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Domestic Resource Mobilization in Pakistan

Selected Issues

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ABSTRACT

This paper focuses mainly on the relationship between taxation and the three main components of saving--public, personal and business savings. The emphasis is on tax reform with a view to raising additional revenues and encouraging household and business savings. Attention is confined to federal taxes; taxes levied by the provinces and local authorities are not considered. Proposals for tax reform take account of the need to keep tax-induced distortions in the allocation of resources to a minimum as well as equity considerations. Other important aspects of improved saving such as appropriate policies on current expenditures, subsidies, user charges, public enterprise pricing, and self-financing of investment by public enterprises are also highlighted.

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EXTRACTO

El presente documento se centra principalmente en la relación entre la tributación y los tres componentes principales del ahorro --a saber, el ahorro público, el personal y el del medio empresarial. Se concede importancia sobre todo a la reforma tributaria con la mira de recaudar ingresos adicionales y alentar el ahorro tanto de las unidades familiares como de las empresas. La atención se limita a la esfera de los impuestos federales, sin que se incluyan los establecidos por las provincias y las autoridades locales. En las propuestas de reforma tributaria se toman en cuenta tanto la necesidad de mantener en un mínimo las distorsiones ocasionadas por los impuestos en la asignación de los recursos como también algunas consideraciones de equidad. Se destacan además otros aspectos importantes de un mayor nivel de ahorro, tales como las políticas adecuadas en materia de gastos corrientes, subvenciones, cargos a los usuarios, fijación de precios en las empresas públicas y autofinanciamiento de las inversiones de dichas empresas.

Ce document traite essentiellement des rapports existant au Pakistan entre l'impôt et les trois principaux types d'épargne - à savoir l'épargne publique, l'épargne des ménages et l'épargne des entreprises. Il met l'accent sur une réforme fiscale visant à dégager des recettes supplémentaires et à encourager l'épargne des ménages et des entreprises. Seuls sont considérés les impôts fédéraux, ceux qui sont perçus par les provinces et les autorités locales n'étant pas pris en compte. Les propositions relatives à une réforme fiscale tiennent compte de la nécessité de limiter au maximum les distorsions qu'entraîne le régime fiscal dans la répartition des ressources, et aussi de considérations de justice sociale. Le document traite également d'autres aspects importants d'un accroissement de l'épargne, tels que des politiques appropriées en ce qui concerne les dépenses courantes, les subventions, les tarifs payés par les usagers, le système tarifaire des entreprises publiques ainsi que l'autofinancement de leurs investissements.

SELECTED ISSUES IN DOMESTIC RESOURCE MOBILIZATION IN PAKISTAN

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PAKISTAN: SELECTED ISSUES IN DOMESTIC RESOURCE MOBILIZATION

1. SUMMARY AND CONCLUSIONS

1.1 Pakistan has a comparatively low savings rate. The rate of gross domestic saving has fluctuated in recent years in the range of 6-7%; aided by migrants' remittances, the rate of national saving has varied between 11-13%.1/ With the current rate of domestic investment of 16%, the resource gap (the excess of import of goods and services over their export) has amounted to over 4% of GNP (Table 1.1). Given the size of Pakistan's financial requirements and a declining trend in receipts of net external assistance in real terms, the present reliance on foreign savings for financing investment is unlikely to be sustainable. Domestic resource mobilization is, therefore, a major concern of economic policy in Pakistan.

Table 1.1: INVESTMENT AND SAVING, 1977/78-1981/82
(amounts in million rupees)

		Financing of Investment		As % of GNP		
	Gross Domestic Investment	National Savings	Foreign Savings	Domestic Inv't	National Savings	Foreign Savings
1977/78	29,961	24,002	5,959	16.1	12.9	3.2
1978/79	33,348	22,348	11,000	15.8	10.6	5.2
1979/80	41,274	29,974	11,300	16.2	11.8	4.4
1980/81	46,117	36,603	9,514	15.3	12.1	3.2
1981/82	55,895	40,249	15,646	16.0	11.5	4.5

Source: State Bank of Pakistan, Annual Report, 1981-82.

1.2 The recently promulgated Sixth Five Year Plan, 1983-88 proposes to raise the rates of investment and saving to 19% and 16.5%, respectively, by the end of the plan period. The importance of lifting the savings rate is fully recognized. The plan states: "During the Sixth Plan, the saving strategy has to be geared to break decisively the historical stalemate in the saving effort. Raising the ratio of national saving to GNP to around 16.5 percent is the absolute minimum for the realization of Sixth Plan goals."2/

1/ The rate of saving may be understated somewhat if, as is widely believed, investment is underestimated, especially in small-scale manufacturing. Since saving is derived from the familiar national accounting identity I=(M-X)+S, underestimation of investment would also understate saving.

2/ Draft Sixth Five Year Plan, 1983-88 (Planning Commission, Government of Pakistan, 1983), p. 53.

1.3 The issue of the mobilization of domestic resources for the public sector goes beyond that of raising the rate of public savings. In the public sector, domestic resources must be mobilized not only to raise the savings rate but also to meet the recurring costs of public services. The Sixth Plan objective of correcting the relative neglect of the social sector in the past would require greater resources for recurrent costs. In view of the virtual constancy of public sector development expenditures in real terms and inadequacy of allocations for maintenance of infrastructure and efficient operation of public services in recent years, mobilization of domestic resouces by the public sector is especially important at this juncture.

1.4 While still low in relation to investment requirements, public saving (that is, saving by general government, public enterprises and local authorities) has displayed an encouraging trend in recent years. Public saving as a percentage of GNP rose from 1.7% to 2.7% between FY78 to FY82, with the result that public saving now finances 30% of public investment compared to 16% in FY78 (Table 1.2). The share of own saving in investment by general government (federal and provincial combined) has risen from under a third in FY78 to nearly one half in FY82. There has also been a slight improvement in self-financing by public sector enterprises (autonomous and semi-autonomous public bodies); these presently finance 15-20% of their investment from internal resources compared to about 10% in the late 1970s.

1.5 Nonetheless, the main imbalance between saving and investment in Pakistan arises in the public sector. Although accounting for two thirds of fixed investment, the public sector contributes only a quarter of national saving. The greatest disparity between investment and saving occurs in the public enterprise sector, which undertook investment of Rs 20.5 billion in FY82 but generated saving of only Rs 3.2 billion. The investment/saving gap for general government was much lower; the sector's investment and saving amounted to Rs 10 billion and Rs 5 billion, respectively. This saving performance was achieved, in part, by holding down recurrent expenditures on basic economic and social services below desirable levels and understates the financing problem.

1.6 With its saving greatly in excess of investment, the private sector contributed significantly to the financing of the investment/saving gap in the public sector. In FY82, private fixed investment and saving amounted to Rs 16.3 billion and Rs 30.8 billion, respectively. Most saving in Pakistan, in fact, originates in the non-corporate private sector.1/

1/ Estimates of different components of saving have been attempted in Mohammad Zia Masoom Qureshi, Saving in Pakistan, 1970-77: Estimation and Analysis (D.Phil. Thesis, University of Oxford, 1980).

Table 1.2: INVESTMENT AND SAVING BY PUBLIC AND PRIVATE SECTORS, 1977/78-1981/82
(amounts in million rupees)

	1977/78	1978/79	1979/80	1980/81	1981/82 Revised
Gross fixed investment	28,976	31,412	38,861	40,983	48,573
Private	8,764	9,556	12,441	14,160	16,339
Public	20,212	21,856	26,420	26,823	32,234
Federal/a and provincial	5,631	6,476	6,414	8,894	10,039
Autonomous and semi-autonomous organizations	14,129	14,855	19,189	16,616	20,542
Local bodies	452	525	817	1,313	1,653
National saving	24,002	22,348	29,974	36,603	40,249
Private	20,817	20,273	24,825	25,046	30,753
Public	3,185	2,075	5,149	11,557	9,496
Federal/a and provincial	1,808	276	2,464	7,296	5,004
Autonomous and semi-autonomous organizations	925	1,274	2,004	3,211	3,170
Local bodies	452	525	681	1,050	1,322
Memorandum items:	Percentages				
Public inv't as % of total inv't	69.8	69.6	70.0	65.4	66.4
Public saving as % of national saving	13.3	9.3	17.2	31.6	23.6
Private saving as % of GNP	11.2	9.6	9.8	8.3	8.8
Public saving as % of GNP	1.7	1.0	2.0	3.8	2.7
Saving by public sector as % of its inv't	15.8	9.5	19.5	43.1	29.5
Saving by Federal and Provincial Governments as % of their inv't	32.1	4.3	38.4	82.0	49.8
Saving by autonomous bodies as % of their inv't	6.5	8.6	10.4	19.3	15.4

/a Including the Post Office, and Telegraph and Telephone Department.

Sources: State Bank of Pakistan, Annual Report, 1981-82; and Planning Division.

1.7 This report focuses mainly on the relationship between taxation and the three main components of saving--public, personal and business savings. The emphasis is on tax reform with a view to raising additional revenues and encouraging household and business savings. Attention is confined to federal taxes; taxes levied by the provinces and local authorities are not considered. Proposals for tax reform take account of the need to keep tax-induced distortions in the allocation of resources to a minimum as well as equity considerations. Other important aspects of improved saving such as appropriate policies on current expenditures, subsidies, user charges, public enterprise pricing, and self-financing of investment by public enterprises are also highlighted.

1.8 Policies to stimulate national saving are more likely to succeed if they are aimed at all three components of saving, since concentration on a single component may result in a reduction of other types of saving. Policies must also take account of interrelationships among different forms of saving. In particular, effects of taxes on personal and corporate savings need to be considered.

1.9 The major objective in relation to private saving should be to improve the overall climate for saving as well as incentives for investment. The availability of suitable savings instruments, especially in rural areas, and the existence of a tax structure that is conducive to company saving are critical in this connection. Given that the Sixth Plan envisages an expanded role for the private sector, it is also important that the public sector does not pre-empt too large a proportion of private savings.

1.10 Higher tax effort alone will not help to raise sufficient resources for the public sector. Tax policy should, therefore, be supplemented by appropriate policies on user charges, subsidies and self-financing by public enterprises. The ability of public enterprises to finance their investment from their own resources and tax policy will be the major determinants of public saving. The large gap between the investment requirements of public enterprises and the internal generation of funds makes higher self-financing by public enterprises of crucial importance in improving the public sector's saving performance.

1.11 The two main areas of taxation that have not been adequately tapped so far are agricultural income and domestically produced goods. In the area of individual income tax, improvements in tax administration are likely to be more important as a source of additional revenues than changes in the structure of the tax unless major structural changes are made. Even with a more broadly based income tax, it appears that over the next few years the greater proportion of additional tax revenues will need to come from indirect rather than direct taxes.

1.12 Proposed changes in the sales tax, excise duties, the taxation of petroleum products, agricultural taxation and the tax treatment of perquisites would have a large revenue impact. Import liberalization can also be expected to have a significant effect on revenues. Other tax measures discussed in the report are more important for their implications for efficiency and equity than for their potential effects on revenue.

1.13 Other main conclusions of the report are as follows:

Taxation of Personal Income and Wealth

- Any increase in the personal allowance of Rs 12,000 over the next few years should be modest (paragraphs 3.8 and 3.9);

- Perquisites (fringe benefits) should be taxed to the fullest extent consistent with administrative practicability (paragraph 3.10);

- The investment allowance is sufficiently high and should not be increased for some time (paragraph 3.17);

- The taxation of agricultural incomes through the income tax should be seriously considered when the working of ushr becomes clearer (paragraphs 3.23 - 3.24); and

- Greater coordination between zakat and the wealth tax is needed (paragraphs 3.27 - 3.29).

Indirect Taxation

- A broad-based sales tax should be introduced as soon as politically and administratively feasible (paragraphs 4.20 - 4.22);

- It is desirable that the sales tax be a purely revenue tax which treats imports and domestic goods in the same manner (paragraphs 4.25 - 4.28);

- Price controls that seriously depress the growth of tax revenues, especially from excise duties, should be avoided (paragraph 4.16); and

- Taxes on petroleum products should play a larger role in resource mobilization (paragraphs 4.13 and 4.14).

Personal Saving

- The exemption of interest from national savings schemes should be extended to all interest income up to a specified amount, irrespective of source (paragraphs 3.18 - 3.20 and 5.5 - 5.7);

- Higher real returns on commercial bank deposits would facilitate mobilization of savings in rural areas (paragraphs 5.14 - 5.15 and 5.19); and

- A detailed study on the possibilities of increasing personal saving through a further development of private provident funds is desirable (paragraphs 5.25 and 5.30).

Taxation and Company Saving

- The structure of company taxation should be simplified by consolidating different taxes on companies (paragraphs 6.3 - 6.5 and 6.10); and

- Some reduction in the overall rate of company taxation seems desirable (paragraphs 6.9 and 6.14).

2. PUBLIC SECTOR FINANCES

2.1 Pakistan's public sector is large and diverse. It comprises the Federal and Provincial Governments, local authorities (which are referred to as local bodies in Pakistan) and public and semi-public enterprises. This chapter gives a broad statistical picture of the public sector and outlines the main issues in public sector finances. The discussion should serve as a backdrop against which the possibilities and limitations of tax policy as a means of mobilizing domestic resources by the public sector may be judged.

2.2 The budgetary process in Pakistan revolves around the federal budget, the four provincial budgets and the Annual Development Plan (ADP). The ADP includes all development expenditures of Federal and Provincial Governments, but only part of the development expenditures undertaken by public enterprises. All development expenditures of public enterprises financed by the Federal Government and part of the expenditures financed from the public enterprises' own resources are included in the ADP; some expenditures financed through internally-generated resources and all expenditures financed through bank credit and foreign resources do not thus form part of the ADP. The ADP also excludes development expenditures of public financial institutions and local bodies.1/ The Post Office, and the Telegraph and Telephone Department are run as government departments and form part of the Federal Government. On the resources side, the ADP contains contributions by the provinces and public enterprises towards the financing of their ADP as well

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1/ The omission of public financial institutions and local bodies does not distort the picture seriously. Capital formation by public financial institutions is estimated at Rs 285 million for FY81. The capital and current expenditures of local bodies are estimated at Rs 2.6 billion. See National Accounts of Pakistan, 1977-78 to 1980-81 (Karachi: Statistics Division, Government of Pakistan, 1981).

as the Federal Government's contributions for its development expenditures and those of the provinces and public enterprises.1/

Consolidated Public Sector

2.3 In recent years tax and non-tax current revenues have remained constant in relation to GDP, defense and debt servicing have pre-empted a large share of the current budget, and net external assistance has been declining as a proportion of development expenditures and in real terms. As a result, allocations for the recurring costs of major economic and social services have suffered, and development spending has increased only marginally in real terms.2/ The public sector now faces the difficult problem of simultaneously improving the standard of existing services and increasing the rate of public saving.

2.4 Current revenues have amounted to 16-17% of GDP between FY78 and FY82, with tax/GDP and non-tax/GDP ratios amounting to 12-14% and 3-4%, respectively (Table 2.1). The stability of the tax/GDP ratio, despite sizable tax increases introduced in some recent years, suggests a low elasticity of tax receipts. The crucial tasks of tax policy are, therefore, to raise the share of GDP taken in taxes and to improve the elasticity of tax revenues.

2.5 User charges for services (which form part of non-tax receipts) have not been extensively used by the Federal and Provincial Governments. The receipts from charges for services account for 4% of the combined federal and provincial current revenues. Even when imposed, user charges recoup only a small proportion of the cost of services. As is to be expected, the bulk

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1/ Public sector statistics reflect these budgetary procedures. The consolidated public sector statistics used in this chapter include all expenditures and revenues of the Federal and Provincial Governments but only that portion of the development expenditures of public enterprises that forms part of the ADP. Development expenditures of public enterprises undertaken outside the ADP are not included; nor are the development expenditures of public financial institutions and local bodies. To avoid double-counting, transfers between the different segments of the public sector are eliminated when considering the consolidated public sector. However, when provincial and public enterprise finances are discussed, transfers are retained; elimination of transfers when a single segment of the public sector is under consideration would give a misleading picture.

2/ Trends in public sector finances are discussed in detail in the Bank's economic reports on Pakistan. See, for example, Pakistan, Economic Developments and Prospects (Report No. 4215-PAK, February 1983).

of the receipts come from economic rather than social and community services. In FY82 the federal collections of non-tax receipts from economic, social and community services amounted to only Rs 370 million. The provincial collections were Rs 1.7 billion, one half of which came from water charges for irrigation, discussed below. Provincial receipts from charges for economic services amount to about one half of the provincial current expenditures on economic services, including irrigation (see Tables 2.7 and 2.8).

2.6 The demands made by the public sector on national resources have declined somewhat in recent years; public expenditures presently absorb 22.6% of GDP compared to 24.3% of GDP in FY78. The decline is mainly explained by a slow growth in development expenditures, current expenditures having remained remarkably stable at 14% of GDP. Defense imposes a heavy burden on the current budget, absorbing about 40% of it. With debt servicing (interest payments in respect of domestic and foreign debt) claiming about 15% of the current budget, defense and debt servicing account for over 55% of current expenditures. The pre-emption of such a large proportion of the current budget by these outlays has restricted the resources that can be devoted to other activities. There are no completely satisfactory indices for reducing public expenditures to real terms, but deflating public expenditures by the implicit GDP deflator suggests that current expenditures on important services such as agriculture, education and health may not have expanded much in real terms in recent years. While this aggregative evidence is suggestive, sufficient insight can only be gained by studying individual services in detail.

Table 2.1: SELECTED STATISTICS ON PUBLIC SECTOR FINANCES, 1977/78 - 1981/82 (percentages)

	1977/78	1978/79	1979/80	1980/81	1981/82 Revised
	as a percentage of GDP				
Current revenue	15.6	16.0	16.6	17.2	16.3
Tax	(12.4)	(12.8)	(13.7)	(13.9)	(13.1)
Non-tax	(3.2)	(3.2)	(2.9)	(3.3)	(3.2)
Expenditure	24.3	25.3	23.5	23.2	22.6
Current	(14.4)	(14.9)	(14.2)	(13.9)	(14.2)
Development	(9.9)	(10.4)	(9.2)	(9.2)	(8.4)
Overall deficit	8.3	8.8	6.2	5.2	5.7
Bank borrowing	3.2	4.3	2.7	0.8	1.7
	as a percentage of total current expenditure				
Defense	38.6	34.8	37.6	39.2	42.7
Social services	12.5	11.2	11.8	13.0	12.7
Education	(9.9)	(8.3)	(8.3)	(8.6)	(8.3)
Health	(2.4)	(2.2)	(2.2)	(2.0)	(2.1)
Economic services	9.3	10.1	8.1	8.7	7.8
Agriculture	(2.8)	(1.9)	(1.9)	(2.2)	(2.3)
Irrigation	(2.5)	(2.5)	(2.8)	(2.9)	(3.1)
Debt servicing	13.4	13.8	14.7	15.1	14.8
	Rs million (in 1977/78 prices) /a				
Defense	9,674	9,380	10,546	11,504	13,438
Social services	3,133	3,021	3,316	3,802	4,002
Education	(2,475)	(2,246)	(2,320)	(2,529)	(2,599)
Health	(595)	(596)	(606)	(574)	(676)
Economic services	2,331	2,722	2,264	2,553	2,443
Agriculture	(711)	(510)	(533)	(651)	(723)
Irrigation	(618)	(671)	(781)	(866)	(984)
Total current expenditure	25,028	26,967	28,060	29,317	31,474
Development expenditure	17,121	18,898	18,170	19,398	18,519
Memorandum items:					
GDP at market prices (million rupees)	173,665	196,129	236,509	279,627	322,289
GDP deflator (1977/78 = 100)	100	108.4	119.9	132.9	145.8

/a Using the deflator for GDP at market prices.

Sources: Tables 2.2 - 2.4.

Table 2.2: SUMMARY OF CONSOLIDATED PUBLIC FINANCES, 1977/78 - 1982/83
(million rupees)

	1977/78	1978/79	1979/80	1980/81	1981/82 Revised	1982/83 Budget
Revenue	27,128	31,427	39,350	48,154	52,622	63,949
Tax	21,585	25,093	32,507	38,846	42,264	51,856
Non-tax	5,543	6,334	6,843	9,308	10,358	12,093
Self-financing by autonomous bodies /a	523	975	1,464	2,019	1,909	2,738
Expenditure	42,149	49,717	55,477	64,791	72,889	88,228
Current	25,028	29,232	33,672	38,991	45,889	56,763
Development /b	17,121	20,485	21,805	25,800	27,000	31,465
Overall deficit (-)	-14,498	-17,315	-14,663	-14,618	-18,349	-21,541
Financing:						
Domestic resources (net)	8,369	10,604	7,712	6,877	11,999	13,671
Non-bank	2,816	2,102	1,407	4,522	6,552	8,005
Bank borrowing	5,553	8,502	6,305	2,355	5,447	5,666
External resources (net)	6,129	6,711	6,951	7,741	6,350	7,870
Disbursements	7,237	9,216	12,555	11,374	12,491	15,738
Repayments (-)	-1,108	-2,505	-5,604	-3,633	-6,141	-7,868

/a Self-financing of development expenditures of public sector enterprises included in the ADP.

/b Development expenditures of Federal and Provincial Governments and part of the development expenditures of public sector enterprises.

Note: The figures for non-tax revenue and current expenditure may differ from other sources because non-tax revenue includes receipts from irrigation water charges, and current expenditure the outlay on the operation and maintenance of the irrigation system; most sources treat irrigation on a net basis.

Source: Planning Division.

Table 2.3: CONSOLIDATED TAX REVENUES, 1977/78 - 1982/83
(million rupees)

	1977/78	1978/79	1979/80	1980/81	1981/82 Revised	1982/83 Budget
Taxes on income	2,824	3,339	5,150	7,028	8,250	8,400
Individual income tax	1,767	2,195	3,427			
Corporation income tax	1,057	1,144	1,723			
Taxes on capital /a	281	491	572	485	556	561
Major indirect taxes	16,428	19,765	24,361	28,612	31,168	40,109
Import duties	7,967	9,837	12,126	13,569	14,690	19,954
Excise duties	5,994	6,917	9,072	10,414	12,400	14,142
Sales tax	1,590	1,935	2,410	2,893	3,250	3,747
Surcharges /b	877	1,076	753	1,736	828	2,266
Export taxes	345	286	446	707	310	612
Other	1,707	1,212	1,978	2,014	1,980	2,174
Total	21,585	25,093	32,507	38,846	42,264	51,856

/a Federal wealth, estate and gift taxes, and provincial land and property taxes.

/b Surcharges are levied on fertilizer, natural gas and petroleum products. They are, in effect, indirect taxes levied to siphon off surplus profits of companies representing the difference between the cost of production and the fixed sale price of commodities, or between the average import price and the prescribed sale price of locally manufactured goods.

Source: Planning Division.

Table 2.4: CONSOLIDATED CURRENT EXPENDITURES, 1977/78 - 1982/83
(million rupees)

	1977/78	1978/79	1979/80	1980/81	1981/82 Revised	1982/83 Budget
Administration, law and order	3,352	3,860	4,116	4,874	5,701	6,578
Defense	9,674	10,168	12,655	15,300	19,593	22,878
Community services	769	1,165	1,267	1,452	1,767	2,083
Social services	3,133	3,275	3,979	5,070	5,835	6,713
of which: Education	(2,475)	(2,435)	(2,784)	(3,364)	(3,790)	(4,452)
Health	(595)	(646)	(727)	(764)	(986)	(1,197)
Economic services	2,331	2,951	2,717	3,395	3,562	5,305
of which: Agriculture	(711)	(553)	(640)	(866)	(1,054)	(1,190)
Irrigation	(618)	(727)	(937)	(1,152)	(1,435)	(1,474)
Subsidies/a	1,686	3,601	3,821	2,449	2,241	2,302
Debt servicing	3,356	4,031	4,967	5,909	6,794	9,264
Other	727	181	150	542	396	1,640
Total	25,028	29,232	33,672	38,991	45,889	56,763

/a Excluding subsidies included in development expenditures.

Source: Planning Division.

2.7 Subsidies feature in both the federal and provincial budgets and are provided through the development as well as the current budget (Table 2.5). The main subsidies in current expenditures are for wheat and exports.1/ The cost of the fertilizer subsidy is treated as a development expenditure. The only subsidy of any consequence at the provincial level is that for wheat. Resources diverted to subsidies have been reduced since FY80 when they absorbed nearly a fifth of the combined current expenditures of the Federal and Provincial Governments (adjusted by treating the subsidy for fertilizers as a current expenditure). Subsidies cost about Rs 4 billion in FY82 and accounted for 8.5% of the combined current expenditures. Although subsidies are now less important than in the past, further reductions could still free sizable resources for other purposes. The Government has decided to phase

1/ The subsidy for exports takes the form of compensatory rebates. See Annex II, paragraph 10.

out the fertilizer subsidy by FY85; its plans for the wheat subsidy are not known.

Table 2.5: FEDERAL AND PROVINCIAL SUBSIDIES, 1977/78 - 1982/83
(million rupees)

	1977/78	1978/79	1979/80	1980/81	1981/82 Revised	1982/83 Budget
Wheat	1,634	2,513	2,353	1,050	1,329	1,078
Edible oil	-	577	884	583	1	-
Sugar	21	11	20	83	4	-
Export rebate	-	500	550	705	900	920
Fertilizers	617	1,692	2,454	2,457	1,819	1,600
Plant protection	347	267	218	-	-	-
Tubewells	37	24	22	20	24	24
Wheat seeds	25	8	29	2	8	8
Other	31	-	14	28	7	304
Total	2,712	5,592	6,544	4,928	4,092	3,934
Classification by Government						
Federal	1,718	4,819	5,368	3,893	2,909	2,978
Provincial	994	773	1,176	1,035	1,183	956
Classification by Budget						
Current	1,686	3,601	3,821	2,449	2,241	2,302
Development	1,026	1,991	2,723	2,479	1,851	1,632

Source: Planning Division.

2.8 ADP expenditures as a percentage of GDP fell from 9.9% in FY78 to 8.4% in FY82 and also seem to have remained approximately constant in real terms since FY79. Even when account is taken of development expenditures of

public enterprises outside the ADP, total development expenditures do not show much increase in real terms.1/

2.09 Net external assistance varied between Rs 6-8 billion annually during FY78-FY82 (Table 2.2). External resources financed about a quarter of the ADP in FY82, compared to over a third in FY78. Since the prices (unit values) of Pakistan's imports are estimated to have risen by about 70% during the period, net external assistance has declined steadily in real terms. Should this trend continue, the problem of mobilizing domestic resources would become both more urgent and difficult.

Provincial Governments 2/

2.10 The imbalance between provincial responsibilities and revenues and the limited control by provinces over their revenues are the two main issues in provincial finances. The former reflects in part the overall domestic resource constraint in the public sector. The problem of finding, for lower tiers of government, sufficient independent revenues (that is, major sources whose tax rates they could vary) has not been successfully tackled in most developing countries. A National Finance Commission is presently engaged in the periodic review of the financial relationships between the Federal and Provincial Governments provided for in the Pakistan Constitution.

2.11 Provincial Governments play an important role in the provision of services, but their involvement in resource mobilization is limited. The provinces have major responsibilities in the areas of education (excluding universities), health (excluding some hospitals), the irrigation system,

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1/ The ADP and non-ADP development expenditures of public enterprises for 1977/78-1982/83 were as follows:

	Development expenditures (million rupees)		
	ADP	Non-ADP	Total
1977/78	9,480	4,000	13,480
1978/79	9,820	2,847	12,667
1979/80	9,260	4,150	13,410
1980/81	9,540	4,500	14,040
1981/82 Revised	10,120	5,533	15,653
1982/83 Budget	10,576	7,226	17,802

Source: Planning Division.

