DOTGazette

FBR PAKISTAN

The t2gdp enigma



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The tax to GDP ratio is a useful indicator of the efficacy of tax administration in mobilizing tax revenue , given a certain level of GDP. By comparing the t2gdp% in one country with the position obtaining in other countries, we can see at a glance how

that country is faring vis a vis other countries so far as mobilization of tax revenue is concerned.

In Pakistan, the t2gdp% has been on a plateau as it were for the last decade or so, hovering precariously around the 10% mark. While the absolute increase in tax revenue has been good [see fig-1] especially in the last five years, the tax system has been less than effective in translating the increase in GDP into a higher percentage level of tax revenue. Naturally this bodes ill for the country's ability to make a dent in the burgeoning federal deficit, in liquidating the national debt, in making higher allocations for development projects etc.

The reasons for this dismal state of affairs are not difficult to fathom. Given a total population of 170 mill, just 2.2 mill registered taxpayers expresses an extremely narrow tax base. Malaysia has a 20% tax base and Turkey 8%. Again, only approx 16,000 corporate entities file Returns of Income in Pakistan wherefrom the bulk of federal tax revenue emanates.

Although efforts have been made to enlarge the tax base and bring more taxpayers on the tax rolls, clearly there has been only limited success in this regard, as the data so convincingly bears out.

While the reasons for failure could be many, it does appear that the informal sector has had a huge role to play in Pakistan in robbing the federal exchequer of due revenue. This sector is presently estimated at between 35 to 50% of the regular, formal, economy. Many economists are convinced that it cannot be less than 50% of the formal economy. This means that income equal to 50% of the GDP generated in the formal economy is realized in the informal sector. This huge chunk does not enter into national income accounts and as it is "unreported" it suffers no income tax.

Available data further suggests that out of a total labour force of 47 mill, [27] are employed in the non agricultural sector and out of these, only [9] are employed in the formal sector and the balance [18] in the informal sector. The informal sector thus far outstrips the formal sector in terms of number of people employed. Most people working in the informal sector are employed in small scale, subsistence level, cottage industry type enterprises, producing finished goods for sale in the market. Transactions are undocumented and Returns of Income are not filed and thus no income tax is paid. However a great deal of tax evasion cannot realistically be attributed to this segment of the economy. As stated, these are mostly subsistence level enterprises so that significant

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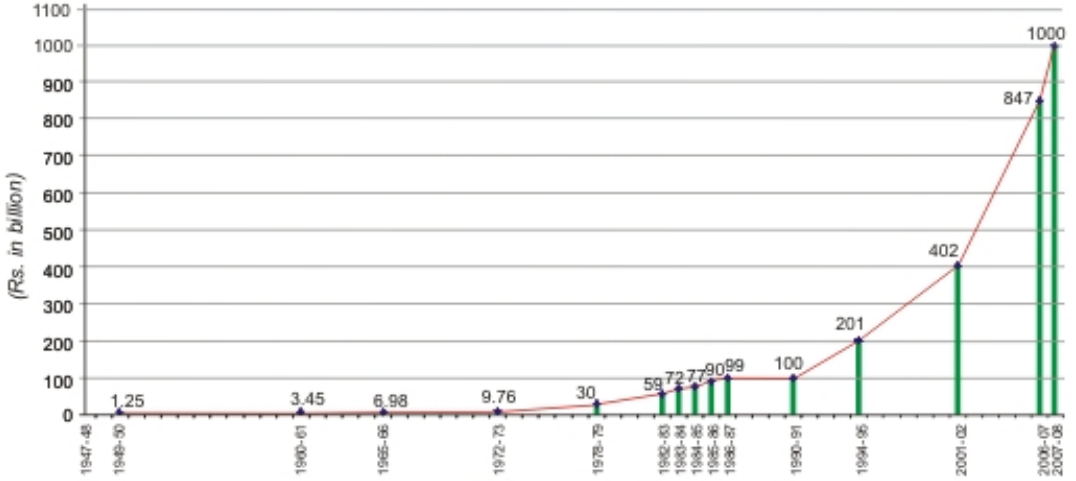
Figure-1. Pakistan Federal Revenue Collection



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EDITORIAL

As the financial year 2008 approaches its close it is time for retrospection and reflections on the performance during the year. Such performance appraisals help the organization in measuring its performance against benchmarks and also in determining the way forward for the future.

