CBR Quarterly Review

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A Review of Resource Mobilization Efforts of Central Board of Revenue

CENTRAL BOARD OF SREVENUE

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The Economy

Until fairly recently Pakistan's economy was the poster child of highly indebted, unstable, and degenerating economies. It was full of puzzles and setbacks. The debt situation was worsening day by day with increasing fears of default. Not surprisingly, government deficit was speeding towards unsustainability. High borrowing costs, inconsistent policies, and intrinsic inefficiencies made profitable investments extremely improbable if not impossible. Combined with an over-valued currency, rampant capital flight, and declining workers' remittances there was the stigma of an alarmingly incredible government that repeatedly reneged on its announced policies. The governance problem was the most appalling aspect of the entire situation. The vision to improve the economy was totally blurred as Pakistan repeatedly failed to honor concerted lending arrangements involving bilateral and multilateral creditors.

With a vision to completely overhaul the system, Pakistan prepared a medium term macroeconomic framework that envisaged revival of the economy with the implementation of prudent and consistent policies. Adoption of the debt management strategy, the draft law on fiscal responsibility and debt limitation ordinance, national anti-corruption strategy, financial sector reforms focusing on financial liberalization and institutional strengthening, and capital market reforms with the establishment of the Securities and Exchange Commission are some of important elements of the 'homegrown' agenda of reforms to promote high growth, reduce vulnerability and ensure debt sustainability. Moreover, Pakistan also entered into an

[1] The analysis is carried out by the Research Team comprising the staff of Fiscal Research Wing of CBR, the Budget Wings of Direct & Indirect Taxes, and Directorate of Research & Statistics.

arrangement with the IMF with stringent conditionalities attached with the disbursement of the agreed line of credit. Mercifully, the program was completed with success and thereby Pakistan qualified for the currently on-going poverty reduction and growth facility (PRGF) arrangement. While the amount of the IMF facility is not significant *per se* for development needs of the economy, it is the allied benefits that matter the most. A successful continuation of the program not only enabled the country to renegotiate external financing needs with the lenders and rescheduling of debt, but also helped in improving its credit rating, which is vital for long-term sustainability and economic viability of the country. With this done, the question that arises now is how far has the economy come out of the flux described above.

While many of us now believe that the economy has gained strength and is moving towards a steady growth path, even the most ardent supporters of the reform process saw the early signs of recovery with skepticism and apprehensions. The consistently improved performance of macroeconomic indicators for the 3rd quarter running on the one hand and the shock absorbing capabilities of the economy on the other are sufficient to support this belief that things are progressing for the better. There has been sustained improvement in key economic indicators, including exports, foreign exchange reserves, stock of internal and external debt, capital inflows in the shape of workers' remittances and foreign investment, and federal tax receipts. The 3rd quarter figures for some of the major sectors of the economy are analyzed in the following to confirm these claims.

The upswing in Foreign Direct Investment (FDI) continues in the current fiscal year (CFY) as FDI increased from US $287.4 million in July-March 2001-2002 to US $658.2 million in July-March 2002-2003, showing an increase of 129%. More importantly, the portfolio investment illustrates an inflow rather than a continuous outflow experienced in earlier period. Similarly, the increasing confidence in domestic economy is also reflected by substantial increase in the home remittances. The first three quarters have witnessed an increase of 101% in remittance to reach US $3.1 billion – well above the full-year target of US $ 2.873 billion. The accumulation of foreign exchange reserves to reach US $10.3 billion at the end March 2003 is a source of strength. These reserves are sufficient to finance the import bill of nearly eleven months. Nonetheless, attempts are continuing by the State Bank to sterilize the monetary impact of these resource flows.

The overall objectives of maintaining macroeconomic stability with high growth are pleasingly on track. The large scale manufacturing sector is growing at the rate of about 7%; the crop outlook is encouraging as exportable surpluses are expected for major food crops, especially wheat and rice; inflation is low; and fiscal deficit is well within the limits prescribed for the CFY. There is marked improvement in the external sector performance as well. A double-digit growth has been recorded for exports and imports during the first nine months of CFY. However, notwithstanding the accelerated demand for credit, the excess liquidity and reduced profitability of the banking sector requires fundamental changes in their lending strategy. Similarly, employment generation and poverty reduction continue to remain areas of immediate concern. These are the anticipated short-term costs of undertaking and implementing wide-ranging reforms. It is high time that the reform process is taken to its logical end so that the cycle of misery is not repeated again.

CBR Revenue Target for FY 02-03

The projected monthly and quarterly targets of the four taxes are reported in *Table 1.* At the start of CFY the overall target for the 3rd quarter was fixed at Rs. 109.6 billion and the monthly targets were set on the basis of historical trends of individual taxes. For instance, in view of the past behavior, a lower collection was anticipated in February and therefore the target for the month was set at Rs. 33.6

billion. Similarly, revenue targets of Rs. 37.5 billion and Rs. 38.6 billion were fixed for the months of January and March, respectively on the basis of historical trends in collection and the anticipated improvements in tax effort. Regarding individual taxes, 32% of the quarterly target was assigned to direct taxes, 44.6% to sales tax, and the remaining 23.4% to central excise and customs duties.

Table 1: Monthly and Quarterly Targets of Federal Taxes: FY 02-03

(Rs. Billion)

	Direct Taxes	Sales Tax	Customs Duties	Central Excise	ALL TAXES
Quarter: 1	*23.2*	*42.4*	*13.8*	*10.6*	*90.0*
Quarter: 2	*42.8*	*47.6*	*9.2*	*10.9*	*110.5*
January	13.5	16.2	4.1	3.7	37.5
February	8.9	16.3	4.6	3.8	33.6
March	12.7	16.4	5.3	4.2	38.6
Quarter: 3	*35.1*	*48.9*	*14.0*	*11.7*	*109.6*
Quarter: 4	*47.4*	*66.8*	*22.0*	*14.3*	*150.5*
Full Year	**148.4**	**205.7**	**59.0**	**47.5**	**460.6**

CBR Revenue Position

CBR has achieved the revenue target of the first nine months of the fiscal year 2002-03. The July-March net collection stands at Rs. 310.3 billion against the target of Rs. 310.1 billion. The task of achieving the revenue target for the first three quarters of CFY has been accomplished in a forthright and straightforward manner. It should be reassuring that with the introduction of the automated refund repository, refund payments during first three quarters have been made promptly. This should be evident from unconventionally high refunds with regard to sales tax and direct taxes. Similarly, to be methodical, the final revenue figures are released only after their cross-verification with the relevant government institutions. Thus, the encouraging performance of CBR could be attributed to continuity of the reform process, gradual implementation of tax policy reforms, collaborative arrangement with inter-government institutions for consistency of polices, and most importantly, the strengthening of the economy, which has started to yield dividends.

Overall Collection and Refunds

The revenue collection in the 3rd quarter has maintained the momentum generated in the 4th quarter of the past fiscal year (PFY) and the first two quarters of CFY. The growth in CBR collection was 16.1% in the 4th quarter of PFY. It was as high as 16.6% and 14.4% during 1st and 2nd quarters of CFY, respectively. The growth in net collection in the 3rd quarter has been 14.2%. In absolute terms, the *gross* and *net* collections during January-March 2003 were Rs. 130.7 billion and Rs. 108.9 billion, respectively *(Table 2)*.

Table 2: Overall Collection and Refunds: A Quarterly Comparison

	FY 01-02	FY 02-03	Growth (%)
Quarter 1			
Gross Collection	98.5	112.5	14.2
Refunds/ Rebates	21.1	22.2	5.2
Net Collection	77.5	90.4	16.6
Quarter 2			
Gross Collection	120.6	127.5	5.7
Refunds/ Rebates	23.5	16.4	-30.2
Net Collection	97.1	111.1	14.4
Quarter 3			
Gross Collection	113.6	130.7	15.0
Refunds/ Rebates	18.3	21.8	18.9
Net Collection	95.3	108.9	14.2
July-March			
Gross Collection	332.7	370.7	11.4
Refunds/ Rebates	62.9	60.4	-4.0
Net Collection	269.8	310.3	15.0

Note: Collection and Refunds in Billion rupees.
The figures are rounded to one decimal place.

The refund and rebate payments during January-March 2003 were Rs. 21.8 billion – higher by 18.9% over 3rd quarter of PFY. In particular, the refund payments on account of direct taxes and sales tax registered substantial increases of 124.1% and 50.2%, respectively during the 3rd quarter of FY 02-03 over the 3rd quarter of FY 01-02. While the consolidated refund/ rebate payments for the first three quarters recorded a decline of 4%, largely due to less refunds in the 2nd quarter of CFY, these payments on account of direct taxes and sales tax increased by 20.8% and 15%, respectively. The considerable growth in direct tax refunds is the immediate consequence of deliberate policy of CBR whereby unlike the previous practice of demand creation and payment of refunds in installments, instantaneous credit is now given to taxpayers if their claims are found legitimate. Secondly, refunds are being liquidated promptly in view of the fact that under SAS scheme, refund claims would have to be cleared within 45 days. Similarly, the increase in sales tax refunds should be viewed in the light of the following two main reasons: (a) substantial increase in exports and therefore refund/ rebate claims during CFY; and (b) improved documentation and transparency in the refund claim and repayment system due to the implementation of the Sales Tax Automated Refund Repository (STARR), which now handles the sales tax related refund claims.

The month-to-month comparison of collection and refunds indicates that the healthy growth in collection maintained during the first six months of the CFY has continued in the 3rd quarter as well *(Table 3)*. A double-digit growth has been observed in gross and net collections during the months of January, February and March of 2003 over the corresponding months of PFY. Whereas the gross collection in these months increased by 11.1%, 23.3%, and 12.3%, respectively, the increase in net collection was 13.5%, 19%, and 10.6%. This confirms that refund payments increased in the months of January and March, but declined in February as compared to monthly figures of PFY.

