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A Review of Resource Mobilization Efforts of
Federal Board of Revenue

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Foreword

CBR has turned into FBR. This is not merely a change of name, rather it is a complete paradigm shift from how various business processes were conducted by the revenue organization prior to the initiation of the on-going reform process and how they are handled now. From an adversarial relationship between taxpayers and collectors, the newly adopted approach focuses on taxpayers' facilitation and education to mobilize resources. The re-organization of field offices into Regional Tax Offices (RTOs) and Large Taxpayer Units (LTUs) is almost complete. As a result all internal taxes are handled under the same roof. For international trade related taxes, the roll-out of Model Customs Collectorates (MCCs) is progressing at advance stages. The hallmark of the new system is that self-assessment is the prime mover of tax compliance. Similarly substantial progress has also been made in the HRM-related area. So far nearly 70% of employees have receipts benefits after completing all the requirements of the IJP process.

It is encouraging that the net collection of federal taxes by the FBR has crossed the 1st quarter (revised) target of Rs. 201.3 billion by about Rs. 4.0 billion. The gross and net collection realized during July-September 2007 has been Rs. 219.6 billion and Rs. 205.1 billion, entailing respective growth of 4.5% and 11.5% over the corresponding period of Past Fiscal Year (PFY). The current issue of FBR Quarter presents a detailed analysis of revenue collection and sectoral performance. The publication also includes a review of relief and revenue related budgetary measures introduced in the Budget 2007-08. An article on structure of international trade of Pakistan and salient features of currently held Perception Survey of stakeholders have also been included in the Quarterly for general dissemination.

We hope that the current issue will be of interest to the readers. We look forward to receiving valuable comments/suggestions of our valued readers.

M. Abdullah Yusuf

Chairman FBR/ Secretary General Revenue Division

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FBR Tax Collection:
An Analysis of Q1: 07-08 Outturn[1]

The Economy

Despite continuing uncertainties and persistence of fiscal and trade imbalances, Pakistan's economy has broadly maintained its growth momentum partly due to uninterrupted commercial and corporate activities and largely due to firmness in consumer and investment demand. Nonetheless, additional risks are looming on the horizon with potential to destabilize the growth process. How quickly such threats are thwarted holds key to future growth prospects of the economy and the success of resource mobilization efforts by FBR.

FBR Revenue Target for FY: 07-08

Keeping in view the continuous upswing of the economy, the revenue target for FY: 07-08 was budgeted at Rs. 1,025 billion that required 21.1% growth over last year's collection of Rs. 846.4 billion (Table 1). Since it was natural to assume that autonomous growth in tax base will not be sufficient to generate the additionality of more than Rs. 178 billion, certain budgetary measures were also introduced essentially to cover those areas that had escaped tax net for various reasons.[2] For example, tax has been extended to all non-fund financial services. Similarly, a single air travel tax has replaced a wide array of previously imposed air travel related taxes. A special excise duty has also been levied on imported and domestically produced goods.[3] The combined impact of these changes would

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[1] The Research Team of the Fiscal Research Wing of FBR has prepared this Chapter. Valuable support has been received from the Budget Wings of Direct & Indirect Taxes and the Directorate of Research & Statistics.

[2] The basis of this assertion is that the anticipated nominal growth in GDP will be no more than 15% and the overall tax buoyancy will stay close to unity.

[3] Complete details of these and other budgetary measures are provided in Chapter II of current issue of the *FBR Quarterly Review*.

largely be on the collection of federal excise duties and sales tax (GST), as most of the new policy interventions relate to these two taxes. However, notwithstanding these changes, the share of direct taxes in total FBR collection is expected to remain in the vicinity of 40% -- the level achieved during FY: 06-07. The remaining amount is projected to be fetched through indirect taxes. Of this, the net collection of GST would be around 37%, followed by customs duties with a share of 13.7%, and the rest will be contributed by FED.

Table 1: Baseline Collection during FY 06-07 and Projections for FY: 07-08

	Provisional Collection FY: 06-07	Projections FY: 07-08 (Rs. Billion)	Growth (Percent)
Direct Taxes	333.4	405	21.5
Sales Tax	309.2	382	23.5
Federal Excise	71.6	98	36.9
Customs Duties	132.2	140	5.9
All Taxes	846.4	1,025	21.1

To further monitor the revenue collection effectively, annual targets have been divided into monthly and quarterly targets on the basis of historical trends of collection and value judgment. Additional adjustments have been made in view of the most recent outturn and the policy initiatives introduced during the year (Table 2).

Within this perspective, despite clear signals that the growth in imports (and of dutiable imports) would maintain its downward slide, the start-of-the-year projections for CD are being maintained for the moment. However, in view of last year's intervention in the advance tax regime of direct taxes and its impact on current year's payments with returns has prompted re-adjustment of monthly targets of direct taxes while maintaining the year-end target unchanged. Similarly, due to delayed receipts of FED revenue on account of air travel, its monthly targets have also been re-adjusted.

Accordingly, the target for July-September 2007 has been set at Rs. 201.3 billion, which constitutes 19.6% of the annual target for FY: 07-08. Within this quarterly target, the share of direct taxes is projected to be 37.6%, GST 40.7%, FED 7.5%, and CD 14.3%.

Table 2: Monthly and First Quarter Targets of Federal Taxes

(Rs. Billion)

	DT	ST	FED	CD	ALL
July	13.5	24.8	1.0	8.2	47.5
August	14.1	25.1	6.5	10.1	55.8
September	48.0	32.0	7.5	10.5	98.0
First Quarter	**75.6**	**81.9**	**15.0**	**28.8**	**201.3**

FBR Revenue Position

The past three months have witnessed extensive changes in the federal tax system. Not only that the tax returns of income tax, sales tax and FED have been revised substantially, but there has been a merger of GST and FED returns into a single return form. The submission date of FED return has been changed from last day of the month to 15th of the following month. The process of e-filing of returns has entered into a phase where large taxpayers have been requested to use FBR portal for electronic filing of income tax and GST/FED returns. Finally, and most importantly process of the re-organization of most of the field offices into Regional Tax Offices (RTOs) has entered into final phase. All these changes often referred to as 'transitional phase of reforms' in the literature, have adverse revenue implications. However, notwithstanding this concern, the net collection of federal taxes by the FBR has crossed the 1st quarter (revised) target of Rs. 201.3 billion by about Rs. 4.0 billion. The gross and net collection realized during July-September 2007 has been Rs. 219.6 billion and Rs. 205.1 billion, entailing respective growth of 4.5% and 11.5% over the corresponding period of PFY. Table 3 presents the tax-wise growth performance. It shows that barring GST, the outcome of other taxes is broadly in conformity with expected outturn. The low growth in CD receipts truly reflects the decline in dutiable imports during the period under review. The FED outcome is consistent with taxpayers' hesitant and cautious approach to new format of return and timing of filing. Moreover, despite the fact that there is an obvious loss of one month for which no FED receipts will be received this year whereas the reporting during PFY was for all three months of the first quarter, the growth of 13.5% in net collection of FED over Q1 of PFY indicates that production activities had not faltered and the economy has maintained its steady course. Similarly, direct taxes have also maintained a stable growth trajectory, albeit not as steady as it was last year. The only exception has been GST where the realized growth in collection appears to be at variance with the projected outturn. Once again reporting and related transitional issues are at the core of this outcome as the manual system of return filing has been replaced in a fundamental way and the taxpayers as well as FBR staff at the field level are still struggling to grapple the issue in its entirety.

Table 3: Comparison of Net Collection: Q1: 07-08 and Q1: 06-07

(Rs. Billion)

	Collection		Difference	
	Q1: 07-08	Q1: 06-07	Absolute	Percent
Direct Taxes	77.5	66.4	11.1	16.7
Sales Tax	82.8	75.6	7.2	9.5
Federal Excise	15.9	14	1.9	13.6
Customs	29.0	27.9	1.1	3.9
All Taxes	**205.2**	**183.9**	**21.3**	**11.6**

Analysis of Refunds/Rebates

With focused attention on liquidating all pending refunds and timely issuance of current claims, the incidence of refund claims has reduced substantially during the current fiscal year (CFY). This is evident from the information provided in Table 4. Approaching the issue in a holistic manner it is clear that there has been 44.7% decline in these payments – a saving of nearly Rs. 12 billion to national exchequer, and the largest reduction has been in the case of direct taxes. The reason is that, as a policy, refund arrears related to the banking sector stuck up for many years have finally been cleared during the past three years. Also because of Universal Self Assessment (USAS) and Pay-As-You-Earn (PAYE) schemes, the reasons for creation of refunds have largely been sorted out. Similarly, to clear the large backlog, the sales tax pendency is also being liquidated promptly but will take more effort to completely clear the deck. Finally, in the case of customs duty, the reduction in rebate claims is due to reduced volume of international trade transactions and introduction of the zero-rate slab.

Table 4: Comparative Position of Refunds/ Rebates Payments: Q1: 07-08 - Q1: 06-07

(Rs. Billion)

	Refunds/ Rebates		Difference	
	Q1: 07-08	Q1: 06-07	Absolute	Growth (%)
Direct Taxes	4.2	10.1	-5.8	-58.4
Sales Tax	7.7	11.3	-3.6	-32.0
Federal Excise	0.0	0.1	-0.1	-85.2
Customs	2.6	4.7	-2.1	-44.7
All Taxes	**14.4**	**26.1**	**-11.7**	**-44.7**

Detailed Analysis of Individual Taxes

A detailed analysis of collection of individual taxes in relation to the economy is important for deeper understanding. This is also relevant because each year new budgetary measures are introduce to boost revenue, promote investment, and facilitate taxpayers for improved voluntary compliance and there is a need to review this position.

Direct Taxes**:** The gross, refund and net collection of direct taxes during the 1st quarter of CFY has been Rs. 81.7 billion, Rs. 4.2 billion and Rs. 77.5 billion, as against Rs. 76.6 billion, Rs. 10.1

billion and Rs. 66.5 billion respectively, in the comparable period of PFY, indicating a growth of 6.5% in gross and 16.7% in net term. As indicated, there has been a negative growth of 58.4% in DT related refund payments, yielding a saving of nearly Rs. 6 billion during the first quarter. The overall growth in direct taxes is almost aligned with the growth in the tax base, which is non-agriculture GDP. The (revised) assigned target of Rs. 75.6 billion fixed for 1st quarter of CFY has been successfully surpassed by a margin of Rs. 1.9 billion (Table 5).

Table 5: Direct Taxes Collection

(Rs. in Million)

Heads	Collection during July-Sept		Growth (%)
	2007	2006	
Gross	81,704	76,581	6.7
Refund	4,172	10,105	-58.7
Net	77,532	66,476	16.6

Components of Income and Corporate Taxes:

Of three major components of direct taxes namely; collection on demand (CoD), voluntary payments (VP) and withholding taxes (WHT), 56.2% of gross income tax is contributed by the WHT, followed by VP having 38.5% share in total; and 5.3% is contributed by CoD. It is important that, in general, the performance of these sources of revenue has been consistent with the overall state of the economy. The WHT has registered a sizable growth of 30.4%, CoD has yielded a gain of Rs. 2 billion – the outturn has almost doubled the amount that was projected under this head. Similarly, other direct taxes (including WWF, CVT etc.) have also registered a substantial growth of 34.1%. More importantly, within the voluntary compliance component, the corporate sector has paid advance tax to the tune of Rs. 25.8 billion against the projected amount of Rs. 25.9 billion, and 21.7% higher than Rs. 21.2 billion received during the corresponding period of last year. Since the advance tax is paid by the taxpayers on the basis of expected profitability, this outcome serves as an indicator that the economy is maintaining its strength and the profitability of the corporate sector remains intact. A detailed analysis of three components is presented below.

