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A Review of Resource Mobilization Efforts of Central Board of Revenue

CENTRAL BOARD OF REVENUE

Government of Pakistan

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Foreword

The regular publication of the CBR Quarterly Review has provided an excellent opportunity for the policy makers at the CBR and the Government of Pakistan to focus on key issues related to industrial, commercial and other key sectors to accelerate economic activity in the country. The 10th issue of the Review is being released with the hope that it provides the necessary information and an update on fiscal matters.

Besides providing in-depth analyses of the four federal taxes, the current issue highlights the impact of various policy initiatives announced at the time of the Federal Budget 2004-05. It may be recalled that the aim of these measures was to reinforce earlier efforts of the Government to promote industrialization, generate exportable surpluses, and create employment opportunities. Among other things, these fiscal measures included further reduction and rationalization of tariff structure, bringing uniformity in the GST rate, and withdrawal of CED on additional commodities. It is heartening that these measures have generated the desired results and the adverse revenue impact has also been 'endurable' so far.

The industry profile section includes an elaborate article on the sugar industry in Pakistan. This paper underscores the need for a comprehensive approach to tackle the concerns of various stakeholders including the farmers, the producers, and the Government. Finally, the Review also provides an update on the Central Registration of Sales Tax under the CBR reform program.

I appreciate the valuable effort put in by the Fiscal Research Wing of the CBR in bringing out the publication and hope that the contents of the Review will be useful for the readers. We look forward to receiving your valuable comments and suggestions for improving this research effort.

M. Abdullah Yusuf
Chairman, CBR

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CBR Tax Collection:
An Analysis of Revenue of Q1: 04-05[1]

The Economy

Has Pakistan's economy gained sufficient strength to withstand internal and external shocks? The continuous improvement in economic fundamentals, especially the growth in the manufacturing and the external trade sectors on one hand and sustainability of deficit and debt positions on the other, are sure signs of departure from a prolonged period of instability and weakness. The two recent developments, i.e., the surge in inflation mainly due to supply side constraints and the sudden downward slide of rupee due to demand pressure have been effectively tackled through imaginative monetary and exchange rate policies. Simultaneously, some headway in the form of additional allocation of funds has also been made to address the lingering unemployment and poverty concerns. However, given the nature and magnitude of the problem, short cut approaches will not be viable strategies, instead a well thought out long-term HRM strategy is desired that is consistent with the industrial vision and the overall objectives of economic growth and equitable distribution in the country.

CBR Revenue Target for FY 04-05

Anticipating continuity in growth momentum in various sectors of the economy, the budgetary target for FY 04-05 has been set at Rs. 580 billion, showing an increase of 13.7% on the start of the year target of Rs. 510 for FY 03-04 and 11.8% over the provisional collection of Rs. 518.8 billion (Table 1). The projections for FY 04-05 are based on the baseline collection of FY 03-04, assumed high

[1] The Research Team of the Fiscal Research Wing of CBR has prepared this Chapter. Valuable support by the staff of the Budget Wings of Direct & Indirect Taxes and the Directorate of Research & Statistics is gratefully acknowledged.

growth for various components of GDP, the elasticity/ buoyancy estimates, and the expected impact of wide-ranging budgetary measures. Specifically, the nominal GDP is expected to grow by 13.5% during FY 04-05, the large scale manufacturing to maintain its buoyant posture and grow by 20%, and dutiable imports to grow by 19.5%. The buoyancy of three major revenue spinners, i.e., direct taxes, sales tax, and customs duties is expected to remain close to unity. However, the only dragging factor, and that too in the short-run, will be the effect of the wide-ranging relief measures announced at the time of Federal Budget 2004-05 to encourage investment and sustain economic activity in the country.[2] Thus, provided the outturn of individual taxes and growth trajectories are materialized, it is anticipated that the share of direct taxes in total CBR collection will be around 31.3% and the rest will be generated through indirect taxes.

Table 1: Provisional Baseline Collection for FY 03-04 and Projections for FY 04-05

(Collection in Rs. Billion)

	Provisional Collection FY 03-04	Projections FY 04-05	Growth (percent)
Direct Taxes	165.3	181.7	9.9
Sales Tax	219.1	249.1	13.7
Customs Duties	89.9	102.3	13.8
Central Excise	44.5	46.9	5.4
All Taxes	518.8	580.0	11.8

Monitoring CBR Revenue Collection

In an effort to regularly monitor CBR revenue collection, the monthly and the quarterly targets of the four federal taxes have been projected on the basis of historical trends in collection, i.e., average collection during FY 97-98 and FY 03-04 and the existing state of the economy. Further adjustments have been made to these guiding posts in the light of the most recent outturn and the policy initiatives

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[2] A brief on budgetary measures and *ex post* impact analysis of these measures is included as one of the articles in the current issue of the *CBR Quarterly Review*.

undertaken during the year *(Table 2)*. For example, with the zero-rating of ginned cotton, the sales tax (domestic) collection is expected to be lower than the previous year receipts during October-February months. However, since the refund claims are expected to reduce on account of this initiative, the overall impact of this measure on the sales tax collection may turn out to be neutral. However, this neutrality may not be observed until the end of the 4th quarter. Thus, the monthly and the quarterly targets have been fine-tuned in the light of this and other such measures related to the four federal taxes.

Table 2: Monthly Targets of Federal Taxes: FY 04-05

(Rs. Billion)

	DT	ST	CD	CED	ALL
July	6.3	14.8	6.5	2.8	30.4
August	8.6	16.8	7.6	3.5	36.5
September	13.6	18.4	7.6	3.5	43.1
Q1	**28.5**	**50.0**	**21.7**	**9.8**	**110.0**
October	9.3	20.0	7.8	3.6	40.7
November	10.4	20.1	8.6	3.8	42.9
December	20.8	22.3	9.2	4.2	56.5
Q2	**40.5**	**62.4**	**25.6**	**11.6**	**140.1**
January	10.8	20.4	8.3	3.7	43.2
February	14.3	20.5	8.8	3.9	47.5
March	20.6	20.7	9.6	4.2	55.1
Q3	**45.7**	**61.6**	**26.7**	**11.8**	**145.8**
April	15.0	20.5	8.6	4.3	48.4
May	20.5	24.1	8.9	4.7	58.2
June	31.5	30.5	10.8	4.7	77.5
Q4	**67.0**	**75.1**	**28.3**	**13.7**	**184.1**
Full Year	**181.7**	**249.1**	**102.3**	**46.9**	**580.0**

Accordingly, the revenue target for the July-September 2004 has been fixed at Rs. 110 billion, which constitutes about 19% of the yearly target. Perceived as future taxes, more emphasis has been placed on sales tax, and income and corporate taxes. Resultantly, nearly 71% of the total collection during July-September 2004 was expected from these sources. Of this, nearly 45.5% was anticipated to come from sales tax and 26% from direct taxes. The collection during the next three quarters has been projected to be about 24%, 25%, and 32% of yearly target, respectively. This pattern is slightly different than previous years in view of the above-mentioned various tax-policy changes effective from CFY.

CBR Revenue Position

The CBR has outperformed in revenue collection during the 1st quarter of CFY. The revenue organization has collected Rs. 125.7 billion during July-September 2004 against the target of Rs. 110 billion, showing a remarkable growth of 33.6% over the corresponding period of PFY. The revenue target for the 1st quarter of FY 04-05 has been surpassed by an outstanding margin of 14.3%, essentially due to higher than anticipated direct tax collection, continued double-digit growth in customs duty receipts, and significant increase in CED receipts *(Table 3)*. Furthermore, the growth in revenue is broad-based, as the collection of all four federal taxes has exceeded their respective targets. This indicates that the momentum in revenue collection has been preserved, it has been further reinforced through wide-ranging incentives and taxpayer-friendly measures. At the same time, the broad-based growth of the economy and the implementation of tax policy and administrative reforms continue to provide the required impetus to CBR collection efforts.

Table 3: Comparison of Collection vis-à-vis Targets: Q1: 04-05

	Collection	Target	Difference	
	Q1: 04-05	Q1: 04-05	Absolute	Percent
Direct Taxes	41.7	28.5	13.2	46.4
Sales Tax	50.4	50.0	0.4	0.7
CED	11.2	9.8	1.4	14.6
Customs	22.4	21.7	0.7	3.2
All Taxes	**125.7**	**110.0**	**15.7**	**14.3**

Note: Collection and Target in Rs. Billion.

Overall Collection and Refunds

Table 4 shows that, in absolute terms, the gross and net collection for Q1:04-05 has been Rs. 148.305 billion and Rs. 125.709 billion, respectively with the refund payments of Rs. 22.596 billion. Both, gross and net collection registered substantial increase of 31.3% and 33.6%, respectively over Q1 of PFY. More importantly, the refund payments have also increased by 19.5% during this period. The monthly performance indicates a consistent growth pattern. For instance, the growth in net receipts during July-04 over July-03 was 31.3%, it was 13.5% in August, and 50% in September over the corresponding months of PFY. The growth in gross revenue during these three months was 23.8%, 14.7% and 49.4%, respectively.

Table 4: Comparative Position of Net Revenue Receipts: Q1: 04-05 - Q1: 03-04

*(Collection in **Rs. Million**)*

	Collection		Difference	
	Q1: 04-05	Q1: 03-04	Absolute	Growth (%)
Direct Taxes	41,734	25,578	16,156	63.1
Sales Tax	50,350	41,597	8,753	21.0
Imports	*33,173*	*27,260*	*5,913*	*21.7*
Domestic	*17,177*	*14,337*	*2,840*	*19.8*
CED	11,230	8,999	2,231	24.8
Customs	22,395	17,888	4,507	25.2
All Taxes	**125,709**	**94,062**	**31,647**	**33.6**

Detailed Analysis of Individual Taxes

The in-depth analysis of individual taxes provides further insight on specific sources of growth. It also helps in understanding the linkages between tax receipts from various components and the sectoral composition of the economy. A number of fiscal policy initiatives have been undertaken during the current and past fiscal years in the realm of broadening of tax bases, reduction and rationalization of tax and tariff rates, automation, and improvement in tax administration. It is, therefore, relevant to know the impact of these policy changes on tax collection and the overall equity and efficiency gains in the taxation system.

***Direct Taxes*:** Direct Tax gross and net collection during the 1st quarter of CFY was Rs. 45.007 billion and Rs. 41.734 billion, respectively with refund payments of Rs. 3.273 billion. This outcome compares with gross and net collection of Rs. 27.38 billion and Rs. 25.578 billion, respectively and payments of refunds amounting Rs. 3.273 billion during Q1: 03-04. As indicated, this unprecedented growth in collection has been possible for two reasons:

(a) Increase in voluntary compliance by taxpayers in response to the USAS, now operational for the second year running; and

(b) The change in the advance tax payment regime whereby these taxes previously paid mainly in October were now due in September.

Thus, part of the advance tax payments of previously received up to October and possibly in November of 2003 have now been received in September 2004. Since a meaningful comparison required adjustment for such payments, the necessary correction revealed that a substantial growth of 19.3% in net direct tax receipts has been possible due to autonomous growth and adoption of USAS.[3]

An Analysis of Income Tax Returns: The preliminary analysis of income and corporate tax returns filed during CFY highlights the following important developments.

- There has been an impressive growth in the number of returns and statements as well as voluntary tax compliance as compared to last year (Table 5);

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[3] It may be relevant to mention that Rs. 1.8 billion were received as advanced tax payments until September 2003, Rs. 6.6 billion in October and Rs. 4.6 billion in November 2003. Assuming *status quo* in growth in these receipts during CFY, an amount of Rs. 11.2 billion is subtracted from net receipts until September 2004. Thus, the 'adjusted' net collection of Rs. 30.2 billion when compared with Q1: 03-04 collection of Rs. 25.6 billion confirms the growth reported in the text.