Table 3: Overall Net Collection and Growth: A Monthly Comparison

	FY 01-02	FY 02-03	Growth (%)
January	32.8	37.2	13.5
February	27.6	32.9	19.0
March	34.9	38.6	10.6
First 3 Quarters	269.8	310.3	15.0

Note: Collection in Billion rupees.
The figures are rounded to one decimal place.

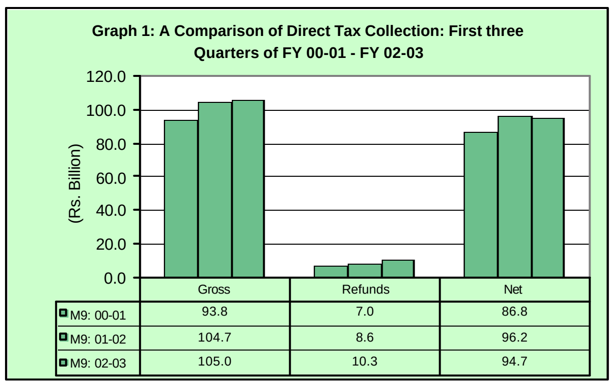
Detailed Analysis of Individual Taxes

The aggregate collection of the four major taxes, i.e., direct taxes, sales tax, customs duties and central excise duties, grew by 15% during the first nine months of CFY. The improved performance has been driven largely by sales tax, both on domestic and import stages, and customs duties – a phenomenon being repeated since past few quarters. It is however pertinent to point out that the growth in net collection from domestic sales tax collection has substantially reduced since February onwards due to substantial increase in refunds. The higher growth in gross collection in March as compared to February suggests that the economy is maintaining its momentum. Moreover, the fear of slow down of business activity in the wake of regional tension and Middle Eastern crisis has apparently remained subdued.

In order to further identify the determinants of growth, the detailed analysis of individual taxes is presented in the following.

***Direct Taxes*:** The gross and net collection of direct taxes during July-March 2002-03 was Rs. 104.986 billion and Rs. 94.654 billion, respectively, indicating that refund payments of Rs. 10.332 billion were made during this period. While the net collection during the first three quarters was lower by only 1.6% than last year's collection for the corresponding period, it was higher by 9.1% than the net collection of July-March 2000-01 *(Graph-1)*. In an effort to further understand the growth in direct tax collection, the outturn on the basis of the components of income and corporate taxes is taken up in the following.

Disaggregated Performance during the Year and in the 3rd Quarter: The components of income and corporate taxes include Voluntary Payments with returns (VP), Collection on Demand (CoD), and Withholding Taxes (WHT). It appears that after a dismal position during PFY, the collection from WHT has started to increase at increasing rate on quarter-to-quarter basis. From 5.2% and 8.5% growth in 1^{st} and 2^{nd} quarters, collection on account of WHT increased by 9.3% in the 3^{rd} quarter of CFY. The major contribution of the 7.7% accumulated growth during the first nine months has come from growth in contracts (18.1%) – an indication of increased government spending due to fiscal space, salaries (14.6%), imports (8.1%) and electricity and telephone bills (27.3% and 50.7%). The WHT from securities, on the other hand, is declining continuously. The 6.7% decrease in WHT on securities has been the result of declining interest rates on government bonds.

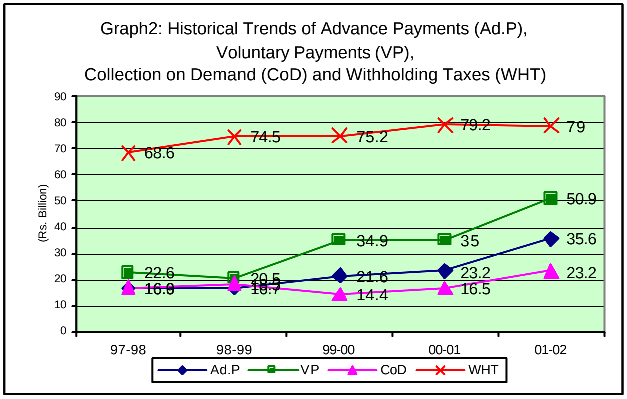


Graph 1: A Comparison of Direct Tax Collection: First three Quarters of FY 00-01 - FY 02-03

The collection on demand, which declined by 17.7% and 22.3% during 1^{st} and 2^{nd} quarters of CFY, increased by 70.9% in the 3^{rd} quarter to register an overall increase of 14.5% for the first nine months. One of the reasons for this improved performance is the increased tax effort at LTU Karachi, which appears to have gained strength after its establishment in July 2002. The increasing tax effort is also evident from increased share of CoD in gross collection during CFY over PFY, i.e., 8.8% as compared to 7.8%. Contrary to this, voluntary compliance has declined in recent quarters.

Voluntary payments increased by over 40% during the 1^{st} quarter, but declined by 22.9% and 14.4% during 2^{nd} and 3^{rd} quarters, respectively. The overall decline in VP during first three quarters has been 11.4%. This decrease could, in part, be attributed to substantial decline in individual and corporate earnings during FY 01-02 due to the global slowdown of the economies after the 9-11 effect. The voluntary compliance is expected to aggravate further as income and corporate taxes will be operating under the self-assessment scheme since July 2003 onwards. However, these apprehensions could be avoided if an effective mechanism of audit and a regime of penalties are fully adhered to.

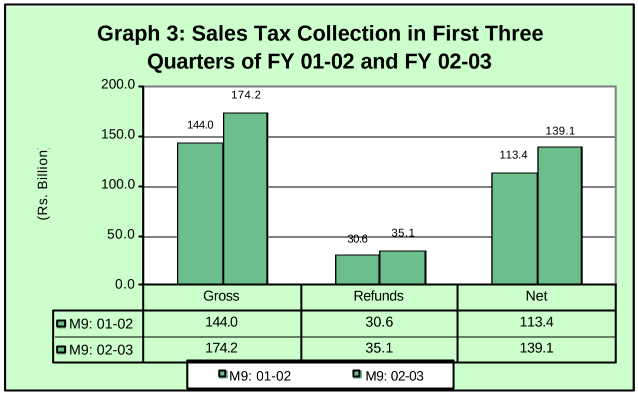
Components of Income and Corporate Taxes in Historical Perspective: In order to gain further insight, the detailed analysis of the components of income and corporate taxes is undertaken in historical perspective. *Graph-2* shows that all the tree components have income and corporate taxes are maintaining an upward trend since FY 97-98. In particular, the overall increase in VP since FY 97-98 until FY 01-02 was 125%. The collection on this account increased to Rs. 34.9 billion in FY 99-00 from Rs. 20 billion in FY 98-99 due to the announcement of a one time amnesty scheme and door-to-door survey to document the economy. A further increase of 45% was observed in FY 01-02 as the after-effects of the survey continued. The collection from CoD displays an uneven growth pattern. Its share in gross income tax collection fluctuated between 11% and 16%. The collection increased to Rs.18 billion in FY 98-99 from Rs.16 billion in the previous year but declined to Rs.14 billion in FY 99-00 to jump again to Rs.23 billion in FY 01-02. This erratic performance shows lack of consistency in demand creation and recovery of the assessed amount. Finally, the collection on account of WHT increased from Rs. 68.6 billion to Rs. 79 billion during the period under consideration, showing an accumulated increase of 15%. However, its share in income tax has reduced from 63.5% to 51.6% between 1997 and 2002, a phenomenon consistent with the income tax reforms.



Advance Tax Payment u/s 53 (now u/s 147): Every taxpayer deriving income from business is required to pay advance taxes on the basis of past year's assessment (tax/ turnover ratio), except for those individuals whose last assessment year's income was less than Rs.150, 000. The advance tax is paid in four installments during the year, i.e., on 7th of October, January, April, and 15th of June. The data pertaining to last five years show that tax collection from this head increased from Rs. 16.6 billion in FY 97-98 to Rs. 35.6 billion in FY 01-02 or a cumulative increase of 114% *(Graph 2)*. The substantial increase in collection from Rs. 23.2 billion in FY 00-01 to Rs. 35.6 billion in FY 01-02 warrants further explanation. A closer look at the data revealed that this jumped has resulted from deposits worth Rs. 8 billion made by large public sector companies, especially the PTCL, the OGDC, the PSO and the Sui Southern Gas Company. While it may seem encouraging that advance taxes have risen consistently over the past few years, but the disadvantage of this phenomenon is that refund claims and repayments have also risen with the increase in advance tax payments by taxpayers.

Sales Tax: Following the 1st and 2nd quarter growth of 26.5% and 24.6%, the net sales tax collection grew by 17.4% in the 3rd quarter of CFY. The growth in net collection has declined due to higher refunds as compared to the corresponding months of PFY. In absolute terms, the July-March 2002-03 gross collection increased to

Rs. 174.243 billion from Rs. 143.984 billion in July-March 2001-02. Similarly, the net collection also increased from Rs. 113.424 billion to Rs. 139.095 billion, showing an increase of 22.6%. The refund payments, therefore, increased from Rs. 30.56 billion to 35.15 billion, registering an increase of 15% over the corresponding period of PFY *(Graph 3)*.