Collection on Demand (CoD): The collection on account of demand creation has increased during the 1st quarter of CFY by 76.1%. Of the two components of CoD, the collection under arrear demand has significantly increased by 130.6% over the PFY. This growth is mainly due to tax drive initiatives by the income tax department against tax defaulters and partially due to the disposal of the 'Brought Forward' cases. The second component, i.e., current demand has also yielded a growth of 13.6% over the corresponding period of PFY. It is expected to receive a further boost during the 2nd quarter of the year when initial assessment of the returns will be completed and cases will be ripe for audit/ assessment through random selection criteria.

Voluntary Payments: VP comprises of payments with returns and advance tax payments on the basis of self-assessed expected income within the PAYE regime. On the whole, Rs. 29.8 billion have been generated during the 1st quarter of CFY on account of VP as compared to Rs. 37.2 billion in the corresponding period of last year. Thus, there has been a decline in growth by 19.9%, which is mainly due to decline in payment with returns. On the other hand, the second component i.e., advance taxes has registered a healthy growth of 21.6% over PFY, reflecting sustained profitably of the corporate sector.

Withholding Taxes: This component has been the major contributor of the income tax gross collection. As indicated, the share of WHT in gross has increased to 56.2% in Q1: 07-08 from 44.6% in Q1: 06-07 partly due to reduced receipts on account of VP, particularly the payments with declared returns and also as a result of substantial growth in WHT on contract and supplies. In absolute terms, Rs 43.4 billion have been generated through WHT against Rs. 34.1 billion in the corresponding period of last year showing a robust growth of 21.5% against the nominal growth in the economy of around 16%.

Within WHT, the major share in the collection has been from the traditional sources, namely, contracts/supplies (34.3%), Imports (15.1%), telephone use (10.1%), salary (9.4%), exports (5.6%) and electricity use (3.0%). Among these sources, significant growth of 50.5% in collection has been recorded in contracts. Similarly, 58.3% growth in the telephone category and 56% in dividends has been instrumental in hefty increase in the overall WHT receipts. Some of the additional contributors to WHT growth are salary, cash withdrawal, and electricity where the quarterly increase in collection has been 28.9%, 28.6% and 12.6%, respectively (Table 6).

Table 6: A comparative Position of Withholding Taxes

(Rs. Million)

Tax Heads	Q1: 07-08	Q1: 06-07	Difference	Growth (%)
Contracts/ Supplies	14,874	9,882	4,992	50.5
Imports	6,557	6,844	-287	-4.2
Salary	4,088	3,172	916	28.9
Exports	2,423	2,512	-89	-3.5
Telephone use	4,397	2,778	1,619	58.3
Electricity use	1,312	1,165	147	12.6
Bank Interest/Securities	3,226	3,086	140	4.5
Cash withdrawal	1,256	977	279	28.6
Dividends	1,063	681	382	56.1
Sub-Total	39,196	31,097	8,099	26.0
Other WHT	4,165	3,048	1,117	36.6
Total WHT	**43,361**	**34,145**	9,216	27.0
Share in Gross	56.2	44.6		

Analysis of WHT Receipts: The 50.5% growth in deductions at source on account of contracts and supplies has been observed due to substantial growth in public spending in the country, particularly on infrastructure development and related projects. Similarly, the boom in the telecom industry has helped the income tax department to collect an additional amount of Rs. 1.6 billion from this source over last year. Like wise the vibrant performance exhibited by the financial sector has pushed the profitability of the corporate sector. Resultantly, substantially higher amount of income tax from dividends was possible during the first quarter. The 28.9% growth in the head of salary has to be viewed within the backdrop of reduction in income tax rates for salaried persons and increased tax-free threshold from Rs.100,000/- to Rs.150,000/-. Finally, it will not be out of merit to mention the remarkable growth in collection from technical fee (44.4%), rentals (44.2%), and commission (31.2%) where such an outcome has been possible due to improved macroeconomic environment in the country.

New WHT Initiatives:

Box 1: Presumptive Tax Regime for CNG Stations.

A substantial growth in CNG stations has recently been witnessed in Pakistan. OGRA has reportedly sanctioned more than 5000 CNG stations out of which about 1400 have started business operations. Thus, with mutual agreement with the CNG Dealers' Association and CNG Station Owners, WHT @ 4% of the amount of bill issued for consumption of gas by Gas Marketing Companies has been levied as final discharge of tax liability of the taxpayer. At the end of Q:1 of CFY an amount of Rs.118 million has been collected, which appears to be on the lower side and contrary to the projected estimates. It is expected that the new system will gain strength with time and the collection will improve as a consequence.

> ***Box2: WHT on Purchase of Locally Manufactured Cars.***
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> *In order to extend the tax base by forcing potential taxpayers to file returns of income and bring local purchasers of cars at par with importers, an adjustable withholding tax @ 2.5% has been levied on purchase of new cars during the budget of FY: 07-08. The tax shall be collected by the manufacturers or their authorized dealers as the case may be. At the end of the first quarter of CFY an amount of Rs 61.2 million has been collected from this levy, which again is on the lower side when compared with budget estimates.*

Analysis of Income Tax Returns

There has been a healthy growth in returns/statements filed during Q1: 07-08 (Table 7). The initial scrutiny of income and corporate tax returns highlights the following points.

- As of October 20, 2007 a total of 1,801,859 returns and statements have been received from Companies, Association of Persons (AOPs), Salaried and Non-salaried individuals; Importers, Exporters, and Contractors etc. At the aggregate level, the number of returns/ statements shows a growth of 25% over the preceding year;

- Even though the number of returns filed by the taxpayers has gone up significantly, but tax paid with returns has shown a negative growth of 74.8%. The largest decline has been recorded by the corporate sector. This sector as a whole has paid Rs. 3,289 million as against Rs. 10,394.8 million during the corresponding period of last year, followed by non-salaried individuals where an amount of Rs. 1128.5 million has been received with returns, showing a negative growth of 32%. It is relevant to mention that the procedural change in the advance tax regime last year has been responsible for the shortfall in the voluntary compliance, especially payments with returns.

- The low tax receipts from corporate sector have been encountered in the jurisdiction of RTO/ LTU at Karachi and RTO Islamabad where major corporate hubs are located. While the numbers of returns filed by the taxpayers are in line with the previous year, but there has been a huge difference in payment with returns. Whereas RTO Karachi had received only Rs. 16.16 million from 231 corporate returns filed during CFY as against Rs. 1482.1 million from 211 corporate returns filed during the corresponding period of last year; LTU Karachi has received Rs. 2061.1 million from 86 returns filed during CFY, as against Rs. 6508.8 from 111 corporate returns filed during PFY. As similar situation has prevailed in the Islamabad region.

- A further analysis confirms that 96% of income and corporate tax has been received with returns during FY 07-08 and the rest is submitted with the statements, whereas last year nearly 99% of the collection came with returns. The share of the corporate sector in total collection with return has been 68.7% during CFY as against 84.4%. No significant change has been observed in the statements category except for the 'other' category.

Table 7: Income Tax Returns and Tax Collection during 2007 and 2006

	Q1: 07-08		Q1: 06-07		Growth (%)	
	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid	No. of Returns Received	Tax Paid
Returns						
Corporate Cases	1169	2889.4	371	12,120.6	46.5	-76.2
AOPs	19730	65.3	20,300	99.6	-2.8	-34.4
Salaried Individuals	88,944	69.5	61,274	183.5	45.2	-62.1
Non-Salaried Individuals	528,135	1128.5	521,644	1,714.7	1.2	-34.2
Sub Total Returns	637,978	4152.7	603,218	1,4118.4	5.6	-70.6
Statements						
Salary certificates/statements	1,071,431	12.2	779,073	58..3	37.5	-79.1
Importers	13,910	0.5	13,176	2.6	5.6	-79.9
Exporters	8,090	1.0	8,261	12.5	-2.1	-92.0
Contractors/ Suppliers	26,600	5.9	30,201	10.1	-11.9	-41.6
Other(including Retailers)	43,850	141.6	37,547	131.6	16.8	7.6
Sub Total Statements	1,163,881	161.2	868,258	215.1	34.0	-25.0
Total	**1,801,859**	**4313.9**	**1,472,274**	**14,333.5**	**22.4**	**-69.9**

Note: Tax paid in Million Rupees.

Sales Tax: The sales tax (GST) is a value added tax and an important source of collection of federal tax revenue receipts. The gross and net collection of sales tax stood at Rs. 90.4 billion and Rs. 82.8 billion, during Q1: 07-08, respectively showing a growth of 4.1% and 9.5% over the corresponding period last year. The collection has exceeded the (revised) target of Rs. 81.9 billion fixed for the first quarter of 2007-08. It may be recalled that sales tax is collected at domestic as well as at import stages. In gross terms, the share of sales tax imports was nearly 53% in total sales tax collection. The outcome of both the components is presented in the following Table 8.

Table 8: Collection of Sales Tax during July-Sep: 2007-08

Tax-Head	July-Sep.07 Collection			Growth (%)		
	Gross	Refund	Net	Gross	Refund	Net
Sales Tax Imports	47,588	35	47,553	6.3	75.0	6.3
Sales Tax Domestic	42,816	7,617	35,199	1.7	-32.2	14.1
Sales Tax (Total)	90,404	7,652	82,752	4.1	-32.0	9.5

Sales Tax (Domestic) Collection: The gross and net collection of sales tax (domestic) has been Rs. 42.8 billion and Rs. 35.2 billion respectively during July-September, 2007 entailing the growth of 1.7% and 14.1% respectively. The difference between the two is due to significant reduction in payments of refunds to the tune of Rs. 7.6 billion in Q1: 07-08 as compared to Rs.11.2 billion paid in Q1: 06-07 with major decline emanating on account of electrical energy and zero-rated sectors. A major chunk of gross collection (72.4%) has been realized from ten major revenue spinners (Table 9) which are: telecommunication, POL products, natural gas, sugar, cigarettes, services other than telecom, iron & steel products, beverages, auto parts and cement. The contribution of these major commodity groups has shown a double-digit growth during the three months of first quarter, which is a healthy sign. However, an overall growth of 1.7% in gross collection also highlight that there are other important sectors that have not performed well during Q1: 07-08 as compared to Q1: 06-07. The most important being the electrical energy sector where the gross receipts have declined sharply.