This directorate has always upheld its tradition of fulfilling the training requirements of the FBR personnel by providing the best available instructional facilities. The year 2007-08 witnessed another achievement for DOT as it not only continued its indigenous trainings , but also paid host to IBA , Karachi related capacity building program for mid career officers. This training program comprised of two separate modules whereby a total number of 542 officers of Income Tax & Customs, Sales Tax and Excise Groups were trained by the IBA faculty. DOT provided all the material and logistic support for this venture.

During the year the 34th STP completed their Specialized Training Program and left for IBA Karachi in January 2008. In addition, the Directorate also launched a comprehensive training program for the support staff in the field formations. The basic thrust of this module was to provide the requisite computer skills to the support staff vital for job performance in an automated environment.

The future appears bright as the Directorate has initiated processes to develop its hitherto dormant research wing. In this regard the membership of IBFD (International Bureau of Fiscal Documentation) shall go a long way in strengthening this wing.

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income levels are not involved and the workers barely manage to eke out enough income to keep body and soul together.

However it would be a gross fallacy to assume that the entire informal sector is cast in this mould. In fact there is a relatively small- small in terms of number of people employed- but hugely significant niche, occupied by enterprises that make a great deal of money, that do maintain records and yet remain outside effective institutional control. These enterprises operate in the murky, 'grey' or 'black' segment of the economy that is outside the pale of law - just as the small, subsistence level enterprises do. The difference of course is that unlike the subsistence enterprises, they make a great, great deal of money which they do not 'declare' to the tax authorities and hence do not pay any tax on the proceeds. These "players" engage in smuggling, dealings in narcotics, counterfeit goods, stolen goods - what have you. Actually the range of activities is mind boggling [see fig-2].

While we do focus a great deal on the "goods" traded in the informal sector, we pay scant attention to the "fuel" that drives the entire economy - the informal and the formal. This "fuel" of course is the media that makes all "exchange" possible - money. It is not only a medium of exchange it is also a measure of value, a "standard" of value and enables value to be "stored" -for subsequent retrieval.

While the currency notes in circulation within Pakistan are all issued by the State Bank ONLY, the movement of currency across national boundaries is not the prerogative of the formal, institutional, banking framework alone. Nor is "credit" within the domestic economy disbursed in it's entirety by the formal banking entities operating "legally." Rather, scores of illegal operatives perform improvised "banking" functions moving huge amounts of "currency" across national boundaries and disbursing significant amounts of "credit" to 'players' placed both in the formal as well as the informal sector. These informal bankers make a tidy profit for themselves through their clandestine activities

[paying no tax thereon of course] but in so doing they do disturb the formal economy and create serious problems for the economic managers of the formal economy.

In Pakistan the informal bankers have been doing a brisk business ever since the nineteen eighties when the post oil shock petro dollar bonanza fueled a surge in demand for blue collar labor in the middle east. Significant numbers of Pakistanis made their way to the middle east since and many patronized the informal bankers who offered their services without the perceived hassle of official banking channels.

Over the years the activities of the informal bankers have continued unabated. They provide banking services through the well known "havala channel" to all overseas Pakistanis in the middle east and beyond, more than [10]

