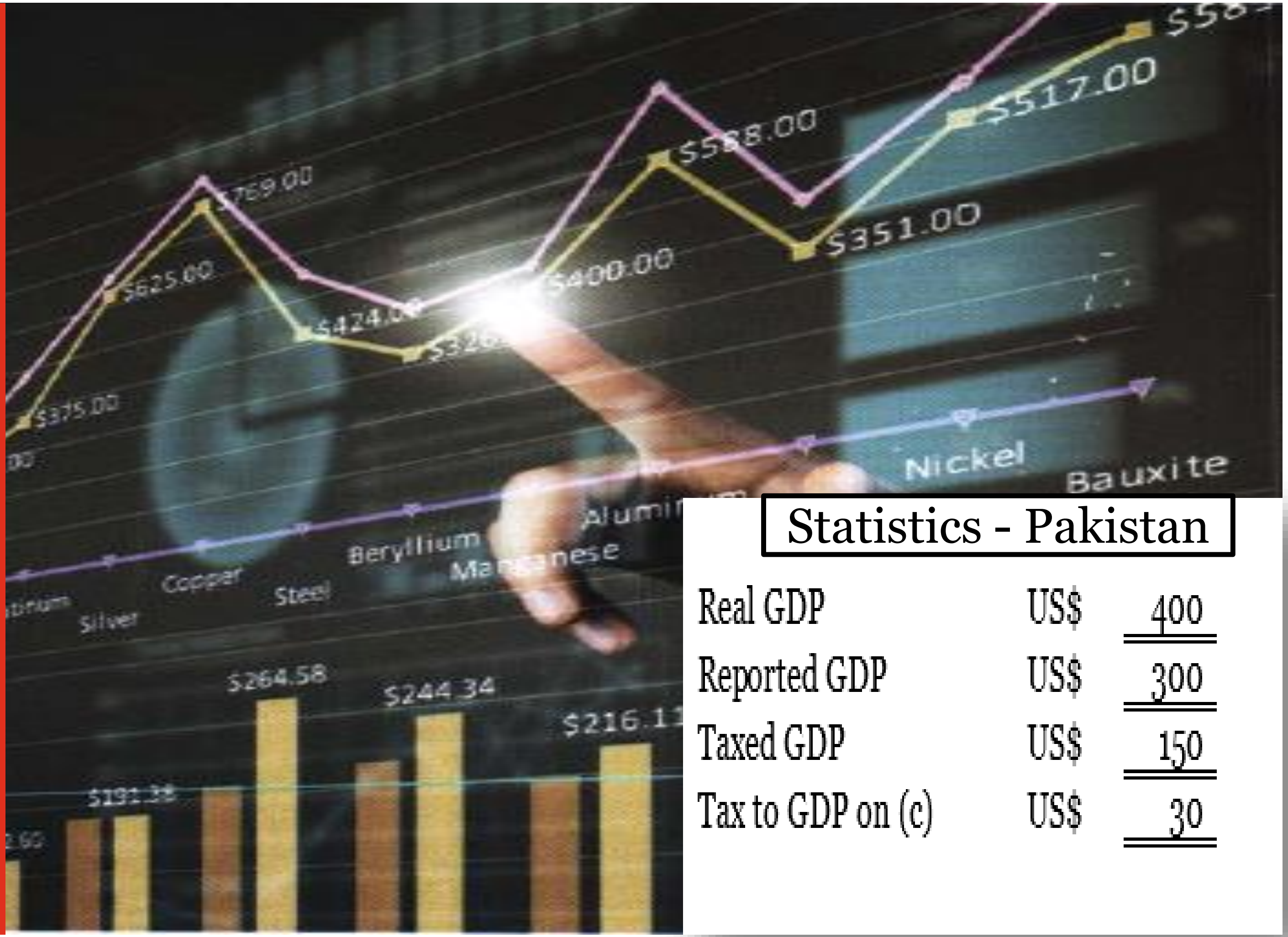


Current Fiscal Policy & Growth

Pakistan's tight fiscal policy, provides incentive for '**selective/non-inclusive growth**', resulting to growth in undocumented & untaxed sector. Consequently, there is concentration of wealth in few hands, non-availability of development resources for the government.

Presumptive tax regime, perpetual amnesty scheme and non-availability of asset database are few primary features of tax regime that has created these two islands within our economy.

In Pakistan, there is effectively no direction to fiscal measures, as they are used as revenue collection measure only. There is general political rhetoric that the tax-to-GDP ratio should be at least 12.5%, of which 6-7% shall be from generated from direct taxation. Unfortunately, even serious and senior people in this field measure the same in terms of money.



Statistics - Pakistan

Real GDP	US$	400
Reported GDP	US$	300
Taxed GDP	US$	150
Tax to GDP on (c)	US$	30

Solutions & Corrections

- Re-establishment of relationship between effective fiscal policy and growth
- Documentation of assets and transactions;

Fiscal policies should focus on:

i. Achieving a Tax to GDP ratio of around 15 percent by 2025;

ii. All sources of income to be taxed at the similar maximum rate of 20 to 25 percent on net income basis. Complete removal of all forms of presumptive taxation.

iii. Same effective rate of tax for all persons (natural/legal). No concept of dual taxation on distribution in the form of dividend;

iv. Exemption regime for certain sector to be replaced by zero rating regime;

v. Similar rate of sales tax on goods and services under the Federal and Provincial Government at a level of 7.5 to 10 percent.

To sum up, fiscal policy regime should focus on taxing the all at lower rate instead of a few at an exorbitant rate.

Questions

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