Sectoral Analysis: The collection from telecommunication has maintained its vibrant posture contributing Rs. 10.9 billion with a significant growth of Rs. 31.2% during July-September, 2007. The stable demand and continued increase in airtime usage due to attractive packages offered by the telephone companies during the month of *Ramazan* and *Eid* holidays has been the main driving force behind this improved collection. However, despite this healthy growth, the collection remains short of expectation as last year's average annual growth in collection from this source was 58.1% whereas during Q1: 07-08 it has been 37.1%. Since there is still ample scope for business in this field to flourish, it is expected that the collection will maintain a robust growth in coming months.

POL products hold the second position as major source of sales tax (domestic). An overall growth of 14% in gross collection has been observed during Q1: 07-08. The main reasons for increase in the collection from this source are increased sales and reduced input adjustment claims. Similarly, the collection from natural gas has also exhibited a growth of 17.8%.

Compared to this, an overall decline of 1.3% has been observed in the collection from sugar during the reference period mainly due to sharp reduction in September. The major sources of decline were units registered in Hyderabad and Faisalabad regions. While there is no apparent reason for this decline, those who have paid less argue that reduction in per KG price of sugar for the purpose of sales tax liability in February 2007 from Rs. 29/KG to Rs. 24/KG could be one of the factors. However, greater possibility of short-filing by some of the major units cannot be ignored either that requires further investigation.

Table 9: Gross Collection of GST (Domestic) from Major Revenue Spinners

	Q1: 2007	Q1: 2006	Growth (%)		Q1: 2007	Q1: 2006	Growth (%)
Telecommunications				Services			
July	3,767	2,659	41.7	July	534	372	43.5
August	3,546	2,682	32.2	August	395	367	7.6
September	3,616	2,991	20.9	September	448	443	1.1
Q1	10,929	8,332	31.2	Q1	1,377	1,182	16.5
POL Products				Iron & Steel Products			
July	2,184	2,032	7.5	July	123	302	-59.3
August	2,715	2,491	9.0	August	880	168	423.8
September	2,722	2,164	25.8	September	325	144	125.7
Q1	7,621	6,687	14.0	Q1	1,328	614	116.3
Natural Gas				Aerated Waters/Beverages			
July	613	449	36.5	July	298	315	-5.4
August	1,043	1,074	-2.9	August	384	346	11.0
September	1402	1,074	30.5	September	435	321	35.5
Q1	3,058	2,597	17.8	Q1	1,117	982	13.7
Sugar				Auto Parts			
July	850	789	7.7	July	500	244	104.9
August	804	786	2.3	August	203	190	6.8
September	751	860	-12.7	September	177	213	-16.9
Q1	2,405	2,436	-1.3	Q1	880	647	36.0
Cigarettes				*Cement*			
July	332	322	3.1	July	260	556	-53.2
August	478	433	10.4	August	275	438	-37.2
September	623	551	13.1	September	323	432	-25.2
Q1	1,433	1,306	9.7	Q1	858	1,426	-39.8
Major Ten Commodities				*All Commodities*			
July	9,461	8,040	17.7	July	13,947	13,571	2.8
August	10,723	8,975	19.5	August	14,455	10,395	39.1
September	10,822	9,193	17.7	September	14,414	18,118	-20.4
Q1	31,006	26,208	18.3	Q1	42,816	42,084	1.7

After a modest growth in July, the collection from cigarettes has increased consistently during the next two months and thereby yielding an overall increase of 9.7% during Q1: 07-08. This growth appears to be consistent with 5.2% increase in production coupled with increased prices. A strong growth in collection from services (other than telecom) during July 2007 has helped in maintaining a double-digit growth of 16.5% during the first quarter, confirming robust electronic media activity in the country. The collection from iron & steel had been encouraging during the first quarter of CFY when viewed within the broad parameters of policy intervention. Despite a significant decline in July 2007, the collection started improving during the next two months indicating that the change in policy regime of tax collection through electricity bills has been instrumental in reducing tax evasion. However, due to weak tax compliance historically this sector needs consistent monitoring. The collection from beverages has exhibited a growth of 13.7% which is attributable to higher demand during summer months.

The collection from auto parts although recorded a double-digit growth during the first quarter but it has been due to strong growth in July only. In fact, the decline in August and September 2007 does not auger well for GST collection during coming months.

Finally, the collection from cement has continued its declining trend during all the three months of current 1st quarter. However, the significant decline of 53.2% in July 2007 has gradually come down to 25.2% in September 2007. During Q1: 07-08, it remained short by 39.8% as compared to last year's collection probably due to sharp decline in sale price during the period. In the light of substantial increase in construction activities and continued investment in mega projects related to infrastructure, the domestic demand of cement appears to have increased manifold. But there has been a decline in tax collection which on the face of it, seems an inconsistent outcome requiring further probing. In view of continuous expansion in production capacity, the price factor alone should not reduce profitability of the sector to the extent that GST collection has suffered so badly. Incidentally, the growth in FED from cement in August and September further confirms that 'taxable' sales are on the rise. Thus a detailed unit-wise analysis is warranted.

Box 3: Iron and Steel Sector -The Impact of Change in Sales Tax Rates During July-September, 2007

Iron and steel sector is vital for industrial development. Scrap and some of the steel products serve as raw material for host of industries ranging between nail to vehicle manufacturing industries. Remeltable scrap (HS Code 72.04) was zero-rated for sales tax purposes through SRO 462(1)/2007 dated 27th June, 2007. This measure no doubt spurred the import of scrap by 120%; it also resulted into a loss of Rs. 488 million in sales tax collection. Simultaneously, the rate for selected steel items was raised from 15% to 17.5%.This change has not hampered the import of iron and steel items and in the process the sales tax on import has increased by 40%.. On the other hand, the upward adjustment of rate to 20% for selected steel items has resulted into a decline in the value of imports by 29%. The loss in the collection of sales tax due to lesser imports has also dropped sales tax collection by Rs. 37 million. Thus, the overall revenue impact has been a loss of Rs.154 million.

On domestic front, the collection of iron and steel sector has improved by Rs. 713 million during July-Septembr2007. The reason for this outcome has been better enforcement, adjustment in sales tax rate structure, and better performance by Pakistan Steel. On the whole, the impact of change in policy regime for iron and steel sector has been favorable but it requires careful monitoring for better compliance in future.

Sales Tax Collection at Import Stage

The major portion of gross sales tax is contributed by collection at import stage. Its share has been 52.6% of gross and 57.5% of net collection of sales tax during Q1: 07-08. An amount of Rs. 47.6 billion has been realized from this source entailing an increase of 6.3% as compared to last year. The growth in the collection of sales tax is in line with 8.8% growth in total imports. It is evident from Table 10 that fifteen major commodities groups have contributed

87.4% of the collection of sales tax and 77.3% of the imports during Q1: 07-08.

The sectoral analysis confirms that POL products have been the major revenue source of sales tax during July-September 2007. It has the highest contribution of 41.8% of the total collection of sales tax at import stage. The collection from edible oil has registered a significant growth of 57.7% as its import value has increased by 67% which, in turn, is attributed to increase in international prices. The collection from plastic products has increased by 39% despite only 10.7% growth in its import value. Within this perspective, the reason for better collection could be the increase in its rate of duty to deal with the unorganized sector (Table 10).

Table 10: Chapter-Wise Growth in Imports and Sales Tax Collection

PCT Head	Description	Growth (%) in Import Value	Growth (%) in Sales Taxable Value	Growth (%) in Sales Tax	Share (%) in Total Sales Tax
27+ 99.28	POL Products	5.7	4.7	5.2	41.8
15	Edible Oils & Waxes	67.0	51.9	57.7	7.2
39	Plastic & Articles	10.7	10.7	39.3	6.9
87	Vehicles	-15.2	-16.5	-16.6	6.8
72	Iron & Steel	51.8	49.1	5.7	5.5
84	Mechanical Machinery	-3.0	-2.8	-7.7	3.2
85	Electrical Machinery	14.1	14.7	22.4	3.1
29	Organic Chemicals	6.5	5.9	15.6	2.4
48	Paper & Paperboards	17.7	18.5	28.3	2.3
12	Oilseeds	103.9	103.9	108.8	2.2
38	Miscellaneous Chemicals	-0.4	-0.5	6.4	1.6
40	Rubber & Articles	8.0	8.4	12.3	1.3
9	Coffee, Tea and Spices	-11.8	-11.1	-13.5	1.1
76	Aluminum and Articles	0.8	1.1	14.8	1.1
73	Articles of Iron & steel	-5.7	-4.8	26.2	0.9
	Sub-total	10.2	9.1	10.4	87.4
	Others	4.0	4.2	-15.6	12.6
	Grand total	8.8	8.0	6.3	100.0

The decline in sales tax collection from vehicles is in conformity with the revised regime of automobile sector whereby age of imported vehicles has been reduced to no more than three years from five years. Similarly, notwithstanding the strong growth in value of imports by 51.8%, the collection from iron and steel has increased by 5.7% only. The detailed review reveals that despite the increase in duty rates of major products like flat-rolled products of iron and non-alloy steel, from 15% to 17.5% in FY: 07-08; as well as significant growth in value of imports of various iron & steel products, the zero-rating of imported scrap under the head 7204 has reduced the sales tax from this source. Finally, the collection from mechanical and electrical machinery and oil seeds is well-aligned with the respective import of these commodities.

Federal Excise: The recent budgetary measures introduced in FY: 07-08, included full coverage of Non-fund Financial Services (NFFS), rationalization of FED on International Air Travel (IAT), 1% special excise at domestic and import stage and increase in the retail prices of cigarettes. These new measures have enhanced the scope and coverage of FED, thus making FED yet again a prominent source of federal tax revenues.

The net collection from FED has been Rs.16 billion during the first quarter of FY: 07-08 against Rs. 14 billion in the corresponding period of PFY, entailing a growth of 13.5%. This growth is reasonable for the simple reason that a revised procedure of FED return filing has been introduced from CFY due to which the FED revenue realization has started with a lag of one month. Despite this, the share of FED in total collection during Q1: 07-08 has been around 8% and the revised annual target has been met to the extent of 16%.

The detailed outlook confirms that more than 90% of FED collection is being generated by top six revenue spinners, namely;

cigarettes, cement, natural gas, POL products, beverages & concentrates and services. The month-wise performance of these major revenue spinners is depicted in Table 11.

Table 11: Federal Excise Major Revenue Spinners

(Rs. Million)

	FY 07-08	FY 06-07	Difference	
			Absolute	Percent
Cigarettes				
July	0.0	1043.7	-1043.7	-100.0
August	1977.1	1358.2	618.9	45.6
September	2448.4	1832.9	615.5	33.6
Q 1	4425.5	4234.8	190.7	4.5
Cement				
July	98.3	1092.8	-994.5	-91.0
August	1315.2	1130.5	184.7	16.3
September	1428.1	1216.6	211.5	17.4
Q 1	2841.6	3439.9	-598.3	-17.4
Natural Gas				
July(*)[4]	307.3	455.0	-147.7	-32.5
August	651.3	477.0	174.3	36.5
September	671.1	487.0	184.1	37.8
Q 1	1629.7	1419.0	210.7	14.8
POL Products				
July	1.9	370.5	-368.6	-99.5
August	208.8	333.7	-124.9	-37.4
September	215.0	190.1	24.9	13.1
Q 1	425.7	894.3	-468.6	-52.4
Beverages & Concentrates				
July	13.5	559.8	-546.3	-97.6
August	689.4	595.4	94.0	15.8
September	727.4	605.7	121.7	20.1
Q 1	1430.3	1760.9	-330.6	-18.8
Services				
July	548.3	77.7	470.6	605.5
August	376.3	247.4	128.9	52.1
September	878.9	387.9	491.0	126.6
Q 1	1803.5	713.0	1090.5	152.9
Total (Major Commodities)				
July	***969.3***	***3595.1***	***-2630.2***	***-73.1***
August	***5218.1***	***4142.2***	***1075.9***	***26.0***
September	***6368.9***	***4720.2***	***1648.7***	***34.9***
Q 1	***12556.3***	***12461.9***	***94.4***	***0.8***

[4] The due date of furnishing of return for gas producing companies is 25th of the month (SRO. 749 (I) 2006).