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Figure - 2 Black Economy

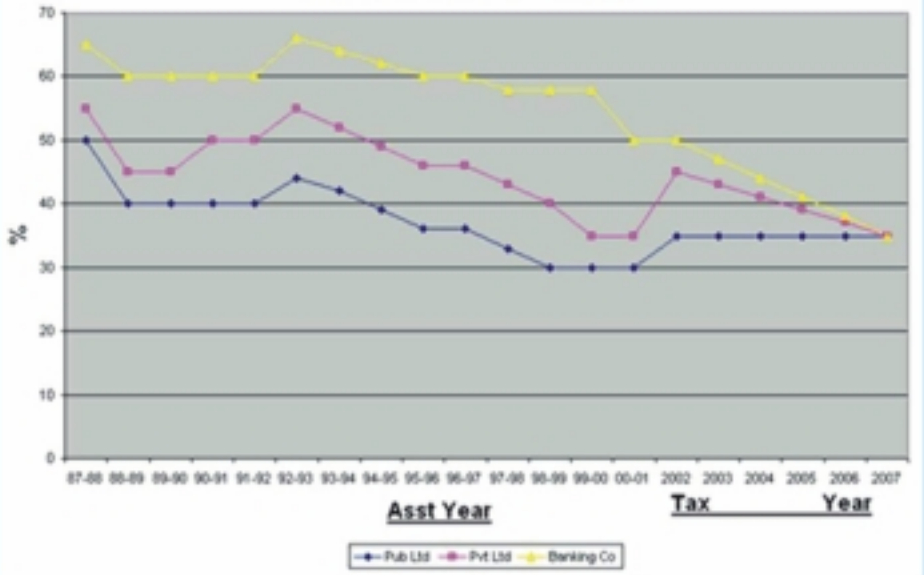
HAVOCSCOPE GLOBAL INDEX		
1.10 Trillion	48 Products	437 Citations

HAVOCSCOPE ILLICIT MARKET SEGMENTS

Segments	Market Value	Number of Products
Counterfeit Goods and piracy (CGP)	650 Billion	27
Global Drug Trade (GDT)	321.6 Billion	5
Environmental Goods (ENV)	55.7 Billion	6
Humans (HUM)	42 Billion	5
Consumer Products (CP)	34 Billion	3
Weapons (WEA)	4 Billion	2

fig.1

Corporate Taxation in Pakistan



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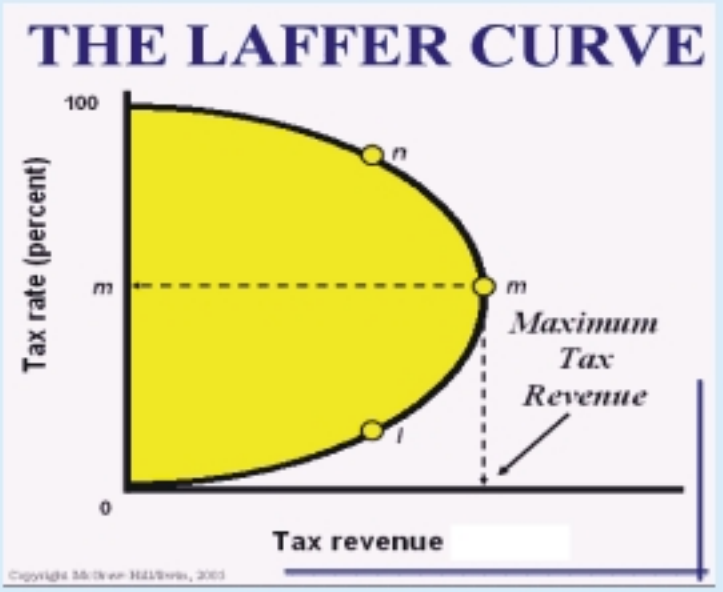
remitting [5] to [6] bill dollars [US] annually to Pakistan- the same as is being sent through "official" channels. The "havala" channel did slow down significantly post 9/11, but they again appear to be back in business now on almost the same scale as before.

What connection can all this have with the low t2gdp% enigma in Pakistan?