Table 5: An Analysis of Returns and Tax Collection during 2004 and 2003

	Up to October 15th 2004		Up to October 15th 2003		Difference (Absolute)		Growth (%)	
	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid
Returns								
Corporate Cases	1353	5299.7	1153	925.5	200	4374.2	17.3	472.6
AOPs	24612	95.9	21364	78.4	3248	17.4	15.2	22.2
Salaried Individuals	129069	186.2	110042	204.3	19027	-18.1	17.3	-8.8
Non-Salaried Individuals	496334	1076.9	442519	933.0	53815	143.9	12.2	15.4
Sub Total Individuals	625403	1263.1	552561	1137.3	72842	125.9	13.2	11.1
Sub Total Returns	***651368***	***6658.7***	***575078***	***2141.2***	***76290***	***4517.5***	***13.3***	***211.0***
Statements								
Salary	372713	131.8	296320	98.0	76393	33.8	25.8	34.5
Importers	8375	3.4	3925	5.8	4450	-2.4	113.4	-41.0
Exporters	9078	1.9	6001	3.5	3077	-1.6	51.3	-45.3
Contractors/ Suppliers	36249	50.4	33839	51.2	2410	-0.7	7.1	-1.4
Other	25017	93.3	9373	34.1	15644	59.2	166.9	173.8
Sub Total Statements	451432	280.9	349458	192.6	101974	88.4	29.2	45.9
Total	**1102800**	**6939.6**	**924536**	**2333.7**	**178264**	**4605.9**	**19.3**	**197.4**

Note: Tax paid in Million Rupees.

- As of October 15, 2004 a total of 1,102,800 returns and statements have been received from Companies, Association of Persons (AOPs), Salaried and Non-salaried individuals; and Importers, Exporters, and Contractors etc. At the aggregate level, the number of returns/ statements shows a growth of 19.3% over the preceding year;

- The voluntary tax compliance has recorded a sizeable growth of 197.4% over PFY that partly reflects the success of the introduction of universal self-assessment in income and corporate tax structure;

- Even though the number of returns filed by all categories of taxpayers has registered a double-digit growth, the amount of tax paid by the salaried individuals has declined by a small amount of Rs. 18 million;

- The largest increase in amount has been from the corporate sector that partly includes the effect of the change in the advance tax payment regime, as explained above; and

- The regional comparison reveals that the improvement has been broad based. For instance, the growth in the number of returns and statements in the Northern Region was 14.8%; Eastern Region 32.4%; Central Region 18.9%; Southern Region 17.8%; Corporate Region 5.7% and LTU Karachi 16.3%. The growth in tax payment with returns has been substantial in LTU Karachi (903.8%), followed by the Northern Region (211.4%), Corporate Region (42.9%), and Southern Region (24.4%). However, even though the Eastern and Central Regions have reported a decline in tax receipts by 4% and 16%, respectively, the decline in terms of amount is only Rs. 56.6 million, which is less than one percent of the amount received.

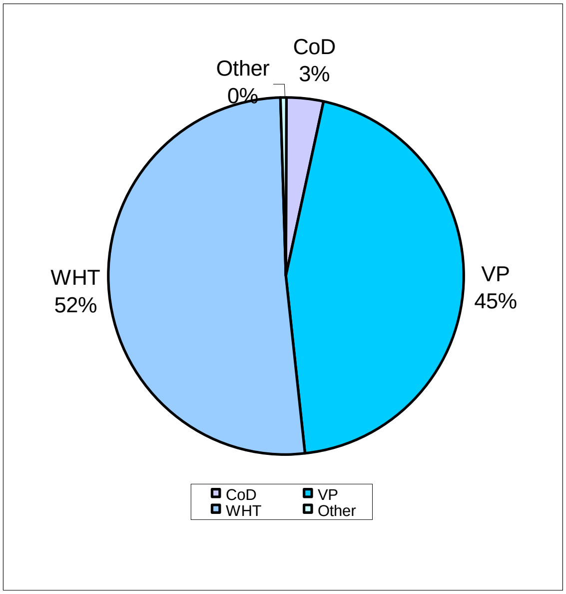
A further analysis confirms that during FY 04-05 nearly 96% of income and corporate tax has been paid with returns and the rest is submitted with the statements. This outcome is slightly better than last year when 92% of voluntary compliance was with returns. However, in sharp contrast to last year, the share of the corporate sector in the amount of tax paid has gone up to 79.6% during CFY compared to 43.2% during PFY even though their share in the number of returns filed has remained stagnant *(Table 6)*. Specifically stating, the amount of tax paid by the corporate sector has increased from Rs. 925.5 million during FY 03-04 to Rs. 5299.7 million during FY 04-05. As indicated, this sharp rise has been due to (a) natural growth in the system; and (b) a sizeable proportion of this amount constitutes advance tax payments that have been fully reported during CFY. No significant change has been observed in the statements panel except for the 'other' category, which indicates the emerging share.

Table 6: A Further Analysis of Returns and Voluntary Compliance

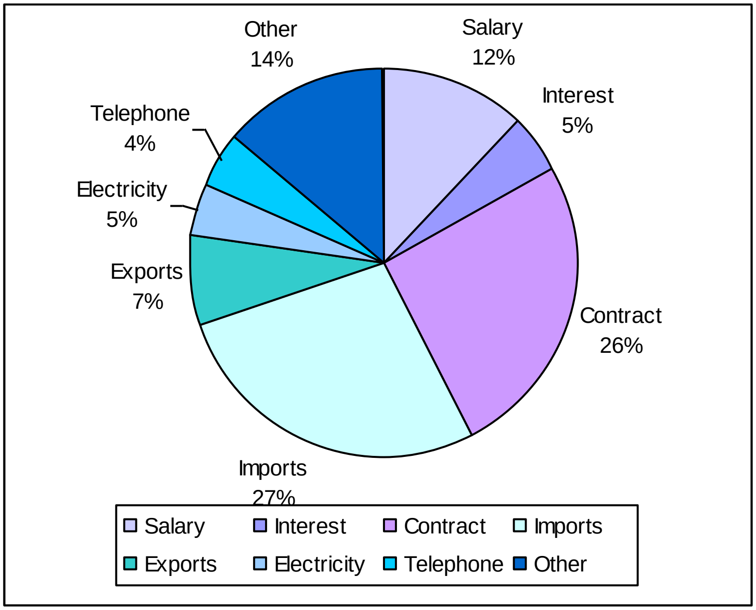
	Up to October 15, 04		Up to October 15, 03	
	No. of Returns Received (Share %)	Tax Paid (Share %)	No. of Returns Received (Share %)	Tax Paid (Share %)
Returns				
Corporate Cases	0.2	79.6	0.2	43.2
AOPs	3.8	1.4	3.7	3.7
Salaried Individuals	19.8	2.8	19.1	9.5
Non-Salaried Individuals	76.2	16.2	76.9	43.6
Sub Total Individuals	96.0	19.0	96.1	53.1
Sub Total Returns	100.0	100.0	100.0	100.0
Statements				
Salary	82.6	46.9	84.8	50.9
Importers	1.9	1.2	1.1	3.0
Exporters	2.0	0.7	1.7	1.8
Contractors/ Suppliers	8.0	18.0	9.7	26.6
Other	5.5	33.2	2.7	17.7
Sub Total Statements	100.0	100.0	100.0	100.0

Components of Income and Corporate Taxes:

Compared to 1st quarter of last year, a considerable growth has been recorded in the three major components of income and corporate taxes (Graph 1). As indicated above, the significant increase in voluntary compliance has been partly due to the adoption and acceptance of the USAS, the rest has been due to the change in the advance tax regime. While collection on demand has registered 38.6% growth during July-September 2004 compared to the corresponding period of PFY, this growth has been mainly driven by current demand that grew by 47.7%. Finally, the collection on account of withholding taxes has also increased by 20.8% due to 43% growth in WHT on salary, 30.1% on contracts, 14.4% on exports, 8.3% on imports, and 61.5% on telephones (Graph 2). This growth pattern is consistent with the overall economic progress in the country.



Graph 1: Share of Components in Income and Corporate Tax Receipts.



Graph 2: Share of various WHT Components in WHT Collection

Sales Tax*:* Compared to PFY, the gross and net sales tax collection has shown a remarkable growth of 21% during the 1st quarter of CFY. In terms of value, the gross and net collection stood at Rs. 65.5 billion and Rs. 50.4 billion, respectively and refunds paid to the extent of Rs. 15.5 billion. While the import related net sales tax receipts increased from Rs. 27.3 billion during Q1: 03-04 to Rs. 33.2 billion in Q1:03-04, showing an increase of 21.7%, the net domestic collection also jumped from Rs. 14.3 billion to Rs. 17.2 billion, yielding a healthy growth of 19.8% signaling an upsurge and expansion in the domestic economic activity. The domestic demand continues to be strong in view of the overall improvement in the macroeconomic environment.

Domestic Sales Tax Collection: Around 69% of domestic sales tax collection has been realized from ten major revenue spinners during the first quarter of CFY, which suggests that the sales tax base continues to be narrow (Table 7). However, in view of the anticipated expansion in economic activities and the on-going effort to develop an effective sales tax base, it is expected that sales tax registration will improve in the coming months.

A comparison of the current quarter data with the first quarter figures of PFY indicates that, on the whole, the revenue from ten revenue spinners has increased by 33.3%. Barring collection from cement, cigarettes and fertilizer that has declined during the 1st quarter and sugar where the growth is quite low, the rest of the commodities/services/utilities have registered a double-digit growth. The decline of ST (D) in the case of fertilizer has been due to shifting of sales tax levy from ad valorem to deemed price mechanism in the Federal Budget 2004-05. Similarly, even though the 1st quarter decline in collection from cigarettes is due to decline in September, it has also been influenced by budgetary changes whereby distributors in response to withdrawal of further tax have paid less tax. Finally, the collection from cement has declined due to substantial increase in cement export, which is zero-rated. It may also be relevant to add that the net sales tax collection has also been affected by higher than usual input claims by some of the leading cement manufacturers. However, despite the acceleration in economic activity in this sector, the collection of gross sales tax receipts remain rather low and needs further elaboration.[4]

Table 7: Gross Collection of GST (Domestic) from Major Revenue Spinners

	FY: 04-05	FY: 03-04	Growth (%)		FY: 04-05	FY: 03-04	Growth (%)
POL Products				*Sugar (including Baggasse & Molasses)*			
July	1631.1	948.9	71.9	July	520.0	544.3	-4.5
August	2154.0	2000.6	7.7	August	683.4	557.9	22.5
September	1891.5	1891.5	0.0	September	510.9	596.0	-14.3
Q1	5676.6	4841.0	17.3	Q1	1714.4	1698.2	1.0
Services (Including telephone/ fax)				*Cigarettes*			
July	1432.2	602.7	137.6	July	309.7	282.6	9.6
August	1545.6	672.2	129.9	August	346.8	335.7	3.3
September	2082.1	948.3	119.6	September	417.0	460.8	-9.5
Q1	5059.9	2223.2	127.6	Q1	1073.5	1079.1	-0.5
Electrical Energy				*Cement*			
July	52.8	15.2	247.4	July	312.6	329.3	-5.1
August	47.6	35.6	33.6	August	298.3	325.2	-8.3
September	2489.1	1291.1	92.8	September	301.2	326.8	-7.8
Q1	2589.4	1341.9	93.0	Q1	912.1	981.3	-7.0
Iron & Steel				*Cotton Yarn*			
July	198.2	7.5	2542.9	July	316.1	317.2	-0.3
August	233.5	206.3	13.2	August	433.1	381.7	13.5
September	214.1	238.6	-10.3	September	490.6	343.2	42.9
Q1	645.7	452.4	42.7	Q1	1239.8	1042.1	19.0
Natural Gas				*Fertilizers*			
July	835.534	535.5	56.0	July	332.6	295.5	12.5
August	833.537	845.9	-1.5	August	348.7	405.1	-13.9
September	966.433	881.2	9.7	September	248.1	242.2	2.4
Q1	2635.504	2262.6	16.5	Q1	929.4	942.8	-1.4
Major Ten Commodities				*All Commodities*			
July	5940.9	3878.7	53.2	July	9644.1	7330.1	31.6
August	6924.5	5766.2	20.1	August	9724.0	9072.0	7.2
September	9610.9	7219.7	33.1	September	12967.1	10928.0	18.7
Q1	22476.3	16864.6	33.3	Q1	32335.3	27330.2	18.3

[4] The cement production has registered nearly 22% increase in during July-September 2004.