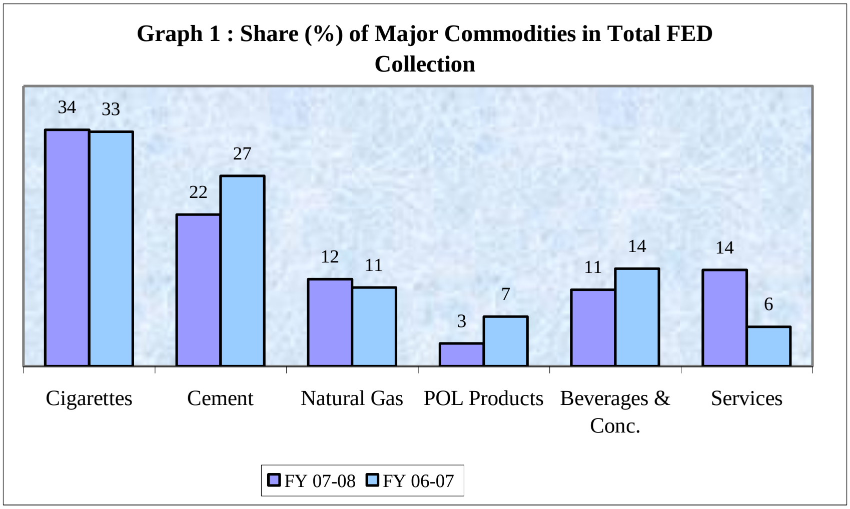
Cigarette has been the leading revenue source of FED collection with 34% share in total collection.[5] The collection has recorded a growth of 4.5% during the CFY. In absolute terms Rs. 4.4 billion has been collected which indicates an addition of Rs. 191 million only compared to the corresponding period of last year.

Cement is the second major source of revenue for FED, contributing around 23% in total collection. After a negative growth in July, the collection grew by 16.3% and 17.4% in August and September of CFY, however overall growth has been -17.4%, mainly due to the procedural change in return filing. The same has been the reason for 18% decline in collection from beverages and concentrates.

The collection from natural gas has also shown a healthy growth of 15% during the period under review as the revised timing of return filing has not affected natural gas. But the collection from POL products has declined by 52.4% during CFY, mainly because its base has further shrunken due to withdrawal of 88 paisa levy on certain POL products at the time of Federal Budget 2007-08.

FED on Services: After the introduction of FED on services, particularly IAT and NFS, the share of major commodities has also changed. Services have captured a significant share in total FED revenue. The share of services has increased from 6% in the PFY to 14% during the CFY (Graph-1) and it is expected to climb up further with better enforcement.

[5] With the introduction of services, this share has declined from over 40% in the preceding years.



The overall revenue target of services during FY: 07-08 has been set at Rs. 11.1 billion. While the realized collection during CFY indicates a healthy growth of more than 150% but it needs careful interpretation as many services were not in place during PFY and also those that were introduced initially had compliance problem (Table 12).

Table 12: FED Collection from Services

(Rs. Million)

Services	Collection		
	July-Sept: 07-08	July-Sept: 06-08	Growth (%)
Non-Fund Services Provided by the banks	261.1	100.7	159.3
Franchise Services	50.9	19.2	166.5
International Air Travel	1,004.1	188.7	432.1
Insurance	486.3	382.4	27.2
Total	1,803.5	713.0	152.9

Within services, the major source of revenue has been International Air Travel with 55% share, followed by Insurance (26%), Non-fund services (15%), and Franchise (4%). It may be recalled that to facilitate passengers, various levies on Air Travel like excise duty, foreign travel tax and the airport tax have been clubbed in the shape of Air Travel Tax in budget FY: 07-08. In addition to this, the exemption for the passengers coming from abroad was withdrawn, which was necessary to correct discrepancy in the system. It is expected that through these measures a sum of Rs. 7.2 billion would be generated. Similarly, the scope of financial services has been extended to all non-fund services except cheque book issuance charges, cheque return charges, *Hajj* and *Umra* service and utility collection charges. The extension in the base of non-fund services merely from 12 in the PFY to almost all the remaining services, except the above mentioned four was felt necessary to rationalize the tax structure and minimize evasion.

Another important budgetary measure announced during budget FY: 2007-08 was the levy of 1% special excise duty, both at domestic and import stages, with annual target of Rs.12 billion (Table 13). It is relevant to mention that, already zero-rated commodities, food products and many other items of sensitive nature have been exempted from special excise duty. These include vegetables, seeds, fruits, edible oils and fats, petroleum oils and oils obtained from bituminous minerals, natural gas and LPG, Fertilizers, goods produced or manufactured and exported by manufacturer etc.

Table 13: Collection from 1% Special Excise Duty

(Rs. Million)

	Collection		
	Domestic	Import	Total
July-07	-	269.3	269.3
August-07	220.5	302.1	522.6
September-07	127.4	258.2	385.6
Quarter-1	347.9	829.6	1177.5
Annual Target	5960	6040	12000
Achievement (%)	*5.8*	*13.7*	*9.8*

During the first quarter of CFY only 10% of annual target has been met from special excise duty both at domestic and import stages. Thus the collection has fallen short of expectation. However, the system of collection and reporting is being strengthened that should result into improved outcome in coming months.

Customs Duties: Like other taxes, Pakistan Customs has also been exposed to policy and tax administration reforms. The element of self assessment, taxpayers' facilitation, end-to-end automation and speedy clearance have been the hallmark of a new beginning. Based on the experience of model projects, the new system is being rolled out to other key ports. Pakistan has also adopted HS 2007 through necessary amendments, additions and deletions made in the Pakistan Customs Tariff (PCT) conforming to standard of World Customs Organization (WCO). Similarly, the slab of 0% has also been inducted into the PCT thus making the tariff structure more transparent and presentable. Finally, the tariff escalation issue has been addressed through a well-pronounced policy, i.e., low rates for primary raw materials, comparatively higher rates for semi-processed and finished products.

However notwithstanding these steps, the slow down in growth of total as well as dutiable imports that started during 2006-07, has continued in Q1: 07-08. While imports grew by 8.8% during Q1: 07-08, the dutiable imports had declined by 2.4% during this period. Moreover, the proportion of dutiable imports had also declined to 49% of the total imports during July-September 07-08 against 54% during Q1 of PFY. Thus, there has been lesser gross collection of customs duties of around one billion rupees as compared to corresponding period last years (Table 14). On the other hand, saving of around Rs. 2.1 billion due to less refund/ rebate payments has not only enabled the net collection of customs duties to exceed the last year net collection but has also helped in achieving the Q1 target of Rs. 28.8 billion.

It is also relevant to mention that although a sizable portion of CD has been fetched by applying existing slabs but 1/3rd of the collection is still being realized through the application of either specific rates or tariff over and above maximum rate of 25%. It implies that there is further scope of tariff rationalization and bringing more items into the fold of existing slabs.

Table 14: Collection of Customs Duties and Refund/Rebate during Q1: 07-08

(Rs. Million)

	FY: 07-08	FY: 06-07	Difference	
			Absolute	Percent
Gross	31,579	32,565	-986	-3.0
Refund/Rebate	2,603	4,675	-2072	-44.3
Net	28,976	27,890	1086	3.9

Major Sectors of Revenue Generation

As has been the case for other taxes, a significant proportion of gross collection of CD is realized from 15 major sectors generating around 81% of the collection during Q1: 07-08. These sectors covered 76% of the total imports and 84% of the dutiable imports. The pattern of collection by these sectors is depicted in Table 15.

The automobile sector is the leading source of revenue for CD as close to 20% of gross collection originates from this source. The recent policy of restricting the import of old and used vehicles that are more than three years old has reduced the import of motorcars and Jeeps. Resultantly, the collection has dropped by 20.3% during Q1: 07-08 as compared to the corresponding period last year.

The second important source of CD revenue is edible oils including fats. Although the value of imports of this sector has grown by 67% but the collection of CD has increased by 2.2% only. This uneven correspondence makes sense as edible oils are subjected to specific duty rates. Therefore, the low growth in CD is mainly due to little variation in quantity imported rather than its price that incidentally has escalated during this period. The major component within

Chapter 15, namely palm olien has recorded a negative growth of 9.4% in CD due to reduced imported quantity by 7.3%.

Table 15: Sector-Wise Gross Collection of Customs Duties

PCT Ch.	Sectors	CD Collection July-September			Share (%)	
		2007-08	2006-07	Growth	2007-08	2006-07
87	Vehicles	6,226	7,808	-20.3	19.7	24.0
15	Edible Oils & Fats	4,313	4,219	2.2	13.7	13.0
85	Electrical Machinery	3,042	2,396	26.9	9.6	7.4
84	Mechanical Machinery	2,526	2,500	1.0	8.0	7.7
27	POL Products	2,183	3,211	-32.0	6.9	9.9
39	Plastic & Articles	1,469	1,327	10.7	4.7	4.1
72	Iron & Steel	1,310	1,190	10.1	4.1	3.7
48	Paper & Paperboard	1,003	807	24.4	3.2	2.5
29	Organic Chemicals	741	838	-11.6	2.3	2.6
73	Articles of Iron & Steel	541	507	6.8	1.7	1.6
32	Dyes, paints etc	459	382	20.2	1.5	1.2
40	Rubber and Articles	433	381	13.6	1.4	1.2
38	Misc. Chemical Products	416	425	-2.1	1.3	1.3
34	Soap & Detergents	395	323	22.4	1.3	1.0
09	Coffee, Tea, Mate & Spices	371	387	-4.2	1.2	1.2
	Sub Total	25,427	26,701	-4.8	80.5	82.0
	Other	6,152	5,864	-24.3	19.5	18.0
	Grand Total(Gross)	31,579	32,565	-3.0	100.0	100.0

The collection from electrical machinery has improved by around 27% due to 14.1% growth in its imports. The main drivers of growth are telecommunication and transmission apparatus, transformers and generating sets. On the other hand, the imports of various types of mechanical machinery have declined by 3% but CD has increased by 1%. While the reduction has been on account of reduced textile machinery, there has been strong growth in the import of industrial goods, construction machinery and engines that has compensated for the loss in CD. The collection of POL (Ch: 27) has exhibited 16.2% growth in dutiable imports while the collection of CD has dropped by 32% mainly due to reduced quantity of HSD imports.