It would appear that regular, 'formal sector' business activity in Pakistan has faced a variety of problems that have impacted adversely on the peoples perception of their profitability. For a long time his had a lot to do with the extremely high tax rate structure [see fig-3]. These rates have been going down over the years and are presently pitched at their lowest ever. While the high tax rates of yesteryears drove many [especially in the retail sector] out of the formal sector, the present day low rates are apparently not providing the impetus to bring them back to the formal sector. However what is really worrisome is that the huge amounts of 'super normal profits' generated in the informal sector "niche" referred to above along with large amounts of hard currency remittances from overseas Pakistanis are being moved to perceived, high profit, "safe havens" abroad, especially for investment in real estate, with Dubai being a much favored destination. With the economy robbed of significant financial resources on a recurring basis [the annual drain may be in the region of [7] to [10] bill dollars] , this outflow is eroding the vital resource base of the national economy making it that much more difficult to mobilize tax revenues effectively. The fact that the t2gdp% has leveled out at 10% for the last decade now is due in no small part to this impoverishment of the national economy. Just imagine if instead of moving to Dubai, these resources were being invested annually within Pakistan in the formal sector - in areas other than real estate that is -, what a sea change it could bring in terms of enhancing the ability of the economy to generate revenue for the federal exchequer.

While Dubai does appear at the present time to be a very attractive investment opportunity, in the opinion of many who understand the phenomena, it has all the makings of a "bubble" much like the real estate bubble in Japan of the not too distant past that led to huge investment in that segment. Inevitably, such "bubbles" eventually do burst much sooner than later- driving property prices down calamitously and spelling ruin for those who have sunk their fortunes here in the wholly misguided notion that prices will continue to rise for ever.

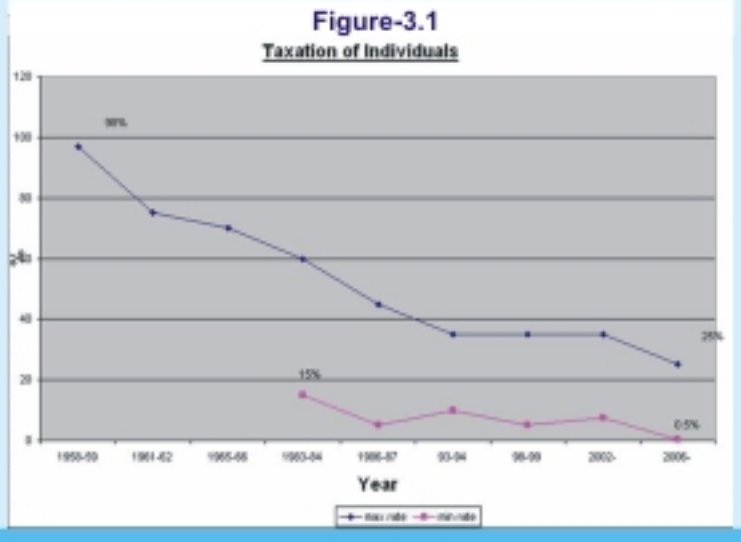


Perception is said to be nine tenths of reality. In Pakistan, players in the informal sector [mis]shape peoples perception significantly. They do so by fostering a cult of greed whose ravenous appetite drives people to take rash and foolhardy decisions that will eventually spell ruin for themselves and for the country. Government must do all it can to understand better the actual role of the informal sector and must not hesitate to act aggressively especially against the dangerous niche occupied by those reaping supernormal gains through criminal activities.

UnderGround Economy in Pakistan vital statistics

Year	UGE - GDP	UGE - Tax Evasion	UGE/% of GDP
	Bill.Rs	Bill.Rs	
1973	15	2.15	20
1978	41.832	4.844	23.51
1983	104.759	13.361	28.75
1988	192.752	26.672	28.54
1993	470.124	62.913	35.27
1998	1449.891	193.397	54.52
1999	1146.839	152.499	39.03
2000	1094.052	141.077	34.76
2001	1298.233	169.025	38
2002	1388.064	175.472	37.25

Source : M. Ali Kemal, Underground Economy & Tax Evasion in Pakistan A Critical Evaluation



Informal Economy

- The Informal Economy is a process of income generation that is unregulated by the institutions of society, in a legal & social environment in which similar activities are regulated. "
- " The Informal Sector is an 'oxymoron '- on the one hand it is an unorganized nuisance sector whose members do not pay any form of tax; on the other it provided jobs & increases incomes of the most vulnerable groups in a city – the very low income group. "
- "A group of production units which form part of the household sector as unincorporated enterprises owned by households. "