There are a number of commodities and services where significant positive growth has been registered. These include: POL products, telephone and related telecom services, electrical energy, iron and steel products, natural gas, and cotton yarn. Among them, the telecom sector has been the fastest growing sector in recent years. Accordingly, the domestic sales tax collection has witnessed a phenomenal increase of Rs. 2.8 billion mainly due to widespread use of mobile phones and increase in demand due to the reduction in telephone rates. The entrance of new companies in the business and introduction of attractive packages of various facilities for the consumers by the key private sector players has brought a notable expansion in the telephone use. Similarly, the collection from electrical energy has registered a healthy growth of 93% during the current quarter. The increase in collection can be attributed to higher demand for electricity due to improvement in economic activity and the living standard of the general populace. The latter can be gauged from higher domestic demand for electrical gadgets (TV, refrigerators, deep freezers, electric fans, washing machines etc.) that has been fulfilled through significant growth in the production of these products during the first quarter of CFY.[5] Similarly, the expansion in commercial and industrial activities has also contributed towards increase in electricity demand. The information collected from M/O Water and Power has confirmed the increase of load by as much as 1000 megawatts since March 2004, as compared to last year. The increase in natural gas use, especially in summer months, is also a reflection in increase in domestic demand in response to higher demand for manufactured products. Finally the 19% growth in collection from cotton yarn and 42.7% from iron and steel is in conformity with the improved economic activity in the textile and housing sectors.

[5] The 1st quarter growth in the production of electrical appliances has been generally fairly high. For instance, the growth of refrigerators has been 59%, deep freezers 84.2%, TV sets 33.4%, electrical fans 11%, electrical transformers 48.1%, and electric meters 75.8% [Source: FBS 2004].

Risk-Based Audit in Sales Tax: With the introduction of self-assessment in sales tax, the role of audit has assumed greater importance. It serves as an effective tool to curb tax evasion. It is therefore necessary that the system remains transparent so that the stakeholders use the flexibility envisaged in the system judiciously. This also requires that the system run on the risk management principle whereby taxpayers are classified into various risk categories for effective management. Undoubtedly, the high-risk category invites greater attention and scrutiny.

The 1st quarter data of sales tax audit presented in Table 8 reveals that the number of audits conducted and amount detected has increased considerably during the CFY over the corresponding period of PFY. Similarly, as has been the case in the past, the overall recovery of the detected amount shows no sign of improvement. This situation has obviously raised valid concerns about the effectiveness of audits conducted by the auditors on one hand, and the incidence of harassment and lack of transparency that leads to adversarial relationship between taxpayers and the department on the other. As a first corrective measure to understand the whole system, CBR has stopped internal audit for a period of six months.

Table 8: Sales Tax Audits: A Comparison

(Rs. Million)

	FY: 04-05	FY: 03-04	Growth (%)
July-September			
No. of Audits conducted	3313	1921	72.5
Amount Detected	3802	1816	209.4
Amount recovered	134.0	185.0	-27.6
Recovery (%)	3.5	10.0	

Customs Duties: Customs Duties continue to be an important source of federal tax receipts. The enormous sustained increase in the imports during the past few years has improved the CD collection despite rationalization and reduction of tariff rates. Specifically, the effective tariff rate for total imports has come down from 10.5%

during July-September 2003 to 8.9% during the 1st quarter of CFY. Similarly, the same for dutiable imports has declined from 16% to 14.1% during this period. On the other hand, the gross collection from customs duties has yielded an increase of 20.8% by collecting Rs. 26.5 billion during Q1: 04-05 as compared to Rs. 22 billion during the corresponding period of PFY. Similarly, an increase of 25.2% has been recorded in the net collection during the same period. In absolute terms, the net collection during Q1: 04-05 has been Rs. 22.4 billion against Rs. 17.9 billion in Q1: 03-04. Only a modest growth of 1.6% has been observed in the rebate payments due to rationalization of DDB rates.

The month-to-month growth presented in Table 9 reveals that net CD collection has improved significantly during first two months of the 1st quarter. In July and August the net CD collection increased by 32.7% and 41%, respectively. However, the growth slumped to 9.3% in September due to 19.1% increase in the rebates payments.

Table 9: Comparison of Gross and Net collection of Customs Duties and Refund/ Rebate Payments

(Rs. Million)

	FY: 04-05	FY: 03-04	Difference	
			Absolute	Percent
Gross Collection				
July	8,001	6432	1,569	24.4
August	8,958	6858	2,100	30.4
September	9,587	8676	911	10.5
Q1	26,546	21,966	4,580	20.9
Refund/ Rebate				
July	1,456	1,499	-43	-2.9
August	1,382	1,484	-102	-6.9
September	1,301	1,095	209	19.1
Q1	4142	4,078	64	1.6
Net Collection				
July	6,545	4,933	1,612	32.7
August	7,576	5,374	2,202	41.0
September	8,283	7,581	702	9.3
Q1	22,404	17,888	4,516	25.2

The analysis of 15 major revenue spinners categorized within PCT chapters provides further insight to CD collection vis-à-vis its base (Table 10). While these fifteen commodity-groups cover 61.6% of total imports and 81.4% of the total dutiable imports, the share of dutiable imports of the commodities in total imports has been 83.4%. In response to lowering of duty on some categories of vehicles, imports of vehicles (chapter 87), has emerged as the top revenue-generating source of customs duties. A growth of 42.8% in CD collection has been recorded against 40% rise in the dutiable imports. The auto industry remains heavily protected as rate of duty charged on imported vehicles well over the maximum tariff slab of 25%. This has been partly because of its nascent nature and partly to allow its allied vendor industry to grow. However, the tariff peak problem emerging from this rate structure will have to be addressed on priority basis for two reasons. Firstly, high protective rates generate anti-export bias, as factors of production move from low-tariff to high-tariff industries thereby introducing further inefficiencies in the system, and secondly, it constitutes transfer of income from consumers to producers, without raising total national income [Schuler (2004)].

Chapter 15 relating to animal and vegetable fats (essentially edible oil) has been the second largest source of CD collection during the first quarter of CFY. Its growth in the revenue was 5.4% in response to 14% increase in dutiable imports.[6] However, here again the effective tariff rate on the basis of total and dutiable imports has been around 30% during the 1st quarter of CFY, which means that the final consumers are subjected to additional burden of high tariff structure.

In the case of electrical and mechanical machinery (Chapter 84 & 85) the duty structure was revised downward to promote investment

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[6] Since specific duty is charged on edible oil imports, therefore quantity rather than value of import is expected to provide better insight to this situation.

in the country. As anticipated, this measure has given impetus to the inflow of machinery – the imports of machinery and mechanical appliances have gone up by 59.5% and of electrical machinery by 10.7%. The increase in CD collection in these two cases has been 24% and 16.7%, respectively.

Table 10: Chapter-Wise Growth of Major Revenue Spinners and Effective Rates

PCT Ch.	Tariff Description	July-September Growth (%)			Effective Rates (%) With Dutiable Imports	
		Import Value	Dutiable Imports	Customs Duties	Jul-Sep 04-05	Jul-Sep 03-04
87	Vehicles	36.6	40.7	42.8	36.4	35.8
15	Animal or vegetable fats	14.1	14.0	5.4	29.9	32.4
84	Mechanical Machinery	59.5	58.3	24.0	8.1	10.3
27	POL Products	51.5	72.5	67.0	9.9	10.2
72	Iron &Steel	66.2	84.7	51.2	13.1	16.0
39	Plastics & Articles thereof	47.9	56.5	2.2	12.2	18.6
85	Electrical Machinery	10.7	17.2	16.7	13.5	13.5
29	Organic Chemicals	28.8	12.5	4.7	9.1	9.8
48	Paper & Paperboard	20.9	22.3	27.6	18.7	18
38	Misc. Chemical Products	45.0	51.7	24.5	9.1	11.1
9	Coffee, Tea, mate and Spices	49.4	56.6	-11.5	10.7	18.9
32	Dyes, paints etc	22.0	21.8	-4.3	14.4	18.4
40	Rubber products	26.2	19.8	-0.1	11.7	14.0
54	Man made filaments	6.6	7.7	2.7	15.8	16.5
34	Soaps & Detergents etc	43.6	42.5	35.8	18.3	19.2
	Sub-total	38.1	40.5	21.2	14.8	17.2
	Others	41.8	12.8	7.4	11.1	11.7
	Grand total	39.5	34.4	19.0	14.1	16.0

The dutiable import of POL (Chapter 27) has increased by 72.5% and the collection also increased by 67%. This has been despite the fact that the effective rate on POL products has come down slightly. Similarly, as a result of reduction in rates for iron and steel (Chapter 72) and increased economic activity in the housing sector, dutiable imports of these commodities have increased sharply by 84.7% while CD collection has went up by 51%. In a similar fashion, the collection from paper & paperboard and chemicals has recorded significant growth of 27.6% and 24.5%, respectively. Compared to this, some of the commodities that registered negative or slow growth in collection as compared to Q1: 03-04 were: coffee and tea (Chapter 9) due to reduction in duty rate in view of its smuggling-prone nature, and dyes and paints (Chapter 32), plastics and articles (Chapter 39), man-made filaments (Chapter 54) and rubber (Chapter 40) mainly due to rationalization of tariff structure.

It is worth mentioning that a desired pattern is emerging as far as the composition of imports is concerned. Whereas the imports (and dutiable imports) of capital goods and raw materials for capital goods are growing at a faster pace of over 50%, the imports of consumer goods and raw material for consumer goods have witnessed a comparatively slower growth of around 30% during Q1: 04-05.[7] This outcome has been due to government resolve to strengthen the industrial sector on one hand and the continued vibrant performance of the manufacturing sector on the other hand.

Central Excise: The magnificent performance of CED exhibited in the 1st quarter of CFY is in line with a double-digit growth in the manufacturing sector. Not only that the collection has exceeded the allotted target by 14.6% during Q1: 04-05, it has surpassed the collection of PFY by a healthy growth of 24.8%.[8] In absolute terms, a sum of Rs. 11.2 billion has been realized as compared to Rs. 9 billion during first quarter of PFY.

The administrative setup for CED has undergone changes during CFY. Due to the limited number of commodities in the fold of CED, its administration has been brought under the control of the Member sales tax who is now in-charge of both, sales tax and CED.

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[7] Further work is progressing to decompose this overall effect into price and quantity effects to get a better feeling of the situation.

[8] It may be added that in view of the continued policy, CED was withdrawn from paint & varnishes and juices at the time of Budget 2004-05.

Similarly, three tax policy decisions were also introduced at the time of Federal Budget 2004-05 pertaining to withdrawal of CED on paint and varnishes and non-aerated waters, and increase in the price and rates of Cigarettes. Along with these measures, the manufacturers of cigarettes have been given the incentive of adjustment of CED paid on un-manufactured tobacco used in the manufacturing of cigarettes.

The month-to-month comparison indicates that the revenue generation through CED has been growing consistently during the three months of the 1st quarter.[9] The growth in collection has been 56.6%, 20.2% and 11.9% during July, August and September 2004 respectively as compared to the corresponding months of PFY. This growth pattern is consistent with the growth in production of the five major revenue spinners that contribute nearly 90% of CED receipts.

The item-wise collection from CED reflected in Table 11. Each of the major revenue spinners has exhibited more than 15% growth during first quarter of CFY as compared to the corresponding period of last year, which is an encouraging development in view of the anticipated increase in sales tax in subsequent months. This vibrant performance is also vital for the overall achievement of yearly targets at the end of CFY. Individually stating, the cigarette industry has emerged as the top source of the collection of CED constituting more than 1/3rd of overall collection of CED during Q1: 04-05. The collection recorded a significant growth in July and August 2004 partially due to increased production and clearances by 13.2% and 9.7%, respectively. However, due to sudden drop in production during September 2004, the collection grew only by 1.9%. Nonetheless, the overall growth during Q1: 04-05 was 32.8%. It may be added that while the increase in production and clearance of

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[9] Even though CED is charged on local production as well as imports, the share of the latter is fairly small. Therefore, despite a substantial growth of 84.7% in CED on imports and only 22.9% in CED on local production, the overall growth during 1st quarter over Q1 of PFY has been around 25%.

cigarettes during Q1: 04-05 has been substantial; the additional factor behind accelerated growth in CED collection from cigarettes has been the changes in price and duty structure after the announcement of Federal Budget 2004-05.