2/ For a detailed examination of provincial finances, see S.M.P. Suriyaarachchi, Sind Government and Karachi City Finances (World Bank, mimeo, September 1979).

domestic water supply, roads, agricultural support services and internal law and order (i.e., police). On the other hand, they derive the bulk of their tax revenues through tax sharing arrangements with the Federal Government, and their development expenditures are largely financed by the Federal Government, mostly in the form of soft loans.1/

2.12 Provincial Governments presently receive 80% of the proceeds (net of costs of collection) from the following taxes collected by the Federal Government: (i) export duty on cotton; (ii) sales tax; and (iii) personal and company income taxes (excluding the income tax paid by federal employees). These divisible taxes are allocated on the basis of population (Punjab 60.25%, Sind 22.50%, NWFP 13.39% and Baluchistan 3.86%).2/ The provinces also receive the revenues from the excise duty and royalty on natural gas, and the gift tax; the former are divided on the basis of the location of well-heads, and the latter on the basis of actual receipts from different provinces.

2.13 Resources are also transferred to the two poorer provinces outside the framework of revenue sharing. The Federal Government meets the current deficits of the North-West Frontier Province (NWFP) and Baluchistan, which are estimated at Rs 875 million and Rs 286 million, respectively, for FY83. It also provides the NWFP and Baluchistan fixed annual grants of Rs 100 million and Rs 50 million, respectively.

2.14 The provinces' independent revenues are relatively insignificant. The provinces cannot influence the shared revenues, which account for 80% of their tax revenues (Table 2.6). With receipts from provincial taxes and non-tax levies growing more slowly than receipts from shared taxes, the provinces' dependence on shared revenues has increased in recent years; shared revenues provided 60% of provincial current revenues in FY82 compared to 45% in FY78. Between FY78 and FY82, the share of provincial taxes in current revenues fell from 20% to 16%, and that of non-tax levies from 18% to 14%. Moreover, the relative contribution of non-shared revenues (all current receipts except shared revenues and federal grants) of 30% understates the lack of revenue flexibility because the major tax sources under provincial control (e.g., motor vehicle tax, stamp duties, entertainment tax) are not very responsive to general economic development (Table 2.7).

1/ A consequence of this has been the growth in provincial expenditures on debt servicing. Most of the expenditure on debt servicing shown in Table 2.8 is in respect of federal loans.

2/ For details of the evolution of tax sharing arrangements as well as the present arrangements, see Statutory Orders Regulating the Allocation of Revenues between the Federal Government and the Provinces (Government of Pakistan, 1975).

2.15 The single most important source of non-shared revenue for the provinces is the water charge for irrigation (abiana). Although higher charges have helped to increase revenues from water charges in recent years, the receipts covered only 60% of the cost of operating and maintaining the irrigation system in FY82. The complex analytical problem of determining the appropriate level and structure of irrigation water charges has been much debated in Pakistan. A recent study concluded that there is substantial scope for improving revenues from this source.1/

2.16 The inadequacy of recurrent expenditures to provide a reasonable quality of basic economic and social services is perhaps the most serious financial problem at the provincial level. Although there has been some real growth in per capita terms in provincial recurrent expenditures on all major services except education (total outlays on which do not seem to have grown in real terms) in recent years, detailed sectoral work indicates that the quality of many services is poor and that insufficient allocations for operation and maintenance have prevented an efficient use of existing facilities and assets.2/ A shift of emphasis from development to recurrent expenditures therefore appears to be needed, since some of the country's objectives would be better met by a fuller use of existing facilities than by the creation of new ones.

1/ Muhammad Ali Chaudhary and Malik Muhammad Ashraf, An Economic Analysis of Level and Structure of Irrigation Water Charges (Islamabad: Pakistan Institute of Development Economics, March 1981).

2/ Evidence on this is to be found in many Bank reports. See, for example, A. Nowicki and D. Jones, Cost Recovery and User Charges in the Public Sector (mimeo, November 1982), Health Sector Review (mimeo, January 1983), and appraisal reports on Irrigation Systems Rehabilitation Project (Report No. 3717-PAK, April 1982) and Fourth Drainage Project (Report No. 4380-PAK, April 1983).

Table 2.6: SUMMARY OF PROVINCIAL FINANCES, 1977/78 - 1982/83
(million rupees)

	1977/78	1978/79	1979/80	1980/81	1981/82 Revised	1982/83 Budget
Current revenue	7,823	9,451	11,185	13,595	15,065	16,473
Shared taxes	(3,509)	(4,148)	(6,049)	(8,626)	(9,233)	(9,892)
Other taxes	(1,548)	(1,918)	(2,225)	(2,263)	(2,331)	(2,624)
Non-tax receipts	(2,766)	(3,385)	(2,911)	(2,706)	(3,500)	(3,958)
Current expenditure	7,977	8,856	10,409	12,181	14,633	16,648
Current surplus/deficit	-154	595	776	1,411	432	-175
Development expenditure	3,708	4,289	4,280	4,936	5,796	6,520
Financing of development expenditure:						
Provincial resources	87	776	982	1,634	695	20
Current surplus	(-154)	(595)	(776)	(1,411)	(432)	(-175)
Net capital receipts	(241)	(181)	(206)	(223)	(263)	(195)
Federal transfers	3,621	3,513	3,298	3,302	5,101	6,500

Source: Planning Division.

Table 2.7: PROVINCIAL CURRENT RECEIPTS, 1977/78 - 1982/83
(million rupees)

	1977/78	1978/79	1979/80	1980/81	1981/82 Revised	1982/83 Budget
Tax receipts	5,057	6,066	8,274	10,889	11,564	12,516
1. Share of Federal taxes	3,509	4,148	6,049	8,626	9,233	9,892
2. Provincial taxes	1,548	1,918	2,225	2,263	2,331	2,624
Immovable property tax/a	84	110	156	59	56	59
Land revenue (tax)	117	283	257	216	230	217
Capital gains tax /b	31	38	75	82	101	117
Tax on professions and trades /c	16	18	23	44	45	58
Provincial excises	73	64	27	52	41	51
Registration fees	58	84	97	95	107	128
Stamp duties	441	524	620	664	697	761
Motor vehicle tax	240	263	327	416	463	535
Entertainment tax	238	204	238	273	266	273
Cotton fees /d	60	47	115	110	113	117
Electricity duties	108	146	168	147	135	224
Other	82	137	122	105	77	84
Non-tax receipts	2,766	3,385	2,911	2,706	3,500	3,958
3. Receipts from property and services	1,391	1,551	1,737	1,855	2,098	2,350
Interest and dividends	42	72	67	67	140	195
Economic services/e (excl. irrigation)	359	462	468	550	581	623
Irrigation (water charges)	497	496	576	636	875	895
Law and order	89	87	117	156	198	230
Community services	139	149	182	92	100	105
Social services	87	79	97	156	164	182
Other	178	206	230	198	40	210
4. Federal grants /f	1,375	1,834	1,174	851	1,402	1,608
Total current receipts	7,823	9,451	11,185	13,595	15,064	16,473

/a Although assessed and collected by the provinces, the immovable property tax is a local authority tax. The provinces transmit 80-85% of the proceeds to municipalities and other urban areas from which the tax receipts are derived.

/b A tax on gains in excess of Rs 10,000 from the sale, exchange or transfer of land and buildings in urban areas.

/c A tax on persons engaged in specified employment or trade.

/d Payable by owners of ginning factories.

/e Mainly agricultural services (sale of seeds, soil conservation and plant protection operations, etc.), forestry, and printing.

/f Including miscellaneous adjustments between Federal and Provincial Governments.

Source: Planning Division.

Table 2.8: PROVINCIAL CURRENT EXPENDITURES, 1977/78 - 1982/83
(million rupees)

	1977/78	1978/79	1979/80	1980/81	1981/82 Revised	1982/83 Budget
General administration	655	675	778	972	1,305	1,378
Law and order	840	864	990	1,093	1,271	1,401
Community services	432	529	555	686	912	1,020
Social services	2,701	2,831	3,081	3,567	4,150	4,885
of which: Education	(2,113)	(2,164)	(2,283)	(2,771)	(3,133)	(3,680)
Health	(412)	(504)	(587)	(623)	(784)	(967)
Economic services	1,214	1,389	1,744	2,216	2,711	2,909
of which: Agriculture	(373)	(394)	(519)	(764)	(903)	(1,034)
Irrigation	(618)	(727)	(937)	(1,153)	(1,435)	(1,474)
Subsidies	687	685	992	1,021	1,167	940
Debt servicing	1,384	1,677	2,055	2,425	2,950	3,347
Other	64	206	215	201	166	768
Total	7,977	8,856	10,409	12,181	14,633	16,648

Source: Planning Division.

Public Sector Enterprises

2.17 The large investment requirements of public sector enterprises make their ability to generate internal resources for investment of critical importance in domestic resource mobilization. Proposed investment by public sector enterprises (ADP and non-ADP) amounted to about 45% of total public sector development expenditures in FY83. While self-financing by public enterprises has increased in recent years, internal resources still finance a small proportion of the investment requirements, and the bulk of the resources are generated by a few enterprises. The gap between the public enterprises' investment and self-financing is so large that it would be difficult to ease the overall domestic resource constraint unless public enterprises meet a much larger proportion of their investment requirements from their own funds.

2.18 As already explained, public enterprise investment occurs partly within the ADP and partly outside it. All public enterprise investment financed from Government (budgetary) resources and most of the investment covered by self-financing form part of the ADP. Besides self-financing, the

resources for investment outside the ADP come from borrowing from domestic commercial banks and the National Development Finance Corporation (NDFC), and from foreign sources, mostly in the form of credits (Table 2.9).

2.19 Public enterprise investment for FY83 is projected at Rs 17.8 billion, of which Rs 10.6 billion is included in the ADP and Rs 7.2 billion would be undertaken outside the ADP. The proposed sources of finance for the total investment are Government resources of Rs 7.8 billion (which would cover 44% of the total investment), self-financing of Rs 4.1 billion (23%), bank borrowing of Rs 3.4 billion (19.5%) and external resources of Rs 2.4 billion (13.5%). Should the target for self-financing be realized, internal funds would finance a higher proportion of the investment by public enterprises than in the past.

Table 2.9: PROPOSED INVESTMENT OF PUBLIC AND SEMI-PUBLIC BODIES WITHIN AND OUTSIDE ADP, 1982/83
(million rupees)

Investment within ADP	10,576
Investment outside ADP	7,226
Total investment	17,802
Sources of finance:	
Domestic	15,400
Self-financing	4,111
Federal loans, equity investment and grants	7,849
Bank credit	3,349
National Development Finance Corp. (NDFC)	91
External	2,402
Loans	2,342
Equity	60

Sources: Tables 2.10 and 2.11.

2.20. In the past, the main contribution to self-financing has come from the power wing of the Water and Power Development Authority (Table 2.12). In FY83, the energy and the transport sectors are expected to account for most of the self-financing (Tables 2.10 and 2.11). In the energy sector, the Water and Power Development Authority, Karachi Electricity Supply Corporation, Sui Northern Gas Pipeline Ltd., Karachi Gas Company and the Oil and Gas Development Corporation are expected to finance sizable proportions of investment from their own resources; the same is true of the Pakistan International Airlines Corporation and the National Shipping Corporation in the

transport sector. This favorable picture is greatly modified when manufacturing enterprises are considered. The ADP and non-ADP development outlays of industrial enterprises are projected at Rs 4.5 billion, of which self-financing is expected to account for about Rs 151 million, or 3% of investment; the performance remains disappointing even when steel is excluded.1/

2.21 The ability of public enterprises to generate funds for financing their investment programs depends on a number of factors, including their technical and managerial efficiency, and pricing policies.2/ There is little that can be said about the measures needed to improve the saving performance of public enterprises in general terms. Only careful evaluations of individual enterprises can point to the appropriate policies.

Conclusions

2.22 A significant improvement in the rate of public saving will require higher saving by both general government and public sector enterprises. Given the relatively low level of self-financing by public enterprises, even a substantially improved saving performance by Federal and Provincial Governments would leave a large imbalance between investment and saving in the public sector. Policies to effect a marked improvement in the generation of internal resources by public enterprises should, therefore, be given high priority.

2.23 The achievement of a higher savings rate by Federal and Provincial Governments will require the use of all available instruments. While there would seem to be substantial scope for raising tax revenues as discussed in the following two chapters, higher tax effort alone cannot be expected to have a large impact on the saving rate in view of the need to improve the standard of existing public services and to provide for the recurrent costs of new services. Greater reliance on user charges and reduced use of subsidies should, therefore, supplement tax policy.

1/ High debt/equity ratios in industrial enterprises may have been one major factor limiting their ability to generate internal funds for investment.

2/ For a discussion of some of these aspects, see Leroy Jones, Efficiency of Public Enterprises in Pakistan (prepared for the Pakistan Ministry of Production, mimeo, February 1981).

Table 2.10: PROPOSED INVESTMENT OF PUBLIC AUTONOMOUS BODIES WITHIN ADP, 1982/83
(million rupees)

	Development Expenditure	Sources of Finance	
		Self-financing	Gov't
Water & Power Development Authority (power wing)	4,830.7	2,576.0	2,254.7
Water & Power Development Authority (water wing)	1,874.1	-	1,874.1
Mineral Development Corp.	62.6	-	62.6
Pakistan Railways	1,300.0	-	1,300.0
Pakistan Industrial Development Corp.	7.6	-	7.6
Pakistan Steel Mills Corp.	2,350.0	-	2,350.0
National Fertilizer Corp.	6.2	6.2	-
Chemical & Ceramics Corp.	18.1	18.1	-
Pakistan Automobile Corp.	126.6	126.6	-
Total	10,575.9	2,726.9	7,849.0

Source: Explanatory Memorandum on the Budget, 1982-83.

Table 2.11: PROPOSED INVESTMENT OF PUBLIC AND SEMI-PUBLIC BODIES OUTSIDE ADP, 1982/83
(million rupees)

	Development Expenditure	Sources of Finance			
		Bank credit	NDFC	Self-financing	Foreign
Agriculture	35.2	12.7	-	22.5	-
Power	1,874.8	900.0	-	674.8	300.0
Karachi Electricity Supply Corp.	1,874.8	900.0	-	674.8	300.0
Fuels	2,599.8	843.2	-	323.4	1,433.2
Sui Gas Transmission Co.	508.6	245.0	-	7.9	255.7
Sui Northern Gas Pipeline Ltd.	170.0	120.0	-	50.0	-
Karachi Gas Co.	76.4	20.0	-	56.4	-
Oil & Gas Development Corp.	1,000.0	-	-	200.0	800.0
Indus Gas Co.	94.8	85.7	-	9.1	-
Directorate General, Oil	749.9	372.4	-	-	377.5
Industry	2,028.2	1,593.0	81.3	0.4	353.0
Pakistan Steel Mills Corp.	950.0	950.0	-	-	-
Pakistan Industrial Dev. Corp.	30.8	25.3	-	-	5.5
Chemical & Ceramics Corp.	16.1	14.0	-	-	2.1
Pakistan Automobile Corp.	230.1	49.9	40.0	-	140.2
National Fertilizer Corp.	179.2	23.0	-	-	156.2
State Cement Corp.	317.0	271.0	-	-	46.0
State Electrical Corp.	41.8	-	41.8	-	-
Petroleum Refining & Petro-chemical Corp.	2.1	-	2.1	-	-
Karachi Shipyard & Engineering Works	20.0	20.0	-	-	-
Other	241.2	237.8	-	0.4	3.0
Minerals	18.8	-	9.1	1.0	8.7
Transport & Communications	435.6	-	-	337.8	97.8
NLC	92.8	-	-	2.0	90.8
Pakistan International Airlines	294.9	-	-	294.9	-
National Shipping Corp.	47.9	-	-	40.9	7.0
Planning & Housing (NLC)	24.0	-	-	24.0	-
Miscellaneous (NDFC)	209.4	-	-	-	209.4
Total	7,225.8	3,348.9	90.9	1,383.9	2,402.1

Source: Public Sector Development Programme of the Federal Government, 1982-83.

Table 2.12: SELF-FINANCING OF ADP INVESTMENT BY AUTONOMOUS BODIES, 1977/78-1982/83
(million rupees)

	1977/78	1978/79	1979/80	1980/81	1981/82 Revised	1982/83 Budget
Pakistan Railways	76	135	7	-	-	-
Water and Power Dev. Authority	246	587	1,250	1,759	1,843	2,576
State industrial corporations	156	230	129	256	37	151
Capital Development Authority	20	10	10	-	-	-
Television and broadcasting corporations	25	-	-	-	-	-
Pakistan Mineral Dev. Corp.	-	13	8	4	2	-
Rice Export Corp.	-	-	78	-	-	-
Export Processing Zone Authority	-	-	25	-	-	-
Resources Development Corp.	-	-	-	-	20	-
Other	-	-	-	-	7	11
Total	523	975	1,507	2,019	1,909	2,738

Source: Planning Division.

3. TAXATION OF PERSONAL INCOME AND WEALTH

3.1 Five taxes dominate Pakistan's tax structure. Together, individual and company income taxes, import and excise duties, and the sales tax account for 95% of federal tax revenues (Table 3.1). Export duties, which were an important source of revenues in the early 1970s, presently play a minor role in the tax structure.1/ The taxation of capital gains has been suspended since 1975. Revenues from federal taxes amount to about 12.4% of GDP.

3.2 The tax structure also contains two levies - zakat and ushr - derived from the country's Islamic traditions. The receipts from these levies do not form part of the budget, but are distributed to the indigent (particularly widows, orphans and the disabled). With the introduction of zakat, the taxation of net wealth has assumed importance (see paragraph 3.26 below).

3.3 The most dramatic change in the tax structure over the past decade has been the emergence of import duties as the largest source of revenue. The contribution of import duties to total revenues rose from 21% in FY72 to 37% in FY82. This trend was also reflected in the ratio of import duty receipts to GDP, which increased from 2.1% to 4.6%. The share of excise duties in both total revenues and GDP fell, while that of the sales tax rose modestly. Excise and sales taxes accounted for 29% and 8% of tax revenues, respectively. The relative share of income tax in tax revenues, which stood at 21% in FY82, fell slightly despite an increase in the ratio of income tax receipts to GDP from 2.3% to 2.6% during the period. Reflecting these trends, the relative share of indirect taxes rose from 74% to 78%.

1/ Export taxes on a wide range of products were imposed after the devaluation of 1972 to capture part of the windfall profits accruing to exporters. Export taxes are now confined to raw cotton, hides and skins, molasses and stainless steel scrap.

Table 3.1: TAX REVENUES OF FEDERAL GOVERNMENT, 1971/72, 1976/77 and 1981/82
(amounts in million rupees)

	1971/72	1976/77	1981/82	% of total 1971/72	% of total 1981/82
Taxes on Income	1,379	2,766	8,729	25.6	21.8
Individual income tax	892	1,898	6,737	16.6	16.8
Corporate tax	345	761	1,572	6.4	3.9
Workers' welfare tax	-	25	26	-	0.1
Export duties	142	82	394	2.6	1.0
Indirect Taxes	3,981	13,809	31,121	73.8	77.8
Import duties	1,138	5,958	14,680	21.1	36.7
Federal excise duties	2,111	5,429	11,740	39.2	29.3
Sales tax	418	1,363	3,251	7.8	8.1
Surcharges	314	1,057	1,444	5.8	3.6
Stamp duties	-	-	6	-	..
Taxes on Capital	30	38	151	0.6	0.4
Wealth tax	18	25	135	..	0.3
Estate duty	7	6	4	..	..
Gift tax	5	7	12	..	0.1
Total	5,390	16,611	40,001	100.0	100.0
GDP at current market prices (million rupees)	54,058	149,452	322,289		
Tax revenues as % of GDP at current market prices	10.0	11.1	12.4		
GDP deflator (1971/72 = 100)	100	217	341		
Tax revenues at 1971/72 prices	5,390	7,655	11,730		

Sources: Directorate of Research and Statistics, Central Board of Revenue; and Public Finance Statistics, 1981-82.

3.4 This chapter discusses the individual income tax and the two main taxes on capital, zakat and the wealth tax.1/ Company income tax, including the treatment of dividends in the hands of the shareholders, is discussed in Chapter 6. Indirect taxation forms the subject of the next chapter.

The Individual Income Tax

3.5 The individual income tax has been simplified over the last few years by reducing the range of allowances, with the result that the number of remaining concessions is small. The major exemption is for agricultural income, which is excluded from income tax entirely. Other income earners have a basic exemption of Rs 12,000, irrespective of family size. Tax relief for saving is provided through an investment allowance and the exemption of interest from certain instruments. Finally, perquisites (fringe benefits) are treated more favorably than other forms of income. These features of the tax system are reviewed below.

3.6 The introduction and development of a self-assessment scheme,2/ use of surveys to identify taxpayers and other improvements in tax administration have contributed substantially to the rapid growth of income tax revenues over the last few years. Between FY79 and FY82, the number of taxpayers doubled, increasing from 500,000 to a million, and income tax receipts from individuals and businesses rose from Rs 3.3 billion to Rs 8.3 billion, or by 80% in real terms. Of the total taxpayers, about 240,000 are employees and 8,000 are companies, with the remainder consisting of the self-employed, unincorporated firms and associations.

3.7 The possibilities for raising significant additional revenues from the individual income tax would depend largely on the extent to which the tax base can be enlarged. While the recent broadening of the tax base represents a considerable achievement, the tax base is still narrow, mainly because of the exclusion of agricultural income and the inherent difficulties of taxing the self-employed and small businesses.

3.8 Personal Exemptions. To judge whether the present personal allowance of Rs 12,000 is realistic, its size must be reviewed in relation to the income needed for subsistence by a family of an average size, and the ability of the tax authorities to reach non-salary incomes just above the exemption

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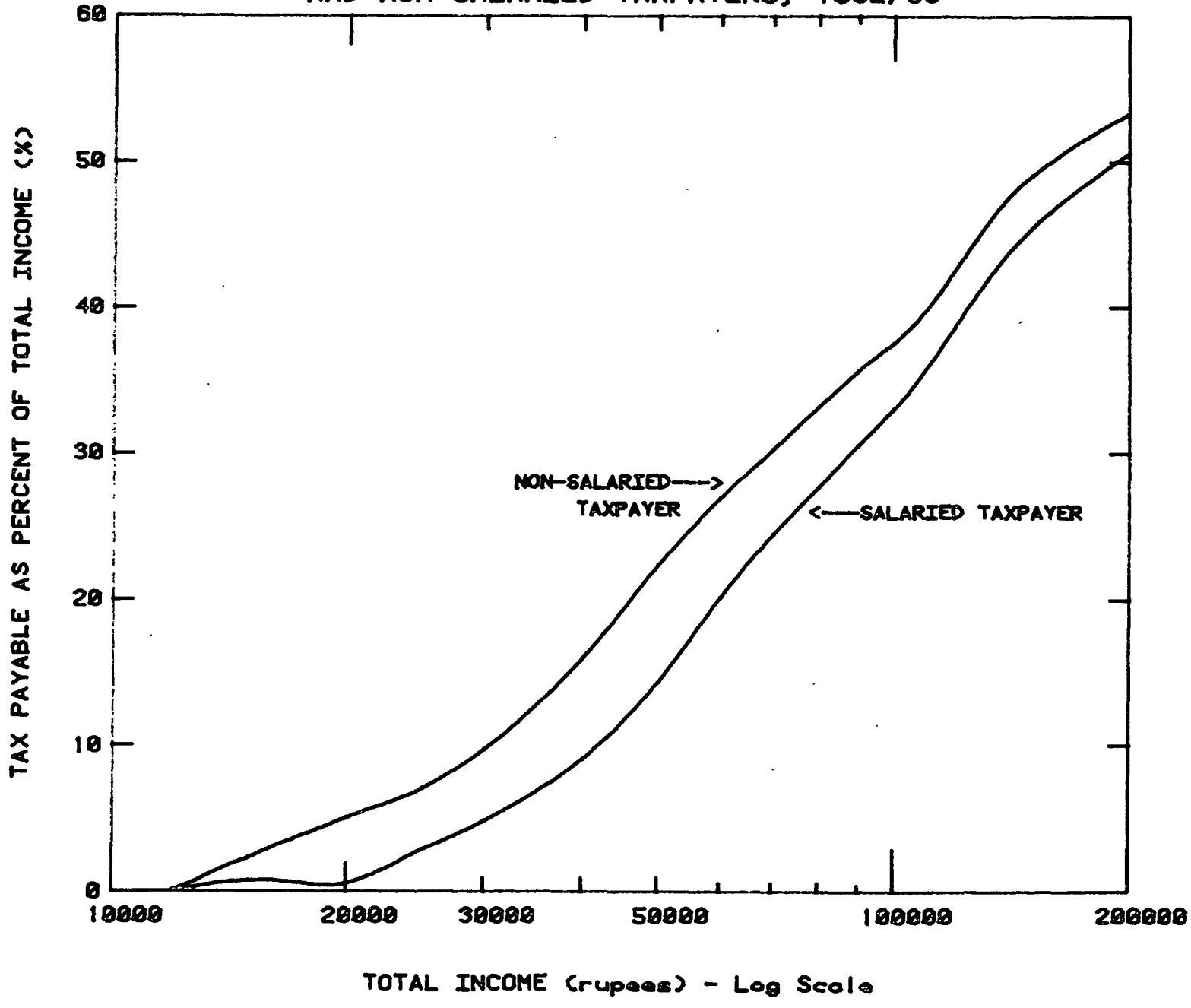
1/ Only the salient features of these taxes will be explained here. A detailed description is given in Annex I.

2/ For details, see Evaluation of Self-Assessment Scheme and Self-Assessment Scheme for 1981-82 (Islamabad: Central Board of Revenue, 1981).

CHART I: EFFECTIVE RATES OF INCOME TAX FOR SALARIED AND NON-SALARIED TAXPAYERS, 1982/83



level. In the absence of reliable direct estimates of income needed for subsistence, some assumptions must be made. Taking six persons to a household and assuming that an income of 75% of per capita GNP is needed for subsistence gives the income needed for subsistence by the household of about Rs 17,785.1/ This suggests that the present allowance is at about the right level, since only nominal amount of income tax is payable on total incomes just above the present exemption level.2/ On the other hand, since the exemption is effectively at about the same level as the subsistence requirements, the taxation of small businesses with incomes just above the exemption level must present difficulties. However, the magnitude of this problem is unlikely to be affected noticeably unless the allowance is raised significantly.

3.9 Furthermore, the present allowance is generous for small families, and for families with more than one earner.3/ All in all, therefore, the size of the present allowance seems reasonable.

3.10 Treatment of Perquisites. The proper tax treatment of cash and non-cash benefits provided by the employer as part of salary could bring substantial additional revenues. Perquisites are not being adequately taxed at present (Table 3.2). The main concession is for housing but that for transport is also important. The maximum income imputed to the employee for unfurnished housing provided by an employer is only 10% of the former's salary. Given current housing costs in Pakistan, this conveys considerable benefits. The maximum taxable amount for transport provided for the business and personal use of an employee is only Rs 3,600. The principal objective in the treatment of fringe benefits should be to tax them to the fullest extent consistent with administrative practicability and not to convey tax concessions.

1/ This probably overstates the subsistence requirements. According to the latest household budget survey, the average monthly income of an urban household in 1979 was Rs 1,345, and 69.3% of urban households had incomes of under Rs 1,500 per month. See Household Income and Expenditure Survey (Karachi: Federal Bureau of Statistics, 1983).

2/ For example, the tax payable by salaried and non-salaried persons with a total income of Rs 20,000 is Rs 120 and Rs 1,020, respectively. See Annex I, Tables 1 and 3.

3/ Broadly, the income of an assessee's spouse is taxed separately if it is unconnected with the assessee's business.

Table 3.2: TAXATION OF SELECTED PERQUISITES

Nature of Perquisite		Extent to which taxed
(i)	House rent allowance	Amount exceeding 45% of the starting salary for a particular post.
(ii)	Rent free unfurnished accommodation	Amount exceeding 45% of the starting salary for a particular post, with a maximum of 10% of salary.
(iii)	Rent free furnished accommodation	Amount under (ii) plus 5% of salary.
(iv)	Conveyance provided by employer for personal use of employee	Amount actually spent by employer on running and maintenance (including normal depreciation).
(v)	Conveyance provided for both business and personal use of employee	50% of the amount under (iv) or Rs 3,600, whichever is less.
(vi)	Conveyance allowance where conveyance is owned and maintained by employee	Amount exceeding Rs 3,600 or exceeding amount actually spent in performance of duties, whichever is higher.
(vii)	Free or concessional passage for travel abroad or within Pakistan in accordance with terms of employment	Amount exceeding the actual expenditure by employee.
(viii)	Entertainment allowance	Full amount of allowance.
(ix)	Medical expenses	Amount received from employer in excess of actual expenditure.