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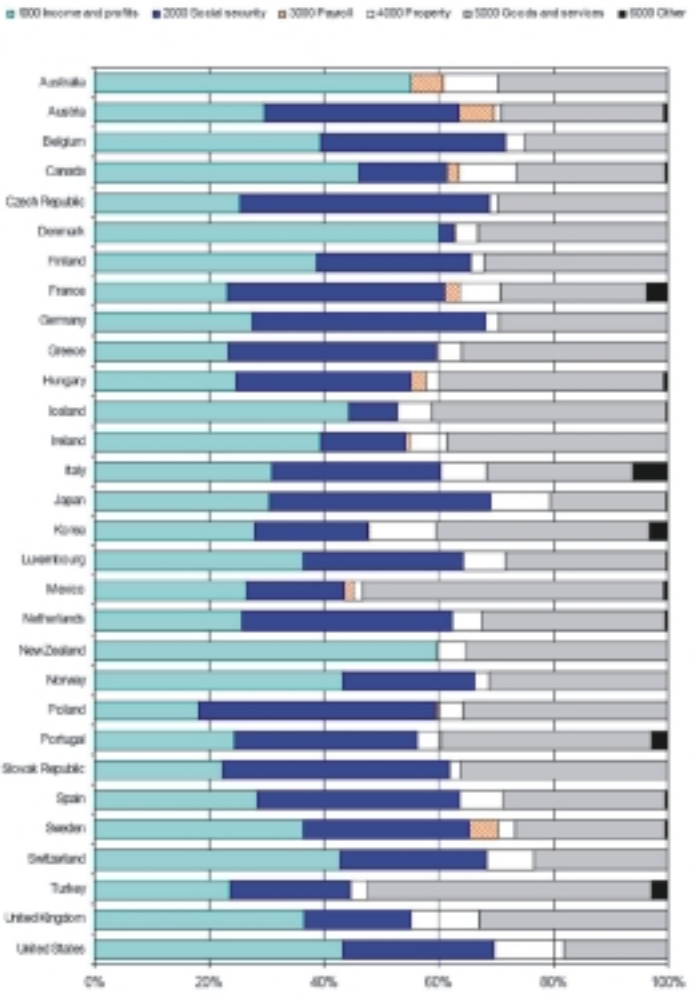
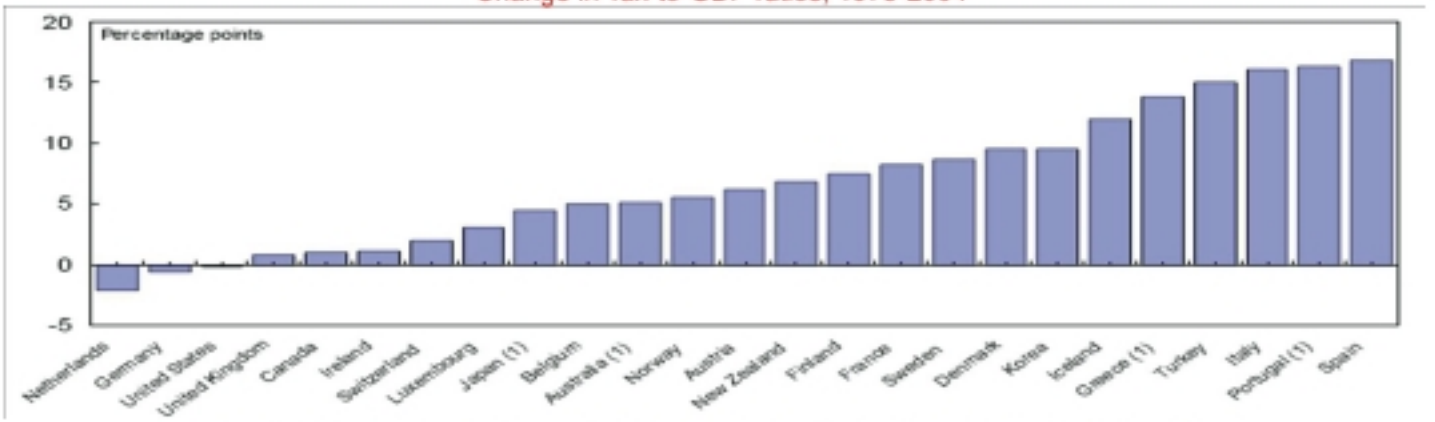
Total tax revenue as percentage of GDP