The collection of CD from plastic during Q1: 07-08 has improved by 10.7% which is consistent with growth in its tax base. Similarly, iron and steel (Chapter 72) has recorded phenomenal growth of around 52% mainly due to 120% growth in import of ferrous waste and scraps etc(72.04). However, since almost all these imports were duty-free the collection of CD has manifested a modest growth of 10%. The overall picture of iron and steel encompassing all the four taxes has already been presented in Box 3.

Concluding Observations

Although the revised target for July-September 2007 has been achieved, but the re-adjustment within individual taxes has put extra pressure on the 2nd half of the year. To circumvent any adverse outcome various initiatives have been undertaken especially in the 'deductions at source' category within direct taxes and GST. As there is tremendous scope, it is expected that these measures would result in improvement in tax collection in coming months. Simultaneously, a systematic audit program has also been initiated to deal with delinquencies. Effort to mobilize additional resources through tax-gap analysis, better enforcement and efficiency gains is also continuing. Similarly, there is an undeterred resolve to facilitate taxpayers to the maximum extent and further boost the conducive environment for business activities. Finally, as part of policy reforms tax incentives are being provided to promote investment in the country. However, notwithstanding all these initiatives, the final outcome remains dependent on the strength of the economy. A continuous up-swing and a risk-free environment would mean that the resource mobilization effort of FBR would also remain on track.

II

Federal Budget 2007-08: Major Relief and Revenue Initiatives[6]

The Federal Budget for FY: 07-08 was announced on 9th June, 2007. The tax-wise highlights of the budget are presented below:

Customs

For the last many years, not only the tariff rates have been gradually reduced, but the number of tariff slabs has also been reduced. Similarly, the problem of tariff escalation has been addressed. The guiding principle of this policy is to improve competitiveness within the country, increase exports, and ensure availability of cheap raw material for industries and finished products for consumers.

There was no 0% duty slab in Pakistan Customs Tariff which did not reflect the true picture for the foreign investors who evaluate duty structure while preparing investment related feasibility studies. More than 2000 tariff lines are being used at 0% duty under different general and industry specific SROs. The items which at present are facing duty-free status without any condition have been assigned 0% duty rate in tariff and accordingly omitted from the SROs. This will make the tariff structure more presentable and transparent.

In order to boost the manufacturing sector by ensuring the availability of raw materials at cheaper rates, the customs duty on raw material used in the electrical, capital goods, paper & paper board, chemicals, plastic and rubber industries has been reduced by 5%. The objective is to keep the momentum of industrialization going so that enough jobs are created for the wellbeing of masses.

[6] The information is compiled by the Fiscal Research and Statistics Wing.

Moreover, customs duty has been withdrawn from the machinery used in horticulture, furniture, marble & granite, surgical and medical instrument-business to boost export of these sectors.

In the face of persisting shortage of electricity, customs duty on gas generators for industrial establishments has been withdrawn. Similarly, customs duty has been reduced on generators for industrial consumption. Likewise, on the components used in alternative energy sources such as solar energy and wind energy, customs duty has also been withdrawn. The sales tax at import stages on these items has also been waived off. To encourage energy saving lamp, customs duty is reduced from 15% to 10%. Similarly, electric transformers play a major role in power transmission, therefore in order to provide incentives to the local manufacturing of this product, duty rates on its raw materials and components have been reduced from 20% and10% to 10% and 5% respectively.

Presently, CVT is levied on imported cars, while the domestically manufactured vehicles are exempt from CVT. In order to remove this disparity, CVT on imported vehicles has been withdrawn. However, to maintain protection level intact, adjustment in customs duty at the rate of 5%, 10% & 15% for different CCs of cars has been ensured. Withholding tax @ 5% on the local vehicles has been levied. Finally, the capping for old and used cars previously for 5 years is being reduced to 3 years so that the domestic industry could flourish. The condition of 3 years will be applicable to Transfer of Residence Scheme, Gift Scheme, and Baggage rules.

Textile is, undoubtedly, the back-bone of the economy. Besides export earnings, it is a prime source of employment generation. Therefore, more attention is required to be focused on this sector so that to make it internationally competitive. The R&D facility was provided to this sector a while ago. Now the DTRE system is being revamped whereby the import of PSF will be allowed. Through

DTRE, R&D facility will also be available to fiber manufacturers @ 3.5%, which will be availed through SBP. The facility of debt/swap to spinning sector is granted. Similarly, for exporters, the existing WHT rate of 0.75% to 1% is being rationalized and 1% rate of WHT is levied. The textile exporters will also be the beneficiaries.

A tariff plan for the auto industry, 2-wheelers, tractors and HCVs has been prepared in consultation with Ministry of Industries and the local assemblers. This plan envisages providing a transparent and predictable five-year tariff structure whereby customs duty rate on import of motorcycles in CBU condition is being reduced from 90% to 80% and duty on its CKD kits duty has been reduced from 30% to 25%. Likewise, duty on semi-trailers/trailers (CBU) is reduced from 30% to 15%.

Industry is the backbone and strength of our economy. At the moment, 116 industrial sectors and sub-sectors are enjoying either total exemption or reduced rate of customs duty on their inputs. Further industrial inputs used in sectors/sub-sectors like Acetic Acid, Cosmetics, Digital Radio system, DOP, Ethyl Acetate, Locomotive parts, Paper Bobbins, Polyethylene etc have been identified in consultation with the stakeholders for allowing duty concessions/exemptions in order to provide incentives the local manufacturing activities. Existing rates on the inputs range from 5% to 20% except ethyl alcohol @ 50%, which have been reduced to 15%, 10% and 0% respectively.

Direct Taxes

Acquisition and merger is invariably treated as a non-tax event. The existing provisions of law do not expressly provide disposal of an asset under amalgamation/merger to be a tax neutral event. Therefore, there was a need to introduce specific provisions regarding non-taxability of capital gains in the hands of share holders. The transfer of shares between companies and share holders in one direction under an approved scheme, (not involving cash) will not be taken as taxable event if the purpose of such transfer is formation of a group. The incentive will be available under scheme of Merger and Acquisition, approved by High Court, SECP or SBP (as the case may be) which does not involve cash payments.

For computation of income of the banking companies a separate schedule has been added to the Income Tax Ordinance, 2001. Inter corporate dividend is subjected to adjustable withholding tax @ 10%.

Amendments are made in legislation relating to Holding Companies; 75% share holding will be required if none of the companies is a listed public company; 55% share holding will be required if one of the group companies is listed public company; Current losses can be surrendered by Holding Company to a subsidiary or between subsidiaries which fulfill the requirements of share holding; inter-corporate dividend shall be liable to 10% adjustable withholding tax.

It is decided that for formation of group, transfer of shares between companies and the owners in one direction may not be treated as taxable event. Further, group taxation is allowable for 100% owned companies as one fiscal unit and no relief will be available in respect of losses prior to formation of group. Furthermore, group taxation will be restricted to domestic companies only and for assessment on group basis option will have to be exercised for a minimum period of 5 years.

To provide incentive to NGOs and middle income groups and to upgrade themselves as Micro Finance Banks (MFBs) and to encourage entry of more MFBs, tax shield for 5 years was approved. During this period, MFBs will not be paying dividend to their share holders and income would be ploughed back in to MFBs operations.

The withholding tax on imports is reduced from 6% to 5%. However, reduced rate will be applicable on the import of edible oil.

Sales Tax and Federal Excise

Social well being of poor segment of the society is the primary objective of the Government. With increasing transport fares, majority of the poor people rely on bicycles as their primary mode of transport. The levy of sales tax on bicycles is a burden on the poor and needs to be reviewed to ensure cheaper availability of bicycles to the common people. Another item now mainly used in poor households is the sewing machine. Presently, supply of house hold sewing machines are subject to 15% sales tax. In order to provide relief to the common and poor man, therefore, sales tax has been zero-rated on import and local supply of house hold sewing machines and bicycles.

Excise duty @ Rs 25 per connection per month was levied on services provided by cable TV operators in Finance Act 2006 which was subsequently reduced to Rs 8 per connection. Keeping in view the small revenue impact and the fact that the levy is a direct charge on the households, the levy has been abolished *ab-initio*.

In the country, iron and steel, plastic and paper industries are fast growing but unfortunately majority of them are functioning in the unorganized sectors; resultantly the government as well as the organized sector industry is facing continuous losses. In order to establish equilibrium, the raw material imported for iron and steel plastic and paper industries the sales tax of 15% is enhanced to 20%. However, the rate of 15% sales tax on final product for these sectors will remain the same. To bridge the tax gap due to non-compliance of small and medium manufacturers of these sectors, the rate of sales tax on iron & steel (Chapter 72), plastics (Chapter 39), paper (Chapter 48), and chemicals are subjected to 20%. The organized sector will be able to adjust the sales tax against their final liabilities whereas the un-organized sector will either be forced to become compliant to obtain input tax adjustment or otherwise the revenue presently unpaid by them will be captured at import stage.

In the budget, other non-fund financial services provided by both banking and non-banking companies have also included in the excise duty regime with the same rate of excise duty i.e. 5%. Such services include discount income, inward/outward clearing return charges, investment banking commission, import collection commission, fee income from advising and assistance, etc. However, utility collection services charges, *Umra* & *Hajj* service income/charges and cheque book issuance charges are being excluded from the ambit of excise duty.

There are more than 1200 registered CNG stations paying sales tax. Collection of sales tax from CNG sector is around Rs. 400 million per annum which is much below the potential of revenue keeping in view the actual value addition of CNG stations. Apart from general compliance issues, the issue of wastage of CNG stations has also become problematic leading to revenue leakage. To streamline the collection of sales tax from CNG stations, it has been decided that collection of sales tax liability of CNG stations will be shifted to the level of gas distribution companies to ensure smooth and increased collection. There will be no price increase of CNG.

Presently, international air travel is chargeable to excise duty on destination specific fixed rates with no input tax adjustment. However, there is exemption for passengers coming to Pakistan from abroad and traveling back on return journey. This one sided levy is not only a disparity for Pakistani passengers but also is not in line with international best practices. Thus, it has been decided to levy excise duty on all passengers whether incoming or outgoing. It has been decided that various types of levies on international travel currently in vogue including foreign travel tax, government airport tax and excise duty should be clubbed together in a single levy to be collected from all incoming and outgoing passengers. For this purpose, FED exemption for holding tickets has been withdrawn and a single Federal excise duty to be called Air Travel Tax (ATT) for collection purposes is levied after clubbing all of the above mentioned taxes.

Inappropriate value addition by commercial importers has always been a source of leakage of revenue. In the past commercial importers were required to pay sales tax at import stage on 10% value addition in addition to normal 15% sales tax. This year the regime has been changed and now commercial importers are required to pay a fixed additional amount of sales tax at 2% in addition to normal sales tax payable.

The imports have increased manifold during the past few years. This phenomenon is not only indicative of industrial development, but also highlights improved consumption expenditure by individuals. Therefore, keeping in view, the widening trade deficit and also to restrict the conspicuous consumption, Special Excise Duty at the rate of one percent has been levied, both at import stage with certain exemptions and domestic production.