Source: Income Tax Manual, Part II, Income Tax Rules 1982 (Central Board of Revenue).

3.11 The relatively high marginal rates of tax at the upper end of the tax scale overstate the rates that apply in practice, given especially the present treatment of perquisites. Adequate taxation of perquisites could, therefore, be accompanied by some reductions in marginal rates at high incomes.

3.12 It is recognized that the present salary structure in the country takes account of the undervaluation of perquisites for tax purposes, and that a change in the present practice may lead to the need in some cases for adjustments in salary levels. Despite this, and apart from its possible contribution to revenues, adequate taxation of perquisites would be desirable for the important contribution it could make to the equity of the tax system.

3.13 Investment Allowance. The investment allowance is granted for investment in qualifying assets of up to 1/3 of total income, with a maximum of Rs 50,000. The allowance is essentially a tax rebate given at the taxpayer's average rate of income tax. Thus, a taxpayer investing Rs 100 and paying tax at the average rate of 20% can deduct Rs 20 from his tax liability. The qualifying investments comprise contributions to provident and pension funds, life insurance premiums, unit trusts and mutual funds, shares and debentures of specified public companies, and defense savings certificates.1/

3.14 The structure of returns on assets is an important element in the formulation of policies for encouraging personal saving. While the issue of the magnitude of the interest elasticity of saving is by no means empirically resolved,2/ a country with a low savings rate is well advised to proceed on the assumption of an operationally significant elasticity of personal saving. To the extent that personal saving responds to the rates of return, it is the real after-tax returns that matter. Broadly, the investment allowance is thought to be a suitable means of providing tax relief for saving, and its operation is reviewed very briefly.

3.15 The scope of the investment allowance is comparatively wide. While most countries grant tax relief for saving through provident and pension schemes and life insurance, the treatment of company shares, unit trusts and mutual funds seems to be more generous than in other countries. However, in view of the low interest in equities, a change in the present arrangements is not recommended. It will be suggested later that consideration should be

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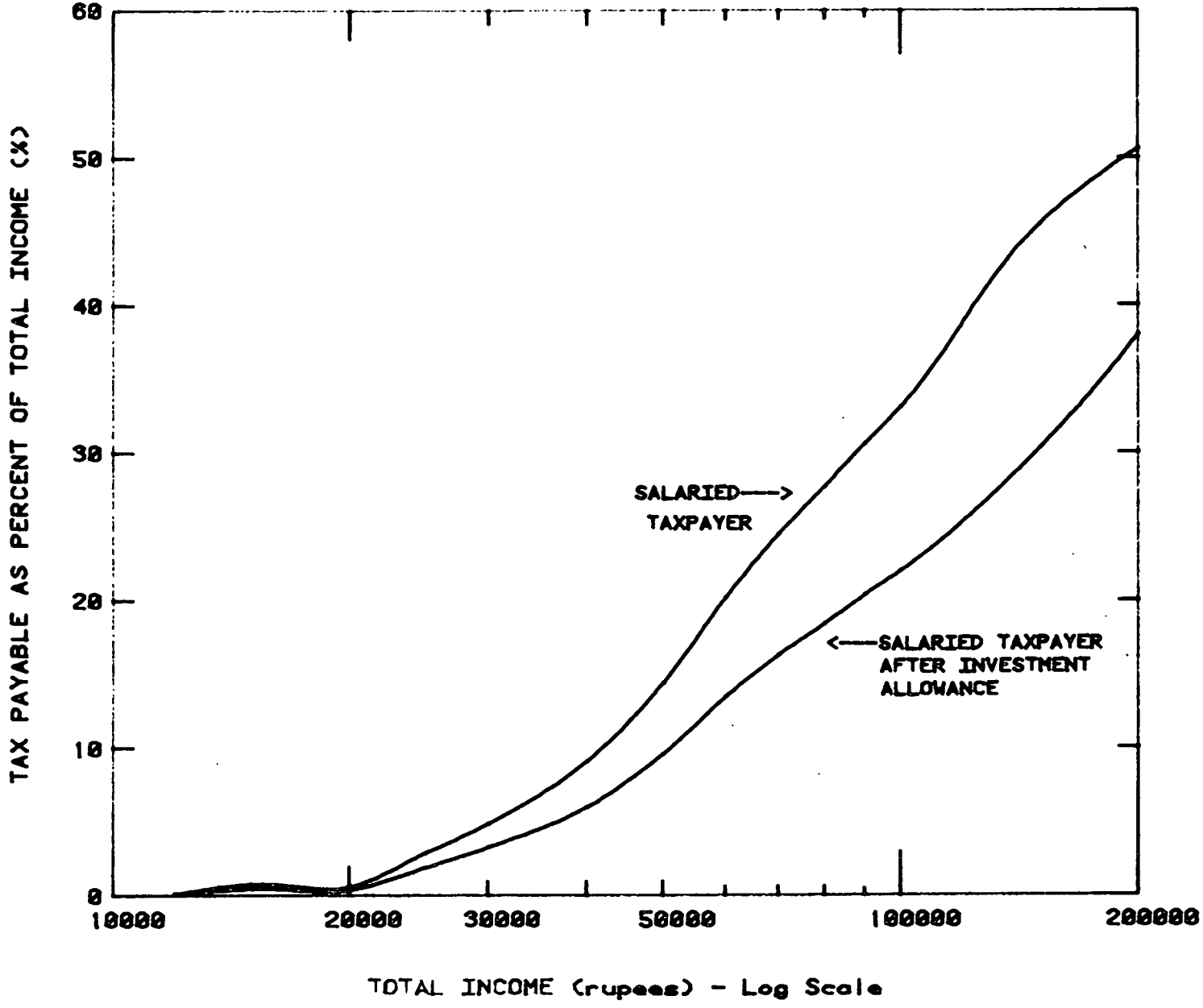
1/ For further details, see Annex I, paragraphs 11-14.

2/ See, especially, Michael J. Boskin, "Taxation, Saving and the Rate of Interest," Journal of Political Economy, April 1978, and E. Philip Howrey and Saul H. Hymans, "The Measurement and Determination of Loanable Funds Saving," Brookings Papers on Economic Activity, No. 3 of 1978.

CHART II: EFFECT OF INVESTMENT ALLOWANCE ON EFFECTIVE RATES OF INCOME TAX FOR SALARIED TAXPAYERS, 1982/83



NOTE: CALCULATIONS ARE BASED ON THE ASSUMPTION THAT THE INVESTMENT ALLOWANCE IS UTILIZED TO THE MAXIMUM EXTENT PERMISSIBLE.

given to the withdrawal of the investment allowance from defense savings certificates.

3.16 There has been some uncertainty in Pakistan concerning the rate at which the investment allowance should be given. Until a few years ago the rebate was given at the taxpayer's marginal rate, but it is now given at the taxpayer's average rate. It would appear that tax relief at a single rate would not be satisfactory for all assets. For instance, since pension benefits are taxed at the marginal rate, it would seem appropriate to provide tax relief for the contributions also at the marginal rate. On the other hand, there is no obvious reason why tax relief for life insurance should depend on the taxpayer's marginal rate; in this instance, tax relief at a uniform rate, which would reduce the relative cost of life insurance for all taxpayers equally, is probably preferable. However, since granting tax relief for some investments at the marginal rate and for others at a uniform rate would be administratively cumbersome, the present approach should be retained.

3.17 The investment allowance is widely used by middle and high income taxpayers and is perhaps the most costly concession in terms of the revenue foregone. However desirable substantial relief for saving may be, the revenue considerations cannot be ignored. Therefore, when details of the use of the allowance by the type of taxpayer and asset become available,1/ the operation of the allowance should be reviewed. Meanwhile, the allowance seems sufficiently high and should not be increased.

3.18 Exemption of Interest from National Savings Schemes. Interest paid on instruments under the Government's national savings schemes is exempt from tax, but that on commercial bank deposits is taxable. The resulting large gap in after-tax yields on bank deposits and national savings instruments may limit the role of the banking system in resource mobilization, especially in rural areas, as discussed further in chapter 5.

3.19 Under the present arrangements, there is a danger that too large a proportion of household saving may flow into the public sector. The role of national savings schemes in the mobilization of deposits has already increased significantly. The relative share of national savings deposits in total deposits (national savings and bank deposits) rose from about 13% in 1971 to 19% in 1982. More striking is the gain made by national savings

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1/ The publication of comprehensive income tax statistics ceased in 1972. With the recent computerization of income tax returns, the compilation of income tax statistics has been resumed.

schemes in fixed deposit type accounts.1/ Fixed deposits under national saving schemes accounted for about 40% of total fixed deposits in 1982, compared to 26% in 1971. If the present differentials in after-tax returns persist, fixed deposits under national savings schemes could be expected to outstrip those at commercial banks.

3.20 The simplest way of dealing with these problems, while at the same time retaining some tax relief for interest income, would be to exempt interest from all sources up to a specified amount. Income from profit and loss sharing (PLS) accounts,2/ which presently qualify for the dividend exclusion,3/ should also be brought within the scope of such an exemption. The effect of a uniform tax treatment of all interest income on tax revenues would depend on the size of the exemption.

3.21 Exemption of Agricultural Income. Agriculture accounts for about 30% of GDP and provides livelihood to over 50% of the labor force. The exclusion of such a large sector from the tax must inevitably limit the opportunities for the mobilization of domestic resources. It can also be expected to be a major source of inequity and inefficiency in Pakistan's tax system; these equity and efficiency effects will tend to be magnified by the treatment of agricultural property under the wealth tax, as explained in the following section.

3.22 The efficiency aspect may be worth explaining in general terms. The main assumption required for this purpose is that there is a tendency for the net-of-tax returns to capital to be equalized in all activities. Since gross-of-tax returns in non-agricultural activities must be higher than in agriculture (where the absence of taxation means that gross and net returns are equal) if comparable net-of-tax returns are to be realized in all activities, and since the gross-of-tax return reflects the marginal productivity of capital, output could be increased by shifting capital from activities where it has a relatively low marginal productivity (agricultural) to those where it has a higher marginal productivity (non-agricultural). It is this loss of real output that is referred to as the efficiency (welfare) cost of taxation. What prevents capital from moving to activities where it is more productive is that taxpayers are concerned with the after-tax returns rather than the gross returns. Taxing agricultural income in the same manner as other incomes would remove the influence of taxation in the allocation of

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1/ All national savings accounts except savings accounts and prize bonds can be considered as such accounts.

2/ The PLS accounts were introduced as part of the policy of Islamization. The returns on these accounts are not fixed in advance but depend on the profitability of the investments financed from such deposits.

3/ Dividends of up to Rs 15,000 from certain sources are exempt from income tax. See Annex I, paragraph 19.

resources between the agricultural and non-agricultural sectors, thereby encouraging resources to move in a direction which would increase national product.

3.23 The situation with respect to the taxation of agriculture has changed with the introduction of ushr from the rabi (winter) season 1982/83. Ushr is a levy on the gross value of agricultural production. To make an allowance for costs of production, the levy is restricted to 75% of the value of production.1/ The levy is assessed on a self assessment basis, but collected compulsorily from landowners, leaseholders and others at the rate of 5% of their share of the produce; tenants are not subject to the compulsory levy of ushr under the proposed system of collection. All persons with production of under 948 kg of wheat (or its equivalent in value) are exempt.

3.24 The introduction of ushr makes an examination of other far-reaching changes in the taxation of agricultural incomes inappropriate at the present time. However, given the important role that the inclusion of agricultural income in the income tax net could play in the country's resource mobilization efforts over the long term, ushr should not be regarded as precluding the taxation of agriculture through income tax in the foreseeable future. The taxation of relatively rich farmers (defined in terms of the size of the holding or other suitable means) through income tax should be seriously considered when ushr has been in operation for a year or two and its working becomes clearer. Provided ushr paid is permitted to be set off against income tax liability, all taxpayers would in effect be subject to a single direct tax on agricultural income.

Taxation of Wealth

3.25 The wealth tax has been a part of Pakistan's tax structure since 1963. When zakat was introduced in 1980, certain assets were exempted from the wealth tax and made liable to zakat. Both taxes are levied on net wealth. There are separate exemption limits for movable property (Rs 300,000), and for immovable agricultural property (Rs 100,000) and non-agricultural property (Rs 500,000 or a house used by the taxpayer) for the wealth tax, but there is no exemption limit for zakat with the exception of savings accounts of under Rs 2,000. Zakat is levied at the rate of 2.5%, as is the wealth tax on all immovable property; the rates of wealth tax on movable property range from 0.5% to 2.5%.

3.26 Zakat is compulsorily deducted from specified assets. Since this method of collection requires that the assets to which the levy is applied must be relatively easy to value, zakat is confined to financial assets such as savings and time deposits, Government securities, shares and debentures,

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1/ Two thirds where tubewell irrigation is utilized.

and mutual funds. With the inclusion of most movable assets in zakat, the wealth tax has become primarily a tax on immovable property; about 80-85% of the receipts from the wealth tax come from real estate. The revenue from zakat amounted to Rs 904 million in FY82, compared to Rs 135 million from the wealth tax. About 90% of zakat receipts are derived from deposits (Table 3.3), which dominate the holdings of financial assets by households. The effect of zakat on returns from deposits is considered in Chapter 5.

3.27 Two taxes on wealth, differing in scope as well as exemption limits, are bound to influence the composition of household assets. Zakat, in conjunction with the wealth tax, would tend to encourage a shift toward assets not subject to the compulsory deduction of zakat. The holding of (non-financial) movable property (e.g., jewelry) would be encouraged since the maximum rate of wealth tax for movable property (which equals the rate of zakat) applies to only very substantial holdings of wealth (that is, movable property in excess of Rs 2 million), and such property held by different members of a family need not be aggregated for tax purposes. More important, the present system of wealth taxation would encourage a shift from financial assets to real estate, since net wealth in the form of real estate of up to Rs 500,000, and considerably more for a taxpayer owning a luxury home (since the taxpayer has the option of substituting a home he occupies for the general exemption), is exempt from the wealth tax.

Table 3.3: RECEIPTS FROM ZAKAT, 1981/82
(million rupees)

Savings bank accounts	658.4
Savings deposit certificates	29.8
Notice deposit receipts and accounts	39.3
Fixed deposit receipts and accounts	111.8
National Investment Trust (NIT) units	19.5
Investment Corporation of Pakistan (ICP) mutual funds	1.1
Government securities	0.9
Shares and debentures of companies	25.5
Life insurance policies	4.7
Provident funds	11.5
Zakat deducted at source	902.4
Zakat paid voluntarily	1.6
Total receipts	904.0

Source: State Bank of Pakistan, Annual Report, 1981-82.

3.28 Although receiving a lower exemption than non-agricultural property, agricultural property is treated much more favorably than other immovable property. There are several reasons for this. A person is exempt from the

payment of the wealth tax on agricultural land if he is not liable to income tax and if no tax would be payable by him on his net wealth excluding agricultural land. This means that a person with income of under Rs 12,000 from non-agricultural sources, and with net wealth in the form of non-agricultural immovable property of under Rs 500,000, would not be liable to the wealth tax on agricultural land. Even when it does not qualify for an exemption, agricultural land is likely to be taxed more lightly than other immovable property because the value of agricultural land for tax purposes is based on out-of-date produce index units (PIU).1/ Moreover, unlike non-agricultural immovable property, agricultural land held by different members of a family need not be aggregated.

3.29 Under the present system of wealth taxation, agricultural land is treated most favorably and financial assets the least favorably. Careful thought is needed on the measures required to avoid or reduce tax-induced shifts in the composition of assets without vitiating the main purpose of zakat of taxing the wealth of the more fortunate members of the society for the benefit of the less fortunate.

Conclusions

3.30 Unless some fundamental changes in income tax - such as the imposition of the tax on agricultural incomes, and the proper taxation of perquisites - are considered, the growth of revenues from the individual income tax over the next few years would depend more on improvements in administration than on structural reforms. The impressive results yielded by the recent initiatives to combat tax evasion and avoidance have already been noted. The small number of possibilities for increasing receipts from the individual income tax through changes in the tax structure give added importance to continuing improvements in tax administration.

3.31 There are no major possibilities for increasing the yield of taxes on wealth. The main issue in the taxation of wealth is how to achieve greater coordination between zakat and the wealth tax so that different types of assets are treated more or less equally.

3.32 The importance of taxing the agricultural sector adequately cannot be stressed too strongly. The proper taxation of agricultural incomes and property is needed not only for revenue reasons but also for considerations of efficiency and equity.

1/ A produce index unit is a rough measure of the gross value of production per acre.

4. INDIRECT TAXATION

4.1 Some broad aspects of Pakistan's indirect taxes are worth noting before reviewing individual taxes.1/ First, taxes with revenue-cum-protective effects dominate taxes with purely revenue effects; the three main indirect taxes all have protective effects. Second, tax receipts from imports (import duties and sales taxes on imports) have grown substantially but those from domestic production (excise and sales taxes on domestically produced goods) have stagnated (in relation to GDP). Third, most of the revenues from import duties are derived from intermediate and capital goods and not consumer goods. This is one of the most unusual aspects of Pakistan's tax system; it is to be explained by restrictions on the import of consumer goods, combined with the fact that the admitted consumer good imports consist mostly of goods such as food and medicines, which are exempt or lightly taxed. These aspects will be discussed further. What is clear, however, is that, in a tax system characterized by these features, the protective effects of revenue measures have to be carefully considered.

Import Duties

4.2 The sizable dependence on import duties for revenues has meant that the rates of import duties are fairly high. Most items of machinery and equipment bear a tax of 40%, but agricultural machinery is admitted free of tax. Most raw materials and components are taxed at rates ranging from 40% to 100%. Most consumer goods are taxed at rates of between 85-120%, but higher rates apply to some consumer durables. Overall, ad valorem rates (as distinct from specific rates) provided 75% of import duty revenues in FY82, with the commodities taxed at the rates of 40%, 70% and 85% accounting for about 70% of the revenues from ad valorem rates.

4.3 This structure of import duties is substantially modified by various concessions. Imports of plant, machinery, raw materials and components for certain purposes are allowed duty free or at concessional rates of duty. For plant and machinery, the main concession is for balancing, modernization and replacement (BMR): plant and machinery for specified industries is completely exempt from duty, and that for industry located in certain parts of the country is completely or partially exempt, regardless of the nature of the industry. In some instances, the concessions are only available if machinery is not manufactured locally.

4.4 For raw materials and components, a preferential treatment is accorded to the manufacture of 22 specified capital goods, a wide range of

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1/ Only the salient features of indirect taxes will be explained here. A detailed description is given in Annex II.

agricultural implements and some agricultural inputs, and the local assembly of tractors and vehicles. As in the case of machinery, there are also BMR and regional incentives: the duties paid on raw materials and components used in the manufacture of the specified capital goods are completely or partially refunded where the goods are used in certain areas and projects for BMR.1/

4.5 Major imports such as iron and steel products, machinery, fuels, vehicles, and yarn and fabrics contributed about 52% of import duty revenues in FY82 (Table 4.1), compared to about 60% in FY73. The relative shares of vehicles, yarn and fabrics have risen while those of iron, steel and products, machinery and fuels have declined.

4.6 Import substitution in steel resulting from the completion of the Karachi Steel Mill would have sizable effects on the revenues from iron, steel and products. In FY82, these goods contributed Rs 2 billion in import duties, or 13% of total import duty revenues. According to rough Government estimates, these products would contribute Rs 3.7 billion less in revenues (than would have accrued in the absence of the domestic production of steel) when the Steel Mill achieves full capacity in 1985.

Table 4.1: IMPORT DUTY REVENUES BY COMMODITY GROUPS, 1972/73 AND 1981/82
(amounts in million rupees)

	Import duty collections		As % of total	
	1972/73	1981/82	1972/73	1981/82
Chemicals and products	61	506	3.8	3.2
Dyes, paints and varnishes	33	368	2.1	2.4
Iron, steel and products	257	2,072	16.0	13.2
Machinery	310	1,793	19.3	11.5
Metals other than gold, silver, iron and steel	29	293	1.8	1.9
Mineral fuel, oil and products	205	503	12.7	3.2
Rubber and products	45	1,020	2.8	6.5
Vehicles	110	1,666	6.8	10.7
Wood, pulp and stationery	23	298	1.4	1.9
Yarn and fabrics	91	2,133	3.6	13.6
Other	347	4,986	29.7	31.9
Total	1,608	15,638	100.0	100.0

Note: The collections are gross of rebates and refunds.

Source: Directorate of Research and Statistics, Central Board of Revenue.

1/ The cost of rebates and refunds of import duties is estimated at Rs 2 billion for FY83.

4.7 The relative contributions of consumer, intermediate and capital goods to import duty revenues have changed somewhat in recent years; the relative shares of consumer and intermediate goods have risen sightly while the relative share of capital goods has fallen (Table 4.2). The increase in the relative contribution of consumer goods from 16% in FY78 to 18% was primarily due to higher rates of duty rather than higher consumer good imports, which grew marginally in absolute terms.

4.8 The protective effects of import duties will be explained when other indirect taxes have been discussed. Two aspects of import duties, however, may be noted here. First, providing protection to selected industries and regions by exempting machinery and raw materials used by them from duties has an unintended effect: the use of imported rather than domestic machinery and intermediate goods is encouraged. Second, the protective effects of the present practice of taxing imported luxury goods, and especially consumer durables, through relatively high rates of import duties are reinforced through the sales tax, which subjects imported luxury goods to higher rates of tax than similar domestic goods.

Table 4.2: IMPORT DUTIES BY ECONOMIC CATEGORIES, 1977/78 AND 1981/82
(amounts in million rupees)

	1977/78			1980/81		
	Import value (1)	Import duty receipts (2)	Tax rates (2 as % of 1) (3)	Import value (4)	Import duty receipts (5)	Tax rates (5 as % of 4) (6)
Consumer goods	3,414	1,194 (16.0)	35.0	3,666	2,210 (18.3)	60.3
Raw materials for consumer goods	5,200	2,243 (30.0)	43.1	11,100	3,701 (30.6)	33.3
Raw materials for capital goods	1,541	720 (9.6)	46.7	3,373	1,381 (11.4)	40.9
Capital goods	9,316	3,325 (44.4)	35.7	13,305	4,784 (39.6)	36.0
Total	19,471	7,482 (100.0)	38.4	31,444	12,076 (100.0)	38.4

Note: Figures in brackets denote relative shares in total.

Source: Central Board of Revenue (based on Custom House, Karachi data).

Excise Duties

4.9 The tax base for excises is domestic production rather than consumption (domestic production plus imports). A major economic effect of excises is, therefore, to reduce protection accorded through the import tariff. Excises are at present levied on 41 commodities, 19 of which are taxed through specific rates and the remaining 22 through ad valorem rates.

4.10 As is usual in countries with limited industrialization, most excise revenues come from a few commodities (Table 4.3). In FY73, 80% of excise revenue was derived from sugar, cotton yarn, natural gas, petroleum, cement, tobacco and vegetable ghee (oil). These products contributed 88% in FY82, though the relative shares of different products have changed significantly. The sharp increase in the relative shares of sugar, cement and tobacco is noteworthy; these three commodities currently account for 62.5% of excise revenues. Equally striking is the decline in the relative contribution of petroleum products from 33% in FY73 to 11% in FY82. Taxation of petroleum plays a major role in resource mobilization in many countries, and its future role in Pakistan needs to be reviewed.

4.11 Rates of excise tax on selected excisable commodities are given in Table 4.4. Specific rates on major commodities have been converted into approximate ad valorem rates to give some idea about the range of tax rates. In general, the rates are not so high as to preclude further increases. Only three commodities (cigarettes, cement and beverages) are taxed at a rate higher than 30%. The combined rate of tax for most goods subject to both the excise and sales taxes is about 20%.

Table 4.3: EXCISE DUTY REVENUES BY COMMODITY GROUPS, 1972/73 and 1981/82
(amounts in million rupees)

	Excise duty collections		As % of total	
	1972/73	1981/82	1972/73	1981/82
Sugar	120	1,614	5.2	13.7
Cotton yarn	182	271	8.0	2.3
Natural gas	45	721	2.0	6.2
Petroleum products	757	1,243	33.4	10.6
Matches	7	21	0.3	0.2
Cement	66	2,034	2.9	17.3
Tobacco	514	3,698	22.7	31.5
Vegetable products	125	725	5.5	6.2
Soaps and detergents	24	192	1.1	1.6
Paints and varnishes	24	143	1.1	1.2
Beverages	16	424	0.7	3.6
Cosmetics	20	60	0.9	0.5
Electric batteries	22	59	1.0	0.5
Hotel services	12	89	0.5	0.8
Woollen fabrics	18	41	0.8	0.3
Man-made fibers and yarns	44	61	1.9	0.5
Soda ash	8	16	0.4	0.1
Tyres and tubes	20	18	0.8	0.2
Electric bulbs and tubes	9	66	0.4	0.6
Bank checks	9	21	0.4	0.2
Other	226	224	10.8	1.9
Total	2,268	11,741	100.0	100.0

Note: The collections are gross of refunds.

Source: Directorate of Research and Statistics, Central Board of Revenue.

Table 4.4: RATES OF EXCISE DUTIES ON SELECTED COMMODITIES

Commodities taxed at specific rates

	Value of production (million rupees)	Excise revenue (million rupees)	Ad valorem tax rate (%)
Vegetable ghee	4,754.5	725.5	15.3
Beverages	1,288.2	423.7	32.9
Sugar	9,229.1	1,614.3	17.5
Cement	3,681.2	2,034.1	55.3
Cotton yarn	8,831.0	271.0	3.1
Paper and paperboard	808.0	18.4	2.3
Petroleum products			
	Retail price	Tax rate	
Motor spirits	Rs 6/litre	Rs 0.88/litre	14.7
High speed diesel oil	Rs 4/litre	Rs 0.25/litre	6.3

Commodities taxed at ad valorem rates

Tyres and tubes	10
Woollen fabrics	15
Paints, pigments, etc.	22
Perfumes	28
Soap	20
Electric batteries	25
Cigarettes (mixed ad valorem/specific)	59

Commodities subject to both excise and sales taxes

	Value of sales	Excise revenue	Sales tax revenue	Total revenue	Combined rate of excise and sales taxes (%)
	(million rupees)				
Paper and paperboard	808.0	18.4	43.4	61.8	7.6
Metal containers	255.7	23.2	31.5	54.7	21.4
Glass products	261.8	23.8	29.9	53.7	20.5
Tyres and tubes	202.4	18.4	20.3	38.7	19.1
Gas appliances	59.8	5.4	7.1	12.5	20.9
Wires and cables	688.0	62.6	8.5	71.1	10.3

Source: Central Board of Revenue.

4.12 The rate of excise duty for cotton yarn is striking. The excise is imposed on yarn rather than on textiles because the administrative problems of taxing textiles through an excise duty are thought to be intractable. While administrative considerations must be taken into account in choosing the point at which a commodity is taxed, the tax rate on cotton yarn of about 3% results in textiles being taxed at a relatively low rate. Textiles are a major consumer good and need to be adequately taxed.

4.13 Petroleum products are taxed through import duties and development surcharges as well as excise duties. The rate of import duty is 5% of cif value; the rates of excise duties for gasoline and high speed diesel oil (HSD) are 14.7% and 6.3%, respectively (Table 4.4). The development surcharge, which is equal to the difference between the sale price and the "prescribed price" available to oil marketing companies, acts as a price stabilization measure. A large proportion of the receipts from the development surcharge is returned to oil companies by way of refunds for specific purposes.1/ In addition, subsidies are granted to refineries to make up any shortfall in the minimum profits guaranteed by the Government. In FY82, receipts from taxes on petroleum products contributed about 6% to the combined federal and provincial tax revenues, and net revenues from petroleum products (tax revenues minus subsidies) about 4.3%; both percentages are no higher than their FY78 levels (Table 4.5).