	Gross	Refunds	Net
M9: 01-02	144.0	30.6	113.4
M9: 02-03	174.2	35.1	139.1

While the net collection from sales tax imports increased by 18% during the first nine months of CFY over the same period of PFY, the net receipts from domestic sales tax recorded a substantial increase of 29.1% during this period. The July-March net collection of sales tax at import stage was Rs. 77.939 billion and that of domestic sales tax was Rs. 61.156 billion. The high growth in sales tax collection has been possible due to increased demand for domestic and imported goods, some of which have been classified as capital goods and raw material for capital goods. Moreover, since the refund payments during the first three quarters of CFY have increased by 15% over the corresponding period of PFY, the growth in sales tax collection points to an acceleration of domestic activity and strengthening of the economy. This phenomenon is further supported by increase in private sector demand for credit and the double-digit growth of leading manufacturing units.

Domestic Sales Tax Collection and Major Revenue Spinners: The detailed information based on sales tax collection from ten major revenue spinners for 3rd quarter of FY 02-03 and its comparison with the corresponding period of preceding two years is highlighted in *Table 4*. These revenue spinners contributed nearly 70% of the domestic sales tax revenue during the period under consideration. The collection in the 3rd quarter of CFY was higher by 24.4% than that of the PFY. The revenue from other sectors/ commodities also exhibited 17.8% increase during the same period.

An in-depth analysis reveals that the leading contributor in the growth of GST revenue in Q3 of CFY was electrical energy that showed a substantial growth of 127.3% emanating from adjustment of Rs. 2.939 billion recovery from WAPDA. The collection from POL products yielded an increase of 50.4%, mainly due to favorable swings in POL prices. On the other hand, 16.7% decline in collection from cement has been observed as a result of falling cement prices after the break down of manufacturers cartel. It appears that the price impact has outweighed the demand impact, thereby reducing the value of sales and the resulting GST collection.

Table 4: Comparison of ST Collection from Major Revenue Spinners

Revenue Heads	January-March			Growth (Percent)	
	2000-01	2001-02	2002-03	Col.4/Col.2	Col.4/Col.3
Col. 1	*Col. 2*	*Col. 3*	*Col.4*	*Col. 5*	*Col. 6*
POL Products	3.06	3.68	5.54	81.1	50.5
Electrical Energy	1.85	2.10	4.78	158.4	127.6
Cotton not Carded or Combed	4.66	3.73	3.92	-15.9	5.1
Sugar	1.68	2.56	2.37	41.1	-7.4
Services	2.60	2.21	2.36	-9.2	6.8
Natural Gas	1.77	1.91	1.95	10.2	2.1
Cigarettes	1.00	1.18	1.18	18.0	0
Cement	0.52	0.88	0.73	40.4	-17.1
Aerated Beverages	0.15	0.23	0.29	93.3	26.1
Cotton Yarn	0.46	0.26	0.19	-57.3	-26.5
Sub Total	*17.75*	*18.74*	*23.31*	*31.3*	*24.4*
Other Sectors	7.73	8.65	10.19	31.9	17.8
Grand Total	25.48	27.39	33.50	*31.5*	*22.2*

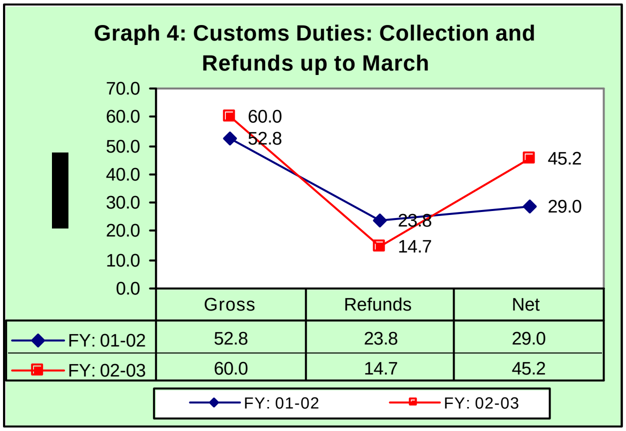
**Value in Billion rupees*

A 7.3% decrease in collection from sugar in the 3rd quarter has dampened the effect of a reasonable growth in the preceding two quarters. The overall growth in domestic sales tax collection from sugar during July-March 2003 has reduced to 3.3%. Similar to earlier months, the collection from cotton yarn has registered a sustained decline in the 3rd quarter as well. The reasons for this decline are explained in earlier issues of the *CBR Quarterly*.

Customs Duties: Customs duties are one of the vital components of federal tax collection contributing 21% of indirect taxes and 15% of total federal taxes despite gradual curtailment of maximum customs duty rates and slabs. The collection of customs duties is directly related to statutory rates and structure of slabs, inflow of foreign direct investment (FDI), rupee to dollar exchange rate, composition of imports, relative shares of dutiable and duty free imports, and, above all, the state of the economy.

The net collection during July-March 2002-03 indicates that the pace of revenue generation has been maintained. The gross and net collection during first nine months of CFY stood at Rs. 59.974 billion and Rs. 45.227 billion, showing an increase of 13.6% and 55.9%, respectively *(Graph 4)*. This unprecedented growth was possible due to various reasons including far lesser payments of refund/ rebate, i.e., Rs. 14.7 billion during the first three quarters of CFY against Rs 23.8 billion in the corresponding period of PFY – a reduction of 38.1%. The other factors that had a positive influence on CD collection are: 13.6% increase in dutiable imports, extension of CD on POL products, lowering of duty rates for capital goods thus encouraging imports of these goods and raw material for capital goods, and an increase in statutory rate from 5% to 10% on import of oil seeds and fruits category. It is also interesting to observe that this achievement was possible despite the fact that a host of negative factors were also operating that hindered further growth in CD collection. Among these were the gradual slashing down of maximum duty rates and slabs, around 20% increase in duty free imports and appreciation of rupee vis-à-vis dollar from Rs. 67 per dollar in FY 01-02 to around Rs. 58 per dollar in CFY.

As far as the situation of refunds/ rebates is concerned, the main reason for decrease in these payments are (a) reduction and rationalization of DDB rates in CFY, and (b) clearing of the pending stocks of refund/ rebate in FY 01-02. The major upswing in collection is mainly due to lesser refund/ rebate payment is also evident from the fact that the growth in gross collection and total dutiable imports are identical, i.e., 13.6%.



Graph 4: Customs Duties: Collection and Refunds up to March

It has also been noticed that dutiable imports in respect of capital goods increased from Rs 40 billion in the first nine months of CFY to Rs 56 billion in July-March 2002-03, depicting an increase of 40%.[2] On the other hand, total import of consumer goods came down from Rs 45 billion to Rs 25 billion or 44.4% during this period. Similarly, dutiable imports of consumer goods also declined from Rs 29 billion July-March 2001-02 to only Rs.19 billion in July-March, 2002-03. This changing pattern of imports confirms that emphasis on imports is shifting from consumer goods to capital goods for two major reasons, (a) increase in the inflow of FDI, and (b) reduction of

[2] Based on Custom House data only.

customs duty from 10% to 5% on most of the capital goods, an investment-friendly move to provide incentive to investors.

The analysis of data from Custom House and Dry Ports for 15 major revenue generating categories indicates that 82% of the collection is yielded by these major items. Out of these major heads, nine have reflected growth in the CD collection over the comparable period of PFY. Higher increase was recorded in POL products (622.4%), oilseeds and fruit group (226.5%), vehicles (68%) and electrical machinery and equipments (57.3%) etc.

Central Excise: The gross and net collections of central excise duties were Rs. 31.49 billion and Rs. 31.312 billion, respectively during first three quarters of CFY, entailing a *negligible* growth of 0.3% over the corresponding period of PFY. On the other side, the gross and net collections during the 3rd quarter were Rs. 11.565 billion and Rs. 11.520 billion, respectively, which registered positive growth of 4.6% and 4.2% over 3rd quarter figures of PFY. Furthermore, the month-to-month record of net collection indicates that a positive growth of 9.5% was recorded in January and 6.1% in March. However, a negative growth of 2.5% was observed in February of CFY. On the whole, this pattern of growth clearly demonstrates that the impact of negative growth in the months of August, September, October and February has been compensated for by positive growth in remaining five months. Consequently, the overall growth in collection has been 0.3%. The encouraging aspect is that the collection has improved despite the fact that the central excise base has shrunk during CFY due to transfer of most of the POL products to customs, and withdrawal of CED from a number of items in the Federal Budget 2002-03.

The detailed analysis indicates that six major revenue spinners, i.e., cigarettes, cement, natural gas, POL products, beverages, and beverages concentrates have contributed around 88% of the total

CED revenue during July-March 2002-03. Collectively these six commodities or commodity-groups have achieved 67% of the annual targeted collection for the CFY in the first three quarters. Individually, the achievement of the annual targets is as follows: cigarettes (60%), cement (81%), POL products (67%), natural gas (76%) and beverages and concentrates (56%).

The collection from cigarettes reflected an increase of 5.1% during July-March 2002-03 and 8% during the 3rd quarter of CFY against the corresponding periods of PFY. This increase in the collection can be attributed to a combination of price and duty increases in the current FY budget and anecdotal evidence of heightened anti-smuggling activities. The impact of the budgetary measures seems to have overwhelmed the overall decline in production and clearance of cigarettes during July-February 2002-03 *(Table 5)*.