III

Structure of International Trade in Pakistan: Recent Scenario[7]

Background

Foreign trade plays a crucial role in the development and economic stability of a country. No country of today's world is self-sufficient in every bit of goods and services required within its domain, therefore trade transactions become quite indispensable. In fact, present era can truly be regarded as the age of openness and globalization where unrestricted trade flows are favored over restrictions on efficiency, productivity gains, and economies of scale arguments. Openness is desired for multiple objectives including achieving industrial development, securing vital foreign exchange, ensuring availability of food, and maintaining a high standard of living. Effective management of foreign trade transactions is equally desired to maintain equilibrium in balance of payments, attaining favorable terms of trade, and creating employment opportunities. For many developing and almost all Less Developed Countries (LDCs), foreign trade is also regarded as a reliable source of generating revenues, and fostering economic growth and welfare.

Sadly, Pakistan's international trade position has not groomed in a manner it has for most of the rapidly growing economies. With the exception of few years, the country has always experienced deficit in trade transactions. There is limited diversification as far as export bundle is concerned. Similarly, a large chunk of the import bill relates to few commodities, namely, POL products, automobile, machinery, and consumer products. Even though over the years serious concerns have been raised about this situation, but there has

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been limited success when viewed objectively. A cross-country comparative analysis of the type where South Korea, for instance, was in the early 1960s and where it is now; and what was its composition of the economy and external trade then and what it is now, is sufficient to crystallize this proposition in a succinct manner.

Within this context, the present study lays bare the most recent structure of international trade related to Pakistan. In the process data-related issues are also examined. Certain policy options are also discussed that need further strengthening.

Pakistan's Foreign Trade Flows:

It is rather unfortunate that despite concerted efforts by the government to augment the volume of foreign trade mainly through expansion in exports very little 'real' progress has been made so far. The improvement, over the years, has more to do with increase in imports rather than exports. Furthermore, it not absolute changes that matter, rather the real gain lies with the internationally recognized indicators generally expressed in relative terms. For example, while the 'openness' of the economy defined as ratio of trade flows (imports plus exports) to GDP indeed shows an increasing trend, the same is not true for export to GDP ratio. It has remained either stagnant during the past many years or it has declined – say from 12.8% in 2000-01 to 11.9% in 2006-07.[8] Even in better days, this ratio has not touched 15%, whereas for fast growing economies it has often exceeded 30%.[9] Compared to this, the upsurge in imports has vastly improved the import to GDP ratio from 14.9% to 21.3% during the period under review. Thus, there is no surprise that the imbalance between export and import has widened sharply (Table 1).

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[8] These years have been selected to avoid mis-interpretation due to re-basing of GDP.

[9] For South Korea, this ratio has increased from 9% in 1960s to 39% during 2000-05.

Table 1: Pakistan's Trade Transactions and Openness

(Rs. Million)

Years	Exports	Imports	Balance of Trade (BoT)	Share in GDP (%) of			Openness (%)
				Exports	Imports	BoT	
1960-61	540	2,173	-1,633	2.8	11.1	-8.3	13.8
1965-66	1,204	2,880	-1,676	3.9	9.2	-5.4	13.1
1970-71	1,998	3,602	-1,604	3.9	7.1	-2.2	11.0
1975-76	11,253	20,465	-9,212	8.6	15.7	-7.1	24.3
1980-81	29,280	53,544	-24,264	10.5	19.2	-8.7	29.8
1985-86	49,592	90,946	-41,354	9.6	17.7	-8.0	27.3
1990-91	138,282	171,114	-32,832	13.5	16.8	-3.2	30.3
1995-96	294,741	397,575	-102,834	13.9	18.8	-4.9	32.7
2000-01	539,070	62,7000	-87,930	12.8	14.9	-2.1	27.7
2001-02	560,947	634,630	-73,683	12.6	14.3	-1.7	26.9
2003-03	652,294	714,372	-62,078	13.4	14.7	-1.3	28.0
2003-04	709,036	897,825	-188,789	12.6	15.9	-3.3	28.5
2004-05	854,088	1,223,079	-368,991	13.1	18.8	-5.7	32.0
2005-06	984,841	171,1158	-726,317	13.0	22.5	-9.6	35.5
2006-07	1,039,035	1,852,136	-813,101	11.9	21.3	-9.3	33.2

Source: Pakistan Economic Survey (Various Editions) and Author's Calculations.

Data Gathering and Reporting

It is relevant that the mode of data collection and data-related issues are discussed up-front before embarking upon an in-depth analysis of structure of imports and exports. The first insight that seems necessary is that data on transaction of goods issued by the Federal Bureau of Statistics (FBS) are taken from the Federal Board of Revenue (FBR) that, in turn, are recorded at entry and exit points supervised by Customs Collectorates. Each and every commodity is classified in the internationally used Harmonized Coding Scheme. The eight-digit classification of commodities spreading over 99 chapters, along with rate of customs duty, is up-dated each year at the time of budget announcement. Both, hard and soft copies of

Pakistan Customs Tariff (PCT) are issued for the convenience of the trading community and other stakeholders. Thus, the trade data, especially imports, can readily be further classified as duty-free and dutiable. The latter can further be disaggregated on the basis of rate of duty, and similar other classifications.

With improvement in technology, complete trade data reflecting national picture is now available for all stakeholders, including the FBS and the Trade Development Authority of Pakistan (TDAP). The consolidated position of information is generated through two systems currently in place in the Customs Collectorates. These are One-Customs and PaCCS. The detailed consolidated data is currently available on monthly basis but the effort is on to have real time availability of this information. The presence of identification code enables users to have an in-depth examination of direction of trade and carry-out unit value analysis.

Besides reporting by FBR/FBS, trade statistics are also released by the State Bank of Pakistan (SBP). However, this information differs from the one produced by FBR/FBS for reasons mentioned below. While FBR deals with actual flow of goods, the SBP is concerned with financial transactions related to trade flows. Thus, there is an obvious timing issue of goods transaction and flow of funds. Secondly, for record keeping of trade related flows, while FBR relies on Good Declaration (GD) Form as basic document, the banking channel uses I or E Forms for this purpose. The problem with this type of arrangement is that unless or until there is a reconciliation of accounts on the basis of two different documents, discrepancies do appear, and at times the differences are quite large.[10] Even though these differences narrow down towards the end of fiscal/ financial year, but it is also important to have a well specified timeframe for such reconciliation effort. Further

[10] A sub-committee within SBP is currently engaged in sorting out modalities of replacing I & E Forms with GD Form. However, it may be a while before anything concrete takes shape on this account.

clarification is also required to be noted on how trade accounts are recorded. In certain cases *cif* value is considered while in other cases it is *fob* value. Thus, there is an obvious need for reconciliation in this area too. Finally, variation in value of import also arises due to differences in 'declared' and 'assessed' value on the one hand and concessions and exemptions for privileged persons on the other. Thus, there are a number of areas that have the potential to create discrepancy between FBR and SBP figures on month-to-month basis but these differences get resolved or narrowed down towards the end of a fiscal/ financial year.

An In-depth Commodity-wise Analysis of Trade Flows

A detailed analysis of structure of imports and exports is critical for in-depth understanding. While it is important to know the composition of imports between consumer, capital and raw material categories, it is also relevant to know what type of machinery is being imported in the country and whether or not industrial sector is responding to various policy initiatives of the government. Similar is the importance of export basket. Within this perspective, we analyze detailed composition of imports and exports.

Structure of Imports

On the pattern of previous years, the imports during Q1: 07-08 grew modestly by 8.8%. Table 3 confirms that while there is substantial growth in some of the commodity-groups, the leading sectors have not grown at a rapid pace and therefore the overall growth is in the single digit. In particular, nearly 50% of import value relates to three commodity-groups, namely petroleum products, and electrical and mechanical machinery. On the whole, around 92% of the import value is covered by 30 commodities classified in various chapters. The growth in this sub-group has been 12.9% during Q1: 07-08. We now turn to individual sub-groups.

Table 3: Structure of Imports Value during July-September 2007-08

(Amount Rs. Million, and Share %)

Commodity Groups	PCT	2007-08	Share (%)	2006-07	Share (%)	Growth (%
POL Products	*27*	128,599	26.4	121,670	27.1	5.7
Electrical Machinery	85	51,286	10.5	44,964	10.0	14.1
Mechanical machinery	84	44,911	9.2	46,305	10.3	-3.0
Iron and Steel	72	26,390	5.4	17,385	3.9	51.8
Organic Chemicals	29	24,017	4.9	22,545	5.0	6.5
Edible Oils and Fats	15	23,205	4.8	13,895	3.1	67.0
Road Vehicles, parts and Accessories	87	19,768	4.1	23,323	5.2	-15.2
Plastic and Articles	39	19,235	3.9	17,383	3.9	10.7
Cotton	52	14,351	2.9	7,826	1.7	83.4
Fertilizer	31	12,210	2.5	7,752	1.7	57.5
Oilseeds	12	8,995	1.8	4,411	1.0	103.9
Articles of Iron and Steel	73	6,306	1.3	6,683	1.5	-5.6
Paper and Paperboard	48	6,185	1.3	5,257	1.2	17.7
Misc Chemical	38	5,754	1.2	5,779	1.3	-0.4
Rubber Products	40	5,370	1.1	4,973	1.1	8.0
Pharmaceutical Products	30	5,144	1.1	3,339	0.7	54.1
Edible Vegetables, Certain Roots and tubers	07	4,616	0.9	5,486	1.2	-15.9
Equipment and Instruments	90	4,611	0.9	3,527	0.8	30.7
Man Made Filaments	54	4,395	0.9	5,095	1.1	-13.7
Tanning & Dying	32	4,273	0.9	3,615	0.8	18.2
Inorganic Chemicals	28	4,154	0.9	3,578	0.8	16.1
Man Made Staple Fibres	55	3,835	0.8	4,662	1.0	-17.7
Coffee, Tea and Spices	09	3,722	0.8	4,218	0.9	-11.8
Aluminum Articles	76	3,045	0.6	3,021	0.7	0.8
Edible Fruits and Nuts	08	3,007	0.6	1,372	0.3	119.2
Soap, Washing Preparation, waxes etc.	34	2,532	0.5	2,020	0.5	25.3
Copper and Articles	74	2,265	0.5	2,895	0.6	-21.8
Ships, Boats and Floating Structures	89	2,198	0.5	1,586	0.4	38.6
Ores, Slag and Ash	26	1,814	0.4	988	0.2	83.6
Raw Hides and Skin and Leather	41	1,518	0.3	1,005	0.2	51.0
Sub Total		**447,711**	**91.8**	**396,558**	**88.4**	**12.9**
Other		**39,955**	**8.2**	**51,860**	**11.6**	**-230**
Total		**487,666**	**100.0**	**448,418**	**100.0**	**8.8**

PCT refers to Pakistan Customs Tariff Chapter Heading.

POL Products (Chapter 27): Nearly a quarter of total import value relates to petroleum products classified in Chapter 27 of PCT. A low growth of 5.7% has been experienced in these items during July-September 2007-08. The major commodities within this group are crude oil, High Speed Diesel, and furnace oil whose share within the group has been 48%, 25%, and 20% respectively leaving behind only 7% for the remaining POL products.