4.14 To improve revenues from petroleum taxes, consideration should be given to, among other things, raising the overall tax rates and narrowing the differential between tax rates on gasoline and HSD. The nominal (statutory) rates of tax on these products (Table 4.6) do not reflect adequately the rates at which they are effectively taxed because of the Government policy of cross-subsidization between different products. Rough calculations suggest that effective rates of tax for gasoline and HSD are 29.5% and -6.5%, respectively.2/ HSD seems to be subsidized, though recent reductions in international oil prices may have turned the negative effective tax rate into

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1/ Refunds are made to cover: (i) transportation cost over and above the freight margins included in consumer prices for the equalization of prices of petroleum products; (ii) import cost of refined petroleum products over and above the ex-refinery prices; and (iii) operating charges of new storage constructed under Government directives. See Explanatory Memorandum on the Budget, 1981-82, pp. 12-13.

2/ The main assumption made in the calculation of effective rates is that the difference between ex-refinery price and cif import price (gross of import duty) represents an implicit tax or subsidy. In addition, only the amount of development surcharge that is not refunded has been treated as a tax. Details of the calculations are explained in Table 4.6.

a low positive rate. Even these rates overstate true tax rates since subsidies to refineries have not been taken into account. Further scope therefore appears to exists for raising tax revenues from petroleum products.1/ To make full use of the revenue possibilities, the disparity in the tax rates on gasoline and HSD should be reduced. The present differential is too high to be justified by relative refining costs; if considerations relating to the cost of public transportation make some differential politically unavoidable, it should be small. Approaching the matter from the point of view of highway user charges also suggests a need for higher taxes on HSD since most of the damage to roads is caused by trucks and buses. Lower international oil prices provide a good opportunity for increased taxation of petroleum products.

Table 4.5: PETROLEUM REVENUES AND SUBSIDIES, 1977/78-1981/82
(amounts in million rupees)

	1977/78	1978/79	1979/80	1980/81	1981/82
1. Receipts from petroleum taxes	1,328	1,369	1,783	2,626	2,513
Import duties	208	260	482	634	539
Excise duties	900	950	1,090	1,112	1,218
Surcharge (net)	220	159	211	880	756
2. Subsidies to refineries	400	424	480	450	693
3. Net revenues from petroleum (1-2)	928	945	1,303	2,176	1,820
	percentages				
Memorandum items:					
Receipts from petroleum taxes as % of consolidated tax revenues	6.2	5.5	5.5	6.8	6.0
Net revenues from petroleum as % of consolidated tax revenues	4.3	3.8	4.0	5.6	4.3
Receipts from petroleum taxes as % of GDP	0.76	0.70	0.75	0.94	0.78
Net revenues from petroleum as % of GDP	0.53	0.48	0.55	0.78	0.56

Sources: Ministry of Finance, and mission estimates.

1/ Kerosene is being subsidized for social reasons. The current retail price of Rs 2.75 per litre compares with cif import price of Rs 3.70 per litre (end-1982).

Table 4.6: EFFECTIVE RATES OF TAX FOR GASOLINE AND HIGH SPEED DIESEL OIL
(amounts refer to rupees per litre)

	Gasoline	HSD
Break-up of sale price		
Retail price	6.00	4.00
Ex-refinery price/a	4.20	2.88
Transportation and distribution margins, and dealer's commission	0.32	0.27
Taxes	1.48	0.85
Excise duty	(0.88)	(0.25)
Development surcharge	(0.60)	(0.60)
Nominal rates of tax:		
Excise duty as % of retail price	14.7%	6.3%
Development surcharge and excise duty as % of retail price	24.7%	21.3%
Alternative break-up of sale price		
Retail price	6.00	4.00
Cif import price (Karachi)/b	3.43	3.51
Transportation and distribution margins, and dealer's commission	0.32	0.27
Refund of development surcharge/c	0.48	0.48
Taxes	1.77	-0.26
Excise duty	(0.88)	(0.25)
Development surcharge/c	(0.12)	(0.12)
Import duty	(0.17)	(0.18)
Implicit tax/d	(0.60)	(-0.81)
Effective rate of tax:		
Explicit and implicit taxes as % of retail price	29.5%	-6.5%

/a Including import duties.
/b Mid-November 1982 quotations. Source: Price of Crude Petroleum and Petroleum Products, Fourth Quarter 1982 (World Bank; February 15, 1983).
/c Between FY78-FY82, about 80% of receipts from the development surcharge were refunded. Only Rs 0.12 out of the total development surcharge of Rs 0.60 has, therefore, been treated as a tax.
/d Ex-refinery price minus (cif import price and import duty).

Sources: Government of Pakistan, and mission estimates.

4.15 An important issue in the reform of excise taxation is the present high reliance on specific rates. Specific taxes account for about 60% of total excise revenues, and four (that is, cement, petroleum products, sugar and vegetable ghee) out of the five largest sources of excise revenues bear specific rates. The advantages of taxing through ad valorem rates in an inflationary environment need no elaboration. In Pakistan, specific rates and the Government's pricing policy are closely related, and the conversion of specific rates into ad valorem rates may not help much unless accompanied by a modification of the pricing policy.

4.16 The Government's pricing policy has substantially dampened the growth of excise revenues. Cement, petroleum products, vegetable ghee and soda ash, which are produced in the public sector, and sugar, the price of which is controlled by the Government, account for 53% of total excise revenues and 87% of excise revenues from specific rates. According to official estimates, additional excise revenues of at least Rs 7 billion would have been realized in FY82 if the tax rates on five major commodities (vegetable products, motor spirits, high speed diesel oil, light diesel oil, and furnace oil) had been maintained at their FY78 levels in ad valorem terms.1/

The Sales Tax

4.17 Pakistan's sales tax is a single-stage tax levied on imports as well as domestic production. Sales taxes paid on raw materials and components are credited against the sales tax liability on finished goods. In terms of their economic effects, three features of the sales tax are especially important. First, domestic and imported goods are taxed at different rates. The general rate of tax for domestically manufactured goods is 12.5%, but a few goods are taxed at lower rates; imports are taxed at the rates of 10%, 20% and 30%. Second, the exemptions for domestic and imported goods are different. A third and related feature is that, while domestic machinery is exempt from the tax, most imported machinery is taxable.

4.18 Each of these features has a protective effect. The first two features would give positive or negative protection depending on whether the rate of sales tax on an imported product is higher or lower than on a similar domestic good. The last feature results in higher protection for the manufacture of machinery, but lower protection for industries using machinery (since the sales tax paid on machinery cannot be set off against the sales tax liability on finished goods). The protective effects of the sales tax are considered more systematically later.

1/ Report of the Sub-group on Mobilization of Financial Resources (for the Sixth Five Year Plan, 1983-88), February 1983.

4.19 About 81.5% of the revenue from the sales tax is derived from imports (Table 4.7). Of the 18.5% that is derived from domestic goods, over three quarters comes from domestic goods not subject to excises. The coverage of domestic production and the differential taxation of imports and domestic goods have contributed to the relatively low share of revenues from domestically produced goods.

4.20 The coverage of the tax on domestic production depends on general exemptions and a cottage industry exemption. A wide range of domestic goods are exempt from the tax.1/ Administrative considerations have been important in determining the scope of exemptions. A variety of other considerations have also played a role. Major commodities such as sugar, beverages, tobacco, petroleum products and cement have been exempted because they are taxed through excises. Social considerations may have motivated exemptions for some goods (e.g., unprocessed foodstuffs and medicines). Exemptions appear to have also been used to pursue economic objectives such as export promotion (e.g., leather goods, and sports goods) and import substitution (e.g., machinery). While a good case can be made for some of these exemptions, the totality of the present exemptions cannot be justified when viewed against the country's revenue requirements. The kind of sales tax that will be suggested later would need to take into account administrative and equity considerations but would not permit the pursuit of economic objectives such as protection and export promotion; objectives of these kinds should be pursued through other taxes.

4.21 The "cottage industry" exemption excludes firms with employment per shift of no more than 15 persons and capital investment of no more than Rs 100,000 from the scope of taxation.2/ While very small firms must be exempted for administrative reasons, the determination of the right level of exemption is difficult.3/ Too small an exemption may make the task of the tax authorities intractable, but a fairly large exemption may encourage the fragmentation of enterprises. The present exemption seems to have resulted in the exclusion of a relatively high amount of domestic production. This may be due more to the difficulties of enforcing the exemption than to the size of the exemption. Different criteria for identifying the smallest firms

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1/ For details, see Annex II, Table 6.

2/ For further details, see Annex II, paragraph 22.

3/ The Government policy of encouraging small scale industry for social reasons (e.g., employment generation) may also have influenced the size of the exemption. Rough calculations suggest that, while employment per unit of capital in small scale industry is generally higher than in large scale industry, the average cost of production is also higher.

(e.g., turnover, or physical characteristics such as electricity use, floor space, etc.) need to be considered.

4.22 A thorough review of the present exemptions and the working of the cottage industry provisions is urgently needed. The country's tax authorities and other persons concerned with taxation within the Government are in the best position to undertake such a review. There is a growing awareness within the Government of the need for a sales tax with a wider coverage. Some measures to broaden the tax base have been taken, and others are being considered. The sales tax was recently extended to products such as footwear, furniture and fixtures, and ready-made garments, where cottage industry production is important, and its extension to other such products is being considered. The possibility of levying the sales tax at wholesale and retail stages on commodities that are difficult to tax at the manufacturing stage is also being examined. Further policies to enlarge the scope of the sales tax could benefit from an examination of the operation of sales taxes in other Asian countries. Should it prove possible to expand the coverage of the sales tax significantly, the prospects for resource mobilization would brighten considerably. In the absence of a wider tax base for domestic production, a prerequisite for a broad-based sales tax, revenue requirements would have to be moderated or greater reliance on taxes with undesirable side effects countenanced.

Table 4.7: REVENUE FROM SALES TAX, 1981/82
(million rupees)

Sales tax on domestic goods (1+2)	601.0
1. Excisable commodities	136.7
Paper and paperboard	43.4
Metal containers	31.5
Glass products	25.9
Tyres and tubes	20.3
Wires and cables	8.5
Gas appliances	7.1
2. Non-excisable commodities	464.3
Biscuits, bakery products and confectionary	41.4
Artificial leather and rexine	65.4
Electrical goods	60.4
Caustic soda	32.1
Chemicals	22.0
Asbestos products	20.2
Liquid glucose	18.1
Footwear	14.0
Bus body-building	11.4
Food items	11.4
Sanitary ware	10.6
Arms and ammunitions	10.3
Industrial gas	9.1
Rubber goods	6.2
Miscellaneous	131.7
Sales tax on imports	2,651.2
Vehicles	518.4
Iron and steel articles	317.3
Boilers and related appliances	297.7
Electrical machinery and equipment	226.0
Paper and paperboard	96.9
Artificial resins and plastic materials, cellulose, and ethers	79.4
Rubber and synthetic rubber	74.3
Inorganic chemicals, organic and inorganic compounds of precious metals, earth metals, radio-active elements and isotopes	67.6
Other organic chemicals	53.7
Miscellaneous chemical products	33.5

Optical, photographic and cinematographic goods, medical and surgical instruments and apparatus	47.4
Dairy produce, birds' eggs, natural honey, and edible products of animal origin	43.4
Edible fruit	42.3
Glass and glassware	34.7
Base metal products	33.1
Oilseeds and oleaginous fruit	32.1
Works of art, collectors' pieces and antiques	32.0
Tanning and dyeing extracts	28.1
Photographic and cinematographic goods	19.5
Glass and glassware	18.5
Wading and felt, twine, cordage, ropes and cables, special impregnated and coated fabrics and textiles for industrial use	18.3
Tools, implements and cutlery	6.6
Aluminium and other articles	14.8
Clocks and watches	12.1
Man-made fibres (continuous)	11.4
Man-made fibres (discontinuous)	3.1
Printed books, newspapers, and other products	11.3
Wood and articles of wood	7.9
Essential oils and resinoids, perfumery, cosmetics, and toilet preparations	4.6
Textiles	4.4
Cork and articles of cork	1.1
Miscellaneous products	449.7
Total	3,252.1

Source: Directorate of Research and Statistics, Central Board of Revenue.

4.23 On the question of tax rates, it will be suggested later that domestic goods and similar imported goods should be taxed at the same rate. Another issue concerning tax rates is whether efficiency in the allocation of resources requires that different types of goods be taxed at the same rate or at different rates. This issue is explored below.

4.24 The traditional theory of taxation concluded that an ad valorem tax at a uniform rate would be "neutral" (that is, it would not distort the

pattern of consumption).1/ Recent research has shown that this conclusion would only be valid if all final commodities (including leisure) could be taxed. The modern approach is based on the assumption that leisure cannot be taxed. The question that the modern approach (known as the theory of optimal taxation) poses is: which tax rates will minimize distortions ("excess burden") caused by indirect taxation, given that a specific amount of revenue must be raised and that at least one commodity cannot be taxed? This approach suggests that tax rates should be so chosen that the demand (strictly, compensated demand) for all taxed commodities is reduced by the same proportion. Since the demand for different commodities would respond differently to an equal proportionate increase in the price of all commodities, a uniform rate of tax for all goods will not be optimal. It follows that considerations of efficiency in resource allocation do not imply uniform taxation. The important conclusion is that an indirect tax at a single, standard rate of tax cannot be justified on economic grounds even when equity considerations are ignored. This conclusion needs to be borne in mind in deciding the structure of sales tax rates.

4.25 The main defects of Pakistan's tax system are that the three major indirect taxes all have protective effects, and the coverage of taxes on domestic production achieved through excise and sales taxes is narrow. A broader coverage of domestic production is needed for revenue purposes. It is also needed to weaken the relationship between revenues and protection. A lower and a less variable structure of effective protection (defined later), which has been suggested by the preliminary findings of the study on the effective rates of protection,2/ would be easier to reconcile with revenue growth if an internal tax that applies equally to imports and domestic production and has no protective effects were available. The sales tax is well suited for development into such a tax. It is considerations such as these that make the reform of the sales tax a matter of urgency.

4.26 There is a bewildering variety of sales taxes to choose from. What kind of sales tax would be suitable for Pakistan? The long term objective should be to levy a sales tax at the wholesale stage, and for some goods at the retail stage, so that a larger value added can be captured. At this juncture, however, the best way to proceed would seem to be to modify the existing sales tax by substantially extending its scope, and by removing its

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1/ The theory of taxation has always been concerned with distortions in consumption. The theory of protection, on the other hand, has been concerned with distortions in production. The two approaches have not been satisfactorily integrated so far.

2/ Study on Effective Protection and Proposals for Incentives Reform for Pakistan, Summary Report (Pakistan Institute of Development Economics, April, 1983).

protective effects. An outline of a sales tax with such characteristics follows.

4.27 Consideration should be given to the introduction of a broad-based sales tax with the following features:

(i) Coverage. The coverage should be as broad as possible. Exemptions should only be granted where strong equity considerations (e.g., unprocessed foods and medicines) or insurmountable administrative problems are involved.

(ii) Exemptions. The range of exemptions for both final and intermediate (raw materials and components) goods should be as narrow as possible. Whatever range of exemptions is decided, it should be identical for domestic goods and imports; otherwise, the coverage of the tax *per se* would give rise to protective effects.

(iii) Treatment of intermediate goods. The present approach should be retained; the set off of taxes paid on intermediate goods against the tax liability on finished goods should be permitted.

(iv) Treatment of machinery. Machinery could either be taxed or exempted. Whatever treatment is decided, imported and domestic machinery should be treated in the same manner; a differential treatment would affect protection accorded to the manufacture of machinery. Should it be decided to tax machinery, the tax paid on machinery should be allowed as a set off against the tax liability on final goods; otherwise, protection in the using industries would be affected.

(v) Tax Rates. The tax could be levied at a single rate or at a few different rates. Unless there are strong administrative reasons for a single tax rate, it is desirable for equity and other reasons that the rate structure differentiate between some broad categories of goods. Whatever rate structure is decided, the tax rate for a domestic good and a similar imported good should be the same; otherwise, there would be protective effects.

4.28 A sales tax along these lines would be neutral in production in the sense that it would not affect effective protection either for industries producing taxable goods or for industries using taxable goods.1/ Were

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1/ This does not apply where import licensing rather than taxes on imports set domestic prices. Even so, it is advantageous to possess one tax that treats imports and domestically produced goods in the same way.

machinery to be taxed and made subject to the same set off provisions as intermediate goods, the tax would be equivalent to a value added tax.

4.29 A broad-based sales tax would have some implications for excise duties. First, if a sales tax were to include most excisable commodities (and it should), then retaining excise duties on goods that are taxed through the sales tax at comparable rates would not make much sense. Second, if a sales tax were to be levied at a single rate on all goods, then the tax differentiation needed for equity and other reasons would have to be achieved through other taxes. There are two main possibilities here. A good could be taxed at a higher rate than the rate of sales tax by subjecting it to an excise duty and a countervailing import duty (that is, an import duty at the same rate as the excise duty, and in addition to that imposed for protective purposes). Alternatively, the excises could be extended to imports. There are no strong reasons favoring one approach over the other; administrative convenience should, therefore, be the deciding factor.

4.30 It is sometimes argued that, if both sales and excise duties applied to imports as well as domestic goods, then the policy on protection could be pursued solely through import duties. This argument is only correct when viewed in the context of nominal protection. Excises on intermediate goods will affect effective protection in using industries.

4.31 Finally, excises have a larger role to play in the taxation of luxuries. As has been explained, luxury goods such as consumer durables are taxed at relatively high rates of import duties. The domestic production of such goods would receive high protection unless relatively high excises are imposed on such goods. In the taxation of luxury goods, as for other goods, protective and other considerations should be kept separate.

Taxation of Domestic Production and Elasticity of Tax Revenues

4.32 As already stated, revenues from import duties have grown much faster than revenues from excise and sales taxes. It is to be expected, therefore, that revenues from taxes on imports (import duties and sales taxes on imports) grew more rapidly than from taxes on domestic production (excise and sales taxes on domestic production). This is, indeed, the case (Tables 4.8 and 4.9). Reflecting higher tax rates as well as a rising average propensity to import (ratio of imports to GDP), import revenues as a percentage of GDP rose from 3% to 5% over the past decade. By contrast, the ratio of revenues from domestic production to GDP remained sticky at 4% of GDP. This ratio would understate efforts to tax domestic production to the extent that taxes on imported inputs have been used to tax indirectly domestic production that could not be taxed directly.

4.33 The above trends are reflected in the estimates of buoyancy of tax receipts from different sources (Table 4.10).1/ The buoyancy coefficients indicate that, on the average, whereas the revenue from taxes on imports increased by 1.39% for every percentage increase in GNP, the corresponding increase in the revenue from taxes on domestic production was only 1.04%. The buoyancy coefficients for import duties (1.59), excise duties (1.04) and the sales tax (1.13) also reflect the greater sensitivity of import revenues to GNP growth. The higher coefficient for the sales tax than for excise duties is due to the faster growth of import revenues; the sales tax revenue from domestic production, in fact, fell as a percentage of GNP, from 0.23% in FY73 to 0.17% in FY82. Thus, excise duties and the sales tax on domestic production have both contributed to the low responsiveness of tax receipts from domestic production to GNP.

Table 4.8: REVENUES FROM TAXES ON IMPORTS (IMPORT DUTIES AND SALES TAXES ON IMPORTS), 1971/72-1981/82
(amounts in million rupees)

	Revenue from import duties	Revenue from sales tax on imports	Total tax revenue from imports	Imports as % of GDP	Import revenue as % of import value	Import revenue as % of GDP
1971/72	1,138	332	1,470	n.a.	n.a.	2.7
1972/73	1,554	312	1,866	12.6	22.2	2.8
1973/74	2,363	533	2,896	15.5	21.5	3.3
1974/75	3,704	752	4,456	18.6	21.3	4.0
1975/76	4,373	886	5,259	15.5	25.7	4.0
1976/77	5,958	1,123	7,081	15.4	30.8	4.7
1977/78	8,040	1,342	9,382	16.0	33.7	5.4
1978/79	9,820	1,637	11,457	18.6	31.5	5.8
1979/80	12,127	1,896	14,023	19.8	29.9	5.9
1980/81	13,433	2,235	15,668	19.2	29.3	5.6
1981/82	14,680	2,651	17,331	18.2	29.6	5.4

Source: Directorate of Research and Statistics, Central Board of Revenue.

1/ The buoyancy coefficient relates tax revenues to GNP without distinguishing between the growth of revenues due to higher national income and that due to changes in the tax structure (e.g., tax rates, coverage, etc.). It overstates the income elasticity of tax revenues, which measures the response of tax revenues to changes in GNP under a given tax structure. The buoyancy coefficient for total tax revenues of 1.1 confirms the low elasticity of tax revenues in Pakistan.

Table 4.9: REVENUES FROM TAXES ON DOMESTIC PRODUCTION (FEDERAL EXCISES AND SALES TAXES ON DOMESTIC PRODUCTION), 1971/72-1981/82
(amounts in million rupees)

	Revenue from Federal excises	Revenue from sales taxes on domestic production	Total tax revenue from domestic production	Tax revenues from domestic production as % of GDP from manufacturing	Revenue from domestic production as % of GDP
1971/72	2,111	150	2,261	29.1	4.2
1972/73	2,211	157	2,368	24.4	3.5
1973/74	2,895	216	3,111	24.4	3.6
1974/75	3,670	305	3,975	22.7	3.5
1975/76	4,585	304	4,889	24.4	3.7
1976/77	5,429	241	5,670	25.5	3.8
1977/78	6,299	243	6,542	25.8	3.8
1978/79	6,916	310	7,226	25.6	3.7
1979/80	9,701	520	10,221	29.1	4.3
1980/81	10,413	657	11,070	26.3	4.0
1981/82	11,740	601	12,341	25.3	3.8

Source: Directorate of Research and Statistics, Central Board of Revenue.

4.34 Most studies1/ have attributed the limited sensitivity of Pakistan's tax revenues to the growth of GNP to one or more of the following factors: (i) exclusion of agricultural income from income tax; (ii) prevalence of a wide range of exemptions and allowances under income tax; (iii) administrative difficulties of assessing certain types of income; (iv) a heavy reliance on specific rates in the excise tax structure; and (v) restricted coverage of the sales tax. The first factor has probably not been important, and the second factor is now less important. The extension of the tax net to agricultural income, while highly desirable from many viewpoints, would broaden the tax base but is unlikely to increase the revenue elasticity given the practical problems of measuring agricultural income. Pakistan's income

1/ There have been many studies on the income elasticity of tax revenues in Pakistan. An interesting study that also reviews previous work is Azad Jeetun, Buoyancy and Elasticity of Taxes in Pakistan (Karachi: Applied Economics Research Center, Discussion Paper No. 23, May 1978).

tax used to be characterized by excessive exemptions and allowances, but this is no longer true. The experience with the self-assessment scheme for income tax has clearly demonstrated the importance of improved administration in raising tax elasticity. The last two factors ((iv) and (v)) must have depressed the growth of revenues from domestic production. These considerations would seem to point to the wide use of specific rates of excise duty, the narrow base of taxes on domestic production, and tax administration as the main explanation for the low elasticity of the tax system.

Table 4.10: BUOYANCY OF INDIRECT TAXES IN PAKISTAN

	Buoyancy coefficient	Standard error	$\bar{R}^2$
Import duties	1.59	0.0670	0.9842
Excise duties	1.04	0.0274	0.9940
The sales tax	1.13	0.0404	0.9900
Taxes on imports	1.39	0.0629	0.9819
Taxes on domestic production	1.04	0.0447	0.9837
All indirect taxes	1.06	0.0337	0.9910
Personal and company income taxes	1.21	0.0932	0.9550
All taxes	1.10	0.0330	0.9930

Note that the buoyancy coefficients were estimated from the double log function of the form: $\log X = \log a + b \log Y$, where X represents tax receipts from the relevant tax, Y represents GNP, and b is the buoyancy coefficient. Data for 1972/73 to 1981/82 were used.

Source: Mission estimates.

Revenue Possibilities and Effective Protection

4.35 Since indirect taxes with protective effects are significant in Pakistan, revenue proposals must take account of their protective effects. For this purpose, it is the effective rather than nominal protection that

matters. 1/ In the past, it was not possible to take account of the protective effects of various taxes on imports and domestic production in a systematic way. Now that estimates for the structure of effective protection in manufacturing are available, the desired structure of effective protection could provide a useful guide for the evolution of indirect taxes.

4.36 The implications of the various tax arrangements in Pakistan for effective protection2/ may be summarized as follows:

(i) Import duties on final goods increase effective protection for those goods. Since nominal protection is increased, effective protection also increases.

(ii) Import duties on inputs (intermediate and capital goods) increase effective protection for those industries, but reduce effective protection for using industries. Effective protection for using industries is reduced because their costs of production increase.

1/ The effective rate of protection (ERP) differs from the nominal rate of protection in two main ways: it takes account of taxes on inputs, and it is calculated with reference to value-added rather than price. ERP for a good whose production requires one imported manufactured input is defined as:

$$ERP = \frac{r - at}{1 - a} \times 100 \qquad (1)$$

where r = rate of import duty on the good;
t = rate of import duty on the input; and
a = the relative share of the cost of the input in the price of the good (where both prices exclude import duties).

Note that 1 - a gives the value-added in the production of the good. This formulation can be generalized to include many inputs, and excise and sales taxes. See W.M. Corden, The Theory of Protection (London: Oxford University Press, 1971), Chapter 3.

2/ Since quantitative restrictions on imports are important in Pakistan, statements relating to taxes on imports made in this paragraph are only valid if such taxes rather than quotas determine domestic prices. If the margin between the domestic price and the tax-paid import price produced by a quota is greater than the import tax, it is the quota that sets the domestic price. In this case, the import tax is redundant from the point of view of the domestic price and the volume of imports; the only task that the import tax performs is that of transferring part of the quota profits from importers to Government revenues.

(iii) Exemption of import duties on inputs increases effective protection for industries using those inputs.

(iv) Excises on final goods reduce effective protection for those goods. Since nominal protection is reduced, effective protection also declines.

(v) Excises on inputs reduce effective protection for those industries, but do not affect effective protection in using industries. The effect on using industries needs clarification. Effective protection for using industries is not reduced because the input can be purchased at its import price plus tariff (provided its import is not banned).

(vi) Sales taxes on final goods affect effective protection for those goods. Since sales tax rates on domestic production and imports are unequal, nominal protection is affected; hence, effective protection changes.

(vii) Sales taxes on raw materials and components affect effective protection for those industries, since the rates of tax on domestic and imported goods are different. However, the rate of effective protection for the final goods is not affected, since the mode of operation of the sales tax ensures that using industries do not pay sales taxes on raw materials and components.1/

(viii) Sales taxes on machinery increase effective protection for the manufacture of machinery. Since domestic machinery is exempt from sales taxes, sales taxes on machinery increase nominal protection; hence, effective protection increases.

(ix) Sales taxes on machinery decrease effective protection for using industries. Since sales taxes on machinery cannot be set off against sales taxes on finished products, the cost of production of using industries increases; hence, effective protection declines.

4.37 The relationship between protection and revenue is straightforward. Lower protection does not mean lower revenues if there are no insuperable difficulties in taxing domestic production. In this instance, the loss of revenues due to a lowering of import duties could be made up by imposing

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1/ This is not true when taxable goods are used to manufacture goods that are not subject to tax. See Annex II, paragraph 23.

internal revenue taxes (that is, taxes that apply to domestic production as well as imports). It follows that lower protection is not inconsistent with higher revenues from indirect taxes provided broad-based internal revenue taxes can be developed.

4.38 If, in the light of the study on effective protection, it is desired to lower the levels and variability of the effective rates of protection, what would be the kind of tax changes needed, and what would be the broad revenue implications? The main measures that would be indicated are: (i) lower import duties; (ii) reduction of disparity in import duty rates on various goods; (iii) imposition of import duties on most items of machinery and intermediate goods; (iv) elimination of the present exemptions of import duties on machinery and intermediate goods for selected industries; and (v) higher excises. Item (i) is likely to result in lower revenues, and this is also probably true of (ii); on the other hand, (iii)-(v) are likely to raise revenues.1/ The sales tax would continue to be available for revenue purposes.

4.39 Moreover, rationalization of the tariff structure in Pakistan should provide an important alternative means of raising revenues. Import liberalization must form a key element in tariff reform in view of the finding of the study on effective protection that, in most industries, quantitative restrictions are a more important source of protection than tariffs. The gradual replacement of import restrictions by tariffs can, therefore, be expected to have a significant effect on revenues.