Table 5: CED Collection from Major Revenue Spinners

(Rs. Million)

Revenue Heads	Quarter 3			July-March		
	CFY	PFY	Growth (%)	CFY	PFY	Growth (%)
Cigarettes	4420.1	4090.9	8.0	11048.9	10515.2	5.1
Cement	2944.8	2331.8	26.3	8287.3	7054.1	17.5
POL Products	858.1	1308.8	-34.4	2651.2	3653.4	-27.4
Natural Gas	1149.8	1117.3	2.9	3274.0	3102.7	5.5
Beverages	458.9	562.1	-18.4	1456.7	1735.5	-16.1
Beverages Concentrates	228.0	177.1	28.7	705.9	700.3	0.8
Sub Total	10059.7	9588.1	4.9	27424.0	26761.2	2.5
All Other	1460.3	1462.9	-0.2	3888.1	4467.8	-14.3
Grand Total	11520	11051	4.2	31312	31229	0.3

The CED collection from cement increased by 17.5% during the first nine months of CFY and by 26.3% during the 3rd quarter. While the breaking down of cartel of cement manufacturers resulted in reduction of prices of cement, but it is central excise duty structure that has resulted into a healthy growth in collection. This observation is further confirmed by 18.3% and 11.4% growth in production and clearance of cement, respectively during the July-

February 2002-03 period. The CED collection from beverages has decreased continuously in all of the first three quarters of CFY, i.e., 16.3% decline in the 1st quarter, 12.7% in the 2nd quarter and 18.4% in the 3rd quarter. The overall decrease until March-03 has been 16.1%. The main reasons for this unimposing track record are reduction in the rate of duty from 15% to 12% and decreased clearance of beverages by 15%. In part, this phenomenon could be attributed to Iraq war. Incidentally, the CED revenue from concentrates of beverages has increased in the 3rd quarter by 28.7%, indicating that the manufacturers are anticipating a revival of demand in beverages in the summer. Finally, the CED collection from POL products has declined by 27.4% due to transfer of most of the POL items to CD net.

Concluding Observations

The preceding analysis corroborates that improved performance of CBR is the result of various factors including the continuity of the reform agenda, improvement in tax administration and the overall progress in the macroeconomic environment in the country. The 14% growth in exports during the first nine months of CFY is indicative of the fact that domestic production is increasing to generate exportable surpluses. The demand for locally produced and imported raw materials has increased to meet domestic and external demand. This boost in economic activity has, in turn, resulted into increased CBR revenue collection in the shape of sales tax on domestic and imported goods and customs duties levied on dutiable imports. The improved CED collection also manifests continuous improvement of the large-scale manufacturing sector.

It is anticipated that CBR would continue to improve its performance so long as the current state of economic progress is maintained. If the performance of the past three quarters is any indicator, then there is ground for optimism for the economy to continue to do well and for CBR to meet its revenue target.

Fortunately, the economy has survived the scare emerging from the conflict in the Middle East. As far as domestic events are concerned, it is important that the steady course of economic reforms in maintained. Any deviation from this route, either because of popular demand or otherwise, has the potential of derailing the consolidation efforts. Consequently, the achievement of the revenue target will also become a distant possibility.

II

How Effective is the Federal Tax System in Pakistan? A Baseline Analysis[3]

To tax and to please, no more than to love
and to be wise, is not given to men.
Edmund Burke: *Speech to American Taxation, 1774]*

Introduction

The success of an organization like CBR crucially depends on how well it serves the interests of the wide spectrum of its stakeholders. The list of taxpayers includes importers, manufacturers, exporters, wholesale and retail traders, turnover taxpayers, service providers and employees of the public and private sectors organizations. Besides, the revenue organization has to safeguard the interests of the government and its own employees.[4] With this continuum of stakeholders and diversity of business processes, the staff of CBR and its field offices are found engaged in wide-ranging activities including registration, appraisement, valuation, collection, audit and inspection, enforcement, adjudication, release of refunds and rebates, and vigilance against tax evasion and smuggling activities. Notwithstanding the continuous efforts to improve the working of the organization and to create a business-friendly environment, many stakeholders including the government, remain disenchanted and dissatisfied. Resultantly, the revenue organization is dubbed as mendacious and untrustworthy.

The real questions are: What are the bases of such beliefs? How serious are these concerns? And how to improve upon the prevailing perceptions of stakeholders about working of CBR? The aim of the present study is to address these questions by preparing a list of

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[4] The new addition to this list of stakeholders is the International Financial Institutions (IFIs), who have designed their own sets of demands under the guise of structural adjustment and reforms.

performance indicators or measures of successes (or failures) for comparison with performance standards (benchmarks) to bring concreteness to the idea of performance evaluation and to contest perceptions on scientific grounds.

However, before proceeding further, it may be desirable to define performance standards first for evaluation purposes. Sifting through the literature on performance evaluation, one finds a whole array of authors who relate performance with actions. For example, Kane (1996) believes that performance is something that the person (organization) leaves behind. Similarly, Bernadin *et al* (1995) define performance as the outcome of work. On the contrary, there are others including Campbell (1990) who consider it as behavior – the way in which organizations, teams and individuals get their work done.[5] Integrating these two dimensions, a comprehensive view of performance has been put forward by Brumbach (1988), who states:

> *Performance means both behaviors and results. Behaviors emanate from the performer and transform performance from abstraction to action. Not just the instruments for results, behaviors are also outcomes in their own right – the product of mental and physical effort applied to the tasks – and can be judged apart from results.*[6]

Defining Performance Standards

Within the above stated broader perspective, performance standards can be defined as statements of conditions that exist when jobs are being performed effectively. The performance standards in terms of time-based targets could be either subjective or objective in nature.

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[5] See for example Kane, J. S. (1996) 'The Conceptualization and representation of total performance effectiveness' *Human Resource Management Review*, Summer, pp. 123-45; Bernadin, H. K. and others (1995) 'Performance Appraisal Design, Development and Implementation, in (eds) G. R. Ferris, S. D. Rosen, D. J. Barnum, *Handbook of Human Resource Management*, Cambridge (Mass.): Blackwell; and Campbell, J. P. (1990) 'Modeling the performance prediction problem in industrial and organizational psychology' in M. P. Dunnette and L. M. Hugh (eds), *Handbook of Industrial and Organizational Psychology*, Cambridge (Mass): Blackwell.

[6] Brumbach, G. B. (1988) 'Some Ideas, Issues and Predictions about Performance Management' *Public Personnel Management*, Winter, pp. 387-402.

But, for performance evaluation purposes it is desirable that measurable constructs, i.e., quantifiable benchmarks are prepared even for the subjective measures. Thus, given the level of professionalism, commitment, and effective effort, the performance of the organization and its staff is tied to these benchmarks. In this scenario, the performance management process aims at the extra effort of the individuals to make the *good even better* while preserving the structure and management style of the organization.

Performance Measures of CBR

In the light of the argument that the taxation system in Pakistan does not generate enough revenues given the level of the Gross Domestic Product (GDP) and that there are gross inefficiencies, the performance indicators have been identified by giving due consideration to the 'diversified' concerns of all the stakeholders. This study aims at three sets of performance indicators, namely, aggregate fiscal indicators, tax-specific indicators, and indicators related to tax administration.

Aggregate Fiscal Indicators

Three aggregate fiscal indicators have been selected for detailed analyses. These include tax collection relative to tax capacity, tax mix, and cost of collection. The performance standards in each of these three cases are revenue targets set by the government, increasing share of direct taxes in total collection to minimize regressivity, and maintaining collection costs within the limits observed for other economies of the world that approximately lie within a tight range of less than one percent to three percent of revenue collection.

Tax Effort: The overall tax effort has been captured by such aggregate ratios (indicators) as: total revenue/GDP, tax revenue/GDP, CBR-revenue/GDP, and CBR-revenue/ total tax revenue. The figures presented in *Table 1* show that total revenue (federal and provincial tax, non-tax, and surcharges) to GDP ratio (TR/GDP) has hovered around 16% to 18% since FY 90-91. Similarly, total tax to GDP ratio (TTR/GDP) has stayed between 12.6% and 14.4% and finally CBR-revenue (federal receipts only) to GDP ratio (CBR-R/GDP) between 10.8% and 12.6%. The general perception is that all these ratios, even at their peak levels, are below taxable capacity of the economy and far less in terms of comparison with countries in the region. While there may be some merit in these assertions but they are not entirely correct if economic structure, especially the composition of GDP, and performance standards are considered. Whether or not tax relative to GDP, which also includes a large component of agriculture income, is a relevant measure of tax effort, especially in agrarian societies, is highly debate-able. With necessary adjustment in tax base, these ratios increase by at least two percentage points, thus indicating a healthy tax effort in the country. Similarly, when tax/GDP ratio is compared with the relevant performance standard, which in the present case is the agreed target under the PRGF program, one finds no slippage either. Incidentally, the targets under the PRGF program have been set within the medium-term macroeconomic framework that takes into account all efforts towards fiscal consolidation.

Table 1: Aggregate Indicators of Fiscal Effort

(percent)

	TR/GDP	TTR/GDP	CBR-R/GDP	TTR/TR	CBR-R/TR	CBR-R/TTR
1990-91	16.1	12.7	10.8	79.1	67.4	85.2
1991-92	18.0	13.6	11.6	75.9	64.5	85.1
1995-96	17.9	14.4	12.6	80.4	70.5	87.7
1996-97	15.8	13.4	11.6	84.5	73.4	86.9
1999-00	17.1	12.9	11.0	75.6	64.7	85.5
2000-01	16.0	13.0	11.5	81.2	71.6	88.2
2001-02	16.6	12.6	10.8	76.3	65.5	85.8
2002-03*	17.0	13.4	11.3	78.9	66.6	84.4

* *Estimates*

Regarding relevance of cross-country comparison, it may be pertinent to point out that statistics from various countries are not readily comparable even when GDP or per capita GDP is same in two or more countries – a point very convincingly highlighted by Musgrave and Gillis (1971).[7] In the face of this deficiency, a single source of data is often used for such comparisons to avoid computational inconsistencies. The *Asian Development Outlook 2002* reports that the central government revenue as percent of GDP was 16.2% in India in 2001 (compared to 15.7% in Pakistan), 17.4% in China, 17.1% in Sri Lanka, 20.7% in Malaysia, and 20.1% in Singapore. A similar picture also emerges from data published in the *World Development Report (1997)* of the World Bank.[8] This comparison also indicates that tax effort in Pakistan is not too different than other countries of the region even though accurate measurement of relevant variables continues to be a serious concern for researchers.