	1975	1985	1990	1995	2000	2002	2003	2004 Provisional
Canada	31.9	32.5	36.9	35.6	36.5	34.0	33.8	33.0
Mexico		17.0	17.3	16.7	18.5	18.1	19.0	18.5
United States	28.6	25.6	27.3	27.9	29.9	26.3	25.6	25.4
Australia	26.5	29.1	29.3	29.8	32.1	31.4	31.6	n.a
Japan	26.9	27.4	29.1	26.7	26.5	25.8	26.3	n.a
Korea	15.1	16.4	18.9	19.4	23.6	24.4	25.3	24.6
New Zealand	28.5	31.3	37.7	36.6	33.9	35.0	34.9	35.4
Austria	36.7	40.9	39.6	41.1	42.6	43.6	43.1	42.9
Belgium	46.6	45.6	43.2	44.6	45.7	46.2	45.4	45.6
Czech Republic				37.5	36.0	37.0	37.7	37.6
Denmark	46.0	47.4	47.7	49.5	50.1	48.7	48.3	48.6
Finland	36.8	40.2	44.3	46.0	46.0	45.6	44.8	44.3
France [1]	35.5	42.4	42.2	42.9	44.4	43.4	43.4	43.7
Germany [2]	35.3	37.2	36.7	37.2	37.2	35.4	35.5	34.8
Greece	21.8	28.6	28.3	32.4	36.2	37.1	35.7	n.a
Hungary				42.4	39.0	39.8	39.5	37.7
Iceland	29.8	28.7	31.8	32.1	38.4	38.6	39.8	41.9
Ireland	28.1	35.0	33.5	32.8	32.2	28.7	29.7	30.2
Italy	26.1	34.4	38.9	41.2	43.2	42.6	43.1	42.2
Luxembourg	37.5	45.1	48.8	42.3	46.8	41.3	41.3	40.8
Netherlands	41.3	42.8	42.9	41.8	41.2	39.2	38.8	39.3
Norway	39.3	43.0	41.5	41.1	43.2	43.8	43.4	44.9
Poland				37.8	32.5	34.7	34.2	n.a
Portugal	26.8	26.6	28.2	33.6	36.4	36.5	37.1	n.a
Slovak Republic					34.3	33.0	31.1	30.8
Spain	18.2	26.9	32.1	31.8	34.8	34.6	34.9	35.1
Sweden	42.0	48.2	53.2	49.6	53.9	50.1	50.6	50.7
Switzerland	27.4	26.1	26.0	27.8	30.5	30.1	29.5	29.4
Turkey	16.0	15.4	26.0	22.6	32.3	31.1	32.8	31.1
United Kingdom	35.3	37.7	36.5	35.1	37.5	35.6	35.6	36.1
Unweighted average:								
OECD Total	30.3	33.5	34.8	35.7	37.1	36.4	36.3	
OECD America	28.8	25.0	28.8	28.7	28.0	26.1	26.1	25.8
OECD Pacific	22.7	26.0	28.7	28.2	29.0	29.1	29.3	
OECD Europe	32.1	36.4	37.3	38.3	39.7	39.0	38.9	
EU 19	33.1	38.6	38.3	39.8	40.4	39.6	39.4	
EU 15	33.1	38.6	38.3	40.1	41.7	40.6	40.5	

Tax revenue of main headings as percentage of total tax revenue 2003



Change in Tax-to-GDP ratios, 1975-2004



Note: (1) indicates that the change is from 1975 to 2003. Czech Republic , Hungary, Mexico, Poland, and Slovak Republic are not included because data for 1975 are unavailable.