4.40 There is no concensus among economists on the tax treatment of machinery and intermediate goods. The retention of import duties on machinery, raw materials and components and the discontinuance of selective exemptions from such duties are recommended here for reasons of industrial efficiency. Relatively high rates of effective protection on final goods, coupled with the exemption of machinery and intermediate goods from import duties, would tend to bias the industrial structure toward the production of final goods; this would be undesirable. The suggested approach would also deal with the problem created by the selective exemption of import duties on machinery and other inputs (see paragraph 4.8).2/ In addition, when the tariff structure is formulated within the framework of the concept of effective protection, duties on machinery and intermediate goods would not matter

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1/ Stronger statements would require a careful consideration of substitution possibilities in production and consumption.

2/ If most concessions for imported intermediate and capital goods were eliminated, the regional incentives would need to be restructured.

for using industries, since the calculations of rates of effective protection for using industries would take account of such duties.1/

4.41 In sum, the broad tax strategy that emerges in the context of effective protection is not too different from the present policy, although the relative roles of import, excise and sales taxes in the taxation of individual commodities would change significantly. The major changes in the present policy that are suggested are a different treatment of intermediate and capital goods, and a greater role for taxes on domestic production. The main advantage of the concept of effective protection is that it facilitates a systematic consideration of protective effects of revenue measures. This is invaluable in a country striving simultaneously to improve tax revenues and to rationalize the structure of industrial incentives.

Conclusions

4.42 The main priorities in the reform of indirect taxation are (i) a significant expansion in the scope of taxes on domestic production; and (ii) the development of a broad-based internal revenue tax free of protective effects. In addition, price controls that seriously restrict the growth of revenues, particularly from excise duties, should be avoided. The two objectives above could be achieved by the introduction of a sales tax along the lines indicated. Indeed, the main implication of the analysis contained in this chapter is that the early introduction of such a tax is needed to raise revenues, weaken the nexus between revenues and protection, and improve the elasticity of the tax system. Sales tax reform should be coordinated with the restructuring of industrial incentives.

4.43 Appropriate reform of direct as well as indirect taxation would be facilitated by a greater emphasis on the collection of tax statistics and empirical research on fiscal issues. In the past, lack of data has severely hampered careful study of the economic and equity effects of Pakistan's tax system. Recent initiatives to improve statistics and empirical research relating to taxation are therefore welcome and need to be continued. The computerization of income tax statistics, the latest household budget survey and the study on effective protection will help to remove some of the more serious gaps in knowledge concerning the likely economic effects of the tax system. The Bank-sponsored research on the effective rates of tax (tax rates on final goods that take account of taxes paid on inputs used in their manufacture) should also correct a major deficiency. In a country like

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1/ The way in which exports could be insulated from taxes on intermediate and capital goods is well known and need not be discussed here. See, W.M. Corden, "Trade Policies", in John Cody, Helen Hughes and David Wall (eds.), Policies for Industrial Progress in Developing Countries (Oxford University Press, 1980).

Pakistan, where revenues from imported intermediate and capital goods are important, calculations of effective rates of tax are necessary for a proper assessment of the economic and equity1/ effects of the tax system.

1/ Satisfactory analysis of incidence of taxation in Pakistan has been hampered in the past by the difficulty of imputing taxes paid on imported inputs and machinery to final products. A recent study on incidence, which ignores import duties, is Talat Alaudin and Bilquees Raza, Tax Progressivity in Pakistan (Islamabad: Pakistan Institute of Development Economics, October 1981). The study found the incidence of excise and sales taxes combined to be more or less proportional.

5. PERSONAL SAVING

5.1 Household saving behavior depends on a number of complex economic and non-economic factors. Social attitudes may be an important determinant of saving in Pakistan. Among the economic factors, the availability of suitable savings facilities, the structure of returns and institutional factors, both tax and non-tax, are important. This chapter reviews the structure of real after-tax returns on deposits, aspects of savings facilities in rural areas, and possibilities for enlarging the scope for saving through retirement schemes.

Composition of Financial Assets

5.2 A comprehensive picture of household assets cannot be given because details of household wealth in the form of non-financial assets (such as land and buildings, capital goods and inventories, durable consumer goods and gold and jewelry) are not available. Such assets normally account for the greater part of household wealth. However, the importance of deposits in the holdings of financial assets by households is striking (Table 5.1).1/ The bulk of savings deposits and a large proportion of fixed deposits with commercial banks are held by individuals. Individual holdings also dominate national savings schemes, which qualify for tax benefits. Deposits with NDFC do not attract tax advantages, and are held mainly by institutions. The next main category of assets, government bonds, yield lower returns than comparable assets, and are predominantly held by the banking system. With only a small proportion of listed companies declaring dividends and a meager supply of new issues (which attract the investment allowance), stock exchange securities have failed to attract much interest; equities (held directly, or indirectly through the NIT unit trust and ICP mutual funds) have remained unimportant relatively to deposits. The insurance habit has yet to take root, and life insurance as a medium of saving is insignificant.2/ With the country's only housing finance institution, the House Building Finance Corporation, relying exclusively on the Government for its resources, there has been no mobilization of deposits for housing. Saving through provident and pension schemes is more important than the table indicates, but complete details of investments of these schemes are not available at present.

1/ The data in Table 5.1 include the public sector (e.g., government deposits) and are subject to double-counting (e.g., NIT's equity holdings are included under both the investments of NIT and the market value of shares on the stock exchange). Also, no attempt has been made to distinguish between personal and private savings. These factors do not affect the conclusions drawn here.

2/ There were only 413,000 ordinary life and 2.6 million group life policies in force in 1980.

Table 5.1: MAJOR FINANCIAL ASSETS
(million rupees)

Currency in circulation (December 1982)		41,145
Scheduled banks' deposits (January-March 1982)		79,884
Current, call and similar deposits	23,757	
Savings deposits	34,737	
Fixed deposits	21,390	
Under 1 year	(10,641)	
1-3 years	(3,852)	
Over 3 years	(6,896)	
National savings schemes (October 1982)		19,204
Savings accounts	860	
Khas deposit certificates/accounts	7,298	
National deposit certificates/accounts	2,353	
Defense savings certificates	4,701	
Premium saving certificates	51	
Prize bonds	3,941	
National Development Finance Corporation deposits (June 1982)		1,757
Federal Government bonds (December 1982)		22,060
Provincial Government bonds (December 1982)		1,461
Market value of quoted shares (December 1982)		11,267
National Investment (Unit) Trust (June 1982)		1,139
Investment Corporation of Pakistan mutual funds (June 1981)		416
Life Insurance (State Life) investments (December 1981)		3,467
Employees' Old-Age Benefits Institution investments (June 1982)		539

Note: Scheduled banks' deposits include profit and loss sharing (PLS) deposits. On June 24, 1982, PLS deposits totalled Rs 7,907 million, of which Rs 3,300 million were savings deposits and Rs 4,607 million were time deposits.

Sources: Publications of the State Bank of Pakistan, and accounts of various financial institutions.

5.3 An aspect of the composition of households' financial assets that stands out is the limited importance of assets which are normally associated with the provision of long term finance to industry. Overall, households seem to have a preference for relatively short term financial assets. A large proportion of savings accounts are probably used as current accounts. While about a third of fixed deposits have a term of over three years, and defense savings certificates and national deposit certificates have maximum terms of ten and seven years, respectively, the most popular national saving instrument - the Khas deposit1/ - has a maximum term of only three years. As already explained, equities, unit and mutual funds, and life insurance play a limited role, and this is probably also true of private provident and pension funds.

5.4 Measures that would encourage greater diversification of the financial investments held by households would be desirable. Although tax relief for saving through retirement schemes, equities and life insurance is at a sufficiently high level, changes of other kinds need to be considered. Initiatives to raise saving through contributory provident schemes, for instance, would be helpful. The returns on different types of deposits and the tax treatment of these returns are also of crucial importance in promoting and diversifying savings.

Structure of Returns on Deposits

5.5 The commercial banks and the Directorate of National Savings,2/ between them, provide a variety of deposit facilities, with widely varying returns. Nominal rates of return after the payment of zakat range from 6% on bank savings deposits to 15.3% for the national savings schemes' 10-year defense certificate (Table 5.2). For deposits of under three years, the return on Khas deposits, which yield about 15% before zakat and 12.5% after zakat, dominate all other returns. For 5-year deposits, the after-zakat returns vary from 10.25% on fixed deposits with commercial banks to 13.71% on national deposit certificates. Returns on bank deposits are generally lower than on comparable assets under national savings schemes.

5.6 Tax provisions also favor national savings schemes. All interest from national savings instruments is exempt from income tax. Defense savings certificates receive further relief by way of the investment allowance. By

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1/ Khas deposits have a term of three years, but are encashable at any time after issue. The return for each of the first five complete periods of six months is at the rate of 15% per annum, while that for the last complete period of six months is at the rate of 17% per annum.

2/ The Government's national savings schemes are operated by the Directorate of National Savings.

contrast, the only accounts with commercial banks that receive tax relief are PLS accounts, which qualify for the dividend exclusion.1/ These provisions have made the bank savings and fixed term accounts, the accounts through which the commercial banks raise the greater proportion of deposits, relatively unattractive.

1/ Dividends of up to Rs 15,000 from certain sources are exempt from income tax. See Annex I, paragraph 19.

Table 5.2: NOMINAL RATES OF RETURN ON SELECTED SAVINGS INSTRUMENTS (percentages)

	Nominal rate before Zakat	Nominal rate after Zakat
Commercial banks		
Special notice deposits	5.50	3.00
Savings bank deposits 1/	8.50	6.00
Fixed (or term) deposits:		
1 yr. & over but under 2 yrs.	10.50	8.00
3 yrs. & over but under 4 yrs.	11.75	9.25
5 yrs. & over	12.75	10.25
Profit and loss sharing account: 2/		
Saving deposit 1/	8.50	6.00
1 yr. deposit	11.75	9.25
3 yr. deposit	13.25	10.75
5 yr. deposit	14.50	12.00
National saving schemes		
Savings accounts 1/	10.00	7.50
Defense savings certificates:		
1 year	12.00(12.00)	9.20(9.20)3/
3 years	11.90(20.51)	10.93(19.49)
5 years	12.10(17.21)	11.53(16.62)
7 years	14.00(17.68)	13.57(17.25)
10 years	15.60(18.20)	15.30(17.91)
National deposit certificates:		
1 year	12.00	9.20
3 years	11.87	10.93
5 years	14.29	13.71
7 years	14.63	14.21

Notes: (1) Figures in brackets give returns taking account of the investment allowance (rebate) of 20% of the amount of investment.
(2) On certificates where the return is reflected in the value of the certificate at maturity, zakat is levied (on the full maturity value) when the certificate matures and not annually.

1/ Non-checking accounts.

2/ Returns announced by Habib Bank on December 31, 1982. Returns given by different banks vary.

3/ The investment allowance is not applicable because the maturity period is less than the minimum holding period for the investment allowance.

Source: Mission estimates.

5.7 Since returns from bank deposits are lower and taxable, a wide spread of interest rates has emerged. Thus, while a saving deposit yields 6% (after zakat but before income tax), a 3-year defense savings certificate (for a person receiving the investment allowance at the rate of 20%) yields 19.5% (after both zakat and income tax). To reduce this wide dispersion, the exemption of interest from income tax should be extended to all interest income up to a specified amount, irrespective of its source. Although PLS deposits embody an element of risk, they are closer to bank deposits than to equities and should also be brought within the scope of such an exemption. Consideration should also be given to devising a desired structure of interest rates without granting the investment allowance to defense savings certificates; the present returns on defense savings certificates are out of line with returns from economic activities.

5.8 The present disparities in the structure of returns on savings instruments are accentuated by wide year-to-year variations in the rate of inflation. In FY82, with inflation around 10%, the real after-tax returns on national savings schemes ranged from -2.5% to 5.3% (ignoring the investment allowance), while the maximum real return on fixed deposits (after zakat but before income tax) with commercial banks was zero and the return on savings deposits was substantially negative. With the rate of inflation declining to 5-8% in FY83, the returns on some national savings instruments may be too high, but the returns on most commercial bank deposits, and especially on savings deposits, remain unattractive.

5.9 Since the rural population has a closer contact with the banking system than with other financial institutions, availability of bank deposits with reasonable real after-tax returns would facilitate the mobilization of rural savings. However, the ability of the banks to provide more attractive savings facilities will depend on their ability to earn better returns on their assets, especially on government securities and long-term loans. The current yield on recent issues of long-term government securities is 11.5-11.75%. The rate of interest on loans for investment in industry and agriculture is fixed by the Government at 11% compared to a minimum rate of 14% for working capital and most other purposes. An increasing use of participation term certificates (equity-type fixed term lending), the returns on which are uncontrolled and have exceeded 15%, would help to improve returns on the banks' assets.

5.10 The policy changes discussed above would have implications for the budget. Rates of interest on government securities that are more in line with market rates would increase interest charges (thereby reducing government saving), while a lower gap between the yields on bank deposits and national savings schemes would tend to reduce the flow of resources to the budget through these schemes. These considerations, however, should not be allowed to detract from the importance of improving savings facilities in rural areas.

Rural Savings

5.11 The problem of rural savings has not been adequately studied in Pakistan. A lower per capita income and a greater incidence of poverty than in urban areas have frequently been considered as the main factors constraining the capacity of rural households to save.1/ Little attention has been given to the fact that the rural population has been the main beneficiary of the migrants' remittances (currently amounting to over US$2 billion annually), and that some segments of the rural population have benefited substantially from higher public investments in agriculture, a greater flow of concessionary agricultural credit, and more remunerative prices for major crops.

5.12 Mobilization of resources in rural areas does not seem to have kept pace with the growth in rural incomes. Financial assets still play a peripheral role in the wealth of rural households. According to a recent study on migrants' remittances, for instance, about 22% of the receipts were diverted to real estate and 11.5% to agricultural and commercial investments, compared to 1.5% channelled into financial assets.2/

5.13 Physical access to savings facilities is a major problem in rural areas. For about 70% of villages, the nearest bank is more than four kilometers away; for about 50% of villages, the nearest post office is a similar distance.3/ Poor transportation facilities further aggravate the problems of accessibility. However, within the overall constraint imposed by the availability of infrastructure, commercial banks, post offices and national savings centers provide a wide coverage of saving facilities.

5.14 Commercial banks dominate all other financial institutions in the mobilization of savings in rural areas. The commercial banking network consists of about 7,000 branches, of which about 5,000 are located outside the larger cities. The latter account for nearly one half of the total deposit liabilities of commercial banks of about Rs 80 billion. The bulk of

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1/ See Syed Mehdi Mustafa, "Resource Mobilization in the Rural Sector - Technique and Institutional Structure", in Resource Mobilization in Pakistan (Lahore: Pakistan Administrative Staff College, 1981); and Irfan-ul-Haque, "Problems Faced in the Mobilization of Household Saving in Rural Areas in Pakistan", Journal of Institute of Bankers, 1979.

2/ See Ijaz Gilani, M. Fahim Khan and Munawar Iqbal, Labor Migration from Pakistan to the Middle East and its Impact on the Domestic Economy (Islamabad: Pakistan Institute of Development Economics, June 1981).

3/ Mouza Statistics (Settled Areas Only) (Islamabad: Agricultural Census Organization, Statistics Division, 1980).

the deposits at the branches outside the larger cities are held in the form of about seven million savings and term deposits accounts.1/ While overstating the importance of rural areas as a source of deposits,2/ these statistics nonetheless bring out the significant role of the banking system in resource mobilization in rural areas.

5.15 The importance of commercial banks in rural areas also emerges from a consideration of savings deposits. About Rs 40 billion is held as savings deposits in 14 million accounts. If it were assumed that every urban household has one savings account, the total number of savings accounts would suggest that every rural household has also a savings account (given the average household size in Pakistan of about six persons). This certainly overstates the spread of the banking habit in rural areas. However, even the assumption that every urban household has two savings accounts would suggest that about half of rural households maintain a savings account and that the commercial banking system is a significant medium of mass saving in Pakistan.

5.16 In terms of coverage, post offices have an advantage over both commercial banks and national savings centers. Of the 8,860 post offices located in rural areas, about 7,200 undertake savings bank work. With their main function being the delivery of mail, however, the post offices have attached secondary importance to the mobilization of savings. The rural post offices mobilize an estimated Rs 2 billion through 400,000 accounts. Notwithstanding the relatively low level of deposits mobilized by post offices in rural areas, the post offices provide a valuable service by extending saving facilities to areas not served by commercial banks and national savings centers.

5.17 Although national savings centers have attracted growing deposits, their success in mobilizing savings in rural areas has been very modest. A narrow coverage of their facilities, and the use of instruments that are more likely to appeal to sophisticated investors than to a rural population with low literacy may be the main reasons for this. Though about half of the national savings centers are located at the tehsil (sub-district) level,3/ their savings facilities are virtually inaccessible at the village level,

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1/ Based on statistics provided by the Pakistan Banking Council.

2/ If a stricter definition of rural areas were adopted, the deposits attracted by rural branches would be lower. The number of branches in centers with populations of under 50,000 persons is about 3,340. See Growth of Pakistani Banking (Karachi: Research and Planning Division, Muslim Commercial Bank Limited, 1982).

3/ Strictly, some of these cannot be regarded as rural centers. However, tehsil centers are expected to provide savings facilities to a large number of surrounding villages.

since there are only about 300 national savings centers in total.1/ The minor role of national savings schemes in rural areas is demonstrated by the fact that only about 8,800 out of a total of about 67,460 Khas deposit accounts, the most popular of all national savings instruments, originate in rural areas. In terms of amounts, rough estimates suggest that only Rs 200 million of the new deposits attracted by national savings centers in FY82 may have come from rural areas.

5.18 The combination of lending facilities with deposit mobilization gives commercial banks a considerable advantage over post offices and national savings centers. Given a limited supply of credit from other financial institutions, and a growing involvement of commercial banks in agricultural lending, the attractiveness of an account with a bank has increased. Commercial banks now account for nearly one half of the institutional credit to agriculture.2/

5.19 Better access to savings facilities and availability of suitable savings instruments seem necessary for stimulating rural savings. Improvements in rural transportation would probably have a higher impact on the coverage of savings facilities than any other measure, but greater use of mobile units could help a great deal. While all three institutions have a role to play in the mobilization of savings, the predominance of the banking system in the mobilization of rural deposits underscores the importance of enabling commercial banks to provide diversified savings instruments with reasonable real returns.

1/ National savings instruments may also be purchased from post offices and banks. Banks cannot, however, be expected to push competing instruments. Of the outstanding amount of national savings deposits (excluding prize bonds) of Rs 15,260 million as of October 31, 1982, Rs 9,190 million were raised by national savings centers, Rs 4,160 million by commercial banks, and Rs 1,910 million by post offices (Source: State Bank of Pakistan Bulletin, January 1983).

2/ The advances extended to the agricultural sector in FY82 were as follows:

	(million rupees)
Commercial banks	2,436
Other financial institutions	2,666
Agricultural Development Bank of Pakistan	(1,557)
Federal Cooperative Bank and cooperatives	(1,101)
Taccavi loans	(8)

Source: Pakistan Economic Survey, 1982-83 (Islamabad: Economic Adviser's Wing, Ministry of Finance, 1983).

5.20 Inculcation of the savings habit clearly constitutes the main problem in connection with rural savings. Measures to improve the access to, and the attractiveness of, rural savings facilities may not, by themselves, be sufficient to modify deeply entrenched social attitudes. However, such measures, together with aggressive and prolonged savings campaigns (in contrast to the brief campaigns that are being held from time to time) would be essential ingredients of any strategy for transforming the rural population's attitude toward thrift.

Saving through Retirement Schemes

5.21 Saving through contributions to pension and provident schemes is important in developed countries. Compulsory national provident schemes for those in wage and salary employment have also helped to raise saving for retirement in many developing countries. This section reviews existing schemes in the public and private sectors in Pakistan with a view to arriving at broad conclusions for future policy.

5.22 The Federal and Provincial Governments provide similar pension and provident schemes for their employees. The pension scheme is non-contributory. Civil servants with a qualifying service of five years and above but less than 10 years receive a gratuity (in lieu of a pension) at the rate of one month's salary for each year of service. Those with a qualifying service of 10 years or more receive a pension calculated with reference to the length of employment and average emoluments over the last 12 months of employment. Broadly, up to 50% of the gross pension may be commuted into a lump sum on retirement.

5.23 All civil servants must compulsorily join the Government Provident Fund after two years of service. The fund is strictly a compulsory savings scheme rather than a provident scheme, since only the employees contribute; the Governments do not supplement the employees' contributions. The rates of monthly contributions range from 6% on monthly salaries of up to Rs 500, to 12% on salaries above Rs 1,000. The rate of interest on contributions, which

is determined annually, is currently 13.2%. Provisions exist for the granting of advances from the fund, and for an early withdrawal of balances.1/ The accumulated balance in the fund is not represented by investments; instead the annual contributions and disbursements are reflected in the Governments' development budgets. In FY82, the contributions to and payments from the Government Provident Fund for federal employees amounted to Rs 415 million and Rs 165 million, respectively.2/

5.24 Most public enterprises have provident fund and gratuity schemes for their employees; employers contribute to provident funds at the same rate as employees. In commercial banks, membership of pension plans was recently made compulsory for new employees, while existing employees had the option to continue with their provident fund and gratuity benefits.

5.25 The coverage of retirement schemes in the private sector is not as wide as in the public sector. There is no statutory requirement for the establishment of provident funds by employers, but firms of a certain size that do not have provident fund schemes are required to pay gratuities to employees on their resignation or retirement. Gratuity is payable by commercial establishments employing 20 or more workers and by industrial establishments employing 50 or more workers. The rate of gratuity is 20 days' wages for every completed year of service. Since there is no statutory provision for the setting up of provident funds, gratuities are more common than provident funds.

5.26 A survey of factories with more than 20 employees in 1977 found that only 25% of the factories had contributory provident fund schemes, and total contributions amounted to a mere Rs 32 million. However, the response to the

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1/ Members may be granted temporary advances for certain purposes (e.g., for expenses incurred in connection with prolonged illness); each such advance must not, however, exceed three months' salary or 50% of the member's balance, whichever is less. An advance amounting to the lesser of two years' salary and 80% of the balance may also be granted for the purchase of a house. For a member aged 50 years and above, an advance for this purpose may not be recovered but treated as part of the final payment of his credit balance. Members are entitled to withdraw 60% of the accumulated balance after the age of 50, and 80% of the balance after the age of 55. The full amount standing to his credit is payable when a member leaves Government employment.

2/ Recent information concerning contributions of provincial employees is not readily available; the net contributions of Provincial Government employees to the Government Provident Fund amounted to about Rs 85 million in 1976/77.

survey was low and the finding may be unreliable.1/ The compilation of income tax statistics currently underway should give a better picture of the scope of provident funds in the private sector. Approved provident funds enjoy substantial tax benefits.2/ Since most funds seek these concessions, the income tax statistics should provide comprehensive data on contributions to private provident funds and, together with details of rules and accounts of each fund, information on their net contribution to saving.

5.27 The coverage of private retirement schemes expanded with the introduction of the employees' old-age benefits scheme (EOBS) in July 1976. All commercial and industrial establishments employing at least 10 persons are required to contribute in respect of workers3/ earnings up to Rs 1,000 per month; no contributions are required from the employees. The contributions are at the rate of 5% of the monthly wage. The Federal and Provincial Governments, public corporations and commercial banks are outside the scope of the scheme. The main benefit is a pension, payable at the flat rate of Rs 75 per month to men (women) over 55 (50) who have retired and in respect of whom contributions have been paid for at least 15 years. Contributions amounting to Rs 126 million were made in respect of 873,000 members in FY82.

5.28 Several changes in the EOBS were announced recently. Workers, once enrolled in the scheme, are to retain their membership even when their monthly earnings exceed Rs 1,000; however, the maximum contribution is to remain at Rs 50 per month. Pensions are to be payable after the age of 50 years irrespective of whether a member has retired. At the same time, the qualifying period of 15 years would be reduced to five years for men over 45 years and women over 40 years. Both the range and the magnitude of benefits are also to be increased; benefits would vary from a minimum of Rs 90 to Rs 345 per month.

5.29 There are further possibilities for increasing saving through provident fund schemes in the private sector. The EOBS, given its partial

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1/ Enquiry on Labor Welfare, 1977 (Karachi: Statistics Division, Government of Pakistan, May 1981).

2/ The employer's contributions are deductible, the employee's contributions qualify for the investment allowance, and the income of the funds and the accumulated balances paid to the members are exempt from tax. See Annex I, paragraphs 20-22.

3/ According to the Industrial Relations Ordinance of 1969, a "workman" is defined as a person employed by commercial and industrial establishments "to do any skilled or unskilled, manual or clerical work for hire or reward"; this definition would seem to exclude administrative, supervisory and managerial personnel from the scheme.

coverage of employees, and with its restriction of contributions to employers and the maximum rate of contributions to Rs 50 per month, cannot tap such possibilities fully. In addition, retirement schemes should be saving rather than welfare-oriented; this requires, inter alia, that employees supplement employer contributions, and advances against credit balances be permitted only in exceptional circumstances.

5.30 One possibility is to make statutory provision for the establishment of provident funds by all establishments above a certain size. The basic features of such funds could be specified, and an institution established to manage the funds of establishments that are unable to do so themselves. Another possibility is to transform the EOBS into a full-fledged provident fund covering all employees of establishments with 10 or more employees and requiring contributions from employees as well as employers. Still another possibility is to establish a national provident scheme for both private and public sector employees. This would have many advantages (e.g., portability of provident fund rights, uniform treatment of all employees in similar circumstances, etc.), but would necessitate suitable modifications in existing public and private retirement schemes. A proper evaluation of the alternatives would require greater data about the existing schemes than are presently available. A careful study of the future role of retirement schemes is needed.

Conclusions

5.31 The structure of returns on deposits and the taxation of interest income should be reviewed. The present arrangements confer too great an advantage on national savings schemes in relation to bank deposits and impede the role of commercial banks in resource mobilization. The predominance of the banking system in the mobilization of rural deposits underscores the importance of enabling commercial banks to provide diversified savings instruments with reasonable real returns.

5.32 The establishment of the employees' old age benefits scheme represents an important step toward a broader coverage of retirement schemes. While the coverage of retirement schemes in the public sector is good, there is further scope for increasing saving through retirement schemes in the private sector. A study to review the coverage and working of existing private provident funds, and the possibilities for extending the role of retirement schemes in household saving is recommended.1/

1/ The study should also examine which contributions presently made by employers could be eliminated or consolidated if more comprehensive provident fund arrangements were introduced. Employers contribute in respect of their employees for a large number of purposes, including medical care (through Provincial Social Security Institutions), group life insurance, housing (under the Workers' Welfare Fund Ordinance, 1971) and education (through the provincial education cess).

6. TAXATION AND COMPANY SAVING

6.1 Taxes affect business saving through their effect on profits available for saving and by influencing the choice between retention and distribution. This chapter examines whether the present system of company taxation is conducive to company saving (retained earnings). This, in turn, involves a consideration of the structure of company taxation and the level of the tax rate. Specifically, the following questions are asked. First, is the present structure of company taxation satisfactory? Second, are the present tax rates at a reasonable level? Third, is the differentiation between different types of companies, and especially between domestic public companies and private companies,1/ desirable?

Present System of Company Taxation 2/

6.2 Pakistan follows the "classical" system of company taxation. There is complete separation between the individual income tax and company taxes. Shareholders receiving dividends cannot claim credit for any taxes paid at the company level. Since distributed profits are first subject to company taxes and then to the individual income tax, the system gives rise to what has been termed "double taxation" of dividends. However, partial relief from double taxation is provided by exempting certain amounts of dividends from the individual income tax (see paragraph 6.5).

6.3 The company tax rate structure has three components: company income tax, super tax and a surcharge. All companies are liable to an income tax at the rate of 30%. Companies are also subject to a super tax of 25%, but a proportion of the tax is rebated to domestic companies that satisfy specified conditions. Additionally, a surcharge at the rate of 5% of the income tax and super tax payable is levied. Profits from exports of domestically manufactured goods are taxed at the rate of 45% of the combined rate of income and super taxes otherwise applicable; the reduced rate applies to all exports except raw cotton and rice.