Tax Mix and Incidence: Diversification within the existing tax system has been examined through the changing composition of direct and indirect taxes under the reform process. The historical information reveals that the tax structure of Pakistan has undergone significant changes since early 1990s when the first phase of the tax reform process was initiated. From a heavy reliance on indirect taxes, which are often considered more regressive, the dependence on direct taxes has increased gradually. Similarly, within indirect taxes, the share of trade related taxes and central excise has declined from nearly 46% and 21% to 12.3% and 11%, respectively within a short span of 12 years. Simultaneously, the emphasis on a broad based GST has increased, raising its share in total federal receipts from 15.4% in FY 90-91 to 41.2% in FY 01-02 *(Table 2)*. This evidence illustrates that the tax system is moving towards base-elastic taxes through a conscious policy to allow policy makers to

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[7] Musgrave, R. and M. Gillis (1971) *Fiscal Reforms for Colombia*. Cambridge: The Law School of Harvard University.

[8] In this case the 1995 Revenue/GDP ratio was as follows: Pakistan 22.5%, Sri Lanka 28.8%, India 13.6%, Indonesia 22.6%, Thailand 24.5%, Malaysia 27.2%, Singapore 21.8%, and Korea 24.2%. Even though the tax revenue to GDP ratio for Pakistan is comparatively low, but it is compensated by non-tax revenue/GDP, which is fairly high. It may be added that surcharges on POL products and natural gas are not included in calculating tax/GDP ratio in Pakistan but they do appear in Revenue/GDP ratio.

introduce smaller proportionate changes in taxes to generate additional revenue relative to base-inelastic taxes, thus putting less and less extra burden on taxpayers. Furthermore, a comparison of the value added version of GST and the cascading nature of the sales tax structure prevalent in the country prior to 1990s also reconfirms that the redesigned tax system has proven to be more equitable and growth promoting.[9]

How far these efforts of introducing equity in the tax system are successful? The answer crucially depends on the choice of performance standards. Should tax mix of developed economies be a benchmark where direct taxes constitute 60-80% of tax collection or the tax mix of developing economies be adopted where the contribution of direct taxes is no more than 25-30%? If latter is accepted as benchmark then the reform process has already put Pakistan's tax structure in the high-achievers category, otherwise a lot more is desired. However, to achieve the tax mix standard of developed economies would require huge effort not only to document the economy, but also to transform the economic structure from a fairly large informal set up to a formal structure.

Table 2: Composition of CBR Revenue Relative to GDP and Cost of Collection

	Direct Taxes (percent)	Sales Tax	Customs	C. Excise	Indirect Taxes (percent)	Cost of Collection Relative to Collection
1990-91	18.0	15.4	45.7	20.9	82.0	0.634
1995-96	29.2	18.6	33.2	19.1	70.8	0.783
1997-98	35.1	18.4	25.4	21.1	64.9	0.715
1999-00	32.5	33.6	17.8	16.1	67.5	0.663
2000-01	31.8	39.1	16.6	12.5	68.2	0.637
2001-02	35.3	41.2	11.8	11.7	64.7	0.619
2002-03*	32.2	44.7	12.3	10.9	67.8	0.673

**Estimate*

[9] For details see Ahmed, Ather M., Robina A. Ahmed and M. A. Khan (2002) 'From ST to GST: The Development of Sales Tax in Pakistan' *CBR Quarterly Review*, 2:2, pp. 18-30.

Cost of Collection: The cost of collection as a measure of efficient utilization of scarce resources has been derived as a ratio of total expenditure of CBR, including its field formations, as a proportion of CBR revenue collection at a given point in time. It reflects the expenditure incurred on collection of federal taxes relative to federal tax receipts. Notwithstanding the presence of discrete bases of expenditures and revenue, it is widely regarded as an important parameter for gauging the efficiency of revenue collecting organization. *Table 2* shows that the cost of collection is reasonably low in Pakistan as compared to the rest of the world. Even though low cost of collection manifests efficiency, but it also acts as constraint to revenue maximization through compliance. In this respect, paucity of logistics, insufficient infrastructure, and meager investment in human resource development are the key elements hindering further growth in revenues. On top of this, the sweeping powers delegated to tax officials by law and below subsistence wage structure has resulted into governance problems and created inefficiencies. Thus, cost of collection, as a measure of success requires careful evaluation. On a reasonable note, it may be desirable to increase cost of collection in the short run to improve working environment through better infrastructure and to develop and enhance human resource endowment. Improvement in revenue collection through reduced cost of collection should then be viewed as a by-product of effective management of human and physical resources.

Indicators Related to Individual Taxes

Under the optimal taxation principle, the two key policy options available to the government to increase tax collection are: (a) broadening of tax bases, and (b) continuous adjustment of tax rates. In Pakistan tax bases vary with individual taxes. For instance, non-agriculture income serves as the base for income and corporate taxes, value addition in large scale manufacturing sector determines the outturn of domestic sales tax and central excise duties, and rupee value of imports and dutiable imports serve as the bases of sales tax on imports and customs duties. The tax rate structure also varies widely not only across direct and indirect taxes, but also within each of the federal taxes. Thus, the present study identifies tax base and tax rate as tax-specific performance indicators. The ensuing discussion focuses on various efforts to enlarge tax bases besides analyzing revisions in tax rates.

Tax Base: The issue of broadening of tax base can be addressed from two angles: (a) how the number of taxpayers has evolved overtime, and (b) how the coverage of individual taxes has been extended to bring previously untaxed income or commodities into the tax net. Since no specific benchmarks have been set for comparison purposes, the analysis is restricted to tax specific efforts to enhance tax bases and rationalization of tax rates.

Issues Related to Direct Taxes: The income tax base currently includes 2.14 million 'individual' and 24,372 corporate taxpayers.[10] The number of individual taxpayers has increased by an average annual growth rate of 8.3% since FY 96-97, much higher than the population growth, and the same for corporations has been 6.8%. Since income and corporate tax has emerged as one of the leading taxes, the healthy growth in its base is in accordance with the overall reform strategy. As far as coverage is concerned, a large number of specific measures have been introduced to enhance income tax base. These include withdrawal of exemptions and bringing previously exempted incomes in tax net, and systematization of the withholding tax regime. The latter two aspects warrant in-depth investigation and as such the attention is now turned to WHT tax structure in Pakistan.

[10] This number constitutes 1.46% of population in 2002, which may sound alarmingly low. However, a further analysis indicates that the proportion of income taxpayers in employed labor force is as high as 5.59%. Assuming the household size of 7.3 and vast majority of them having single earners, this percentage increases to 10.63% per household for entire Pakistan and 31.94% per household for urban residents. It may further be added that the number of income taxpayers does not include those withholding taxpayers, which incidentally constitutes over 50% of direct tax receipts.

Withholding taxes were first introduced in the late sixties not only to broaden the income tax base but also to arrest tax evasion, especially by the undocumented sector of the economy. Initially tax deductions were introduced for three sources of income, namely; salaries, interest on securities and payments to non-residents. Since then the WHT net has kept on increasing on regular basis. In 1979, there were six kinds of payments/ transactions subject to WHT, which increased to 19 in FY 94-95 and to 25 in FY 99-00. Now, in accordance with income tax reform strategy, the reliance on WHT is being reduced gradually.[11] Furthermore, the nature of WHT taxability, i.e., final or adjustable to determine presumptive nature of the tax has emerged as a crucial issue from equity standpoint. This aspect has been captured in *Table 3* along with the nature of payment of the tax. It is clear that in majority of the cases WHT is adjustable, i.e., these taxes should not be regarded as presumptive as they do not introduce regressivity in the system.

Tax Exemptions: Section 53 of the Income Tax Ordinance, 2001 empowers the Federal Government to exempt from tax any income or classes of income, or person. Tax exemptions are granted under restrictive set of conditions but take many shapes with far reaching revenue implications. In certain cases these are granted to promote investment, exports and growth, in other cases privileged personalities are entitled to such exemptions, or they are allowed to vulnerable groups to preserve equity in the tax system (essentially tax expenditure). Some of these exemptions are time-bound, i.e., they lapse after the due date unless renewed further or they have no expiry date and their termination (or continuation) depends on the design of tax policy being pursued.

With the passage of time the list of exemptions had grown bigger to include tax rebates, concessions and non-standard exemptions. This

[11] The chronological development of WHT is enclosed as Annex-A.