Table 11: Central Excise Major Revenue Spinners

(Rs Million)

	FY 04-05	FY 03-04	Difference	
			Absolute	Percent
Cigarettes				
July	751.7	157.5	594.2	377.3
August	1511.8	1166.0	345.8	29.7
September	1672.3	1640.8	31.5	1.9
Q 1	3935.8	2964.3	971.5	32.8
Cement				
July	867.0	675.4	191.6	28.4
August	825.8	720.8	105.0	14.6
September	948.9	771.6	177.3	23.0
Q 1	2641.8	2167.8	474.0	21.9
POL Products				
July	331.8	223.6	108.2	48.4
August	358.5	255.4	103.1	40.4
September	367.2	310.3	56.9	18.3
Q 1	1057.5	789.3	268.2	34.0
Natural Gas				
July	441.1	397.5	43.6	11.0
August	454.5	369	85.5	23.2
September	443.6	395.2	48.4	12.2
Q 1	1339.2	1161.7	177.5	15.3
Beverages & Beverage Concentrates				
July	371.68	297.96	73.7	24.7
August	380.42	358.7	21.7	6.1
September	372.15	293.32	78.8	26.9
Q 1	1124.25	949.98	174.3	18.3
Total (Major Commodities)				
July	***2763.4***	***1752.0***	***1011.4***	***57.7***
August	***3530.9***	***2869.9***	***661.0***	***23.0***
September	***3804.1***	***3411.2***	***392.9***	***11.5***
Q 1	***10098.4***	***8033.1***	***2065.4***	***25.7***
Share in Gross CED (%)	***89.9***	***89.3***		

The collection realized from cement was 21.9% higher during Q1: 04-05 as compared to FY: 03-04 due to 22% and 14.7% growth in production and clearance, respectively. More than 14% growth for cement was recorded in each of the month during Q1: 04-05 as compared to previous year. This growth pattern reflects higher domestic and foreign demand due to the recent upsurge in the construction activity in the country and in Afghanistan. The collection of natural gas grew by 15.3% during July-September 2004 while month-wise increase was in the range of 11% to 23.2%. Once again the main factor responsible for this growth has been the increase in industrial use of natural gas.

Finally, the combined collection of beverages and beverage concentrates has reflected 18.3% increase in the collection during Q1: 04-05 against PFY. However, without beverage concentrates the growth has been 15.6%. Quite possibly the withdrawal of CED on non-aerated waters in the budget of PFY has impeded the faster growth in the collection.

Concluding Observations

The CBR has outperformed in revenue collection during the 1st quarter of CFY. The revenue receipts of all the four federal taxes have exceeded the respective projections for the quarter, which is a significant development in view of the fact that wide-ranging tax policy changes (mostly in the nature of relief and business friendly measures) were introduced at the beginning of the year. The strong performance of direct taxes partly reflects the confidence of taxpayers in the universal self-assessment scheme. The voluntary compliance has improved significantly even when the necessary adjustment is made for the change in the advance tax regime. Another important aspect has been the double-digit growth in CED collection that reflects improvement in industrial activity in the country. Similarly, the revenue receipts on account of customs duties due to unprecedented growth in (dutiable) imports have been a significant source toward the achievement of the overall revenue target. Within this perspective, the composition of imports (and dutiable imports) into economic categories, i.e., capital and consumer goods adds further insight to the nature of economic development. It is reassuring that the demand for plant and machinery and raw material for capital goods has been increasing at a faster pace than the growth in the imports of consumer goods.

A comprehensive review of economy provides the necessary reassurance that the medium-to-long term planning that envisioned respectable growth and stability of the economy has started to yield dividends. The CBR performance that serves as one of the key indicators provides further support that the process of change and economic development is on track. It is, therefore, anticipated that provided the manufacturing and services sectors continue to repeat their respective performance of the 1st quarter of CFY, the achievement of the projected high growth of GDP will not be a difficult proposition. Nevertheless, while there are ample reasons to be contented with, the path to the ultimate objective of being among the elite class of high achievers remains arduous. The high incidence poverty and implacable unemployment situation remain the two most critical areas of concern for policy makers and planners, which requires that the facilitation effort to create conducive environment for productive investment will have to be pursued consistently and religiously for some foreseeable future. At the same time the private sector while reaping the benefits of wide-ranging incentives will have to be equally supportive in achieving the high growth objectives of the government. Thus, there should be no exclusivity for any segment of the society when the objectives are common and mutually shared.

II

Streamlining the Taxation System in Pakistan: An *Ex Post* Analysis of Budgetary Measures FY: 04-05[10]

Background

Pakistan had, in the past, pursued policies of protection and resource mobilization through higher tax and tariff rates. However, due to the success of worldwide tax reforms, the direction of the tax policy and administration in Pakistan has also changed from narrow to a liberal approach. Taxes are now being used as effective tool to boost production, create demand, promote investment, and encourage imports of capital and manufactured goods. Curtailment of tariff rates has been the major feature of the taxation reform in Pakistan. Given the dimension of these changes, it is imperative to have an ex post assessment of fiscal policy initiatives. The present paper is undertaken precisely to have an in-depth assessment of policy changes introduced at the time of Federal Budget 2004-05.

A Brief Review of Budgetary Measures

The purpose of the budgetary measures announced at the time of Federal Budget 2004-05 was diverse in nature. Starting with relief measures to taxpayers, the simultaneous objectives were to promote investment in the country and generate economic activity by rationalizing tariff structure on primary, semi-manufactured and finished products, discourage tax evasion and bring equity in the taxation structure. The a priori expectation has been that while some of these measures will have adverse revenue implications in the short-run, the long-term impact of such measures will be positive, as demand-side effect will take over the initial negative impact. On the other hand, measures that aimed at widening of tax base and enhancing the coverage are expected to have favorable revenue

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implications. The analysis in this paper starts with budgetary measures related to direct taxes followed by sales tax and customs. It may be relevant to mention that policy changes related to the latter two taxes are fairly widespread and the expected revenue implications are also significant.

Direct Taxes

a) *Change of Regime for Advance Income Tax Payment:* One of the significant move regarding income and corporate taxes has been the regime change of advance tax payment whereby not only the calculation of advance tax has been changed from the latest tax/turnover ratio to estimates of income, the date of payment of advance tax has also been advanced to 15^{th} of 3^{rd} month of every quarter. However, to discourage under estimation of income, a penalty system has also been introduced that imposes an additional tax @ 12% if estimated advance tax falls short of 80% of actual tax liability. The revised schedule of Payments are highlighted below:

Quarter ending 30^{th} September:	*15^{th} of September*
Quarter ending 30^{th} December:	*15^{th} of September*
Quarter ending 30^{th} March:	*15^{th} of March*
Quarter ending 30^{th} June:	*15^{th} of June*

b) *Increase in Basic Threshold from Rs 80,000 to Rs 100,000:* The limit of basic threshold for salaried individuals has been raised from Rs. 80,000 to Rs. 100,000 for withholding tax paid on or after first day of July 2004.

c) *Withdrawal of Withholding Tax on Import of Plant, Machinery & Equipment:* The withholding tax provision on import of machinery both for industrial or commercial purposes have been withdrawn. This is in line with the government policy of attracting investment and encouraging industrialization.

d) *Relaxing Limitation For Statutory Filing of Wealth Statement:* Section 116 of the Income Tax Ordinance, 2001 has been amended to provide for mandatory filing of wealth along with return of income by all taxpayers whose last declared or assessed income is five hundred thousand rupees or more. The amendment shall be applicable, both to salaried and non-salaried taxpayers, for the tax year 2004 and onwards.

e) *Removing The Condition of Payment of 15% of Disputed Tax Demand for Filing First Appeal:* The condition of payment of 15% of disputed tax demand or 20% of the tax assessed for last tax year etc has been omitted. It would be applicable, in respect of appeals filed before commissioner (Appeals) on or after July1, 2004 irrespective of the year of assessment.

f) *Raising the Limit of Payment Through Crossed Cheque Under Single Account Head Through Cheque from Rs. 5000 To Rs. 10,000:* Clause (I) of section 21 of the Income Tax Ordinance, 2001 has been amended to raise the limit to Rs.10, 000 for the purpose of making payment through a cross cheque under a single account head.

g) *Raising the Limit of Salary Payment Through Cheque from Rs. 5000 To Rs. 10,000:* Clause (m) of section 21 of the Income Tax Ordinance, 2001 has been amended to raise the limit to 10,000 for the purpose of making payment through a crossed cheque or direct transfer of the funds to the employee's bank account. The earlier limit was Rs.5000.

Sales Tax

h) *Abolition of Further Tax of 3%:* In order to reduce the level of fake/ flying invoices and unlawful refund payments, further tax has been abolished. Its abolition will spur growth in industries like textile, steel, chemicals, cement, beverages and wide range of consumer items.

i) *Reduction of Higher Rate of Sales Tax i.e. 20% to 15%:* This measure will certainly remove problems of multiple tax rates on one hand and reduce the upfront cost of the industry on the other hand.

j) *Abolition of Turn Over Scheme and Raising Threshold for exemption for retailers:* Turnover scheme has been abolished, as its contribution in the revenue collection was insignificant. The threshold of exemption for retailers and manufacturers was raised to Rs. 5 million. They are not subjected to requirement of Sales Tax Law. This would provide impetus to the pace of growth in this category of SMEs.

k) *Sales Tax Package for Gawadar Special Economic Zone:* All supplies made and imports into the Gawadar Special Economic Zone excluding vehicles are allowed with zero rating. This will help in attracting investment and increasing export.

l) *Sales Tax Refund Rules, 2004:* The discriminatory powers of tax personnel have been significantly reduced. The new rules envisage direct payment into claimant's bank account from Central Refund Office. It will also help in expediting the refund claim through automation on the basis of risk management. The quantum of documentation has been reduced for manufacturers.

m) *Zero Rating on Supply of Ginned Cotton:* The sale tax collected on ginned cotton was adjusted or refunded at subsequent stages of production by the spinning sector. Zero rating measure would be revenue neutral.

n) *Allowance for availing the Facility of Payment of Outstanding Sales Tax Arrears:* In order to facilitate taxpayers in hardship, the collector of sales tax are allowed to grant facility of payment of outstanding sales tax arrears in installments to avoid closure of units.

Customs

o) *Reduction of Custom Duties on Plant, Machinery and Equipment not Locally Manufactured:* In order to attract investment, the customs duty on the imports of plant, machinery equipment etc has been reduced to 5%.

p) *Reduction of customs duty on smuggling prone items*.

q) *Reduction of Custom Duties on Inputs of Locally Manufactured Agricultural Machinery:* The higher rates of customs duty on the import of agricultural machinery mitigated the interest of progressive farmers in the imports of agricultural machinery. The customs duty has been reduced from 20% to 10% on the import of specified agricultural machinery.

r) *Reduction of Custom Duties on Commercial Import of CBU Cars:* In order to rationalize the duty rates and encourage competition, duty on the imports of new CBU cars has been reduced. The new slabs are 50% up to 1300 cc, 70% up to 1600 cc, 80% up to 1800 cc and 100% for above 1800cc.

s) *Duty Concession on Industrial Raw Materials:* The customs duty on a large number of items has been slashed.