1/ Throughout this chapter, the term "public company" refers to a company which is listed on the stock exchange or a company in which at least 50% of the shares are held by the Government; all other incorporated businesses are considered private companies. This definition is needed because for the purposes of tax rates (the first schedule of the Income Tax Ordinance, 1979), the definition of public companies differs from that given in the Companies Act.

2/ For a detailed description, see Annex I, paragraphs 23-41.

6.4 While the tax rates are uniform for all non-banking companies, the system of rebates under the super tax gives rise to differential taxation. Public companies and new industrial companies (with fixed assets of below a specified level) each qualify for a rebate on super tax of 5%, and food processing companies for 10%; public companies with paid-up capital and reserves below certain levels receive a further rebate of 5%. Thus, the present structure of company taxation, inter alia, favors domestic public companies relatively to private companies. The foregoing structure of taxation results in an overall rate of company taxes of 52.5% for most public companies and of 57.75% for most private companies.1/

6.5 Private companies are less favorably treated than public companies in two other ways: they are liable to a higher rate of super tax on intercorporate dividends received by them, and the dividend exclusion for their shareholders is more limited than for the shareholders of public companies. The rate of tax on intercorporate dividends received by public companies is 10%, compared to the rate of 20% for private companies. In addition, while dividends of up to Rs 15,000 received from companies listed on the stock exchange are exempt from tax, the exemption is limited to Rs 5,000 for dividends received from private companies.2/

Assessment of the Present System

6.6 The classical system of company taxation has some widely known defects. It results in incorporated businesses being taxed more than unincorporated businesses, dividends being taxed differently than other incomes, and debt finance being favored over equity finance. Tax relief for dividends does not deal with these defects satisfactorily. The dividend exclusion approach pursued in Pakistan, for instance, has two shortcomings. First, substantial over-taxation of dividends for low and middle-income groups remains, since distributed profits bear a minimum rate of tax of 52.5%, or much higher than the likely marginal rates of low and middle-income investors. Second, the relatively wealthy taxpayers benefit more, since the value of a rupee of tax-exempt dividends is greater the higher the marginal tax rate. Many schemes to provide partial relief from the double taxation of the distributed portion of company income have been devised, but all of them are in some way deficient.

1/ The tax rates for public and private companies have been arrived at by applying a surcharge of 5% to the combined company and super tax rates of 50% and 55%, respectively.

2/ For further details of dividend exclusion, see Annex I, paragraph 19.

6.7 An alternative to the classical system of company taxation is the "imputation" system. Under the latter, the company tax paid on distributed profits is treated as a withholding tax. Shareholders are taxed on gross dividends (dividends received plus company taxes paid by companies on those dividends) but receive a tax credit equivalent to the company taxes paid; any excess of the tax credit over other tax liability is refunded. Under this approach, the double taxation of distributed profits is eliminated, since dividends are taxed at the taxpayers' relevant marginal rates of tax.

6.8 The imputation system has some obvious advantages; it reduces the disparity between taxes on incorporated and other firms, brings the tax treatment of dividends in line with that of interest, and improves horizontal equity (since dividends are taxed in the same manner as other income). However, it also has some disadvantages; it would weaken the present strong inducement for profit retention (since the differential between tax rates on retained and distributed profits would narrow), substantially reduce tax revenues, and would be more difficult to administer (since the tax withheld from dividends at the company level would have to be refunded in certain circumstances).

6.9 Pakistan's nominal rates of company taxes fall at the upper end of the rates prevailing in both developed and developing countries; company rates in excess of 50% are unusual. Many countries that have high nominal rates of company taxes have significantly lower effective rates of company taxes (which take account of fiscal incentives under company taxation). This does not seem to be true in Pakistan, where the only major fiscal incentives available to existing firms are an initial allowance for buildings and machinery and, possibly, a tax credit for the balancing, modernization and replacement (BMR) of plant and machinery (Table 6.1). New industrial undertakings set up outside the country's relatively developed areas face effective rates that are substantially below nominal rates, since their profits are partially or wholly exempt from company taxes for five years. However, since only a small proportion of firms are in a position to utilize these incentives, most firms probably face effective rates that are close to nominal rates.

Table 6.1: MAIN FISCAL INCENTIVES UNDER COMPANY INCOME TAX

Relatively Developed Areas (Karachi, Hyderabad, Faisalabad and Lahore)

Accelerated depreciation - Initial allowances at the rates of 10% for buildings and 40% for machinery and plant, in addition to the normal depreciation allowances.

Tax credit for the balancing, modernization and replacement (BMR) of plant and machinery - Tax credit (against the tax payable) of 15% of the amount invested.

All Areas except the Relatively Developed Areas

Accelerated depreciation

BMR

Exemption from tax of newly established industrial undertakings - Profits of up to 10% of the capital employed exempt for five years.

Less Developed Areas (Baluchistan and Other Specified Areas)

Accelerated depreciation

BMR

Exemption from tax of newly established industrial undertakings - Profits completely exempt for five years.

Source: Annex I, paragraphs 42-49.

6.10 A tax concession for small companies (not limited to only small public and new industrial companies as in Pakistan) features in tax structures of many countries, but a distinction between private and public companies for tax purposes is difficult to justify. The less favorable treatment of private companies relative to public companies may be meant to induce the conversion of the former into the latter. While the preferential treatment of public companies can be expected to encourage some private companies to go public, a wider shareholding would not seem to be necessary or practicable for the vast majority of private firms. A major effect of tax differentiation is, therefore, likely to be a distortion in the allocation of resources. To the extent that there is a tendency for the net-of-tax returns in different activities to be equalized, capital would move from higher productivity uses in private companies to lower productivity applications in public companies.

6.11 Despite the bias imparted by the tax system to retained earnings, it is widely believed in Pakistan that the magnitude of company taxation, together with large holdings of equities by institutions which have a strong preference for dividends, has restricted company saving. In addition, the

concessional rate of interest on industrial loans from commercial banks is thought to have reinforced other considerations favoring a high reliance on external finance (as distinct from retained earnings). At first sight, these impressions seem to be contradicted by statistics on non-financial companies listed on the Karachi Stock Exchange. Table 6.2 gives sources of finance for investment by these companies. Retained earnings have clearly been important, financing over one half of the companies' capital spending. The stock exchange has played a minor role in meeting the companies' financial requirements; the share of new equity capital in the financing of investment fell from 28% in 1976 to about 9% in 1980. Although new issues offered to the public have been small, the popularity of rights issues suggests that established companies paying good dividends have not found it difficult to raise fresh share capital.1/ Finally, long term borrowing provided under one third of the financing; with only a few corporate debentures quoted on the stock exchange, most long term debt finance came from commercial banks and development finance institutions. Overall, equity finance, defined as retained earnings plus new share capital, met two thirds of the financing requirements despite the present favorable tax treatment of debt finance and the concessional rate of interest for long term loans.

6.12 The financing pattern of listed companies suggests that either business savings were so buoyant that a significant proportion of the financing needs could be met from internal sources, or that the level of investment was sluggish so that there was no need to raise large amounts of resources from external sources.2/ The latter conjecture seems more plausible. The companies under consideration accounted for only 7.5% of private saving, and their investment in 1980 was no higher in real terms than in 1976.

Conclusions

6.13 Although sufficient evidence is lacking, the level of company saving appears to be low in Pakistan. Government policies to revitalize the industrial sector should, therefore, consider lower company taxation as a means of stimulating company saving as well as investment.

1/ New issues offered to the public during 1975/76 to 1981/82 varied between Rs 18 million to Rs 92 million, except in 1979/80 when they amounted to Rs 400 million. Rights issues have been much larger in many years; for example, they amounted to Rs 195 million in 1980/81.

2/ The textile industry may also have significantly influenced the financing pattern. See Dr. Abdul Karim, "The Role of Corporate Saving in Pakistan, 1972-77" in Resource Mobilization in Pakistan (Lahore: Pakistan Administrative Staff College, 1981).

Table 6.2: SOURCES AND USES OF FUNDS IN NON-FINANCIAL COMPANIES LISTED ON THE KARACHI STOCK EXCHANGE, 1976-80
(amounts in million rupees)

	1976		1977		1978		1979		1980	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Uses										
Fixed assets	2,090	97.8	2,616	98.9	2,399	82.6	1,032	98.8	2,979	96.3
Working capital	46	2.2	30	1.1	507	17.4	13	1.2	115	3.7
	2,136	100.0	2,646	100.0	2,906	100.0	1,045	100.0	3,094	100.0
Sources										
Internal										
Retained earnings	976	45.7	1,088	41.1	1,592	54.8	577	55.2	1,851	59.8
(of which depreciation)	(78%)		(80%)		(62%)		(100%)		(57%)	
External										
Share capital	603	28.2	405	15.3	623	21.4	166	15.9	273	8.8
Long-term loans and debentures	557	26.1	1,153	43.6	691	23.8	302	28.9	970	31.4

Source: Investment Corporation of Pakistan, Annual Report, 1981.

6.14 In view of the desirability of encouraging saving and the substantial loss of revenue that a changeover in the system of taxation would entail, the replacement of the present system of taxation by the imputation system is not recommended. The best way of encouraging company saving may be to consolidate the different taxes on companies into a single tax that is somewhat lower than the combined rate of prevailing company taxes. Changes in the present rates of tax should be based on a careful review of effective rates of tax for different types of companies, data on which should become available shortly as a result of the computerization of income tax statistics. Double taxation of dividends would be of lesser consequence if the overall rate of company taxation were reduced. The merger of different company taxes and a reduction in, or elimination of, the differentiation in the tax treatment of different companies would also help to simplify the present unnecessarily complicated structure of company taxation.

ANNEX I

STRUCTURE OF DIRECT TAXES

Personal and Company Income Taxation

1. Personal and company income taxes, zakat and the wealth tax constitute Pakistan's main direct taxes. This section describes the main features of the individual income tax, tax incentives for saving by individuals (investment allowance, the treatment of interest and dividend receipts, and retirement schemes), taxation of businesses, and tax incentives for exports and investment. The remaining taxes are described in the following sections. The relevant legislation is contained in the Income Tax Ordinance, 1979, the Wealth Tax Act, 1963, the Zakat and Ushr Ordinance, 1980, and subsequent amendments.

The Individual Income Tax

2. All income is subject to tax unless specifically exempted. Perquisites (that is, benefits provided by an employer as part of salary) are considered part of income, but their valuation is generally below market levels.1/

3. Main Exemptions. The major exemption is in respect of agricultural income. Additionally, the taxation of capital gains has been suspended up to June 30, 1984.

4. Treatment of Other Taxes. Zakat and wealth tax paid are deductible.

5. Every taxpayer with a total income of Rs 50,000 and above is required to submit a wealth statement along with his return of income. Should the combined income tax and wealth tax liability exceed 75% of total income, income tax is reduced by the amount by which the combined liability exceeds 75% of total income. 2/

6. Taxable Income. Taxable income is defined as total income (after the deduction of zakat and wealth tax paid) less the standard allowance of Rs

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1/ Details are given in Chapter 3, Table 3.2.

2/ Note that this does not mean that the combined liability cannot exceed 75% of total income; it will not exceed 75% of total income only if the liability for the wealth tax is below 75% of total income.

12,000. The income of an assessee's spouse is separately assessed unless it is derived from a firm in which the assessee is a partner, or from assets transferred by the assessee other than by way of gift or for adequate consideration.1/

7. Tax Rates. The rates of tax are as follows:

Taxable Income (Rs)	Income Tax Payable
Up to 10,000	15% of taxable income
10,000-15,000	1,500 + 20% of amount exceeding 10,000
15,000-20,000	2,500 + 25% of amount exceeding 15,000
20,000-25,000	3,750 + 35% of amount exceeding 20,000
25,000-30,000	5,500 + 40% of amount exceeding 25,000
30,000-60,000	7,500 + 50% of amount exceeding 30,000
60,000-100,000	22,500 + 55% of amount exceeding 60,000
Above 100,000	44,500 + 60% of amount exceeding 100,000

8. The tax liability is determined from the above schedule in conjunction with the following provisions:

(i) Where the salary income comprises more than 50% of total income, and the total income does not exceed Rs 21,000, the maximum tax liability is restricted to Rs 120; where the total income exceeds Rs 21,000, the first Rs 9,000 of taxable income is subject to a tax of Rs 120, and the tax payable on the remaining taxable income is calculated from the tax schedule. 2/

(ii) Where non-salary income comprises 50% or more of total income, the tax liability computed from the tax schedule is reduced, as follows:

1/ For further details, see the Income Tax Ordinance, 1979, sections 69 and 83.

2/ Examples may clarify. At the total income of Rs 21,000 (taxable income of Rs 9,000), the tax liability is Rs 120, even though the schedule gives a liability of Rs 1,350 (15% of Rs 9,000). At the total income of Rs 25,000 (taxable income of Rs 13,000), the first Rs 9,000 of taxable income would be subject to a tax of Rs 120, and the remaining Rs 4,000 of taxable income would be taxed at 15%. The tax liability in this instance would be Rs 720 (see Table 1).

Total Income (Rs)	Reduction 1/
12,001-15,000	20% of the amount of tax
15,001-25,000	15% of the amount of tax
Above 25,000	Rs 315

(iii) Where the total income is between Rs 12,001-13,000, the maximum tax liability is restricted to 50% of the excess over Rs 12,000.

(iv) Where taxable income exceeds Rs 100,000, a surcharge of 10% of the income tax payable (after taking account of any rebate for investment) is levied.

9. The effect of this rate structure is to subject non-salary incomes to higher taxation than salary incomes. This will be seen by comparing Tables 1 and 3. A possible reason for the favorable treatment of salary income may be the recognition of the greater opportunities for under-reporting non-salary income.

Tax Relief for Saving

10. Tax relief for saving is given through an investment allowance, exemption of certain amounts of interest and dividend receipts, and a favorable treatment of retirement schemes.

11. Investment Allowance. Tax relief is granted for qualifying investments of up to 1/3 of total income, with a maximum of Rs 50,000. The main qualifying investments are:

(i) contributions to a recognized provident fund (up to 20% of salary);

(ii) contributions to an approved superannuation fund;

(iii) life insurance premiums (up to 10% of the capital sum assured);

(iv) Defense Savings Certificates;

(v) unit trust certificates issued by the National Investment Trust (NIT);

1/ An example may clarify. At the total income of Rs 20,000 (taxable income of Rs 8,000), the schedule gives the tax liability of Rs 1,200. This sum must be reduced by Rs 180 (15% of Rs 1,200) to arrive at the actual tax liability of Rs 1,020 (see Table 3).

(vi) mutual fund certificates issued by the Investment Corporation of Pakistan (ICP);

(vii) shares of specified Pakistani investment companies;

(viii) specified debentures of public companies;

(ix) participation term certificates;

(x) shares of specified Pakistani industrial public companies;

(xi) modaraba 1/ certificates; and

(xii) shares of specified holding, investment and industrial public companies.

12. To qualify for the investment allowance, (vi)-(xii) must not be acquired from a previous holder. (iii)-(v) and (vii)-(ix) require a holding period of three years to qualify for tax relief; where an asset is sold within three years, the amount of tax relief previously granted is recovered.

13. The tax relief for investment takes the form of a tax credit (that is, a deduction from tax liability). The credit is given at the average rate of tax, defined as the tax liability (before the surcharge) divided by total income. The details of the calculations are explained in Table 2.

14. The effect of the investment allowance will be seen by comparing Tables 1 and 2. A salaried person with a total income of Rs 100,000 has a tax liability of Rs 33,070. If the same person utilizes the investment allowance to the fullest extent by investing Rs 33,333, his tax liability would fall to Rs 22,047. Thus, in effect, in this instance, investments worth Rs 33,333 were acquired for Rs 22,310 (investment of Rs 33,333 minus tax saving of Rs 11,023).

15. Treatment of Interest. Interest from the following sources is exempt:

(i) National Savings or Deposit Certificates (including Defense Savings Certificates) issued under the National Saving Schemes; and

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1/ A modaraba is a business in which subscribers participate with finance and the manager participates with effort and skill. The activities of modarabas are restricted to those permitted under the Islamic law.

(ii) Deposits at the Post Office Savings Banks or National Savings Centers under the National Saving Schemes.

16. Interest received from a deposit in a savings account at a commercial bank is exempt up to Rs 1,000.

17. Interest of up to Rs 5,000 received from the following sources is exempt:

(i) securities of Federal and Provincial Governments;

(ii) approved debentures; and

(iii) approved participation term certificates.

18. Interest paid to a bank on the amount borrowed for investment in the securities of Federal and Provincial Governments or debentures of Pakistani companies is deductible from the interest received from such securities.

19. Treatment of Dividends. Dividends of up to Rs 15,000 received from the following sources are exempt:

(i) NIT unit trusts;

(ii) ICP mutual funds;

(iii) companies listed on the stock exchange;

(iv) dividends of up to Rs 5,000 received from unlisted companies;

(v) *modaraba* certificates; and

(vi) profit and loss sharing (PLS) accounts with a bank.

The Tax Treatment of Retirement Schemes

20. Special tax provisions apply to provident and superannuation schemes for employees that satisfy specified conditions.1/ Contributions made by employers to provident and superannuation schemes are deductible. Contributions by employees are treated as part of the investment allowance and receive tax relief in the same manner as other investments qualifying for the investment allowance (that is, tax rebate is granted at the relevant average rate of tax). The tax relief for contributions to provident funds is further

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1/ Different provisions apply to the retirement schemes for persons in non-pensionable employment and to the self-employed.

restricted: contributions by an employee must not exceed 20% of the salary, and contributions by an employer above 10% of an employee's salary are treated as the latter's income.

21. The income of provident and superannuation funds is exempt from tax.

22. The accumulated balance in a provident fund received by an employee is not taxable. In contrast, pensions are taxable except when received by a citizen of Pakistan over the age of 60; however, that part of the pension which is commuted into a lump sum is exempt.

Company Taxation

23. In the computation of taxable income, all expenses wholly and exclusively incurred in the production of income are allowed, including interest on debt1/ and depreciation.

24. Depreciation Allowances. The allowances are given for buildings, furniture, and machinery and plant. The deductions relate to original cost, and are given on a reducing balance method. The main rates are as follows:

Factories and workshops	10%
Other buildings	5%
Furniture	10%
Most items of machinery and plant	10%
Motor vehicles	20%

25. Buildings erected by June 30, 1983, and machinery and plant installed by that date qualify for an initial allowance, in addition to the annual depreciation allowances.2/ The rate is 10% for buildings and 40% for machinery and plant.

26. Balancing adjustments are made on the sale of assets. When the sale proceeds exceed the written down value, the excess is treated as income; on the other hand, when the sale proceeds are less than the written down value, the deficit is deductible. However, in the case of a building, "sale

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1/ Payments in respect of borrowings from a modaraba and participation term certificate holders are also allowed.

2/ Note that an initial allowance increases the depreciation allowance in the first year but not total depreciation allowances, which are restricted to the original cost of an asset.

proceeds" are defined as the lower of the original cost or the market price.1/

27. Valuation of Inventories. The legislation does not specify the method to be used for the valuation of stock in hand but the following methods are permitted: (i) cost, (ii) market, or (iii) cost or market price, whichever is lower. However, stock at the beginning and end of an accounting period must be valued on the same basis (that is, using the same method).

28. The Treatment of Losses. If the net income is a loss, it may be carried forward for up to six successive years.

29. Tax Rates. Company taxation has three components: income tax, super tax and a surcharge. Income tax and super tax are levied on net income excluding intercorporate dividends received and bonus shares issued. Certain types of domestic companies receive rebates on the super tax payable. Intercorporate dividends and bonus shares are taxed at special rates of super tax; they are not subject to income tax. The surcharge is levied on the income tax and super tax payable.

30. The rates of income and super taxes are uniform for all non-banking companies but the system of rebates results in differential taxation. Domestic companies are treated more favorably than foreign companies, and public companies more favorably than private companies. This occurs primarily because rebates on super tax are confined to domestic companies, and because every non-banking public company receives a rebate of 5% on super tax payable (see paragraph 33).

31. There is complete separation between the individual income tax and company taxes. Shareholders receiving dividends cannot claim credit for any taxes paid at the company level but, as already explained, certain amounts of dividends received from companies are exempt from the individual income tax.

32. The rates of company taxes are:

Income tax:	30%	
Super tax:	Banks	35%
	Other companies	25%

1/ The effect of this is to exempt capital gains in respect of buildings. An asset that is purchased for 100 and in respect of which depreciation allowances of 40 have been received has a written down value of 60 (100-40). Suppose the asset is sold for 150. If the asset were machinery, tax would be levied on 90 (150-60); but if it is a building, tax would be levied on only 40 (100-60).

33. The rates of rebates on super tax for domestic companies are:

(i) 5% for every public company1/ other than a bank.

(ii) 5% for every non-banking public company to which (iii) does not apply and if its paid-up capital plus free reserves do not exceed Rs 500,000.

(iii) 5% for every public industrial company2/ if its paid-up capital plus free reserves do not exceed Rs 1 million.

(iv) 5% for every industrial company commencing production between July 1, 1975 and June 30, 1983 if the original cost of its fixed assets (exclusive of the cost of land) does not exceed Rs 5 million.

(v) 10% for food processing companies.

(vi) 15% for every company on income derived from abroad and brought into Pakistan.

34. The rates of super tax on intercorporate dividends are:

public company 5%
foreign company 15%
other companies 20%

35. The rates of super tax on bonus shares are:3/

public companies 10%
other companies 15%

1/ For the purposes of tax rates, a "public company" is defined as a company which is listed on the stock exchange or a company in which at least 50% of the shares are held by the Government. For other purposes, the relevant definition is that given in the Companies Act.

2/ The definition of an "industrial company" includes the requirement that it employ at least ten persons.

3/ Companies are exempt from the payment of the tax until June 30, 1983. Bonus shares are not taxed in the hands of shareholders.

36. A surcharge of 5% of the income tax and super tax payable is levied.1/ At the same time, a rebate based on the ratio of retained income to after-tax profits is granted to companies whose free reserves are less than 200% of their paid-up capital (300% in the case of banks and other financial institutions).2/

Taxation of Partnerships

37. Three types of partnerships are distinguished for tax purposes: registered partnerships formed by certain professionals, other registered partnerships and unregistered partnerships. The tax treatment of registered partnerships is more favorable than that of unregistered partnerships. The privilege of registration is intended only for genuine partnerships.

38. The net profits of a registered partnership are subject to the super tax. In addition, each partner is taxed on his total taxable income (including his share of partnership profits3/) at standard individual income tax rates. The rates of super tax for registered firms are as follows:

1/ Note that since the surcharge is related to the combined rate of income tax and super tax rather than profits, it raises the combined rate by less than 5%. For a company paying tax at the combined rate of 55%, the surcharge would raise the overall rate to 57.75% (55 x 1.05).

2/ The operation of the rebate is best explained through a numerical example. Consider the following situation:
20,000 profits
11,000 income tax and super tax payable at the rate of 55%
9,000 profits after income tax and super tax
3,000 retained profits before the surcharge
6,000 distributed profits
If the company did not retain any profits, it would pay the surcharge of 550 (5% of 11,000). Since the company retained a proportion of profits, the liability to the surcharge is reduced by x, calculated as follows:

$$\frac{3,000}{9,000} = \frac{x}{550}$$

Since x = 183 (approximately), the surcharge payable is 367 (550-183).

3/ Partnership profits are taxed in the hands of a partner net of the super tax.

Total Income (Rs)	Tax Payable
Up to 15,000	Nil
Above 15,000 but below 30,000	5% of amount in excess of 15,000
Above 30,000 but below 60,000	750 + 10% of amount exceeding 30,000
Above 60,000 but below 100,000	3,750 + 20% of amount exceeding 60,000
Above 10,000	11,750 + 30% of amount exceeding 100,000

39. A registered firm whose income depends wholly or mainly on the professional qualifications of its partners, who are prevented by law or convention from constituting themselves into a corporate body, is exempt from the super tax. The partners (as distinct from the firm) of such a firm are taxed in the same manner as the partners of other registered firms.

40. An unregistered partnership is treated as a sole proprietorship.1/ The total taxable income of such a firm is taxed at standard individual income tax rates.2/

41. All unincorporated firms are subject to a surcharge of 10% of the income tax and super tax payable. Unlike individuals, firms with taxable incomes of less than Rs 100,000 are also liable to the surcharge.

Tax Incentives for Investment in Less Developed Areas

42. Three main types of incentives are given for investment outside the more developed areas.

43. Industrial Undertakings Established Outside the More Developed Areas. Profits of up to 10% of the capital employed are exempt for five years for industries established by June 30, 1983 anywhere in Pakistan excluding the talukas of Karachi and Hyderabad and tehsils of Faisalabad and Lahore.

1/ The tax authorities are empowered to treat an unregistered firm as a registered firm if the aggregate amount of tax payable would be greater than the aggregate amount that would be payable by the firm and the partners individually if the firm were assessed as an unregistered firm. It may be advantageous for a firm to remain unregistered if the total income of an individual partner is much higher than that of the unregistered firm.

2/ The share of profits received by a partner does not bear further taxation in the hands of the partner, but his share is included in his total income for computing the average rate of tax applicable to his other income (that is, his total taxable income excluding his share of profits).

44. Industrial Undertakings Established in Specified Less Developed Areas. Profits of an industrial undertaking set up between March 1, 1978 and June 30, 1983 in Baluchistan and certain other parts of the country, including areas of the North-West Frontier Province (NWFP), are exempt for five years. A similar exemption applies to an industrial undertaking set up in an approved industrial estate in the NWFP, and certain areas of Punjab and Sind.

45. Investment in Share Capital of Industrial Companies Set Up in Specified Less Developed Areas. Tax credit is available for investment by a company in the shares of another Pakistani company established in a specified area. The rate of credit is 30% of the amount of investment in Baluchistan and certain other areas, and 15% for other specified areas. The credit can be carried forward until it is fully set off against tax liability.

Tax Incentives for Exports

46. Tax incentives for exports are of two types, one relating to profits from exports of domestically manufactured goods and the other to industries established in export zones.

47. Profits from Exports of Domestically Manufactured Goods. Export profits qualify for a tax rebate of 55% of the amount of income tax and super tax payable.1/ The rebate is available in respect of all exports except raw cotton and rice.

48. Export Zone. Profits from an industrial undertaking set up in an export processing zone as well as salaries paid to foreign employees are exempt for five years and for such further period as may be approved. Furthermore, for five years after the expiry of the period of exemption, profits are taxed at 25% of the actual rates. The treatment of losses is also more liberal than for other enterprises; losses may be carried forward as long as required to set them off against profits.

1/ The tax rebate would reduce the combined rate of income and super tax (for a firm that does not qualify for any rebate for super tax) from 55% to 24.75%. Allowing for a 5% surcharge, the overall rate would be 25.99%.

Tax Credit for Replacement, Balancing and Modernization of Machinery and Plant

49. Investment by June 30, 1983 in plant and machinery in an industrial undertaking for the purpose of balancing1/, modernization and replacement (BMR) of machinery and plant qualifies for a tax credit of 15% of the amount invested. The credit for BMR may be carried forward for up to two years.

The Tax Treatment of Income from Housing

50. The provisions for housing relate to owner-occupied housing, rental housing and housing provided by industrial undertakings for their low-income employees (those earning less than Rs 1,000 per month). The net imputed income from owner-occupied housing is not taxable, but mortgage interest cannot be deducted.

51. Tax concessions are provided for rental and industrial housing. Income from rental housing constructed by June 30, 1983 and with an annual value below Rs 18,000 (Rs 24,000 in the case of Islamabad) is exempt for five years; the exemption is restricted to Rs 9,000 where the annual value exceeds these limits. Similar provisions apply to income from apartments with annual values of under Rs 12,000.

52. Industrial housing constructed by June 30, 1983 qualifies for an initial depreciation allowance of 25%, in addition to the annual rate of depreciation of 10%.