Table 3: WHT Structure and Taxability

Section of repealed IT Ordinance 1979	Section of IT Ordinance 2001	Nature of Payment/ Transaction	Taxability
50(1)	149	Salary/ Perquisites	Adjustable
50(2)	151(1) (c) 151(1) (b)	Profit/ Interest on Securities Yield on National Saving Deposit Certificates	Adjustable
50(2A)	151(1) (b)	Profit/ interest on debt paid by banking company and financial institutions	Adjustable
50(7D)	151(1) (A)	Profit on any bond certificate, debenture, security etc.	Adjustable
50(3)	152(1)	Payment to non-residents on account of - Royalty, and - Other cases.	Final Adjustable
50(3A)	152	Fee for technical services paid to non residents	Final
50(4)	153	Contracts executed with Residents - Rice, cotton seed, edible oil - Others - Transport services - Other services	Final Final Final Adjustable
50(4A)	233	Commission or brokerage	Adjustable
50(5)	148	Imports - Edible oil - Others	Final/ Adjustable Final
50(5A)	154	Exports	Final/ Adjustable
50(5AA)	154	Supply of goods to exporters	Final
50(5AAB)	154	Export of goods to industrial undertakings located in EPZs	Final
50(6)	234	Transport	Final/ Adjustable
50(6A)	150	Dividend	Final
50(7B)	155	Rent	Adjustable
50(7C)	156	Prize Bond winnings etc.	Final
50(7E)	235	Electricity Consumption	Adjustable
50(7F)	236	Telephone Bills	Adjustable

problem is being addressed through a conscious effort that includes withdrawing of all such exemptions whose relevance has become hard to justify. The most recent example in this respect is the withdrawal of fifty-one exemptions from Part-I of the Second Schedule and four rebates available under the First Schedule in the

Federal Budget of FY 02-03. The process is expected to continue in future as well when some of the additional exemptions stated in the CRITO-list will be withdrawn.[12]

Issues Related to Sales Tax: The first objective towards broadening of sales tax base is to increase the number of sales tax registrants within various categories including wholesale and retail traders, manufacturers and turnover taxpayers. The evidence confirms that the overall number of sales tax registrants has increased steadily from nearly 33 thousand in FY 96-97 to 152 thousand in February 2003. Within this, the share of domestic sale tax registrants is close to 84%, of which 48.9% are wholesale and retail traders and 25.6% are manufacturers. The second objective concerning the expansion in sales tax base is to bring additional categories of taxpayers into the tax net. In this respect GST has been extended to utilities and services. Similarly, previously untaxed commodities such as fertilizer, sugar, and edible (cooking) oils have also been brought into the tax net since FY 97-98 onwards *(Table 4)*.

Tax Rate: Frequent revisions in tax rates are also part of the additional fiscal policy measures not only to raise revenue, but also to simplify tax structure. In the recent past, the tax rate revisions have been more pronounced for direct taxes and customs duties as compared to general sales tax (GST) and central excise duties.

Within income and corporate taxes, the minimum and maximum rates for taxable income have most recently been revised at the announcement of the Federal Budget 02-03. The rates for taxable income for individuals have been fixed within the range of 7.5% and 35%. Similarly, in order to create parity between income tax rates for companies, the banking companies' rate has been reduced from 58% to 50%. Since FY 92-93 the banking companies' rate has been continuously slashed from 66% in FY 92-93 to 50% in FY 02-03.

[12] The chronological development on withdrawal of exemptions is enclosed as Annex-B.

This decline, at the rate of 3% per year, will continue in the future as well so that the reform target rate of 35% is achieved within five years time. [13]

Table 4: Sales Tax Standard Rates and Coverage: A Historical Perspective

Year	Rates	Coverage
1990-91	12.5%	Exemption of around 40 items withdrawn
1991-92	12.5%	Coverage extended to the level of sales by commercial importers, distributors and wholesalers on items like air conditioners, deep freezers, and TV sets etc.
1992-93	12.5%	Exemption withdrawn on some of the locally manufactured items including cartons, marbles, barbed wire etc
1993-94	12.5%	Exemption withdrawn from ten goods including electric fans, desert coolers etc.
1994-95	12.5%	All production units over half million subjected to pay fix tax except processed fabric industry.
1995-96	18%	Compulsory registration of all importers for the purpose of issuing tax invoices to buyers of imported raw materials and components.
1996-97	18% and 12.5%	All existing exemptions at import and manufacturing stages are withdrawn except those, which are separately notified as exempt from tax. Some significant items to remain exempt are sugar, edible oil/ ghee, POL products, unprocessed food stuff and agriculture produce
1997-98	18%	Registration of Importers has been made compulsory. Extension of GST to Sugar
1998-99	12.5% and 15%	GST extended to Retail Stage
1999-2000	15%	GST extended to utilities, i.e., electrical energy, POL and natural gas
2000-2001	15%	GST extended to Services
2001-2002	15% and 20% on some items	Levy of GST on Fertilizer
2002-2003	15% and 20% on some items	Levy o f GST on vegetable ghee, cooking oils and medicines (later withdrawn)

As far as GST rate is concerned, it has varied between 12.5% and 18% between FY 90-91 and FY 97-98. The standard rate of 15% is partially applicable since FY 98-99, even though some commodities,

[13] For revised income tax rates and threshold limit see 'CBR Tax Collection: A Systematic Analysis' in *CBR Quarterly Review 2002*, Volume 2, Number 1.

especially raw material, are taxed at a higher rate of 20%. Administrative difficulties apart, rate differentiation has been introduced to increase tax compliance by un-registered taxpayers and to generate additional revenue *(Table 4)*.

Adjustment in Customs Tariff Rates: Pakistan's taxation system has over-relied on international trade taxes in the past. The use of high rates of customs duty to protect domestic industry from international competitors was widespread. While the infant industry argument might have been valid to some extent but it introduced severe inefficiencies in the system. The introduction of tariff reforms in the early 1990s was the natural outcome to make indigenous industries more competitive, efficient and receptive to face the future trade-related challenges emanating from regional countries and the world at large. Moreover, a downward revision was also necessary to reduce the gap between bound tariff under WTO and applied tariff, and to reduce the incidence of smuggling, especially of electrical and mechanical equipment, auto parts, tyres, cloth and cigarettes.

Thus, the maximum statutory rate of customs duty was curtailed gradually from 80% in FY 93-94 to 25% in FY 02-03 and likewise the effective rate also plummeted from 38% to 14%. The accumulated reduction in customs duty rate since the initiation of tariff reforms has been 220% and the effective rate decline has been 171%. The gap between the two rates has emerged because of the fact that, during this period, the duty free imports increased by 91% as compared to dutiable imports, which registered an increase of 75%. With reduction in the maximum rate of duty and reducing the number of slabs, the current rates of duty and slabs in vogue are 25%, 20%, 10%, and 5%.

Indicators Related to Tax Administration

Since the outcome of tax policy measures aimed at broadening of tax base and adjustment of rate relies heavily on the effective administration of the tax machinery, the study also includes measures related to tax administration for assessing the efficiency of the taxation system. The indicators related to this area are categorized under three broad heads, namely, anti-tax-evasion measures, enforcement efforts, and activities related to taxpayers' education and facilitation. While anti-tax-evasion quest includes detection of unreported and under-reported taxable incomes and detection of tax-fraud and smuggling activities, enforcement activities include recovery of taxable amount through actions against tax defaulters including litigation. The taxpayers' education and facilitation on the other hand includes measures to promote tax-culture and redress taxpayers' grievances.

Anti-tax-evasion Measures: A thorough assessment of income tax and corporate tax returns is the tool to determine the extent of under reporting and misreporting of taxable income. For indirect taxes, especially GST, audit of registered taxpayers is administered to determine tax evasion. Furthermore, Customs and Intelligence and Investigation departments are authorized to prevent smuggling activities. The evidence suggests that despite increasing attention to these issues and encouraging performance in certain areas, a lot more is desired on many other fronts. The information presented in *Table 5* indicates that there is an increasing effort to arrest tax evasion through assessment of income tax returns. The average annual growth in 'current demand creation' has been 26.1% between FY 98-99 and FY 01-02 and the amount recovered has increased by 24.1%. Similarly, the growth in the number of sales tax audits and amount detected and collected have also picked up significantly during this period. While the average annual rate of increase of the former has been 86.4%, the latter has increased by over 35%.

Acknowledging that increased assessment and audit is proving to be an effective tool to deter tax evaders, but the amount detected in tax fraud cases as compared to total collection remains fairly insignificant. This might be a probable outcome in economies where tax compliance is high and payment of due taxes is considered national and moral obligation, but not so in developing economies where tax culture is almost non-existent! The sheer size of the undocumented economy testifies that tax compliance is significantly low in Pakistan.

Enforcement Efforts: The percentage of recovery of the assessed amount is no more than 50% in the case of direct taxes, and close to 13% of the amount detected in audits for sales tax in FY 01-02.[14] On the other hand, the total amount involved in default in respect of direct taxes has increased from Rs. 909 million in FY 00-01 to Rs. 1910 million in FY 01-02. Even though the amount recovered has also increased from Rs. 120 million to Rs. 280 million, but the recovery rate lies between 13% and 5% of the total amount. For central excise, the amount involved has decreased from Rs. 359 million in FY 00-01 to Rs. 72 million in FY 01-02, but the recovery has also declined from Rs. 4 million to Rs. 2 million during this period. Finally, on the customs side, the amount involved in default has declined from Rs. 613 million to Rs. 573 million, but the recovery has remained low, i.e., between 2% and 4%. These figures suggest that enforcement is not effective. The recovery of the defaulted amount has reduced to insignificant levels due to wide variety of reasons including administrative difficulties, lack of will and political support from the government, harassment issue and pressure tactics adopted by the vested groups. However, despite these limitations tax administration has emerged as a critical area, especially under the self-assessment regime of major taxes, and thus a complete overhauling of work processes has become inevitable.

A further disconcerting situation prevails as far as filing of sales tax returns is concerned. The non-filing has re-emerged as a worrying

[14] It may be clarified that recovery in a particular year does not correspond to demand created in the same year rather it may pertain to settlement of cases initiated in earlier years as well.

issue and so is the tendency of late filing of sales tax returns *(Table 5)*.[15] Even though a well designed penalty-regime exists for such delinquencies, but apparently the outcome is not noteworthy to report.[16] Finally, despite various efforts to reduce the number of litigation cases, the sheer size and the amount involved is yet another area of concern that requires correction.