Central Excise

t) *Withdrawal of CED on Paint and Varnishes:* In order to boost the construction industry and phase out central excise duty on all consumable items, the central excise duty on paints and varnishes has been withdrawn.

u) *Withdrawal of CED on Fruit Juices:* No relief was given to the fruit juice industry in the past. This industry has to compete not only with largely popular aerated water, but also with drinks in powder form, both local and foreign exempt from CED. Therefore, CED on fruit juices has been withdrawn.

v) *Adjustment of CED Paid on Un-manufactured Tobacco:* Central excise duty has been made adjustable against the central excise duty payable on cigarettes manufactured there-from as per procedure laid down in Central Excise General Order No. 02/2003.

w) *Rationalization of Duty Structure on Cigarettes:* Price and excise duty structure on cigarettes has been revised upward. However, the rate of central excise duty on imported cigarettes will however, remain the same i.e., 63% of the retail price across the board. The revised price/duty structure on cigarettes is given below:

New structure of CED on Cigarettes

i) If retail price of locally produced cigarettes exceeds Rs. 12 per ten cigarettes	63% of retail price
ii) If retail price of locally produced cigarettes exceeds Rs. 5.32 but does not exceed Rs.12 per ten cigarettes.	Rs2.27 per ten cigarettes plus 69% per incremental rupee or part thereof
If retail price of locally produced cigarettes does not exceed Rs.5.32 per ten cigarettes	Rs2.27 per ten cigarettes

Ex Post Impact Evaluation Analysis

While it is customary to prepare *ex ante* revenue impact estimates of each and every budgetary measure, it has been increasingly realized that these initial estimates require *ex post* validation for accomplishment of the revenue target. With the availability of commodity-wise data for the first quarter of FY: 04-05, it has now been possible to undertake such an impact evaluation. The detailed *ex post* analysis for some of the critical measures is presented in the following.

Direct Taxes

Change in the Advance Tax Payment Regime: As anticipated, the early payment of advance tax in September 2004 has a significant favorable impact on income tax revenue. Notwithstanding the fact that a comparison of month-wise collection of advance tax during Q1: 04-05 and Q1: 03-04 presented in Table 1 highlights a net impact of Rs. 9.8 billion, this outcome needs further elaboration. Even though the advance tax payments during past fiscal year were due in October, only a fraction of the amount was reported in

October. The rest was spread over November and September. For instance, last year data indicate receipt of Rs. 1.6 billion in September, Rs 6.6 billion in October and Rs. 4.6 billion in November. Thus, the total advance tax collection up to November 2003 was Rs. 13 billion. A comparison of this amount with advance tax payments received during CFY and reported completely shows a decline of about Rs.1.5 billion only. Even though less collection of advance tax is expected to result in less refund claims in the future, it seems inappropriate to discuss revenue neutrality or otherwise of this measure at this juncture. Nevertheless, some indication would be possible when the end of 2nd quarter data is realized.

Table: 1 Impact of Change in Advance Payments Regime

(Collection in Rs. Million)

	Q1: 04-05	Q1: 03-04	Difference	Growth (%)
July	360.2	155	205.2	132
Aug	124.3	52.3	72.0	138
September	11205.3*	1633.9	9571.4	586
Quarter 1	11689.8	1841.2	9848.6	535
Net Impact Rs. 9848.6 Million				

Sales Tax

One of the important objectives of policy changes in the realm of sales tax was to re-introduce uniformity of GST rate to avoid administrative difficulties. This required abolishing the further tax @ 3% and the higher rate of sales tax @ 20%. The impact of both these measures is analyzed in the following.

Abolition of Further Tax: With this policy initiative even though no collection should have been realized, but a sum of Rs. 289 million has been reported for the first quarter of FY: 04-05, which may be a carried forward account from the previous year. The month-wise details of collection and a comparison with the collection during the relevant months past fiscal year are given in Table 2, which shows that apparently a loss of Rs 1976 million has been recorded due to the abolishing of further tax. However, a careful analysis that incorporates all forward and backward linkages portrays a completely different picture.

Table 2: Impact of Withdrawal of Further Tax

Month	Q1: 04-05	Q1: 03-04	Difference	Growth (%)
July	244	771	-527	-68
Aug	21	742	-721	-97
September	24	752	-728	-97
Total	289	2,265	-1,976	-87

Collection figures are in Rs. Million

Table 3 confirms that the overall sales have been boosted by 33% for the same commodities that were previously exposed to further tax. Similarly, the total sales tax collection net of further tax has also increased by 15.2% during July-September 2004-05 of the commodities that paid further tax during July-September 2003-04. Even without such correction the increase in collection is only 3.7%, which appears to be nominal. Thus, the analysis reveals that the abolition of further tax has not only improved the declaration of sales proceeds, the sales tax receipts have also increased during the process.

Table 3: Sales and Collection of the Items that paid Further Tax: July- September Comparison

Sales (July-Sep)				Collection Net of FT			
Q1: 04-05	Q1: 03-04	Difference	Growth	Q1: 04-05	Q1: 03-04	Difference	Growth
598,740	451,416	147,324	32.6%	20,636	17,913	2,723	15.2%

Collection figures are in Rs. Million

Abolition of Higher rate of Sales tax at 20%: Due to the slashing down of sales tax rate from 20% to 15% the normal demand effect has taken place and consequently the imports have risen. For some other commodities, the reverse has taken place. However, on the whole, the imports have increased by 35% during July-September 2004 when compared to the corresponding period of PFY. The increase in the value of imports has more than compensated the negative impact of bringing uniformity in the sales tax rate. The adverse revenue impact emanating from edible oils, organic chemicals, and dying and coloring has been compensated by revenue gains from iron and steel, plastic and articles and oil seeds. The overall impact of Rs. 104 million is favorable yet negligible. It is highlighted in Table 4.

Table 4:Impact of Change of Sales Tax Rates 20% to 15% July-September

Chapters	Q1: 04-05	Q1: 03-04	Difference	Growth (%)
Edible Oils some items (15)	153	199	-46	-23.1
Organic Chemicals (29)	1,513	1,612	-99	-6
Plastic & Articles (39)	1,534	1,402	132	9
Iron & Steel (72)	1,209	995	214	22
Oil Seeds (12)	326	269	57	21
Dying & Coloring (32)	342	394	-52	-13
Sub Total	5,077	4,871	206	4.2
Others	1,396	1,498	-102	-7
Total	**6,473**	**6,369**	**104**	**1.6**

Collection figures are in Rs. Million

Zero-rating on Ginned Cotton: No definite statement can be made regarding the impact of this measure on revenue, as it is the beginning of the cotton season. Very little impact in term of revenue has been observed so far. The net impact is a loss of only Rs. 397 million during the first quarter of CFY (Table 5).

Table 5: Zero-rating on Ginned Cotton during July-September of FY 03-04 and FY 04-05

	04-05	03-04	Difference
July	213	212	1
August	26	170	-144
September	16	270	-254
July-September	255	652	-397

Collection figures are in Rs. Million

Zero Rating of Sales tax on imported Plant, Machinery and Equipment: Partly due to this measure, the imports value have gone up substantially from Rs. 20 billion in Q1: 03-04 to Rs. 33.5 billion in Q1: 04-05 entailing an increase of 67%. This massive increase in imports is in line with the government policy to augment the import of capital goods with minimum loss of revenue. Since, machinery, plant and equipment are concentrated in three PCT Chapters, i.e., in chapters 84, 85, 90, the chapter-wise analysis of collection depicts that while there is negligible impact of zero-rating on revenue, it has boosted imports significantly that in turn should lead to improved investment environment and enhanced economic activity in the country. The overall adverse impact on the collection of sales tax on imported plant, machinery and equipment is Rs. 158 million reflected in Table 6.

Table 6: Impact of Plant, Machinery & Equipment
July-September of FY 03-04 and 04-05

Chapters	04-05	03-04	Difference	Growth
84	1244.3	1467.3	-223	-15
85	1355.6	1284.1	71.5	6
90	258.5	265	-6.5	-2
Total	2858.4	3016.4	-158	-5

Collection figures are in Rs. Million

Levying of upfront sales tax on value addition by commercial importers: The commercial importers are now subjected to pay upfront payment of sales tax on specific percentage of value addition. This measure has added Rs. 533 million in the sales tax during July-September 2004-05.

Sales Tax Collection from Steel Melters: The charging of sales tax on Steel Melters on the basis of value addition has increased the collection from Rs 98.3 million in July-September, 2003 to Rs.222.7 million July-September 2004. Thus, an increase of Rs.124.4 million has been recorded.

Sales Tax Collection from GST Retailers: Due to increasing the threshold to Rs.5 million, the collection of GST retailers during

July-September 2004 has not affected the sales tax collection. The impact has been negligible [Rs. 132.4 million during Q1: 04-05 versus Rs. 136.0 million during Q1: 03-04].

Customs Duties

Impact of CD Reduction on Smuggling Prone Items: A small reduction in CD collection has been observed due to reduction in tariff on a number of smuggling prone items. The collection during Q1: 03-04 was Rs. 636.3 million that has gone down to Rs. 522.1 million. Thus, the revenue loss is only Rs. 114 million. On the other hand, the import of these items has recorded a substantial increase of 63% and 70% in total and dutiable imports respectively. It is, however, expected that revenue collection from smuggling-prone items will increase because of further increase in the value of these items in the ensuing months (Table 7).

Table 7: Impact of Duty Reduction on Smuggling Prone Items

HS Code	Description	Customs Duty (Rs. Million)			
		Q1: 04-05	Q1:03-04	Impact	
				Absolute	Percent
08.01	Nuts etc.	17	13.3	3.7	27.8
09.02	Tea	317	421	-104	-24.7
09.04	Pepper etc	125	90	35	38.9
09.07	Cloves	2	44	-42	-95.5
09.08	Nutmeg, mace and cardamoms	0.5	1	-0.5	-50.0
37.02	Photographic films & similar items	0	2.4	-2.4	-100.0
37.05	Photographic plates and film other than cinematographic film	0	0	0	0.0
37.07	Chemical preps. for photographic uses	2.7	4.5	-1.8	-40.0
40.11	New pneumatic typres, of rubber	49.4	43.2	6.2	14.4
50.04	Silk yarn	0.6	1.3	-0.7	-53.8
50.05	Yarn spun from silk waste	3.8	2.9	0.9	31.0
50.06	Silk yarn and yarn spun from silk waste, put up for retail sale	0.8	0	0.8	0.0
63.01	Blankets and traveling rugs	0	0	0	0.0
83.01	Padlocks and locks	0.5	8	-7.5	-93.8
85.11	Electrical ignition Equipment etc.	1.2	1.7	-0.5	-29.4
85.25	Transmission apparatus	1	0	1	0.0
85.29	Parts suitable for headings 85.25 to 85.28.	0.3	2.9	-2.6	-89.7
90.04	Spectacles	0.3	0.1	0.2	200.0
	Total	**522.1**	**636.3**	**-114.2**	-18

Note: The Description of HS Codes is abbreviated to save space
Source: Customs House, Karachi

Impact of CD Reduction on Machinery: Just like smuggling prone items, an insignificant reduction in CD collection has been registered due to the reduction in tariff for plant and machinery. The collection during Q1: 03-04 was Rs. 132.9 million that has gone down to Rs. 120.1 million. Thus, the revenue loss is only Rs. 12.8 million. This rather small amount of revenue loss has been largely compensated by 72% growth in dutiable imports. It may be added that the phenomenal increase in the import of capital goods is indicative of the fact that the objective of rapid industrialization, employment creation, and generating surpluses for exports are likely to be met if the current trend continues in the foreseeable future (Table 8).

Table 8: Impact of Duty Reduction on Plant, Machinery & Equipment

	Q1: 04-05	Q1: 03-04	Growth (%)
Chapter 84			
Value of Imports	3477.6	1673.5	107.8
Value of Dutiable Imports	2319.2	1380.5	68.0
Customs Duty	113.0	125.8	-10.2
Chapter 85			
Value of Imports	183.5	91.8	99.9
Value of Dutiable Imports	168.0	62.0	171.0
Customs Duty	7.1	7.1	0.0
Chapters 84 + 85			
Value of Imports	3661.1	1765.3	107.4
Value of Dutiable Imports	2487.2	1442.5	72.4
Customs Duty	120.1	132.9	-9.6

Impact of Tariff Rationalization: A significant boost in dutiable imports has resulted into a similar level of increase in CD collection during Q1: 04-05. An increase of Rs.2.5 billion was recorded due to growth of 105% in dutiable imports. It implies that reduction of rates has not disturbed the momentum of the growth in collection rather it has resulted in an increase in collection mainly on account of remarkable boost in imports, which in turn is essential for improvement in economic activity and general well-being of the populace.