1/ The term "balancing" can only be meaningfully defined in relation to specific industries. An example of "balancing" in the textile industry has been provided by a former chairman of the Central Board of Revenue: "The term "balancing" (of machinery) means installation of additional machines in an industrial unit for the purposes of achieving optimum efficiency of the various inter-related components of that unit. For instance, in the textile industry, if an industrial undertaking has both yarn-producing and weaving facilities, 25,000 spindles "balance" with 500 looms... Installation of additional looms or spindles, as the case may be, to bring about the right proportion between the two would mean "balancing" of the existing machinery." See N.M. Qureshi, "Pakistan's Budget for 1980-81 in Perspective - Important Fiscal Measures," Bulletin for International Fiscal Documentation, Volume 35, No. 1, January 1981, p. 36.

Table 1: TAX PAYABLE BY SALARIED TAXPAYERS, ASSESSMENT YEAR 1982-83

(rupees)

Total Income	Taxable Income	Tax Liability	Surcharge	Tax Payable	Tax Payable as % of Total Income
12,000	-	-	-	-	-
15,000	3,000	120	-	120	0.8
20,000	8,000	120	-	120	0.6
25,000	13,000	720	-	720	2.9
30,000	18,000	1,470	-	1,470	4.9
40,000	28,000	3,620	-	3,620	9.1
50,000	38,000	7,220	-	7,220	14.4
60,000	48,000	12,120	-	12,120	20.2
70,000	58,000	17,120	-	17,120	24.5
80,000	68,000	22,120	-	22,120	27.7
90,000	78,000	27,570	-	27,570	30.6
100,000	88,000	33,070	-	33,070	33.1
150,000	138,000	62,020	6,202	68,222	45.5
200,000	188,000	92,020	9,202	101,222	50.6
250,000	238,000	122,020	12,202	134,222	53.7

Source: Mission estimates.

Table 2: EFFECT OF INVESTMENT ALLOWANCE ON TAX PAYABLE BY SALARIED TAXPAYERS, ASSESSMENT YEAR 1982-83

(rupees)

Total Income	Taxable Income	Tax Liability Before Surcharge	Investment	Average Rate of Tax (%)	Investment Rebate at Average Rate	Tax Liability After Rebate	Surcharge	Tax Payable	Tax Payable as % of Total Income (%)
12,000	-	-	-	-	-	-	-	-	-
15,000	3,000	120	5,000	0.80	40	80	-	80	0.5
20,000	8,000	120	6,666	0.60	40	80	-	80	0.4
25,000	13,000	720	8,333	2.88	240	480	-	480	1.9
30,000	18,000	1,470	10,000	4.90	490	980	-	980	3.3
40,000	28,000	3,620	13,333	9.05	1,206	2,414	-	2,414	6.0
50,000	38,000	7,220	16,666	14.44	2,406	4,814	-	4,814	9.6
60,000	48,000	12,120	20,000	20.20	4,040	8,080	-	8,080	13.5
70,000	58,000	17,120	23,333	24.46	5,706	11,414	-	11,414	16.3
80,000	68,000	22,120	26,666	27.65	7,373	14,747	-	14,747	18.4
90,000	78,000	27,570	30,000	30.63	9,190	18,380	-	18,380	20.4
100,000	88,000	33,070	33,333	33.07	11,023	22,047	-	22,047	22.0
150,000	138,000	62,020	49,950	41.35	20,654	41,366	4,137	45,503	30.5
200,000	188,000	92,020	50,000	46.01	23,005	69,015	6,902	75,917	38.0
250,000	238,000	122,020	50,000	48.81	24,405	97,615	9,762	107,377	43.0

Notes: (i) Investment of 33.3% assumed at all incomes.
(ii) Investment rebate at the total income of, say, Rs 50,000 is estimated as follows:

$$\frac{\text{Tax Liability}}{\text{Total Income}} \times \text{Amount Invested} = \frac{7,220}{50,000} \times 16,666 = .1444 \times 16,666 = 2,406$$

Source: Mission estimates.

Table 3: TAX PAYABLE BY NON-SALARIED TAXPAYERS, ASSESSMENT YEAR 1982-83

(rupees)

Total Income	Taxable Income	Tax Liability	Tax Reduction	Tax Liability After Reduction	Surcharge	Tax Payable	Tax Payable as % of Total Income
12,000	-	-	-	-	-	-	-
15,000	3,000	450	90	360	-	360.0	2.4
20,000	8,000	1,200	180	1,020	-	1,020.0	5.1
25,000	13,000	2,100	315	1,785	-	1,785.0	7.1
30,000	18,000	3,250	315	2,935	-	2,935.0	9.8
40,000	28,000	6,700	315	6,385	-	6,385.0	16.0
50,000	38,000	11,500	315	11,185	-	11,185.0	22.4
60,000	48,000	16,500	315	16,185	-	16,185.0	27.0
70,000	58,000	21,500	315	21,185	-	21,185.0	30.3
80,000	68,000	26,900	315	26,585	-	26,585.0	33.2
90.000	78,000	32,400	315	32,085	-	32,085.0	35.7
100,000	88,000	37,900	315	37,585	-	37,585.0	37.6
150,000	138,000	67,300	315	66,985	6,698.5	73,683.5	49.1
200,000	188,000	97,000	315	96,985	9,698.5	106,683.5	53.3
250,000	238,000	127,300	315	126,985	12,698.5	139,683.5	55.9

Source: Mission estimates.

Zakat

53. Zakat is a levy on capital payable by Moslem citizens of Pakistan, and by firms in which Moslem citizens own the majority of shares. It is confined to financial assets; assets not subject to zakat come within the purview of the wealth tax. Zakat is compulsorily deducted from specified assets; on certain other assets, it is payable voluntarily on a self-assessment basis.

54. Treatment of Debts. Debts related to assets subject to the compulsory deduction of zakat are taken into account in determining the value of the assets for the purposes of the levy.

55. Exemptions. Zakat is not deducted from savings bank accounts with credit balances of Rs 2,000 or less.

56. Rate of Deduction. The rate of deduction for all assets subject to zakat is 2.5%.

57. Relationship with Other Taxes. Zakat paid is deductible for income tax purposes. Additionally, assets from which zakat has been deducted at source are not subject to the wealth tax.

58. Assets Subject to the Compulsory Deduction of Zakat. The chargeable amounts for the 11 types of assets subject to the compulsory deduction of the levy are determined as follows:

(i)	Savings bank accounts	Credit balance on the valuation date.
(ii)	Notice deposits	Face value or the credit balance on the valuation date.
(iii)	Fixed deposits	Face value or the credit balance on the valuation date.
(iv)	Savings/Deposit certificates	Value of the certificate on maturity1/ or encashment, if earlier.

1/ An example may clarify. A certificate of deposit with a nominal value of Rs 100 and the value at maturity of Rs 390 after ten years would be subject to zakat in the tenth year on the full maturity value but no zakat would be payable in the intervening years. Zakat on life insurance policies and provident funds is also payable at maturity or termination and not annually.

(v)	NIT units	Repurchase value on the valuation date.
(vi)	ICP mutual funds	The lower of the face value or market value on the valuation date.
(vii)	Government securities1/	Face value on the valuation date.
(viii)	Shares and debentures of companies and corporations	The lower of the paid-up value or market value on the valuation date.
(ix)	Annuities	Annual benefit or surrender value.
(x)	Life insurance policies	Value at maturity or surrender value.
(xi)	Provident funds	Final amount standing to the credit of the contributor less employer's contributions and accrued interest on those contributions.2/

1/ Zakat is not compulsorily deducted from Prize Bonds.

2/ In other words, only the employee's contributions and income attributed to those contributions are subject to zakat.

Wealth Tax

59. The wealth tax is an annual levy on net wealth in the form of both movable and immovable wealth. With the introduction of zakat, however, the tax has come to fall primarily on real estate. The wealth tax is largely confined to individuals, but firms and partnerships involved in certain types of transactions in immovable property are also subject to the tax. All assets except those specifically exempted are treated as wealth for the purposes of the tax. The liability to tax only arises if the values of movable and immovable wealth exceed their respective exemption levels.

60. Scope. Individuals and Hindu undivided families are subject to the tax in respect of movable as well as immovable property. In addition, firms, partnerships and private companies (but not public companies) are liable to the tax in respect of immovable property held for the purposes of the business of construction and sale or renting of property.

61. Tax Base. Subject to the special provisions relating to agricultural land and the overall exemption limits discussed below, all assets are taxable except the following:

(i) growing crops, grass or standing trees on agricultural land;

(ii) any building owned or occupied by a cultivator or a receiver of rent from agricultural land provided the building is on or in the vicinity of the land and is required for use as a dwelling house or an out house;

(iii) any insurance policy before the sum covered by the policy becomes payable;

(iv) the right to receive pension or life annuity in respect of past employment;

(v) the commuted amount of pension;

(vi) the amount standing to the credit of a contributor in an approved provident fund, and the final payment of the accumulated balance in such a fund;

(vii) furniture, household utensils, clothing and other articles (excluding jewelry) intended for personal use;

(viii) tools, implements and instruments used in agriculture, and in a profession or a vocation;

(ix) investment of up to Rs 100,000 in newly issued stocks or shares of a public company engaged in an industrial undertaking (exempt) for two years; and

(x) assets in respect of which zakat has been deducted at source.1/

62. Immovable properties, other than agricultural land, owned by different members of a family (husband, wife and their minor children) are assessed as if they are owned by a single person.

63. The wealth tax is levied on net wealth, defined as the aggregate value of all taxable assets less all debts secured on or incurred in relation to those assets.

64. Special Treatment of Agricultural Land. There are two special provisions relating to agricultural land. First, an individual and a Hindu undivided family are exempt from the payment of wealth tax on agricultural land if they are not liable to income tax and if no wealth tax would be payable by them on their net wealth excluding agricultural land. Second, the value of agricultural land up to Rs 100,000 is exempt from wealth tax.

65. Exemptions. Separate exemption limits (that is, values of net wealth below which no taxes are payable) apply to movable and immovable property, as follows:

(i) immovable property (excluding agricultural land) up to Rs 500,000 or, alternatively, one house used by the taxpayer and his family;

(ii) movable property up to Rs 300,000.

66. Valuation. The rules made under the legislation specify the basis of valuation for different types of assets. Some examples of the valuation procedures follow.

1/ Where no distributions of income are made, shares and debentures are not subject to the compulsory deduction of zakat. However, in such instances, the shares and debentures become subject to the wealth tax.

(i)	securities issued by Government or local authorities	securities quoted on the stock exchange valued at the quoted price; others valued at the face value.
(ii)	shares of joint-stock companies registered in Pakistan	values of quoted shares taken as the lower of the face value or break-up value; value of shares not quoted taken as the higher of the face value or break-up value.
(iii)	unquoted debentures and preference shares	valued at paid-up value.
(iv)	rental buildings	value normally arrived at by capitalizing gross annual rental value over 10 years.
(v)	agricultural land	value per acre is taken as 10 times the produce index unit1/ of that acre.
(vi)	plot	normally valued at the purchase price.

67. Tax Rates. The rates of tax are as follows:

(i) net wealth in the form of immovable property 2.5%

(ii) net wealth in other forms:

on first Rs 300,000	Nil
next Rs 200,000	0.5%
next Rs 500,000	1.0%
next Rs 500,000	1.5%
next Rs 500,000	2.0%
remainder	2.5%

1/ A produce index unit (PIU) is a rough measure of the gross value of production per acre.

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ANNEX II

STRUCTURE OF INDIRECT TAXES

1. The major indirect taxes levied in Pakistan comprise import duties, excise duties and the sales tax. This annex describes the salient features of these taxes. The relevant legislation is contained in the Customs Act, 1969, the Central Excise and Salt Act, 1944, the Sales Tax Act, 1951, and subsequent amendments.

Import Duties

2. Tax Base. The tax is levied on the cif import value.

3. Coverage. All imported goods are taxable unless specifically exempted. The extent of general exemptions (as distinct from concessions for specific purposes) is not wide.

4. Tax Rates. Import duties may be levied at specific or ad valorem rates, but most goods are subject to ad valorem rates. Import duties on selected goods are given in Table 1. In addition to the rates specified in the import tariff, a surcharge of 5% has been payable, since June 1982, on all imports except medicines, printed matter, and accompanied baggage and post parcels eligible for exemption from import duties.

5. In broad terms, the pattern of import duties is characterized by relatively low rates on consumer necessities, raw materials and capital goods, and higher rates on final goods, with the highest rates applying to consumer durables. The rates on most durable consumer goods are 120% and above, with the rates on passenger motor cars varying between 70-350%. The rates on textiles range from 70% on yarn to 120% or 200% on fabrics. The rates on intermediate goods vary with the stage of production, with finished goods being taxed at higher rates than raw materials, and finished consumers' goods being taxed at higher rates than finished producers' goods. For example, on aluminium and products, the rates rise from 40% on waste and scrap to 85% on tubes and pipes, and to 120% on sinks and basins. Most items of machinery are taxed at the rate of 40%.

6. Treatment of Intermediate Goods. Raw materials and components used in certain activities receive a concessional tax treatment. The concessions may apply to some or all intermediate goods used in production, and may apply to the full extent of the duty or be limited to the duty in excess of a specified rate (see Table 2).

7. The range of concessions is too diverse to permit generalizations, but the following concessions are worth noting:

(i) All raw materials and components used in the manufacture of 22 specified capital goods are exempt from the duties in excess of 30%.

(ii) The duties paid in respect of these capital goods are further reduced where the goods are used in certain areas and projects for the purposes of balancing, modernization and replacement (BMR); in particular, the duty paid on the capital goods used in specified less developed areas, and in projects which have been exempted from the payment of import duties on the import of capital goods is completely refunded.

(iii) A concessional treatment at varying rates is granted to components used in the local assembly of tractors and vehicles.

(iv) Raw materials and components for a wide range of agricultural implements, and inputs such as pesticides are partly or wholly exempt from the duties.

8. Treatment of Machinery. Import of plant and machinery for certain purposes is allowed duty-free or at concessional rates of duty (see Table 2). The concessions may be summarized as follows:

(i) Complete exemption is granted for the fertilizer, poultry, and dairy1/ industries.

(ii) Complete exemption is granted for plant and machinery for BMR (or for initial installation and BMR) in a number of industries, including textiles; the concession for the textile industry is only applicable if the machinery is not manufactured locally.

(iii) Complete or partial exemption is granted for plant and machinery for initial installation and BMR used in certain parts of the country, the extent of the tax relief depending on whether the industry concerned is established in specified less developed

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1/ The concession for the dairy industry only applies if the machinery is not manufactured locally.

areas,1/ outside specified more developed areas,2/ or in Government-financed industrial estates.

(iv) Exemption of duty in excess of 30% is granted for plant and machinery imported under the Non-Repatriable Investment Scheme.

9. Treatment of Exports. Import duties paid on raw materials and components used in the manufacture of exports are either rebated at standardized rates (see Table 3) or, where no such rates have been fixed, on the basis of documentary evidence.

10. In addition, certain export industries are granted compensatory rebates at rates varying between 7.5% and 12.5% of the fob value of exports. Cotton textiles, engineering goods, canvas footwear, acetate yarn, cutlery, sports goods and surgical instruments qualify for these rebates.

Federal Excise Duties

11. Tax Base. The tax is levied on domestically produced goods and services; imports are not subject to the tax.

12. Coverage. The tax applies to 41 commodities, including two services (hotels and restaurants, and bank checks).3/

13. Tax Rates. The tax may be levied at a specific rate or an ad valorem rate. Ad valorem rates are, in some cases, related to the retail price or charge (for services), and in others, to the wholesale cash price. Of the 41 commodities subject to the tax, 19 are taxed through specific rates and 22 through ad valorem rates. The tax rates are given in Table 4.

14. Treatment of Small-Scale Industry. Commodities produced in the cottage industry sector (see the section on the sales tax for the definition) are exempt from the tax.

1/ Baluchistan, Northern Areas, Azad Kashmir, and parts of the North-West Frontier Province, Sind and Punjab.

2/ The more developed areas comprise tehsils of Rahimyarkhan, Multan, Faisalabad, Ferozwala, Lahore, Gujranwala, Rawalpindi and Sialkot, talukas of Hyderabad, Kotri and Sukkur, Karachi and Islamabad.

3/ The number of excisable commodities exceeds the number of commodities on which excises are levied; this has no practical significance.

15. Treatment of Exports. The excise duty paid on exports is refunded. The duty paid on some excisable products used in the manufacture of specified exports is rebated at standardized rates (see Table 5).

The Sales Tax

16. Tax Base. Pakistan's sales tax is a single-stage levy. It applies to imports as well as domestic production, and is collected from manufacturers and importers. The tax base for goods produced in Pakistan is the wholesale cash price, and for imports, the import value gross of the import duty.1/ For the few goods subject to both excise and sales taxes, the sales tax is levied on the price of the product gross of the excise duty.

17. Coverage. A wide range of imported and domestic goods are exempt from the sales tax. Though there is some overlap between them, the exemptions for imports are different from those for domestic goods (see Table 6).

18. Aside from the general exemption of specified imports, imported intermediate goods used in certain industries are exempt. An important example of this is provided by the capital goods industry: imported raw materials and components utilized in the manufacture of 22 specified capital goods are exempt from the sales tax (see Table 6).

19. Relationship between Excise and Sales Taxes. Only six commodities on which excise duties are levied are subject to the sales tax. These are: paper and paperboard, metal containers, glass and glassware, tyres and tubes, wires and cables, and gas appliances.

20. Tax Rates. Domestic and imported goods are taxed at different rates. The general rate for domestic goods is 12.5%, but lower rates apply to a few goods. The goods that are taxed at lower rates are tyres and tubes, artificial leather and rexine, paper and paperboard, and calcium carbide (10%), asbestos waste (7.5%), and certain automobile engine and chassis parts (5%).

21. The sales tax on imports is levied at three different rates: 10%, 20% and 30%. Most consumer goods are taxed at the rate of 10% or 20%; the rate of 30% is confined to automobiles, and some consumer durables (see Table 1). Intermediate and capital goods are taxed mostly at the rate of 10%.

22. Treatment of Small-Scale Industry. All goods produced in the cottage industry except footwear, furniture and fixtures, and ready-made garments are exempt from the sales tax. Manufacturing units where the owner is both

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1/ The import surcharge is not taken into account in determining the duty-paid value.

an investor and a worker, employment per shift does not exceed 15 workers, and the capital investment does not exceed Rs 100,000 qualify as part of the cottage industry.1/

23. Treatment of Intermediate Goods. Firms producing taxable goods can set off sales taxes paid on raw materials and components against their sales tax liability on finished goods. However, the sales tax paid on intermediate goods used in the manufacture of goods that are not subject to the sales tax is not refunded.

24. Treatment of Machinery. The treatment of domestically produced and imported machinery is not uniform. All machinery produced in Pakistan is exempt from the sales tax, but most items of imported machinery are subject to the tax. The sales tax paid on machinery cannot be set off against the sales tax liability on final goods.

25. Treatment of Exports. The sales tax is not levied on exports. The sales tax paid on raw materials and components used in the manufacture of exports is either rebated at standardized rates (see Table 3) or, where no such rates have been fixed, on the basis of documentary evidence.

1/ The definition of "capital employed" includes borrowed capital and the value of rented machinery and fixtures, but does not include investment in business premises.

Table 1: RATES OF IMPORT AND SALES TAXES ON SELECTED IMPORTS

	Rate of Import Duty	Rate of Sales Tax
Foodstuffs		
Milk, concentrated and powdered	-	20%
Butter and ghee	100%	-
Tea	55%	-
Coffee	150%	20%
Pepper	Rs 12/kg	20%
Betel nuts	Rs 20/kg	20%
Durable Consumer Goods		
Gas cookers and water-heaters	120%	20%
Vacuum cleaners, food mixers, etc.	160%	30%
Refrigerators	120%	20%
Radios	120%	20%
Televisions	85%	10%
Record players	150%	20%
Air conditioners	200%	30%
Cameras	120%	20%
Watches	60%	20%
Vehicles		
Passenger motor vehicles:		
not exceeding 1,000 cc	70%	30%
1,000-1,300 cc	120%	30%
1,300-1,600 cc	175%	30%
1,600-2,000 cc	350%	30%
above 2,000 cc	350%	30%
Trucks, pick-ups and delivery vans	50%	-
Motorcycles	100%	10%
Bicycles	85%	20%
Textiles		
Yarn of man-made fibres	Rs 40/kg	-
Woven fabrics of man-made fibres:		
Karakuli cloth	70%	20%
Other	200%	20%
Wool yarn (more than 4 counts)	Rs 50/kg	10%
Woven fabrics of wool:		
Karakuli cloth	70%	10%
Other	120%	10%
Cotton yarn	85%	10%
Cotton fabrics:		
Tyre cord, Umbrella cloth and Karakuli cloth	70%	20%
Other	120%	20%

Intermediate Goods		
Chemical products	40% or 85%	10% or 20%
Cement	20%	-
Fertilizer	-	-
Pig iron	40%	-
Blooms, billets, slab and sheet bars of iron and steel	50%	-
Bars, rods, angles and sections of iron and steel	70%	20%
Aluminium and products:		
Waste and scrap	40%	-
Wire, bars, rods and sheets	70%	10%
Tube and pipe fittings	85%	10%
Door and window frames	100%	10%
Sinks and wash basins	120%	20%
Raw rubber	60%	-
Wood pulp	20%	-
Veneer sheets	150%	10%
Plywood	250%	20%
Paper and paperboard	Rs 4,000/tonne	10%
Capital Goods		
Tractors	10%	-
Sugarcane crushers	40%	10%
Cotton spinning, weaving and knitting machines	85%	10%
Grain milling machinery	40%	10%
Glass working machinery	40%	10%
Steam boilers	40%	10%
Gas turbines	40%	10%
Electrical generators	20%	10%
Electrical motors	85%	20%
Compressors (for machinery)	40%	10%
Batteries	100%	10%
Machine tools	40%	10%
Miscellaneous		
Medicines	-	-
Typewriters	40%	10%
Calculators	40%	20%
Records and tapes	120%	20%
Photographic films	85%	20%
Razor blades	120%	20%
Paints and enamels	120%	10%
Polishes and creams	160%	20%

Disinfectants, insecticides and fungicides	-	10%
Tyres and tubes	85%	10%

Note: The rates do not include the 5% surcharge.

Sources: Pakistan Customs Tariff and Import Trade Guide (Islamabad: Central Board of Revenue and Ministry of Commerce, November 1981); and Supplement (September 1982).

Table 2: IMPORT DUTY CONCESSIONS FOR PLANT, MACHINERY, RAW MATERIALS AND COMPONENTS

A. PLANT AND MACHINERY

Complete exemption

(i) Fertilizer and poultry industries
(ii) Dairy industry provided machinery not manufactured locally
(iii) Imports by Pakistan Steel Mills Corporation
(iv) Imports from China for the Heavy Foundry and Forge Project
(v) Imports by National Petrocarbon Ltd. for Carbon Black Plant
(vi) Paddy driers
(vii) Generators of 650 KVA and above imported by industrial units

Complete or partial exemption for initial installation and BMR

(i)	Specified less developed areas	Complete exemption
(ii)	Whole of Pakistan excluding 13 more developed areas	Exemption of 50% of duty
(iii)	All Gov't-financed industrial estates outside the 13 more developed areas	Exemption of 75% of duty
(iv)	All Gov't-financed industrial estates in more developed areas excluding Karachi	Exemption of 50% of duty

Complete exemption for initial installation and BMR provided machinery not manufactured locally

(i)	Textile industry	BMR
(ii)	Made-up garments, hosiery and towel industry	Initial installation and BMR
(iii)	Textile processing industry	Initial installation and BMR

Complete exemption of specified plant and machinery for BMR

(i) Tanning industry
(ii) Boot and shoe making industry
(iii) Leather garment and glove manufacturing industry
(iv) Sports goods industry
(v) Surgical goods and cutlery industry
(vi) Onyx/marble industry
(vii) Ginning industry

Miscellaneous

(i)	Non-Repatriable Investment Scheme /a	Exemption of duty in excess of 30%
(ii)	Machinery, components and spare parts for projects approved for initial installation and BMR	Exemption of duty in excess of 40%
(iii)	Specified plant and machinery for initial installation and BMR for sound recording industry	Exemption of duty in excess of 40%
(iv)	Specified machinery for grain storage silos	Exemption of duty in excess of 5%
(v)	Imports by the Telegraph and Telephone Department	Exemption of duty in excess of 40%

/a The scheme is meant to encourage overseas Pakistanis to invest in Pakistan.

(vi) Spares imported by airfreight	Exemption of duty equivalent to freight in excess of 20% of fob value	

B. RAW MATERIALS AND COMPONENTS

Industry/goods

Capital goods industry	Raw materials/components	Concession
(i) Specified 22 capital goods	All components and raw materials	Exemption of duty in excess of 30%
(ii) Above capital goods when supplied to following areas and projects for initial installation and BMR		
(a) whole of Pakistan excluding 13 more developed areas		Repayment of duty in excess of 15%
(b) specified less developed areas		Repayment of all duties
(c) projects exempted from payment of duty on capital goods		Repayment of all duties
(iii) Wires and cables	All raw materials	Exemption of duty in excess of 20%
(iv) Bolts, nuts and machine screws	All raw materials	Exemption of duty in excess of 20%
(v) Tubing for transformers	All raw materials	Exemption of duty in excess of 20%
(vi) Wire ropes	All raw materials	Exemption of duty in excess of 20%
(vii) Welding electrodes	All raw materials	Exemption of duty in excess of 20%
(viii) Aluminium and wire rods	All raw materials	Exemption of duty in excess of 20%

Locally assembled goods

(i) Agricultural tractors	All components	Complete exemption
(ii) Buses and coaches	All components	Exemption of duty in excess of 30%
(iii) Station wagons built on truck chassis	All components	Exemption of duty in excess of 60%
(iv) Trucks and pick-ups with driver's cabin only	All components	Exemption of duty in excess of 30%
(v) Motor cars, vans and four wheel drive vehicles (4x4) of engine capacity not exceeding 1,000 cc	All components	Exemption of duty in excess of 30%
(vi) Other four wheel drive vehicles (4x4) built on car chassis	All components	Exemption of duty in excess of 60%
(vii) Motor cycles and scooters	All components	Exemption of duty in excess of 45%
(viii) Three wheeler automotive rickshaws	All components	Exemption of duty in excess of 45%
(ix) Bicycles	All components	Repayment of up to Rs 110 per bicycle
(x) TV	Specified components	Exemption of duty in excess of 25%

Agricultural equipment and imputs

(i) Agricultural implements	All raw materials and components	Repayment of all duties
(ii) Agricultural trailers	Specified components	Repayment of duty in excess of 5%
(iii) Fertilizers	Sulphur	Repayment of all duty
(iv) Pesticides	Specified raw materials	Complete exemption
(v) Agricultural sprayers	All components	Complete exemption
(vi) Cooking oil	Palm oil	Exemption of all duty

Miscellaneous

(i)	Incandescent lamps	Specified materials	Repayment of all duties
(ii)	Laminated plastic sheets	Specified materials	Repayment of duties in excess of 45%
(iii)	Bobbins for jute industry	Specified goods	Repayment of duties in excess of 30%
(iv)	Transistors, diodes and Potentiometers	Specified goods	Repayment of all duties
(v)	Plywood or chipboard	Synthetic resins	Repayment of duty in excess of 30%
(vi)	Scientific and medical instruments	Specified components	Repayment of all duties
(vii)	Building, fitting and repairing of boats and ships	All raw materials and components	Repayment of all duties
(viii)	Pharmaceuticals	Selected raw materials and packing materials	Complete exemption for some materials; repayment of duties in excess of 40% for others
(ix)	Paper sacks and bags for cement	Kraft paper	Exemption of duty in excess of 40%
(x)	Aerosol insecticide cans	Raw materials	Repayment of Rs 2.75 per can
(xi)	Polypropylene bags	Polypropylene granules	Repayment of duty in excess of 50%
(xii)	Pesticides for health use or for export	Specified raw materials	Complete exemption
(xiii)	Recording industry	Components of cassettes	Complete exemption
(xiv)	Refrigerators and air conditioners	Raw materials and selected components	Exemption of duties in excess of 40%
(xv)	Electric water coolers	All raw materials and components	Exemption of duties in excess of 40%
(xvi)	Auto parts	All raw materials and components	Exemption of duties in excess of 30%
(xvii)	Printing ink	Specified raw materials	Exemption of duties in excess of 40%
(xviii)	Baby milk food	Specified materials	Repayment of all duties
(xix)	Artificial parts of human body	All raw materials	Complete exemption
(xx)	Vials, ampoules, etc.	All raw materials	Repayment of all duties

Note: Some concessions for specific companies have been omitted.