Table 5: Anti-Tax-Evasion and Enforcement Measures

	1998-99	1999-00	2000-01	2001-02	Average Annual Growth (%)
Direct Taxes					
Current Demand Created	21023	19263	30485	39134	26.1
Amount Recovered	10586	9632	12333	18892	24.1
% Recovery	50.4	50.0	40.5	48.3	
Sales Tax					
No. of Audits Conducted	3896	4977	8627	22267	86.4
Amount Detected	4835	7077	13542	10673	38.8
Amount Collected	921	2304	1390	1375	36.5
% Recovery	19.0	32.6	10.3	12.9	
No. of Non-Filers	13356	18767	8537	16216	25.3
No. of Late Filers	11160	15014	12583	23117	34.0
No. of Short -Filers	3007	2709	3209	3521	6.1
No. of Registered Persons	60211	75538	117416	144537	34.7
% of D-Fillers to Registered Persons	43.8	48.3	20.7	29.6	

Values in Rs. Million

Taxpayers' Education and Facilitation: Although half-hearted measures like setting-up of information centers, publishing of

[15] The analysis is based on the available data. Disintegration of taxpayers by sector, i.e., manufacturers, service providers, and wholesale and retail traders etcetera would have provided for more elaborate assessment.

[16] Under section 26 of the Sales Tax Law, a registered taxpayer is required to furnish the sale tax return on due date. Penalties and additional tax are prescribed to check non-compliance. The non-filers, short-filers and late-filers are separated through computer record. Show cause notices are issued and penalties imposed. For example, in case of short-filers, a penalty of Rs. 5000 or 3% of the principal amount whichever is higher is imposed. An additional tax of 2% is also imposed on the short amount. Late filers have to pay penalty of Rs. 5000 along with additional tax of 2%. Non-filers have to pay Rs. 5000 as penalty.

pamphlets and broachers and frequent contacts with taxpayers' associations have been adopted from time to time, but these efforts were largely unsystematic and disorganized. As a result, taxpayers' insufficient knowledge of their tax obligations not only contributed towards revenue losses, but the revenue organization also invited un-due criticism from its stakeholders. The significance of congenial relationship between taxpayers and tax collectors is now well recognized and within this spirit CBR is evolving a new strategy to strengthen interface with taxpayers. The new strategy aims at universal customer friendly approach, which is crucial for the success of the universal self-assessment schemes.

Summing Up

A number of issues related to tax policy and administration have been addressed in the preceding discussion. The performance of the revenue organization has been assessed on the basis of aggregate indicators and measures related to tax administration. Given the diversity of work processes, it is evident that the performance of CBR, as a public sector organization, is more than satisfactory on many fronts but requires improvement in several other areas. However, it is rather unfortunate to observe that the performance of such a vital organization is so *narrowly* linked to revenue targets only without any regard to the state of the economy, the disturbing level of delinquencies on the part of taxpayers, and most importantly the rudimentary nature of the tax culture prevailing in the country.

It has been highlighted that tax administration remains a relatively neglected area as the revenue organization has continued to function with an outmoded and inefficient structure for a long time. The work processes were poorly organized, out-dated, labor intensive, and open to abuse. The information technology was deficient to support CBR's extensive activities. However, things have started to take new shape with the initiation of a wide-ranging reform process. It is intended to vastly improve tax administration by changing the organizational structure from type-of-tax to functional lines. Substantial progress has already been made in re-engineering of business processes, risk management in audit, taxpayers' education and facilitation, adoption of information technology, and matching jobs with competencies of the work force. The redesigned tax structure has been implemented as pilot projects in four directions, namely, the Large Taxpayers Unit (LTU) at Karachi with an integrated tax system to cater to the needs of large taxpayers, the Medium Taxpayers Unit (MTU) at Lahore for small and medium income taxpayers, the Customs Administration Reform Plan (CARE) at Karachi to facilitate exporters and importers, and the Sales Tax Automated Refund Repository (STARR) project at Lahore for prompt and fully automated sales tax refund system. The outcome of these ambitious undertakings is being monitored closely and regularly to determine the future course of action and to replicate the 'reformed tax structure' at the field-office level. The successful implementation of these plans would surely redress most of the concerns of taxpayers and hopefully tax compliance would also increase in the process. All this is being done with the understanding that an improved level of CBR performance is extremely vital for future economic viability of the country.

Annex A: Chronological Development of WHT

Prior to 1979	50(1)	Salaries
	50(2)	Interest on securities
	50(3)	Payments to non-residents
1979	50(4)	Payments for contracts/ supply
	50(5)	Import of goods
	50(6)	Public motor vehicles
		Private motor vehicles (1992)
1987	50(3A)	Payments to non-residents for technical services
1989	50(4A)	Brokerage or commission
	50(6A)	Dividends
	50(7B)	Rent for house property
1990	50(7C)	Prizes or winnings
1991	50(7D)	Profit/ interest on bonds
1992	50(5A)	Export proceeds
	50(7E)	Electricity bills of commercial and industrial consumers
1994	50(2A)	Interest/ profit by banks and financial institutions
	50(2B)	Bank transactions
1996	50(7F)	Telephone bills and prepaid cards
1999	50(5AA)	Indirect exports (Supply of goods to exporter on back to back inland L/C)
	50(2B)	Commission/discount of petrol pump operators.
2000	50(5AAB)	Export goods from export processing zones

The following heads were omitted through the Finance Ordinance, 2001 with effect from 1st July 2001:

i) 50(5AAA) Import of wheat
ii) 50(5B) Bearer certificates and foreign exchange bearer certificates
iii) 50(7) Bonus or bonus shares
iv) 50(7A) Auction of immovable properties, Octroi and Toll tax
v) 50(7G) Gas bills

Annex B: Chronological Development on Withdrawal of Exemptions

1996-97

1. Any income chargeable under head salary received by a citizen of Pakistan employed outside Pakistan by the government of foreign state with approval of federal government as remuneration
2. Any income being the salary of a teacher or other employees of an educational institution paid by the government or any other authority or person in a foreign country of which such teacher or employee is a national.
3. Any payment not exceeding Rs.25, 000 received by an assessee, not being a professional writer, poet, artist, as remuneration or compensation for literary or artistic work.
4. Any income derived by a person from the running of any school or hospital including donations and contributions received by him set up at any place beyond a radius of ten miles from outer boundary of any municipal corporation or committee or any cantonment board and recognized by the federal, provincial government or by local authority.
5. An amount up to 50,000 rupees per year paid by an assessee on account of repayment of educational loan inclusive of interest obtained from a financial institution under an approved educational loan scheme up to Rs500, 000 for pursuing education in engineering medical management or post graduate studies in pure and applied sciences

1997-98

Following exemptions have been omitted with effect from 1-7-1997

1. Salary of employee of a foreign ship
2. Salary of Pakistanis employed abroad by foreign states
3. Salary of foreign employee of educational institutions
4. Income from cash rewards, honorarium
5. Casual receipts below Rs.25, 000
6. Widows income from house property of less than Rs.24, 000
7. Dividends of ICP paid to non-residents and of companies rendering technical services outside Pakistan.
8. Income of non-professional writers
9. Income of professional sportsmen from benefit matches
10. Income of medical practitioners in rural areas
11. Income of recognized schools and hospitals in rural areas
12. Expatriate employees in Export Processing Zones,
13. Repayment of educational loans
14. Exemptions to donations to Prime Minister’s relief fund for Bosnia

1999-00

1. The yield of National Savings of deposit certificates including defense savings certificates, issued under the National Saving Scheme.
2. Any interest on deposits in Post Office Savings Bank or National Savings Centers under the National Savings Scheme

2001-02

1. Any income of a company registered under Companies Ordinance 1984 or a body corporate formed by or under any law for the time being in force, as represents the face value of any bonus shares issued between the 1-7-97 and 30-6-2001, by the company or the body corporate.
2. Income from Term Finance Certificates held by persons, other than companies.
3. Exemption to donations to prime minister's fund for national debt retirement and National self reliance fund

2002-03

1. Withdrawal of 55 exemptions of income tax from CRITO-list.

III

CBR Reform Program:
Business Process Re-engineering in the Public Sector[17]

Introduction

CBR has embarked on an ambitious medium term tax administration reform program. A key component of this reform program is Business Process Re-engineering (BPR). The present article aims to highlight the importance of BPR in the radical restructuring of any public sector organization, such as CBR. In this spirit, it aims to increase the level of understanding about BPR and awareness of its strategic linkages with other reform initiatives.

The Need for Re-engineering

If citizens could own shares of stock in their government, this would be the ideal time to buy. The most visible indicators of government performance are bad, while the underline fundamentals are strong and getting stronger. Beneath these outward sings of decay, a virtual transformation is occurring in some of the public institutions, a transformation no one could have predicted a decade ago. This sea change is wide sweeping and deep. It is over shadowed, for the moment, by the endless stream of stories documenting the failures of the government, but the change holds enormous promise for public institutions of the country and for the society.

At first sight, the transformation seems to be driven by technology. This is the information age, after all, and we are being overwhelmed with information because of rapid technological advances. Advance technology can accomplish great things; it can speed up problem solving, work on several problems at once, and get paper out of

[17] *Author*: Syed Hamid Ali, Secretary Customs BPR, CBR. Author's Note: This is an abridged version of the paper. Full text is available with the author.

office. What it cannot do is to make fragmented bureaucratic organizations more productive.