Central Excise Duty

Withdrawal of CED from Paint & Varnishes and Non-aerated waters: There has been a loss of Rs.56.4 million and Rs.129.3 million on account of withdrawal of CED from non-aerated waters and paint & varnishes respectively. However, the anticipated favorable impact of this incentive on sales tax collection has not been materialized, both in absolute terms and growth during the July-September 2004 period [Table 9].

Table 9: Sales Tax Collection on Paints and Varnishes and Beverages

	Q1: 04-05	Q1: 03-04	Difference (Absolute)	Difference (Percent)
Paints & Varnishes	102	77	25	32.5
Beverages	665	617	48	7.8
Total	767	694	73	10.5

Collection figures are in Rs. Million

Increase in Price and CED on Cigarettes: With an increase in the price and revision of CED duty structure on cigarettes during the CFY, an additional amount of around Rs. 970 million has been generated. However, domestic sales tax receipts from this source have declined during July-September 2004 as less revenue has been realized from the distributors of cigarettes due to the abolition of further tax.

Summing up

The preceding analysis confirms that the overall impact of the measures implemented at the time of Budget 2004-05 has been generally favorable. As anticipated, these fiscal policy reforms have gone a long way in improving economic activity in the country without any substantial loss of revenue to the national exchequer. The policy of rationalization of tax and duty rates has yielded the desired results of accelerating economic activity and restricting tax evasion. While the imports of capital goods and raw material for capital goods have increased enormously in ‘value’ terms, further work is in-progress to decompose this ‘total effect’ into quantity and price effects to get additional insight. The growth in domestic sales tax receipts implies a constant and significant increase in domestic demand, which means that unlike previous years the growth process is driven by domestic market forces. This growth is even more creditable when viewed within the perspective of re-introducing uniformity in the GST rate, whereby further tax @ 3% and higher rate of 20% have been abolished. Similarly, the impact of zero-rating of various other commodities is also not too insignificant either. It is believed that the industrial activity has picked up as a consequence of these incentives. Similarly, the measures pertaining to facilitation of taxpayers have spurred voluntary tax compliance as the confidence of the taxpayers has been restored to a large extent.

While it may be premature to project the outcome for the entire year, the first quarter outcome nevertheless points toward a brighter outcome. The persistence in this outcome implies that the chances of meeting the beginning of the year revenue target are brighter. It is reassuring that the combined effect of various tax policy measures, administrative reforms and better state of economy has been positive and reinforcing.

III

Industry profile:
Sugar Industry in Pakistan[11]

Background

The sugar industry is the second largest industry in Pakistan after textile. It plays a vital role in the development of agriculture as well as industrial sectors because of its agro-based nature. The historical profile of the industry confirms its gradual growth. With only two manufacturing units at the time of independence, there are now 77 manufacturing units operating in Pakistan with an installed capacity of 5.5 million tons. The geographical distribution of these manufacturing units is diverse as 38 are located in Punjab, 32 in Sindh, 6 in the NWFP and one in AJ&K. All these units are operating in the private sector. Sugarcane is the basic raw material for the industry and only 0.6% of sugar is produced from beet. Thus, sugarcane crop has assumed greater importance over the years. Currently, this cash crop is grown over 1074 thousand acres which is nearly 5% of the total cultivated land in the country.

Notwithstanding the fact that the sugar industry is one of the leading sources of economic activity and employment in the country and it also contributes significantly towards government revenue receipts, it is also confronted with multifaceted concerns. The presence of a large quantity of unsold stock of sugar, high cost of production, idle capacity, low rate of sucrose recovery, lagging behind in producing by-products of sugarcane, inordinate delays in payments to farmers growing sugarcane, low per acre yield of sugarcane, shortage of water etc., are few of the well known factors affecting the industry. On top of these concerns, the sugar industry has to compete with the foreign producers who are enjoying benevolent subsidies from their

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governments. The present study aims to address these issues in greater details.

Historical Profile of the Industry

There are various reasons for slow growth of the industry. To start with, the sugar industry was on the list of 'specified industries' that required prior approval of the government before installation or any expansion in the installed capacity. This requirement continued until 1987. Thus, only six units were operating in 1960. This number started to crawl up during the next two decades for various reasons. Initially, in view of the sugar crisis in the late 1960s, the government imposed further controls over price and distribution of sugar in urban areas. These additional restrictions, which were instrumental in raising domestic prices, continued until 1983. However, rising demand and profitability attracted investment and the size of the industry increased to 26 units in 1975, 33 in 1980 and 41 in 1985. With the removal of the industry from specified list in 1987, the number of production units increased at a faster rate and reached 71 in 1995. Currently, there are 77 operational units in the country with 355150 (TCD) crushing capacity.

The Sugar Industry Raw Material

The study on sugar industry will remain incomplete without a detailed discussion on its raw material, i.e., sugarcane. The sugarcane is one of the four major cash crops of Pakistan with 4.2% share in value added in agriculture, which is about 1% of GDP. In terms of area under cultivation and total production of sugarcane, Pakistan's position in the world is 5^{th} and 11^{th} respectively. In historical perspective sugarcane was produced on 189 thousand hectares in 1948 with the production of 5529 thousand tons. By 2003, the area under cultivation increased to 1074 thousand hectares and its production also reached 53419 thousand tons. However, despite this enormous growth, the per hectare yield in Pakistan has remained between 40,270 kg to 49,738 kg during the past fifteen years, which is the lowest among sugarcane growing countries [Pakistan Economic Survey (2003-04)]. Similarly, the recovery of sucrose has been around 8-9%, which is also very low as compared to the international standards (Table 1).

Table 1: Comparative Position of Sugarcane yield, Sugar Recovery and Sugar Yield (t/ha)

Country	Cane yield (t/ha)	Sugar Yield (t/ha)	Sugar Recovery (%)
Australia	100.4	13.85	13.8
Egypt	110.8	12.74	11.5
Brazil	68.4	9.91	14.5
U.S.A	80.2	9.38	11.7
Colombia	80.5	9.26	11.5
Mexico	79.5	9.22	11.6
India	66.9	6.62	9.9
Pakistan	47.3	4.63	8.7

WWF – Pakistan Sustainable Sugar Incentive

Cost of Production of Sugarcane: The cost of producing sugarcane is based upon input prices, rates of field operations and cost of cultivation etc. The cost of production varies from province to province (Table 2). With the inclusion of land rent in the cost of production, it is highest in Punjab whereas with its exclusion it is highest in the Sindh province. The NWFP province enjoys comparative advantage in either of the two cases.

Table 2: Cost of Production of Sugar (per 40 kg)

Province	Including Land Rent		Excluding Land Rent	
	2002-03	2003-04	2002-03	2003-04
Punjab	36.71	39.34	28.56	30.72
Sindh	36.25	38.15	32.01	33.22
NWFP	34.26	35.68	25.19	26.08

Source: Agriculture Prices Commission

Price Structure of Sugar and Sugarcane

In order to protect the interests of sugarcane producers, support prices of sugarcane is announced by the government each year. Similarly, government intervenes through Trading Corporation of Pakistan (TCP) when there is an excess supply of sugar and there is discrepancy between market price of sugar and its cost of production. The government intervention takes place in the shape of purchase of large quantity of sugar from producers to regulate its supply. The historical growth of support price of sugarcane and retail and international price of sugar provided in Table 3 confirms that the variability and volatility in international price of sugar is far less than it is observed in the domestic market. While the worldwide excess supply could be the reason for the international outcome, the rent seeking behavior of producers cannot be ruled out as far the domestic price is concerned.

Table 3: Support Price of Sugarcane and Retail Price of Sugar

Year	Price of Sugarcane (Rs/ 40 Kg)	Growth (%)	Domestic Price of Sugar (Rs/ Kg)	Growth (%)	International Price of Sugar (Rs/Kg)
1996	21.6	4.9	17.9	24.4	15.082
1997	24.3	12.7	21.5	20.2	14.173
1998	35.3	45.2	18.8	-12.6	12.567
1999	35.3	0	19.6	4.7	11.021
2000	35.3	0	22.9	16.4	13.245
2001	35.3	0	26.7	17	14.856
2002	42.3	19.8	22.0	-17.7	12.624
2003	41.3	-2.4	19.8	-9.9	12.626

Note: International Price has been converted from US$/ton to Rs./Kg by using the Exchange Rat and conversion factor.
Source: Experts Advisory Cell

Production Process of Sugar

Several methods are available for the production of sugar from sugarcane. These include: Double Carbonation Double Sulphitation (DCDS), Defection Remelt Phosphitation (DRP), and Defection Remelt Carbonation (DRC) etc. However, since the DCDS method produces higher quantity of 'filter press mud' – up to 8% of cane crushed – the sugar mills are opting for DRP or DRC methods where the quantity of press mud produced is about 3%. The entire process of sugar production generates a number of useful by-products that include baggasse, molasses, press mud etc. The manufacturing units use baggasse as a fuel for running their units.

Three units namely, Sukarganj, Fatima, and Ashraf Sugar Mill generate electricity from baggasse and also sell it to WAPDA on very nominal price of Rs.1.70/ kwh. The molasses can be used for the preparation of livestock feed, Ethanol, Press Mud and Gums etc. The press mud is obtained from filter waste in the sugar mills and contains the rich organic and inorganic matter. Its use in the sugarcane field not only improves the physical and chemical properties of the soil, it also minimizes the use of chemical fertilizer. In some cases wax is also produced out of it. Interestingly, Pakistan is the biggest exporter of molasses in the world. It produced about 2 million tones of molasses in FY 02-03, whereas nearly 1.3 million tones were exported. The process of sugar production highlighting by-products produced is explained through the following diagram.

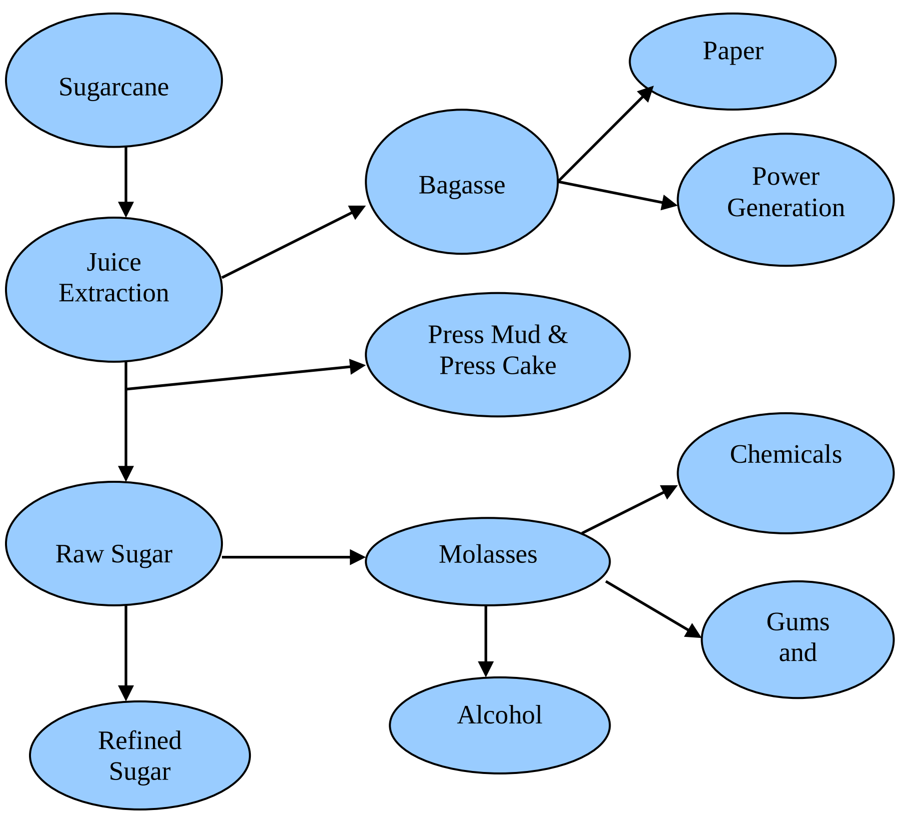

Figure 1: Production Process of sugar and by-products

Consumption and Demand for Sugar

Surprisingly the per capita consumption of sugar has increased sharply in Pakistan. It has gone up from 3.4 kg in 1962 to around 24 kg in 2003, which is very high in the world. This ever-increasing demand had not been met from domestic production until 1999. However, since then the domestic production has exceeded the home consumption requirement. In fact, the over production has resulted into accumulation of stock to the tune of 27,300 tons in 2000 that has further increased to 759,100 tons in 2003. Presently, the total supply is 4322.9 thousand tons, while the domestic demand is 3483.8 thousand tons, which is around 81% of the total available quantity. In other words, 839 thousand tones (or 19.4%) of surplus stock of sugar became available in 2003, of which 80 thousand tons was exported.