Machinery and Parts (Chapters 84 and 85): The import of machinery is vital for expansion of industrial sector and overall development of the economy. A number of incentives have been announced for import of machinery from time to time including zero-rating, lower tariff structure, and concessions etc. to bring down the cost of business and increasing the pace of the business activities. The import of machinery constitutes around 20% of the total imports during Q1: 07-08. This value is broadly divided into two major components, namely mechanical machinery classified in (Ch: 84) and electrical machinery in (Ch: 85). The analysis of both types of machinery is presented separately.

Mechanical Machinery: The major imports of mechanical machinery includes plant, machinery and equipment (PM&E) classified within the broader categories of industrial goods with a share of 24%, textile machinery 17%, pumps 14%, engines 9%, and consumer goods 7% etc. The overall import of mechanical machinery has declined by 3% during Q1: 07-08 mainly due to reduced imports of engines, agricultural appliances, IT related equipment and PM&E related to textile sector (Table 4). On the other hand, the imports related to industrial goods, construction and pumps has increased by 19.4%, 9.8% and 33% respectively. This pattern is consistent with the overall strength of the manufacturing sector with textile being the only exception where some slowdown has been recorded in recent months despite the huge investment in BMR and the availability of R&D support.

Table 4: Mechanical Machinery and Appliance

(Rs. Million)

Machinery Related to	Import Value		
	Q1: 07-08	Q1: 06-07	Growth (%)
Textile	7,541	10,682	-29.4
Industrial Goods	10,769	9,022	19.4
Construction	6,337	5,772	9.8
Consumer Goods	3,157	3,283	-3.8
Pumps	6,361	4,797	32.6
IT	2,951	3,553	-16.9
Engines	4,080	6,316	-35.4
Agriculture	386	447	-13.6
Sub Total	41,581	43,872	-5.2
Others	3,329	2,433	36.9
Chapter Total	44,911	46,305	-3.0

Electrical Machinery (Chapter 85): The import of electrical machinery has witnessed 14.1% growth mainly driven by transmission/ telecommunication and unrecorded disk/ tapes/ board panel console categories etc. Around 91% of the imports of the electrical machinery are contributed by 18 commodities during July-September, 2007-08. Interestingly, 2/3rd of total imports related to transmission apparatus/ telecommunication falling under the HS Codes 85.17 and 85.25. The imports of these items excluding mobile phones have grown robustly by 37% while the import value of mobile phones has declined by 8%.

Iron & Steel and Articles thereof (Chapters 72 and 73): The import of iron exhibited decline during July-June, 2006-07 by 16.6%. During Q1:07-08, the trend has reversed and it has grown by 52%. The major component in this growth has originated from scrap whose import has risen in response to its zero-rating. On the other hand, the imports of articles of iron and steel (Chapter 73) has declined by 5.6% over and above their 13% decline during 2006-07. It appears that there is a transformation in favor of processed material. However, whether or not this can truly be regarded as a move towards intensive value-addition-manufacturing in iron and steel sector is too early to comment; but if true it may be regarded as a sure sign of improvement.

Edible Oils (Chapter 15): A robust growth of 67% has been recorded in the value of import of edible oils during Q1: 07-08 mainly due to spiraling prices. This high growth has been due to palm oil imports where a phenomenal growth of 60% has been recorded. Within Palm oil, two major import components have been palm olien and crude edible oil. The share of these components has been 59% and 27% respectively in the total imports of edible oils. The import of crude edible oil is a recent phenomenon. Its increased import has replaced the import of refined oil that has reduced as refining capability has been developed within the country.

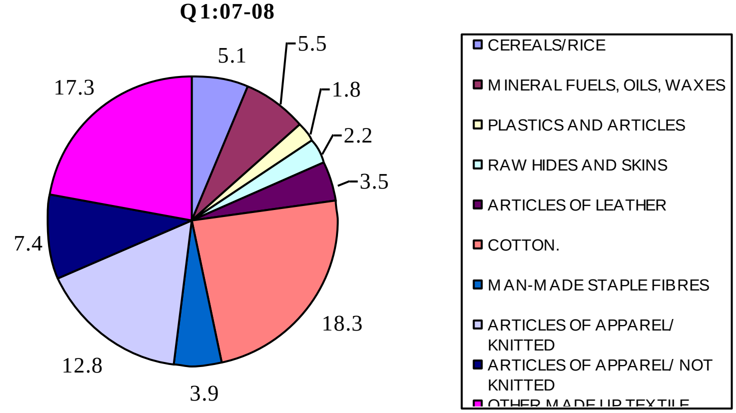
Automobile Sector (Chapter 87): The automobile sector is an important contributor to the total import of the country. Beside, it is a handy contributor to government exchequer in term of tax revenues. A decline of 15% has been registered in the import of vehicles including parts during the 1st quarter of current fiscal year (CFY). Since PCT (87.03) mainly includes motorcars and jeeps with a share of 55.2% in total imports of the automobile sector, a 20% drop in the import of this HS category has been instrumental in the overall decline of overall imports. Once again the recent policy initiative of restricting imports of old and used vehicles to no more than three years has affected the imports growth.

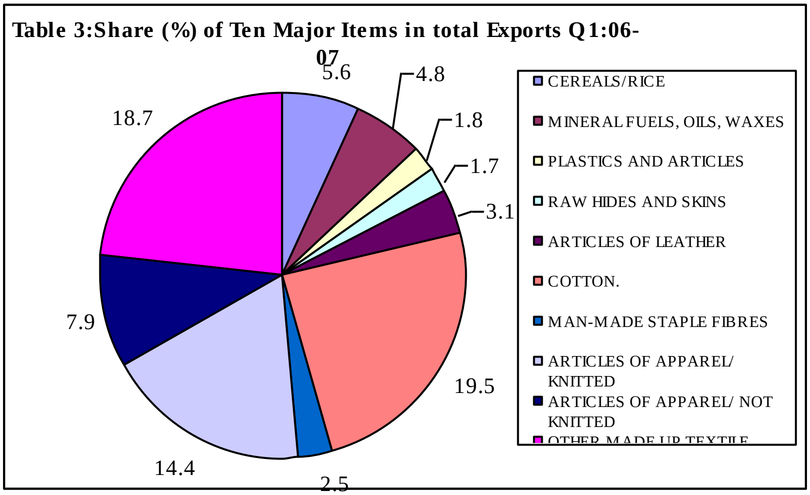
Structure of Exports

The first quarter of CFY has witnessed a low growth of only 4.8% in exports as compared to the corresponding period of last year. Similar to import structure, the composition of export basket has also been fairly narrow for quite sometime. Whereas, the share of cotton and other made up of textile in total exports has declined as compared to 1st quarter of PFY, major export items like cotton, articles of apparel and clothing, other made up textile articles and rice have, in fact, recorded a negative growth. On the other hand, minor items like salt, sulphur, stones, slag, ash, products of milling industry, mineral fuels, inorganic chemicals, raw hides and skins, articles of leather have performed relatively well (Table 5). However compared to major sectors, this performance has limited consequence for improving the overall Balance of Trade (BOT) position. The export performance of the textile sector remains a soaring concern that requires careful review.

A detailed review confirms that ten major commodity-groups contribute nearly 80% of the overall national exports, showing how narrowly the export base has been structured over the years (Graphs 2 & 3). No doubt that there has been a little improvement during the first quarter of CFY and the share of mineral fuel, raw hide and skins, articles of leather, and man-made staple fibers in total exports have increased marginally, there is no doubt that the overall position remains unsatisfactory.

Graph: 2 Share (%) of Ten Major Items in total Exports Q1:07-08





According to Table 5, cotton and textile sector continues to dominate the export basket with an overall share of slightly above 60%. Within the overall basket, 18.3% contribution has been made by products listed in Chapter 52 and it essentially relates to raw cotton. Similarly, 20.2% of export value has originated from knitted and non-knitted apparels and clothing, 17.4% from made-up articles, and 3.4% from man made staple fibre. The exports of grains, essentially rice, has fetched around 5% export earnings and similar has been the contribution of POL products. Unfortunately, the contribution of other traditional export items like leather and leather products, sports and surgical goods has been quite insignificant.

Some of the non-traditional items in the export basket during Q1: 07-08 were wheat and cement where significant growth has been recorded but the volume has been quite small.

Finally, virtually no gains have been made in the export of plant machinery and equipment. Rather, how so ever small the contribution of electrical and mechanical machinery in the export basket is, it has registered a further decline during the 1st quarter of CFY!

Table 5: Structure of Export in terms of Major Contributors

(Rs. Million)

Chap.	Items	Quarter-1 FY:07-08	Quarter-1 FY:06-07	Absolute Difference	% Growth
03	Fish And Crustaceans, Molluscs And Other aquatic Invertebrates	1,393	1,581	-187	-11.9
08	Edible Fruit And Nuts; Peel Of Citrus Fruit Or Melons	2,307	1,697	610	35.9
10	Cereals/Rice	13,703	14,499	-797	-5.5
11	Products Of The Milling Industry; Malt; Starches; Insulin; Wheat Gluten	2,782	399	2,383	597.7
15	Animal Or Vegetable Fats And Oils	1,774	1,826	-51	-2.8
17	Sugars And Sugar Confectionery	1,196	899	298	33.1
22	Beverages, Spirits And Vinegar.	3,175	1,640	1,534	93.5
25	Salt; Sulphur, Earths, Stone And Cement	4,427	2,210	2,217	100.3
26	Orses, Slag And Ash	1,362	585	777	132.9
27	Mineral Fuels, Oils And Products	14,867	12,452	2,415	19.4
28	Inorganic Chemicals; Organic	1,593	608	985	162.0
30	Pharmaceutical Products.	1,445	1,030	416	40.4
39	Plastics And Articles Thereof.	4,823	4,562	261	5.7
40	Rubber And Articles Thereof.	1,160	2,773	-1,612	-58.2
41	Raw Hides And Skins (Other Than Fur skins) And Leather.	5,884	4,384	1,500	34.2
42	Articles Of Leather; Saddlery And Harnesses; Travel Goods Etc	9,402	7,923	1,479	18.7
52	Cotton	49,504	50,230	-726	-1.4
55	Man-Made Staple Fibres.	10,612	6,315	4,297	68.0
57	Carpets And Other Textile Floor Coverings	3,366	3,468	-102	-3.0
61	Apparel And Clothing Accessories, Knitted or	34,472	37,168	-2,696	-7.3
62	Apparel And Clothing Accessories, Not Knitted	19,985	20,321	-336	-1.7
63	Other Made Up Textile Articles	46,799	48,234	-1,434	-3.0
64	Footwear, Gaiters And The Like; Parts Of Such Articles	1,881	1,693	187	11.1
71	Natural Or Cultured Pearls, Precious Metals	1,499	408	1,092	267.7
73	Articles Of Iron And Steel	1,168	1,220	-51	-4.2
84	Nuclear Reactor, Boilers, Machinery Etc.	1,503	2,075	-573	-27.6
85	Electrical Machinery And Equipment	1,203	1,659	-455	-27.4
90	Optical, Photographic, Cinematographic	2,671	820	1,851	225.8
94	Furniture; Bedding, Matresses,Cushions	2,706	1,769	937	52.9
95	Toys, Games And Sports Requisites	2,887	2,656	231	8.7
	Sub Total	**251,549**	**237,101**	**14,448**	6.1
	Others	18,448	20,639	-2,191	-10.6
	Grand Total	**269,998**	**257,740**	**12,257**	4.8

Concluding Remarks

Pakistan's overall trade volume remains small compared to emerging economies. Over the years, country's openness has increased but broadly due to increasing import volume rather than exports. The overall composition of imports as well as exports remains narrow. While bulk of the imports relate to petroleum products and machinery, the textile sector literally dominates the export basket. However, during the 1st quarter some improvement has been found in the share of items other than textile, which no doubt, is a welcome sign, but no particular sector could be isolated as the possible source of gains. Therefore, it is hardly possible to measure the impact of this transformation, either on the overall growth of the manufacturing sector, or the economy.