Sources: Pakistan Customs Tariff and Import Trade Guide (Islamabad: Central Board of Revenue and Ministry of Commerce, November 1981); and Supplement (September 1982).

Table 3: STANDARD RATES OF IMPORT DUTY AND SALES TAX REBATES FOR EXPORTS

Commodity	Extent of Rebate Customs Duty	Extent of Refund Sales Tax
Durries	Rs 70/100 lbs	Rs 1/100 lbs
Toilet soap	Rs 150/100 kgs	
Brass wood screws	Rs 19.85/kg	Rs. 4.82/kg
Bicycles	Rs 176/cycle	
Plastic buttons	Rs 5.40/kg	Rs 1.40/kg
Rubber lined polyester and nylon fire hoses	Rs 6/meter	
Combs	Rs 0.40/100 pieces	
Stainless steel utensils and kitchen ware	Rs 7.00/kg	
Gramophone records	Rs 50/100 pieces	
- Long play records	Rs 200/100 pieces	
Agarbatti of all types	Rs 1.30/100 sticks	
Bicycle tyres, 70x3.75 cms	Rs 275/100 pieces	
Bicycle tubes, 70x3.75 cms	Rs 220/100 pieces	
Gas mantles	Rs 10.70/100 pieces	
Steel for fruit juice cans	Rs 13.36/100 cans	
Stainless steel sheet SISI-304	Rs 5,500/1,000 kgs	
Crown corks	Rs 99/10,000 pieces	Rs 25/10,000 pieces
Plain woollen shawls	Rs 25/kg	
Aluminium utensils	Rs 7.80/kg	Rs 0.18/kg
Ballpoint pens	Rs 60/1,000 pieces	Rs 12.00/1,000 pieces
Cosmetic pencils	Rs 49.10/100 dozens	
- half size	Rs 24.50/100 dozens	
- China graph pencils	Rs 77.80/100 dozens	
Steel wood screws	Rs 3.93/kg	Rs 0.83/kg
Blankets of acrylic yarn	Rs 40/kg	
Domestic sewing machines	Rs 32.64/piece	Rs 8.53/piece
- Zig-zag type sewing machines	Rs 90.97/piece	Rs 32.43/piece
- Sewing machine stands	Rs 14.81/piece	
- Hand attachment parts	Rs 0.35/piece	
Polypropolyene woven fabrics	Rs 0.50/sq mt	Rs 0.18/sq mt
High/low tension electrical porcelain insulator and fuse unit	Rs 29.41/unit	
Sea salt packed in imported jute bags	Rs 5.39/bag	Rs 1.17/bag
Worsted woollen carpet yarn	Rs 15.93/kg	
Semi worsted woollen carpet yarn	Rs 1.66/kg	
Dyed knitting yarn	Rs 25.00/kg	
Dyed knitting yarn, 100%	Rs 21.00/kg	
Woollen jersies	Rs 25.00/kg	
Water suction vinyl hose pipes	Rs 13/kg	Rs 2.20/kg

Solvent extracted rice bran meal	Rs 38/tonne	Rs 26.50/tonne
Solvent extracted rape seed meal	Rs 38/tonne	Rs 26.50/tonne
Alkyd resin	Rs 3.49/kg	Rs 1.21/kg
Complete gas meters	Rs 66.47/meter	
Hard boiled candies	Rs 350/50 kg	Rs 56/50 kg
Toffees and chocolates	Rs 267/50 kg	Rs 87/50 kg
Perfumed hair oil	Rs 3.50/kg	
Mild steel bars, mild steel angles and flats, and deformed bars	Rs 1,065.75/tonne	
Light cut hand shoes	Rs 3.50/kg	
Rolls of telex machine and calculator paper	Rs 4/kg	Rs 0.90/kg
Incense powder	Rs 12.16/kg	Rs 1.03/kg
Plastic tricycles	Rs 29.80/tricycle	Rs 4.64/tricycle

Paints and varnishes:

Paints, incl. synthetic enamel	Rs 4.47/litre	
- Distemper	Rs 0.74/kg	
- Thinner	Rs 0.34/litre	
- Linseed oil putty	Rs 2.34/kg	Rs 0.21/kg

Sports goods: (as percent of fob value)

Hockey sticks	15%
Rackets	26%
Balls (with bladders)	16%
Balls (without bladders)	13%
Cricket bats	15.5%
Latex rubber bladders	3%
Rubber tennis balls	10%
Artificial leather footballs with latex bladders	21%
Artificial leather footballs without bladders	18%
Footballs of natural fibre with latex bladders	13%
Footballs of natural fibre without bladders	10%

Textiles:

Spindles	31%
Spinning and twisting rings	32%
Fluted rollers	10%
Readymade garments	32%
Woven and knitted fabrics	32%

Dyed and printed fabrics of man made yarn	35%	
Dyed drill cloth	11%	
Camouflage printed drill	15%	
Dyed cotton thread (embroidery)	3%	
Bleached white thread (embroidery)	7.20%	
Dyed and printed readymade garments, linen	8%	
Bleached linen	2%	
Polyester yarn	61%	
Dyed cotton hosiery	8%	0.41%
Hosiery	5.25%	1.15%
Grey cotton cloth and linen	0.37%	0.11%
- Dyed or screen painted cloth	9%	1.00%
- Printed cotton cloth	11%	1.36%
Cotton towels:		
- Bleached and white	2.50%	0.34%
- Cotton towels, white and dyed	7.64%	0.20%
- Cotton towels, fully dyed	10.65%	0.21%
Blended fabrics:		
- Grey and bleached blended fabric	15%	0.50%
- Dyed or printed blended fabrics	20.50%	1.34%
Surgical goods:		
Surgical and non-surgical scissors and goods	22.5%	
Scissors of carbon steel	11.25%	
Scissors of nickel or chrome	17.5%	
Scissors of brass	11.40%	
Leather goods:		
Finished leather		
- Cow and bull, including cow calf and bull calf	16%	
- Goat and sheep skins	9%	
Vegetable tanned leather		
- Buffalo and calf hides	2%	
- Sheep and goat skins	1%	

Chrome tanned leather		
- Sheep and goat skins	3.7%	
- Buffalo and calf hides	7.50%	
Picking band leather	16%	
Gloves and garments of goat and sheep skins	9%	
Gloves made from cow and buffalo leather	16%	
Saddlery and riding equipment	16%	
Sole leather	7.5%	
Paper products:		
Brown Kraft paper, duplicating paper, etc.	6.18%	
Printed paper bags, note books, etc.	3.30%	
Printed corrugated containers	4%-24%	
Other specified products	3.78%-10.7%	
Miscellaneous:		
Hand knotted woollen carpets	3%	
Machine made woollen carpets	4.3%	
PVC vinyl panels	30%	5%
Elastic nylon tapes	40%	2.9%
Inner spring quilted mattresses	10%	5%
Plastic watercoolers	26%	4.5%
PVC pipes	35%	2%
Wedding and greeting cards	10.68%	2.38%
Exposed cinematographic film		
- Colored	3.25%	2.9%
- Black and white	5%	2.7%
Articles made of marsawa, maranti and keuring wood (imported)	15%	
Containers of all sizes	23%	5%
Electric fans	33%	9%
Handicrafts made of onyx	2%	
Laundry and washing soaps	10%	0.50%
Shaving blades made of carbon steel	12.68%	2.76%
Shaving blades made of stainless steel	17.88%	4.12%
Solvent extracted rice bran meal	4.30%	1.44%
Transformers of 25 KVA to 1,500 KVA	9%	
Transmission rubber belting	14.5%	
Cigarettes (rate varies with brand)	23.75%, 18.40%, 13% and 3%	
Wooden lead pencils	32%	1%
- Colored and copying lead for pencils	30%	1%

- Black lead for pencils	10%	0.60%
Bleached or dyed tents	8.75%	0.55%
Unbleached or undyed grey waterproof tents	3%	0.55%
Dyed and waterproof camping tents	23%	2%
Dyed non-waterproof tents	2.20%	0.08%
Nylon bristle street brooms and brushes	24%	
Textile and wooden shuttles	12.20%	
Rubber radiator hoses, and rubber hoses	9%	
Match boxes	25%	1%
Artificial leather (rexine)	28%	
Brass hardware and moulded machine brass items	10.50%	
Boxing gloves, hockey or football goal keepers' gloves	5%	1.10%
Blended yarn	31%	
Sporting seat sticks	10%	
Plastic dolls	17%	3%
Canvas shoes	20%	2%
Vermicelli, spaghetti and macaroni	20%	3.50%
Shoes		
- Upper leather sole leather	7.5%	0.90%
- Upper cloth sole leather	5%	0.90%
- Upper leather rubber sole	16%	1.7%
- Chappals (slippers)	6%	0.5%
Plastic bottles used for packing	19%	3%
Elements for heaters	23%	5%
Eye make-up sticks	5.62%	1.65%
Biscuits	20%	3%
Vacuum flasks and jugs	7%	1.5%
Dyestuff	10.74%	
Mild steel plain bars, deformed bars and ribbed torsion bars	40%	0.70%
Bailing hoops and structure wire	21%	
Curry powder	6%	2%
Black pepper powder	12%	5%
Spare parts of bicycles	24%	4.80%
Washing powder (detergent)	16%	3%
Talcum powder	18%	6%
Tyres and tubes of trucks, buses, cars and jeeps	37.5%	

Source: Central Board of Revenue.

Table 4: RATES OF EXCISE DUTIES

Commodity	Specific rate (rupees)
Vegetable ghee	
Up to 2.5 kgs	1.16/kg
2.5 kgs - 5.0 kgs	1.25/kg
5.0 kgs - 16.0 kgs	1.34/kg
Beverages	
Aerated waters marketed under foreign brand names	
Containers of under 260 millilitres	0.80/container
Containers of 260 millilitres or more	3.20/litre
Other	
Containers of under 260 millilitres	0.50/container
Containers of 260 millilitres or more	2.00/litre
Sugar	2.15/kg
Cement	
Grey portland	546.00/tonne
Other	700.00/tonne
Salt	0.03/kg
Soda ash	147.65/tonne
Paper and paperboard	0.30/kg
Bank checks	0.20/check
Textiles	
Cotton yarn, twist and thread	1.00/kg
Man-made fibres (discontinuous)	2.50/kg
Continuous filament, viscose, nylon, polyester and other fibres and yarn	4.75/kg
Yarns of man-made fibres (discontinuous or waste)	1.00/kg
Knitting yarn	1.00/kg
Mild steel products	50.00/tonne
Tobacco	
Unmanufactured for use of cigarettes	1.75/kg
Unmanufactured for use of biris	1.35/kg
Smoking mixture for pipes and cigarettes	26.50/kg
Electric fans	
Cabin, carriage, table and exhaust fans	25.00/fan
Ceiling	35.00/fan
Pedestal	50.00/fan
Table fans not exceeding 254 millimeters in diameter	12.00/fan
Other	25% subject to a minimum of Rs 50/fan

Petroleum Products	
Natural gas and other gases	0.86/deca cubic meter
Furnace oil	35.20/tonne
High speed diesel oil	0.25/litre
Diesel oil not elsewhere specified	0.04/litre
Jet fuel	0.06/litre
Lubricating oil	0.70/litre
Asphalt	127.95/tonne
Motor spirit	0.88/litre

	Ad valorem rate (percentages)
	On wholesale cash price
Tyres and tubes (for trucks, buses, jeeps and motor cars)	10
Metal containers	10
Gas apparatus and appliances	10
Wires and cables	10
Glass and glassware	10
Woollen fabrics	15
Specified parts of electric fans	40
Petroleum Products	
Crude petroleum	5
Petroleum grease	50
Petroleum jelly	67.5
Naptha	80
Petroleum products not elsewhere specified	50% or Rs 100/tonne whichever is higher
	On retail price
Paints, pigments, varnishes and polishes	22
Perfumes, cosmetics and toilet preparations	28
Soaps and detergents (other than laundry soap)	20
Electric batteries and parts	
Storage batteries	25
Primary cells and batteries	40
Electric bulbs	7.5 to 30 depend-on wattage and price of bulb
Automobile bulbs	7.5
Flourescent tubes	15
Matches	6

Cigarettes	
Packet priced under 70 paisa	50
Packet priced 70 paisa and above	Rs 15 per 1,000 cigarettes + 72% of retail price in excess of Rs 30 per 1,000 cigarettes
Cigars and cheerots	75
Hotels	15% of hotel charges 1/
Restaurants	15% of the bill 2/

1/ Applicable only if the room rate exceeds Rs 50 per day.

2/ Applicable only if the annual turnover exceeds Rs 500,000.

Source: Central Board of Revenue.

Table 5: STANDARD RATES OF EXCISE REBATES FOR EXPORTS

Excisable commodity	Products granted rebate	Extent of rebate
Salt		
	Wet salted sheep casings	Rs 0.03 to 21.5/meter
	Tanned and finished leather	Rs 0.43/sq mt
	Leather gloves	0.70%
	Vegetable tanned leather	0.45%
Soda ash		
	Tanned leather	Rs 0.05/sq mt
	Cotton sewing and embroidery thread	Rs 0.14/100 kgs
Paints and varnishes		
	Sports goods (rackets)	7%
	Leather balls	1.4%
	Hockey sticks	0.55%
Cotton yarn and man-made yarn		
	Cotton grey cloth	Rs 1/kg
	Hand knitted woollen carpets	0.15%
	Machine knitted woollen carpets	0.10%
	Fabrics	3.40%
	Ready-made garments	1.50%
	Bed sheets and bed covers	2.50%
	Other linen articles	3.8%
	Canvas and products	4%
	Terry towels	2.60%
	Hosiery	2.65%
	Transmission rubber	3.15%
	Quilts	1.75%
Cotton yarn and solvent oil		
	Canvas shoes	0.70%
Sugar		
	Juices	2.60%
	Squashes	3.86%
	Syrups	7.68%
	Jams and jellies	5.00%
	Vegetable tanned leather	0.045%
Glass bottles		
	Up to 7.50 millilitre capacity	0.15/bottle
	Other	0.06/bottle

Unmanufactured tobacco		
	Cigarettes partly manufactured from imported tobacco	2.95%
	Cigarettes from local tobacco	4.35%

Note: Percentages relate to fob values.

Source: Export Policy, 1982-83 (Ministry of Commerce).

Table 6: MAIN EXEMPTIONS FROM THE SALES TAX

A. Domestically Produced Goods 1/

The following domestically produced goods are exempt:

(i) animals, fish, poultry and dairy products, and animal feeds;

(ii) cereals, vegetables, fruits, trees, and plants;

(iii) prepared foodstuffs;

(iv) edible oils, and oilseeds;

(v) tea, pepper and other spices;

(vi) pharmaceutical products, drugs, and medicines;

(vii) fertilizers, insecticides, pesticides, and agricultural implements;

(viii) artificial resin, cellulose, rubber, and synthetic rubber;

(xi) leather, furskin and products thereof;

(x) wood and products;

(xi) cotton, cotton and man-made fabrics, and hosiery goods;

(xii) umbrellas, headgear, and footwear priced under Rs 125/pair;

(xiii) ceramics and stones;

(xiv) metals, base metal alloys and products thereof;

(xv) sports goods;

(xvi) electric generators, generating sets and parts, and electric batteries and parts;

(xvii) machinery and components, mechanical appliances, implements, and tools;

(xviii) vessels, vehicles, floating structures, and transport equipment;

(xix) cinematographic and photographic films;

(xx) ornaments and jewelry;

(xxi) parts of television receiving apparatus;

(xxii) steel furniture;

(xxiii) spectacle frames, and surgical instruments.

B. Imports

The following imports are exempt:

(i) live animals, fish and selected animal products, live plants, and flowers;

(ii) cereals and cereal flours;

(iii) butter, tea, tobacco, oil seeds, vegetables, fruits, and flower seeds;

(iv) soya bean oil, cotton seed oil, sunflower seed oil, vegetable ghee, and fatty acids;

(v) sugar and molasses;

(vi) selected mineral products including cement, salt, sulphur, graphite, calcium phospate, asbestos, mica, crude natural borates, metallic ores, concentrates and roasted iron pyrites, and coal;

(vii) all petroleum products (except brake fluid, paraffin, wax, bitumen and coke);

(viii) peat, coke, coal gas, water gas, producer gas and similar gases;

(ix) all pharmaceutical products;

(x) unwrought or scrap metals, and base metals;

(xi) fertilizer, and agricultural insecticides and pesticides;

(xii) tanning and dyeing extracts, artificial resins and plastic materials, cellulose, raw and synthetic rubber, and raw hides and skins;

(xiii) cotton, jute and textile based fibres, yarn of man-made fibres, wool and other animal hair, and man-made fibres;

(xiv) pig iron and unwrought cast iron, and waste and scrap of base metals;

(xv) construction material for railway tracks, rolling stock and equipment;

(xvi) concrete components of buildings, and building bricks;

(xvii) locomotives and mechanically propelled coaches and trolleys;

(xviii) agricultural tractors and parts;

(xix) engines of trucks and buses, re-engining kits for railway locomotives, and aircraft engines and parts;

(xx) ambulances, four wheel drives, trucks, pick-ups, delivery vans, airships, helicopters, ships, boats, and other floating structures;

(xxi) lenses, prisms, mirrors, and other optical elements;

(xxii) sports goods and toys;

(xxiii) medical, dental, surgical, and veterinary equipment;

(xxiv) component parts of televisions;

(xxv) all goods of Afghan origin, including dried fruits, but excluding betel nuts and fresh fruits.

C. Imports of Raw Materials and Components for Selected Industries

Materials and components imported by certain industries are exempt from the sales tax, as follows:

(i) components and raw materials imported by manufacturers of 22 specified capital goods;

(ii) raw materials and components used in the manufacture of cone-winding machines by the Textile Machinery Manufacturing Corporation;

(iii) raw materials and components imported by manufacturers of refrigerators, air conditioners, electric water coolers, and automobile parts;

(iv) import of concentrated and powdered milk and aluminium foil by manufacturers of baby milk food;

(v) raw materials used in the manufacture of artificial parts of human body by orthopaedic workshops;

(vi) raw materials used in the manufacture of wires and cables (other than domestic types), bolts, nuts, machine screws, tubing for transformers, wire ropes, welding electrodes, and aluminium and wire rods;

(vii) components for the local assembly of agricultural tractors, buses and coaches with a seating capacity of more than 40, station wagons built on truck chassis, trucks and pick-ups with a driver's cabin only, motor cars, vans and four wheel drive vehicles (4x4) of engine capacity not exceeding 1,000 cc, four wheel drive vehicles (4x4) built on car chassis, motor cycles, scooters and three wheeler automotive rickshaws;

(viii) generators of 650 KVA and above imported by industrial units;

(ix) selected raw materials and packing materials used in the manufacture of pharmaceutical products;

(x) articles imported for the exclusive use of the Telegraph and Telephone Department.

1/ Goods exempt from the sales tax on which excises are levied have been omitted.

Source: Central Board of Revenue.

ANNEX III

TAX CHANGES IN THE 1983/84 BUDGET

1. The report was nearly completed when budgetary proposals for FY84 were announced. This annex lists the main changes in taxation. References to the previous arrangements are given in parentheses.

2. Personal and Company Income Taxation

(i) Personal exemption has been increased from Rs 12,000 to Rs 18,000 (Annex I, paragraph 6).

(ii) The tax rates for individual income tax have been revised (Annex I, paragraph 8), as follows:

(a) Where the salary income comprises more than 50% of total income, and the total income does not exceed Rs 22,000, the maximum tax liability is restricted to Rs 60; where the total income exceeds Rs 22,000, the first Rs 4,000 of taxable income will be subject to a tax of Rs 60, and the tax payable on the remaining taxable income will be calculated from the tax schedule.

(b) Tax relief where non-salary income comprised 50% or more of total income has been abolished.

(c) Where the total income is between Rs 18,000-19,000, the maximum tax liability is restricted to 50% of the excess over Rs 18,000.

(iii) The surcharge of 10% of the income tax payable for individuals with taxable incomes of over Rs 100,000 has been abolished (Annex I, paragraph 8(iv)).

(iv) The surcharge of 5% of the income tax and super tax payable for companies has been abolished (Annex I, paragraph 36).

(v) The surcharge of 10% of the income tax and super tax payable for registered firms has been abolished (Annex I, paragraph 41).

(vi) The rates of super tax for registered firms have been revised (Annex I, paragraph 38), as follows:

Total Income (Rs)	Tax Payable
Up to 18,000	Nil
Above 18,000 but below 30,000	6% of amount in excess of 18,000
Above 30,000, but below 60,000	720 + 12% of amount exceeding 30,000
Above 60,000 but below 100,000	4,320 + 25% of amount exceeding 60,000
Above 100,000 but below 150,000	14,320 + 35% of amount exceeding 100,000
Above 150,000	31,820 + 40% of amount exceeding 150,000

(vii) The tax holiday granted to industrial undertakings in specified less developed areas set up by June 30, 1983 has been extended to cover firms set up between July 1, 1983 and June 30, 1988 (Annex I, paragraph 44).

(viii) The exemption of profits of up to 10% of the capital employed for industrial undertakings outside the more developed areas set up by June 30, 1983 has been extended to cover firms set up between July 1, 1983 and June 30, 1988. The concession will, however, be restricted to firms set up in industrial estates (Annex I, paragraph 43).

(ix) The tax credit of 15% of the amount invested for BMR by June 30, 1983 has been extended to cover investment for BMR between July 1, 1983 and June 30, 1988. However, the concession will no longer apply to "extensions" in the talukas of Karachi and Hyderabad and tehsils of Faisalabad and Lahore (Annex I, paragraph 49).

(x) The exemption of capital gains on the sale of shares has been extended up to June 30, 1988. The concession will be restricted to capital gains on the sale of shares of companies listed on the stock exchange or a company in which at least 50% of the shares are held by the Government (Chapter 3, paragraph 3.1).

(xi) The exemption of bonus shares issued by companies has been extended up to July 30, 1988 (Annex I, paragraph 35).

(xii) The exemption of rental income for certain residential housing constructed by June 30, 1983 has been extended to cover housing constructed between July 1, 1983 and June 30, 1988 (Annex I, paragraph 51).

3. Import Duties

A large number of changes have been made mainly for protective reasons or with a view to removing anomalies.

4. Excise Duties

(i) The rates for cigarettes (Annex II, Table 4) have been changed as follows:

Packet priced under 80 paisa	52% of retail price
Packet priced 80 paisa and above	70% of retail price

(ii) Excise duties have been extended to agro-based beverages as follows:

Syrups, squashes and juices	5% of retail price
Instant drinks	Rs 0.10/bottle

5. The Sales Tax

(i) Manufacturers of washing machines and spring mattresses have been excluded from the scope of the cottage industry exemption (Annex II, paragraph 22).

(ii) Some of the other changes are as follows:

Domestic air conditioners and refrigerators	Tax of 12.5% imposed
Domestic machine-made carpets	Tax of 5% imposed
Domestic cosmetics, toilet preparations and perfumery	Tax of 7.5% imposed
Imported dry fruits	Tax of 20% imposed
Sewing machine parts	Exempted
Domestic baby feeding bottles	Exempted
"Printing type" industry	Exempted
Domestic table clocks	Exempted

Sources: Budget Speech, 1983-84; and the Finance Ordinance, 1983 (no XIV of 1983).

Table 1: TAX PAYABLE BY SALARIED TAXPAYERS, ASSESSMENT YEAR 1983-84
(rupees)

Total Income	Taxable Income	Tax Payable	Tax Payable as % of Total Income
18,000	-	-	-
20,000	2,000	60	0.3
25,000	7,000	510	2.0
30,000	12,000	1,260	4.2
40,000	22,000	3,310	8.3
50,000	32,000	6,760	13.5
60,000	42,000	11,560	19.3
70,000	52,000	16,560	23.7
80,000	62,000	21,560	27.0
90,000	72,000	26,960	30.0
100,000	82,000	32,460	32.5
150,000	132,000	61,360	40.9
200,000	182,000	91,360	45.7
250,000	232,000	121,360	48.5

Source: Mission estimates.

Table 2: TAX PAYABLE BY NON-SALARIED TAXPAYERS, ASSESSMENT YEAR 1983-84
(rupees)

Total Income	Taxable Income	Tax Payable	Tax Payable as % of Total Income
18,000	-	-	-
20,000	2,000	300	1.5
25,000	7,000	1,050	4.2
30,000	12,000	1,900	6.3
40,000	22,000	4,450	11.1
50,000	32,000	8,500	17.0
60,000	42,000	13,500	22.5
70,000	52,000	18,500	26.4
80,000	62,000	23,600	29.5
90,000	72,000	29,100	32.3
100,000	82,000	34,600	34.6
150,000	132,000	63,700	42.5
200,000	182,000	93,700	46.9
250,000	232,000	123,700	49.5

Source: Mission estimates.

World Bank Publications of Related Interest

Adjustment Experience and Growth Prospects of the Semi-Industrial Countries
Frederick Jaspersen

This background study for *World Development Report 1981* examines the successful process of adjustment to external "shocks" of the 1970s (rising prices of oil imports, reduced demand for exports, slower economic growth in the OECD countries) in the semi-industrial developing countries. Presents an analytical framework for quantifying the effects of demand management and structural adjustment in forty-two countries, with particular reference to Uruguay, Brazil, Republic of Korea, and Turkey.

World Bank Staff Working Paper No. 477. August 1981. 132 pages (including 3 appendixes).

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Aggregate Demand and Macroeconomic Imbalances in Thailand: Simulations with the SIAM 1 Model
Wafik Grais

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World Bank Staff Working Paper No. 448. April 1981. 70 pages (including 2 appendixes).

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An Analysis of Developing Country Adjustment Experiences in the 1970s: Low-Income Asia
Christine Wallich

This background study for *World Development Report 1981* examines low-income South Asia's adjustment to the external shocks of the 1970s, especially those factors that helped make the effects of these external developments less severe in the region than in other parts of the developing world.

World Bank Staff Working Paper No. 487. August 1981. iv + 39 pages (including references).

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William Diamond and V. S. Raghavan

Deals exclusively with the management of development banks. The book is divided into eight sections, each dealing with one aspect of management of its problems, and of the various ways of dealing with them.

EDI Series in Economic Development. The Johns Hopkins University Press, 1982. 311 pages.

LC 81-48174. ISBN 0-8018-2571-7, $29.95 hardcover; ISBN 0-8018-2572-5, $12.95 paperback.

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The Johns Hopkins University Press, 1973; 7th printing, 1982. 143 pages.

LC 75-186503. ISBN 0-8018-1604-1, $6.00 paperback.

Arabic: World Bank, 1973. (Available from ILS, 1715 Connecticut Avenue, N.W., Washington, D.C. 20009, U.S.A.)

$4.00 paperback.

French: Tables d'intérêts composés et d'actualisation. *Economica, 4th printing, 1979.*

ISBN 2-7178-0205-3, 36 francs.

Spanish: Tablas de interés compuesto y de descuento para evaluación de proyectos. *Editorial Tecnos, 1973; 4th printing, 1980.*

ISBN 84-309-0716-5, 380 pesetas.

A Conceptual Approach to the Analysis of External Debt of the Developing Countries
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World Bank Staff Working Paper No. 421. October 1980. 25 pages (including appendix, references).

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Development Banks
William Diamond

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Development Finance Companies: Aspects of Policy and Operation
William Diamond, editor; essays by E. T. Kuiper, Douglas Gustafson, and P. M. Mathew

The Johns Hopkins University Press, 1968. 130 pages (including appendix, index).

LC-68-27738. ISBN 0-8018-0166-4, $5.00 (£3.25) paperback.

French: Les sociétés financières de développement: quelques aspects de leur politique et de leurs activités. *(Available free from the World Bank, Washington, D.C.)*

Spanish: Las compañías financieras de desarrollo: algunos aspectos de su política y de sus actividades. *Editorial Tecnos, 1969.*

300 pesetas.

Development Prospects of Capital Surplus Oil-Exporting Countries: Iraq, Kuwait, Libya, Qatar, Saudi Arabia, UAE
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