The tide of revolution arises from a momentous change around the globe; the enormous shift in consumer attitudes and expectations. Requirements of mass production – a large semi-educated work force willing to do routine, dull tasks; specialization of roles; interchangeable parts; interchangeable people within specialized roles; large runs of the same product; stable demand; one-size-fits-all products; division of labor – have driven the work routines and procedures of many of the large organizations for the last few decades. The key shifts in the transformation from a producer to a consumer society can be summarized in following ways:

- From low variety to great variety
- From low convenience to emphasis on convenience
- From limited access to basic services to virtually continuous access
- From few choices to seemingly endless choices

The explosion of information, and ready access to it, increases the choices and power of consumers. As Hammer and Champy (1993) state, 'customers have gained the upper hand in their relationships with sellers, in part, because customers now have easy access to enormously more data'. Osborne and Gaebler (1992) make similar assessment by pointing 'we have been transformed from a mass society .. to a mosaic society… we have come to expect products and services customized to our own styles and tastes'.[18]

Innovative organizations in both public and private sectors are scrambling as they learn to adapt to the new realities. The standards that successful organizations will achieve are well articulated by Carnevale (1991). He gives six 'benchmarks' by which all

[18] Hammer, M., and Champy, J. (1993) *Re-engineering the Corporation*. New York: Harper Business; and Osborne, D., and Gaebler, T (1992) *Re-inventing Government.* Reading (Mass): Addison-Wesley.

organizations will be judged in the near future.[19] These are: Quality, Productivity, Variety, Customization, Convenience, and Timeliness.

Since these consumer demands are not consistent with the strengths of bureaucratic operations, a silent but forceful revolution is taking place in government agencies. Had the top-down, control-oriented, segmented way of providing goods and services met these benchmarks, there would have been no change. Interestingly, the innovative organizations are not primarily the result of visionary leaders, of privatizing services, of incredibly advanced hardware and software systems, or of quality management. Far from that, there is the simple, powerful story of learning to organize work in a holistic, integrated way by using cross–functional teams instead of individuals working in isolated departments and functions, shifting from a pre-occupation with internal activities to a design focused on outcomes.

Principles of Re-engineering

The term business process re-engineering is new, but its design principles have been developing for some time. Challenging fundamental assumptions on which the organization is built by radically redesigning its processes, systems, and structure around desired outcomes. Re-engineering design principles are certainly important, but none is as important as the first part of the definition: challenging fundamental assumptions. Each design principle reverses long-accepted organizational truths, verities developed during an age that assumed we needed people to check people who checked other people in order to ensure accountability and control. The world has changed, and so must our assumptions.

Origins of the Design Principles: The process re-engineering design principles come from three sources, namely, successful experiences,

[19] Carnevale, A. (1991) *America and the New Economy*. San Francisco: Jossey-Bass.

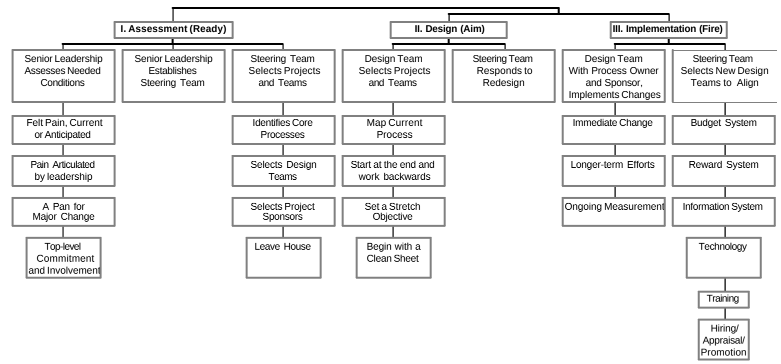
concurrent engineering and time-based competition. Encompassing these three sources, the key re-engineering design principles are:

1. Organization around outcomes and not functions,
2. Substituting parallel for sequential processes,
3. Bringing downstream information upstream,
4. Capturing information once, at the source,
5. Providing a single point of contact for customers and suppliers whenever possible,
6. Ensuring a continuous flow of the ‘main sequence’ (those activities that directly add value to the customer),
    - Identifying value-adding and non-value-adding steps,
    - Eliminating or separating non-value-adding steps, so that the main sequence flows smoothly and quickly,
    - Use of a triage approach to sort out complex and risky cases from the routine ones.
7. Not paving cow-paths but first re-engineering and then automating.

Setting the Stage for Re-engineering

Re-engineering creates profound changes in virtually every aspect of organizational life, changes that must be anticipated and planned for. What begins as a redesign of one specific process spreads to other processes as well. The employees also realize that other changes are needed to support the re-engineered processes, including performance appraisal, budgeting, management information approach and so on. That is, the organization starts realigning to support the new focus. Those interested in re-engineering spend considerable time up front thinking about such core questions as: what they want, why they want to embark on re-engineering, whether they are willing to actively support it over the long haul, whose support they will need, which processes they will begin with, and how they will articulate the purposes of change. The entire thought process with conditions and roles is laid-out in Figure 1.

Figure 1: A Model for Process Re-Engineering.



Overcoming Public Sector Constraints

The following steps are advocated in the re-engineering design:

1. Map the process as it currently exists,
2. Start at the end and work backward,
3. Set a stretch objective,
4. Begin with a clean sheet.

But the question is, can anyone really begin with a clean sheet in any government, where funding bodies, over-sight commissions, and staff agencies micromanage work processes to death? How to begin from the end given that government agencies have multiple customers and stakeholders who frequently have divergent and even opposing needs and expectations? And which processes should be re-engineered first? The answer to these concerns lies in aligning the system to support seamless work.

Alignment refers to the degree of congruence or consistency within an agency's culture: how well the various systems, structures, messages (both spoken and unspoken), and styles support and reinforce each other on an everyday basis. A leader, who preaches the importance of candor, then shoots the first messenger who brings bad news, is not creating alignment. An agency that creates self-managing teams but continues to hire, promote, evaluate, and reward staff based solely on individual accomplishments is not creating alignment.

Most government agencies are out of alignment, which do not send consistent signals to their staff. No wonder employees roll their eyes and give each other knowing looks when their managers come back from conferences and workshops proselytizing for the latest management trend or fad. How can we move toward empowerment, or quality management, or self-managing teams, they wonder, when the personnel system is antiquated, the purchasing system is still impossible, the information systems people insist on controlling everything, the budget process rewards waste, and the same old empire builders control what really goes on everyday? The structure of a government agency is not the most important influence on the staff's behaviors. Rather, most employees respond to the more *immediate* cues they receive from the agency's systems, their supervisor and their peers, the formal and informal reward systems, the specific work situations they find themselves in, and the work culture, its attitudes and norms.

The available literature provides a 7-S framework, an analytical approach to creating alignment within an organization. This framework describes the details as follows: Structure: The organization chart, job descriptions, who reports to whom, and how the units relate to each other; Strategy: The plan for allocating resources to achieve its goals; Systems: The procedures, processes, and routines that characterize how important work gets done; Staff: The kinds of people in the organization, their demographics, experience, and education; Shared Values: What the organization stands for, its overarching purpose; Symbolic Behavior: Managerial actions and styles and the organization's culture (originally termed style); and Skills: The distinctive capabilities of the organization and its key staff.

BPR in CBR

As indicated, BPR in CBR is one of the critical areas of the reform program. BPR is aligned with the strategic objectives of the reform and is designed to include:

1. Making information technology a major enabler by relegating all computational and routine work to application software.
2. Minimizing contact between taxpayers and tax collectors.
3. Taking advantage of strategic developments in stakeholders - businesses/ organizations.
4. Redesigning processes to make them measurable and amenable to application of analytical tools and techniques.

In what follows, a brief outline of BPR initiatives in the various taxes administered by CBR is given.

BPR in Income Taxes: Income tax administration is undergoing a strategic organizational shift from a cylindrical to a functional one. Furthermore, its processes that were traditionally geared towards a dispersed and large number of small offices (731 in total) are being overhauled. The CBR aims to fully support a functional organization where the whole gamut of functions such as registration, taxpayer education and facilitation, audit, enforcement, HRM, IT, internal audit and data processing will be supported. The core processes identified in terms of major impact are tax collection, audit selection and demand enforcement. Extensive use of information technology is the major driving force in the design of these processors.

BPR in Sales Tax: Sales Tax is already administered on a functional basis. BPR is intended to fine-tune the existing processes to eliminate wastages, provide timely and accurate information within and outside the organization and deliver quality service to taxpayers. In this regard, the redesigned refund process titled Sales Tax Automated Refund Repository (STARR) is a major milestone. It is an integrated on-line system. A typical and completely documented refund case is processed within a few days, which previously used to take weeks. Further refinements in the form of risk-based management module are in the offing. Moreover, work is in progress to re-organize the registration process to capture relevant taxpayer data, re-design the audit function to significantly enhance audit capability and control.

BPR in Customs: Customs processes are characterized by complex and cumbersome procedures and extensive interaction between taxpayers and tax collectors. This is causing heavy losses to the importers and manufacturers due to delays in cargo clearances. A customs re-engineering team has conceived and developed the Customs Automated Reform Project (CARE), which is being further refined in the light of in-house discussions. This document addresses some of the key processes including cargo clearance using profiling, selectivity and risk management, transshipment and auction management. The re-configured cargo clearance procedures aim to reduce clearance time from the present 8+ days to 24 hours. Similarly automated transshipment procedure would expedite approval at the port of arrival. Care has been taken to re-engineer the procedures to conform to international best practices recommended by the World Customs Organization (WCO) and other international trade conventions/ treaties.

Authorship:

Article 1: CBR Tax Collection: An Analysis of the 3rd Quarter Data

Research Team comprising the staff of:
Fiscal Research and Statistics Wing
Budget Wings: Direct and Indirect Taxes
Directorate of Research and Statistics

Article II: How Effective is the Federal Tax System in Pakistan?
A Baseline Analysis.

Dr. Ather Maqsood Ahmed, Robina Ather Ahmed,
Naeem Ahmed, and Mir Ahmed Khan.

Article III: CBR Tax Reform: Business Process Re-engineering
In the Public Sector

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