Tax Structure and Revenue Receipts

To start with sugar was operating under the central excise regime that is now completely replaced by GST. The production capacity system within the CED mode was introduced for the sugar industry in the 1966 that continued until 1978. However, the CED rate structure was continuously revised downward until CED was completely withdrawn from sugar in 1999 (Table 4). As far as sales tax is concerned, sugar remained exempted from GST until FY 97-98. Since then GST has been levied on sugar @ 15% that continues till to date. It may be relevant to add that the import of sugar has always been subjected to customs duty.

Table 4: The CED Rate Structure on Sugar since 1979

Year	CED Rates
28.6.79	Rs. 1.35 per kg.
25.6.81	Rs. 2.15 per kg.
18.6.91	Rs. 2.10 per kg.
31.3.98	40 paisas per kg.
16.2.99	15 paisas per kg.
21.6.99	CED Withdrawn

Source: Sales Tax and Central Excise Wing, CBR

To have complete picture, the production of sugar and the amount of indirect taxes from this source are presented in Table 5. The erratic behavior in collection should be obvious by a cursory look. While the production declined significantly in FY 99-00, an upward trend has been maintained since then. The fall in production was the direct consequence of 16% reduction in overall cane production that in turn declined due to reduction in area under cultivation and yield [Pakistan Economic Survey (2003-04) and Pakistan Sugar Mills Association (2003)]. Interestingly, despite a 46% fall in sugar production, the collection of sales tax increased by about 42% between FY 98-99 and FY 99-00 but declined by 30% during the next fiscal year. This sharp fluctuation has been caused by frequent changes in the sales tax regime whereby further tax chargeable from un-registered persons was raised from 1% in FY 98-99 to 3% in FY 99-00 an then revised downward to 1.5% in FY 00-01. However, notwithstanding these dramatic changes in the ST rate structure, the collection has been steady otherwise. It increased from Rs. 164.8 million in FY 96-97 to Rs. 8.4 billion in FY 01-02. With nominal decreases during the past two years, the sales tax collection stood over Rs. 8 billion after reaching its peak in FY 01-02.

Table 5: Production of Sugar and Collection of Indirect Taxes

Years	Production (Million Tons)	Sales Tax (Domestic)	Customs Duty	Central Excise Duty	Indirect Taxes on Sugar	Overall Indirect Taxes Collection	Share of Collection from Sugar (%)
98-99	3.5	5,280	68	860	6,208	198,302	3.1
99-00	2.4	7,320	310	-	7,630	234,154	3.3
00-01	2.5	5,105	1517	-	14,252	267,692	2.5
01-02	3.2	8,396	225	-	8,621	261,565	3.3
02-03	3.7	8,328	93	-	8,421	308,729	2.7
03-04	4.0	8,241	80	-	8,321	353,524	2.4

Source: For Production PSMA and for taxes PRAL and Sales Tax Wing of CBR

In contrast to sales tax receipts, the collection of customs duty on the import of sugar has been fairly un-even during the last eight years due to the varying import requirements during these years.

Incidentally, the highest amount of duty of Rs. 1.5 billion was collected in FY 00-01 in view of the declining domestic production and increasing import requirements. The import of sugar was 66.6 thousand tons in FY 99-00 that jumped to 930 thousand tons in FY 00-01. The sugar industry apart from its contribution towards the above-mentioned federal taxes also contributes in the shape of provincial and local taxes. These levies include road cess, market fee, export tax, and cess on sugarcane etc.

Province-wise Production of Sugar and Sales Tax Collection

The province-wise profile of production and sales tax collection of sugar indicates that the Punjab province has the highest contribution in production as well as sales tax, as the number of operating manufacturing units are higher as compared to other provinces. Its share in production has gone up from 54% FY 99-00 to 65% in FY 03-04. However, the highest share of 67% was observed in FY 01-02. A similar pattern has been followed by the sales tax collection. However, its value has ranged between 57% and 65% during the period under consideration [Table 6].

Table 6: Province Wise Production of Sugar and Collection of Sales Tax

	Production (Billion tons)					Collection (Rs. Billion)				
	99-00	00-01	01-02	02-03	03-04	99-00	00-01	01-02	02-03	03-04
Punjab	1.288	1.437	2.152	2.351	2.599	4,55	2.972	5.434	5.257	5.259
Growth (%)		11.6	49.7	9.2	10.6		-28.5	82.8	-3.2	0.0
Share in Total (%)	53.6	57.9	66.7	63.9	64.7	56.8	58.2	64.7	63.1	63.8
Sindh	0.996	0.968	0.941	1.159	1.221	2.765	1.967	2.605	2.684	2.634
Growth (%)		-2.8	-2.8	23.1	5.4		-28.8	32.4	3.1	-1.9
Share in Total (%)	41.5	39.0	29.2	31.5	30.4	37.8	38.5	31.0	32.2	32.0
NWFP	0.117	0.078	0.134	0.167	0.200	0.399	0.166	0.358	0.387	0.348
Growth (%)		-33.2	70.6	24.8	19.8		-58.5	116.1	8.1	-10.1
Share in Total (%)	4.9	3.2	4.1	4.5	5.0	5.5	3.2	4.3	4.6	4.2
Grand Total	2.402	2.484	3.227	3.677	4.021	7.320	5.105	8.396	8.328	8.241
Growth (%)		3.4	29.9	13.9	9.4		-30.3	64.5	-0.8	-1.0

Source: Pakistan Sugar Mills Association and CBR

Notwithstanding this steady pattern as far as shares are concerned, the growth in production as well as sales tax collection has not been smooth. It is particularly true for the sales tax collection that has kept on fluctuating during the period possibly due to frequent changes in the rate of further tax charged from un-registered persons and inventory accumulation, as indicated above.

Incidence of Taxation

It needs to be highlighted that as the name suggests, the incidence of indirect taxes is borne by final consumers. Thus, the amount paid in the shape of sales tax and customs duties cannot be regarded as the contribution of the industry or importers not refuting the fact that it is the product that fetches these revenues. Similarly, the incidence of provincial and local taxes is also on final consumers as the burden of these taxes is also shifted forward. On the other hand, income and corporate taxes paid by the industry is their real contribution towards national exchequer. The amount of income tax paid by the leading producers presented in Table 7 highlights the fact that their contribution is fairly negligible.

Table 7: Payment of Direct Taxes by Leading Sugar Producers

(Rs. Million)

Manufacturing Units	00-01	01-02	02-03	03-04
Hamza Sugar Mills, R.Y.Khan	0.0	0.0	0.0	3.78
Shakarganj Mills, Toba Tek Singh	0.0	0.0	0.0	0.0
J.D.W. Sugar Mills, R.Y. Khan	0.0	0.0	0.0	5.69
Sheikoo Sugar Mills, D.G. Khan.	5.8	0.67	0.44	0.0
Shahtaj Sugar Mills, Gujrat	0.0	0.0	0.0	74.24
Indus Sugar Mills, Rajanpur	0.0	0.0	0.0	0.50
Fatima Sugar Mills, Multan	0.39	0.27	9.96	0.0
H. Waqas Sugar Mill, Sheikhupura	0.0	2.94	3.66	8.51
Ramzan Sugar Mills, Jhang	0.0	5.02	4.58	5.31
Habib Sugar Mills, Nawabshah	0.0	0.0	0.0	14.04
Sub Total of Leading Producers	6.19	8.90	18.64	112.12
Sugar Industry as a Group	43.17	35.62	44.21	357.39

Note: For zero entries there is no information with PRAL
Source: PRAL

Controversies and Concerns

We now move to a rather crucial section of the paper where the concerns of various stakeholders, including sugar producers and farmers are analyzed.

Loss of Competitive Edge due to High Cost of Production

High cost of production on the one hand and general withdrawal of subsidies on the other have eroded the competitive edge of the farmers as well as sugar producers. While the producers are confronted with high energy and other raw material costs, the farmers are also facing high fertilizer and other input costs.[12] A comparison of the situation with competing countries indicates that widespread subsidies are available to sugar producers in the EU region, Australia, and India. In certain cases inputs are also subsidized.[13] This area needs to be further explored within the overall context of the WTO environment. Agricultural subsidies by Western countries require a methodical response from adversely affected developing economies.

The Accumulation of Stocks

According to the published figures, the sugar industry produced 3015 thousand tons of sugar in 2001 that along with the previously accumulated stock of 27.2 thousand tons was cumulatively sufficient to meet the domestic demand. However, the import of 628 thousand tons of sugar during the same year worsened the supply-demand situation. The situation aggravated further in the following years, as the production continuously exceeded the demand. This accumulation of unplanned stocks had various adverse implications. To start with, it has resulted into delayed payments to sugarcane

[12] The average increase in price of fertilizers used for cane cultivation has been 16.6% during FY 03-04 [FBS/ National Fertilizer Development Center].

[13] In India, for example, subsidized or free electricity is available to the farmers and the cost of fertilizer is also subsidized. In addition to that the exporters of sugar also enjoy a subsidy of US$25 per ton. Similarly, subsidies in European Union worth Euro 471 and in Australia worth A$ 182/per ton are being provided. (WWF-Pakistan Sustainable Sugar Initiative-Marketing issues of sugarcane and sugar in Pakistan).

farmers. This phenomenon has badly affected the agriculture activity on continuous basis. As a damage control measure, while the government regularly intervenes through TCP and purchases the accumulated stock, this procedure has its own ramifications. For instance, the imposition of pre-condition that the industry obtains a certificate from the Regional Cane Commissioner indicating that the producers have made due payments to the sugarcane farmers has introduced procedural difficulties for the stakeholders. While the farmers deserve fair treatment so that the entire chain of unpleasant events could be checked, a careful analysis is also required to understand the problems faced by the producers.

The accumulation of stocks also has adverse implications for the resource availability of the Government. Elaborating this point further, it may be recognized that whether the stocks are piled up with the industry or with the TCP, they have no revenue consequence, as the sales tax is chargeable when sales actually take place. This situation takes a further turn when the purchases made by the TCP are not immediately lifted from the godowns of sugar mills. In this case since no physical sale takes place, therefore, no sales tax is accrued! The entire process thus creates difficulties for the concerned collectorates to meet their revenue targets.

Low Yield and Low Sucrose Content

As indicated, the sugarcane production in Pakistan suffers from low per acre yield and lesser sucrose content. However, this situation has been the result of multiple factors. Besides inefficient production and cultivation techniques, the primary reason is the long stalling time. It is worth mentioning that 8 days stalling usually reduces the recovery rate by 12-31% in different varieties than their original potential. In our case it usually takes 8 to 20 days for sugarcane to reach factories. The delay further reduces the weight of the sugarcane crop by 4% to 10%. Needless to add that this colossal loss can easily be averted through proper planning and coordination among different parties, especially the farmers and the producers and the delivery system particularly the infrastructure is improved.