Concentrating on the textile sector, it is more than evident from experiences of past few months that the international competition would get stiffer in the future. Countries like China, Bangladesh, Thailand and India have already captured a sizeable market in the world. Resultantly, judging from historical data, it is clear that Pakistan's textile exporters are struggling. The argument that there is discriminatory dumping duty on the bed linen might be valid to some extent, but it is also true that international markets are being lost due to many other crucial reasons. Since huge resources were invested in recent years, it seems natural to investigate weather or not the machinery installed was good enough to maintain competitive edge in the region and across the world. Finally, notwithstanding the voluminous R&D support by the Government, why no visible difference is there on quality control, HRD, and branding issues etc? Why the skill gap is so wide-spread, not only in the textile sector, but also in the manufacturing sector as a whole? Thus, with so little to offer as guidelines for the manufacturing sector and a rather dismal approach to handle vital human resources, the chances that Pakistan could make a major break through in the field of trade transactions are quite small.

IV

FBR Reform Program:
The Outcome of Perception Survey[11]

Background

The comprehensive reform agenda of the FBR includes fundamental changes in the structure of tax instruments, tax assessment, and collection procedures and practices. The reform agenda also includes changes in the personnel policy, data base development, and improvement in taxpayer facilitation within FBR and its field offices. A major focus of the reform agenda is on improving the organizational and administrative set up, tax filing and compliance requirements, speedy refund/ rebate payments, and tax audit selection processes etc. The ultimate objective of the reform process is to raise productivity of the workforce that should lead to improved revenue collection and reduce the possibility of tax evasions and avoidance.

Objectives of the Perception Survey

There is no denying the fact that feedback by the stakeholders plays a key role in shaping up the performance of a public-dealing organization like FBR. In the pre-reform era to obtain feedback from stakeholders was given least importance. However, with the introduction of tax administration reforms, this vital area has been given due attention to understand stakeholders' concerns to rectify them promptly and to bring further efficiency in the system. In this regard M/s Gallup Pakistan was awarded the contract to conduct the perception survey during 2006-07.

To what degree CBR has achieved its objectives, particularly those concerning taxpayers' facilitation, change in attitudes and improving

[11] The information is compiled by the Fiscal Research and Statistics Wing.

the overall fiscal environment, has been the primary objective of the perception survey. The specific terms of reference for the study were carryout a nationally representative survey of the taxpayers, general public, and employees of FBR and its field offices on the quality of services delivered and the ethical aspects of tax management. In specific terms, the objective was gain insight on:

1. Quality of services provided by model taxpayer units established in major cities;
2. General perception about CARE/ PaCCS pilot projects;
3. The impact of Alternate Dispute Resolution (ADR) for speedy disposal of pendency;
4. The introduction of universal self assessment scheme (USAS) in Income Tax;
5. Transparency in the sales tax refunds mechanism through STARR/STREAM projects;
6. Transparency/adequacy of DTRE scheme;
7. Facilitation and tax education initiatives;
8. Helpline, Web sites, Software, Worksheets;
9. Simplification of laws, rules, procedures;
10. Introduction of user friendly forms with detailed instructions

Survey Design: The survey was designed to the unique identification of stakeholders for each tax. Four categories of stakeholders were identified:

1. Income and Corporate Taxpayers
    - Salaried Individuals;
    - Non-Salaried Cases
2. Sales Tax, Federal Excise and Customs Duty Payers
    - Wholesalers and Retail Traders;
    - Exporters;
    - Turnover Taxpayers;

- Manufacturers;
- Service Providers; and
- Importers

3. Employees of FBR and its Field Offices

4. Employees of other Government Agencies with specific interest in FBR activities.
   - Courts and Prosecutors;
   - Officials of the Ministry of Finance.

The overall sample of respondents was 3500. It included 2500 companies including 200 large companies, 1100 medium businesses and 1200 small business. Five hundred individuals paying income tax were also interviewed. These included 250 government employees, and 250 private individuals. In addition, 500 stakeholders were interviewed, which included 320 officials of the Tax authority (Direct and Indirect), 60 representatives of trade bodies, 60 opinion leaders from the NGO community and 60 intermediaries/ agents. The actual number of interviews was slightly larger than the designed sample.

Major Findings

The perception survey about the taxation structure/ reforms program has been a sensitive task. It is extremely difficult to have true responses from the stakeholders and particularly from the taxpayers who are usually evasive in tax payments. It is generally true that trade bodies, retailers and self-employed persons seldom want to express their true opinion on their tax potential and actual tax payments. However, notwithstanding this difficulty, it is essential to know the perceptions of the stakeholders to overcome shortcomings in the tax system and make it more efficient and transparent.

It is encouraging that Gallup Pakistan managed to have responses of the stakeholders recorded through well-developed questionnaires and field interviews. On the whole, the responses were interesting and at times thought provoking. The overall survey results indicate that the introduction of the reforms program by the Federal Board of Revenue is perceived to be successful, both in terms of awareness of its various details among the relevant audience groups and their perceptions on its achievements. Over 70% of the tax officials believe that the reforms would lead to an efficient and modern revenue organization, improved revenue collection, enhanced staff productivity, improved taxpayers' facilitation, taxpayer friendly environment and reduced corruption. On specific issues the reposes are as follows.

Large Taxpayer Units: The creation of LTUs was a historic step towards the facilitation of large taxpayers on modern lines. It was expected that the large taxpayers will respond positively and the revenue collection will be enhanced and there will be effective administrative controls and enforcement. In this regard the responses of the respondents particularly the large taxpayers would be important to frame the future policies. Amongst the respondents, between 18%-34% FBR field employees indicated that this transformation has been instrumental in achieving effective administrative controls of tax base. However, around 2/3rd of the respondents other than tax officials believed that effective controls are place only moderately. In respect of audit only 10%-26% tax employees and 21-26% other respondents indicated that effective audit was in place. Regarding effective enforcement of tax collections 20-37% of tax officials and 12-24% other respondents indicated it was at high level. This response highlights the firmly held belief that audit and enforcement continue to be weak areas of tax administration.

Corruption and related governance-related issues have always tainted the overall position of the organization. It was believed that through the establishment of dedicated field offices the extent of this menace will be reduced greatly. The responses in this regard are interesting as 31-53% of tax employees believed that there is a high level of reduction in corrupt practices. On the other hand, 50-73% of other respondents (including trade bodies, large taxpayers and intermediaries) perceived that although some improvement in this area is there but a reduction in corruption in only moderate.

USAS: The second important area was the introduction of USAS in income tax. The objective of the USAS was to minimize the contact between taxpayers and tax collectors not only to enhance the confidence of the taxpayers but also to improve transparency in the system. On the one hand, with the introduction of USAS the responsibility has essentially been shifted to the taxpayers to honor their tax obligations honestly and on the other hand, to reduce the possibility of coercion by tax officials. Since the stakes are high on both sides, the possibility of biased response from both types of respondents cannot be ruled out altogether. Thus, as expected only 5-22% tax officials believed that the taxpayers have complied with tax obligations to the best of their abilities, more than 50% of them indicated that taxpayers have performed their responsibilities only to some extent. In fact, 37-43% of tax employees contended that taxpayers have not performed their responsibilities at all. Contrary to this only up to 10% of trade representatives and intermediaries believed that the taxpayers have not performed their duties. Regarding revenue loss due to USAS, 56-67% of tax employees thought that the introduction of USAS has caused revenue loss, whereas only 8-22% taxpayers and intermediaries shared this perception. One of the important findings of the survey has been that up to 65% of the respondents including tax officials, trade body representatives, and intermediaries believed that a large number of persons earning taxable incomes are not registered with FBR.

Simplification of Laws/Rules: One of the major objectives of the reform program was the simplification of laws and rules. In this regard a mixed response has been received. Up to 74% of all categories of respondents indicated that the filing requirements have simplified to some extent. Between 42% and 66% of all respondents indicated that the refund process has improved only marginally, 15-37% believed that sales tax refund laws and procedures were not easy to comply. Ironically, 49-68% respondents indicated that they had no idea that tax policy reforms have also focused on simplification of laws, rules and procedures. This outcome needs immediate attention of the Facilitation and Taxpayer Education (FATE) wing within FBR.

ADR: The response in respect of Alternate Dispute Resolution has been positive as 68-73% of tax officials, 80-90% of others respondents had confirmed that ADR has been a speedy system of dispute resolution.

Taxpayers Facilitation: The taxpayers' facilitation drive has also received positive response in meeting the objectives as 81-89% of tax employees and 50-77% of other respondents (trade bodies, taxpayers) had confirmed that necessary measures for ease in filing of tax documents were in place. Around 90% tax officials and 47-69% taxpayers and intermediaries endorsed that publication of simple and easy to understand material has been helpful.

CARE/ PaCCS: In respect of compliance of trade regulations, 59-75% of tax officials believed that compliance has improved. Similarly 62.5% trade body representatives agreed that PaCCS has improved compliance. Up to 89% tax employees and 72% taxpayers and their representatives agreed that clearance/ dwell time has reduced due to implementation of new system of customs clearance.

Sales Tax Refunds (STARR/STREAMS): Up to 79% of tax officials and 71% of other respondents believed that the overall objective of issuance of refunds has been met only partially. Furthermore, 35-40% tax officials and 34-43% of other respondents agreed that effective check on bogus refund claims is still not properly in place.

DTRE: 45-50% tax officials and up to 88% of taxpayers and intermediaries perceived that there is substantial reduction in malpractices because of the new DTRE scheme.

HR: Within the revenue organization the remuneration package of employees remains a sensitive area. It is generally perceived that low salaries pave the way for corrupt practices resulting into evasion and huge revenue losses. Similarly trained, skilled and motivated workforce can be innovative and creative if their work and initiates is given due weightage and appreciation. The findings of the perception survey indicated that only 23% tax employees were satisfied with the structure of pay, allowances and benefits. 89% of them opined that salary package should include a performance based incentive scheme; 43% of them also contended that their seniors do not encourage new ideas and initiatives. At the same time, 60% of them believed that they have sufficient formal learning and development opportunities available through seminars and workshops.