Dormant Role of Agriculture Research and Extension Departments

The recurring water shortage is a persisting issue along with the fluctuations in the weather system. While the integrated water management through drip irrigation technique, sprinkle irrigation and Innovative irrigation methods have been effectively used elsewhere, we have not been successful in implementing these systems in the country. It is now well documented that the drip irrigation technique reduces evaporation losses by 95% as well as reduces water use by an estimated 40-60% compared with the gravity system. This system is being used successfully in the US, Australia, Israel, Mexico, New Zealand, South Africa etc. Similarly, the innovative irrigation is another method that has reduced the use of irrigation water by 75% in India.[14] The concern is why the stakeholders in Pakistan are hesitant in adopting these techniques. Probably, there is lack of information at the grass root level. Credit availability could also be a constraining factor. However, whatever is the reason, the onus clearly falls on agriculture research and extension departments. They have not only to promote modern and efficient techniques in agriculture, there is a pressing need to develop and encourage cultivation of less-water-demanding varieties of cane with better sucrose contents.

Linking Price of Sugarcane with Sucrose Content

At present, the price of sugarcane is not linked with its sucrose content whereas, as indicated, the amount of sugar produced is dependent upon the sucrose content of sugarcane. Can a linkage be established between the price of sugarcane and the sucrose content? Can the Government announce the support price of sugarcane accordingly? These are critical concerns that require basic changes

[14] See, The Water-efficient Sugarcane Farming, UNDP Report, India 2003.

in the whole system. Under the reformed scenario, the farmers will not only have to adopt the latest techniques for improving the quality of their cane production, they will have to adopt those sugarcane varieties yielding better results.

Establishing Forward and Backward Linkages

There is a need to strengthen forward and backward linkages between farmers and the Industry. In order to ensure timely supply of better quality cane from the surrounding fields, mills can play their role and provide their by-products, i.e., press-mud and stillage to the farmers at subsidized rates. The use of press-mud as organic manure not only improves the chemical properties of the fields but also helps in overcoming the nitrogen deficiencies in the initial stages of plant growth. The use of the compost of mud cake and stillage proved highly beneficial for soil conditioning.

Requirement for Vertical Integration

Sugar is the principle produce of sugarcane in Pakistan whereas it is a by-product elsewhere in the world. Steps are required to encourage and induce the industry for vertical integration and converting the vast scope for manufacturing of various by-products like spirit, yeast, acetic acid, citric acid, glucose etc in its favor. In FY 98-99 when huge stock of sugar was available and international prices were attractive, the government took measures for ensuring export of 500 thousand tons of sugar in stock. A lucrative rebate of Rs.1500/ PMT was also offered with imposing mandatory condition of exporting 5% of the total production of each mills or paying Rs.1.85/ kg on the non-exported quantity. This scheme resulted in the export of 0.514 million tons of sugar. It may be relevant to further examine whether similar incentives could induce the sugar mills to expand their output of by-products. Similarly, given the worldwide competitive nature of the industry, sugar mills could reduce their cost of production by engaging themselves in electricity generation activity through the use of baggasse as fuel. After all 'captive power' is not an alien concept for the industry in Pakistan.

Use of Cess

The sugarcane cess is being collected and maintained by the provincial governments. The rates of cess vary from province to province. The cess is deducted by the sugar mills from the growers on their sale proceeds. An equal amount is contributed by the respective sugar mill in this fund. Among other objectives, one of the purposes of the cess fund is to generate resources for research and development (R&D) of sugarcane crop. Unfortunately, a huge amount of cess fund remains un-utilized with the provincial government due to lack of coordination and planning amongst different agencies. An immediate action is required to remove the bottlenecks and devote the whole fund for R&D as roads and other infrastructure has already been covered through various other projects.

Concluding Remarks

A number of pressing issues have been raised in this paper that involve almost all the stakeholders including the Government. However, it is rather unfortunate to observe that coordinated effort to address these concerns has either been missing or there is lukewarm response from the concerned quarters. Instead there appears to be an undue emphasis on the piled-up stocks of sugar.

It cannot be over emphasized that a meaningful solution requires a comprehensive strategy. Starting with R&D issues that involve development on high-yielding crop varieties, their adoption by the farmers, availability of water and water management through water-conserving techniques, the nature of the problem also requires intervention by the financial institutions. Availability of credit for the farmers to resolve cash-flow situation needs to be studied. Similarly, the necessary infrastructure between farms and mills needs up-gradation to reduce stalling time and reduction in weight. Simultaneously, the coordination among various stakeholders is desired to overcome delays in the purchase of sugarcane from the farmers and also the delay in the crushing season. The sugar industry being the main beneficiary of the produce has to provide necessary support to the farmers in the shape of technical guidance to improve their produce. It needs to diversify its production process and divert its focus exclusively from sugar to other by-products. The role of TCP also requires re-examination.

Finally revenue stability for the Government is an important priority area. Whereas the collection of indirect taxes from this source has been stagnant around Rs. 8 billion over the last three years, the preliminary analysis reveals a significant gap between the actual and the potential sales tax receipts. Similarly, the real contribution of the industry in terms of income and corporate taxes has been quite insignificant and appears to be far less than its actual potential. This situation warrants immediate remedial measures, as the Government cannot continue to bestow incentives forever if its own revenue security is not ensured.

IV

CBR Reform Program:
Centralized Sales Tax Registration [15]

Background

The emergence of VAT on the world arena influenced Pakistan to adopt VAT in the form of GST. The main features of GST in Pakistan are self-assessment, audit, and promptness in refund payment through an automated system. Since registration is one of the core areas within the overall sales tax structure, as it helps in identifying taxpayers through their business traits, a rejuvenated effort has been made recently to centralize this process. A Centralized Registration Office (CRO) has been established in the CBR Headquarter Islamabad with Local Registration Offices (LRO) in each of the Sales tax collectorates to promote compliance through facilitation.

Under the Sales Tax Act, 1990, a person is liable for registration in terms of business activity. While retailers with sales above Rs. 5.0 million are subjected to register, the wholesalers and commercial importers are also required to register regardless of their level of sales. Similarly, all commercial exporters, who want to claim the refund of sales tax because of zero-rated export of the goods, are required to register as well.

The Requirement for Registration

The taxpayer is required to make an application for registration within 30 days of his/her liability to be registered. A person, who is not otherwise, liable for registration because of area wise exemption, may still opt for registration in order to claim input tax credit in respect of his/her business purchases and pass on the tax credit to

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the registered person who is the purchaser of the goods. Similarly, if a person who is required to register under the sales tax act, does not apply for registration, is subject to penalty and other necessary action and will be deemed to have been registered from the date s/he becomes liable for registration. Furthermore, s/he will be required to account for her/his taxable supplies from that date.

A registered person is required to:

Keep a record of goods purchased and supplies made by him in the course of his business. Determine his tax liability in respect of supplies made during the course of a month, pay the tax within the time specified and furnish monthly tax return. The tax return relating to the business transacted in a month will be submitted in a prescribed form not later than the 15^{th} of the following month.

Sales Tax Registration: The Old Procedure

A large number of steps were involved in the old procedure for registration (including compulsory registration and de-registration). The excessive involvement of administrative staff (at least five officers and as many support staff) to carry files and the use of vehicles for their movement made the registration process extremely costly. Similarly, the number of documents required at the time of registration was not standardized for different kinds of taxpayers. For instance, the following documents were required at the time of registration:

i) In all cases copies of the NIC, the National Tax Certificate and a rent deed of property document;

ii) In the case of companies, additional documents like list of the Board of Directors, memorandum and articles of association and certificate of registration by the Registrar of Companies;

iii) In the case of importers and exporters the import/ export registration certificate and for partnerships, the partnership deed;

iv) Electricity Bill, NIC of Partners/ Directors, List of Machinery, Bank certificates.

The nature of steps, functional description and output in the process of registration are highlighted in Table 1 below.

Table 1: The Gist of the Procedures

Steps	*Functional Description*	*Output*
Application	○ Verification of Documents. ○ Examination of Particulars.	Assesses Eligibility.
Computer Processing	○ Entry of Particulars. ○ Check over Duplication.	Generation of the Certificate.
Dispatch	○ Certificate Posted or mailed by Courier.	Receipt of Certificate.
Physical Verification	○ Confirmation of veracity of documents. ○ Check on Existence.	Confirmation / Rejection of Particulars and alteration of registration status, if necessary.
Record-Keeping	○ Manual / Physical.	File storage.

The New Procedures of ST Registration

In order to overcome the concerns of the taxpayers, CBR under the Sales Tax Rules 2004 has replaced the old registration system with a new automated centralized registration system effective from July 2004. The primary objective of the Centralized Registration System has been the facilitation of the taxpayers by reducing the number of steps involved in the process of registration and using a uniform (standard) mechanism for speedy disposal of the cases.

As a first step, the registration form (ST-1) has also been simplified. The persons engaged in making taxable supplies in Pakistan (including zero- rated supplies) in the course of furtherance of any taxable activity carried on by them, are required to register under the Sales Tax Act 1990. The threshold for manufacturer and retailers with an annual turnover from taxable supplies has been raised to Rs. 5.0 million.

An intending registrant is required to fill the registration form and without enclosing any document, submits the same to the LRO of the respective Sales Tax collectorate through courier service. The staff at the LRO after initial examination of the application form for accuracy and completeness transmits it to the CRO. The particulars of the taxpayers are verified at CRO with the databanks of Income Tax and NADRA that have been integrated with CRO network for this purpose.

The registration certificate is issued through mail within two days if the information is found correct and the taxpayer is not a manufacturer. In the case of manufacturer with high-risk evaluation, physical verification is carried out by the tax administrators for confirmation of the veracity of information and other particulars provided by the taxpayer.

Performance of the CRO

While the new centralized system is still in its infancy stage, it has made sufficient progress as far as simplicity of the system, data verification, and minimization of fake and fraudulent activities are concerned. The processing of the entire activity is swift and there are few complaints from the taxpayers. The data for the July-September period even though indicates an overall decline nevertheless, it should be clear that the activities have gradually started to improve for the better. The evidence for September confirms this proposition (Table 2).

Table 2: Monthly Comparison of Registration

	FY: 04-05	FY: 03-04	Growth (%)
July	323	969	-66.7
August	884	878	0.7
September	1044	649	60.9
Total	2251	2496	-9.8

International Comparison

The economies of the developed countries are fully documented therefore the registration is simple and automated. In the EU system of VAT, where a person carrying on an economic activity, is required to register with the local taxation authorities. The taxpayer simply applies for registration on-line where the taxpayer profile is linked with country's main network. Thus, the chances of bogus and fake registration are rare. The same procedure is followed in the UK where Customs and Excise department is responsible for administering the system.

Even though in many developing countries, the VAT mode system is based on the UK module, but the procedures are cumbersome and complicated due to non-application of computerized system of registration, audit and refund payments. In Kenya and India, for example, the VAT system is more or less the same, as in the UK, where all business and organizations are to register for VAT in the local VAT office nearest to their offices or operation bases. A business or organization, which has registered for VAT, is classified as registered person. However, the registration procedure is manual based and the local offices/ collectorates are responsible for issuance of the registration certificates after obtaining large number of documents and completing the procedure of physical verification.

In Pakistan the concept of CRO is rather new and therefore the performance is not comparable with the data from the developed world. Nevertheless, the tax reforms measures introduced in diverse areas have started to yield positive results. The same is expected of the CRO.

Conclusion

The most pressing issues facing the sales tax administration at this moment are the limited numbers of sales tax registrants and their poor compliance. A number of factors are contributing to the current situation. The most significant being the old manual, complicated, and time consuming registration procedure. Within the broad CBR reform package simplification of business procedures supported by automated processing techniques has been categorized as the key to success. The new system of centralized registration has been initiated within the same spirit with fairly reduced level of document requirement. However, physical verification of the unit cannot be done away with at this stage. This area has been further complicated by the non-availability of laid down procedure for carrying out physical verification. Needless to add that while this was the most irritating concern in the previous system, one hopes that with the passage of time and successful implementation of the new system this issue will be addressed on priority basis.