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INTERVIEW

Fareed Zakaria, on his new book, "The post American World."

"In my book, "the post American World," I talk of a phenomena that I describe as, 'The rise of the rest.'

Over the last two years, [124] countries have grown over 4% a year. If you look around, you see the results

- the largest Company in the world, is in Beijing;
- the largest refinery in the world is in India;
- the largest passenger aircraft in the world is built in Europe.

If you look around even at the symbols of capitalism, the largest Ferris wheel in the world is in Singapore;

The largest casino is in Macau, China.

It used to be said that the Minneapolis mall, the mall of the America's, is the largest mall in the world.

Today, it doesn't even make the first ten.

In the book I talk about the incredible challenges the United States has going into this world, but I also talk about the incredible strengths the United States has.

Let me give you four reasons why I think the United States can fare well in this new world.

The first is... the United States has an incredible momentum and adaptability which allows it to take the up's and the down's and adjust.

Second- look at the industries of the future.

From nanotechnology, biotechnology and a whole array of new information technologies.....the United States leads the world by far.....we have more dedicated nanotechnology centers in America than the rest of the world put together.

Three- our best industry is actually, higher education.

[8] of the top [10] universities in the world are American;

[38] of the top [50] universities of the world are American..... and on and on.

We look at the world of higher education, it's links to industry and it's ability to generate scientific discovery, patents, what have you.....America dominates the field.....the rest of the world is far behind and will take a long time to catch up...

And finally, while the other countries have their economic strengths, the advanced industrial world is aging and aging fast....Europe in five to ten years is going to look like Florida demographically, that is, not aesthetically..... but the United States will stay young and hardworking because of immigration.....we take in the first draft picks of the world, and we take in lot's of them....one million....more than the rest of the world put together.....and that's legally.

My argument is.....if the United States can adapt.....if it can really adjust to the fact that the rest of the world is rising, it could maintain a central position, a unique position and America will thrive in a post American world."

[Newsweek
Video transcript]

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MID-CAREER MANAGEMENT COURSE



By
Badar Zaman
Deputy Director

A ten week long mid career Management Course concluded at National Institutes Of Management Peshawar, Quetta and Karachi on 17 .05 .2008. The course is mandatory for officers in BS-18 due for promotion in BS-19. The course consisted of five modules namely Economics and Finance, Budgeting and Accounts, Local Government System, Human Resource Management, Current issues/International affairs with special emphasis on war on terror, situation in F.A.T.A, Pakistan's relations with super powers etc.

Training module consisted of lectures, discussions, panel discussions, work shops, seminars, exercises through syndicate and tutorial discussions followed by presentations by the group and critical analysis of presentations by other groups.

The faculty also chose one topic for each participant out of three choices presented by the participant for writing a research paper. Each participant was assigned one topic on current affairs for making a presentation followed by critical analysis and questions by faculty and other participants respectively.

As a part of experiential learning a simulation exercise on local government system was conducted at Charsadda. Ninety participants were divided in seven groups allotting one department to each participant and focal points to each group for making group presentations. These presentations were made in the presence of respective departmental/provincial Heads of Departments followed by critical analysis by other groups and comments by concerned departmental heads. A similar exercise was conducted through field study tour where participants were divided in three groups, one group toured earth Quake hit Mansehra and Azad Kashmir, the second group went to Karachi to examine developmental activity in Metropolitan Area and the third group toured Quetta with a special reference to law and order situation in the province and role of Frontier Constabulary . The six day field trip was followed by presentations chaired by respective Heads such as E.R.R.A (Earthquake Relief & Rehabilitation Authority) and Frontier Constabulary who in turn commented on the presentations made and also presented their departmental objectives.

The course emphasized on preparing the potential B.PS.-19 officers for there assignments in future, ensuring knowledge of current issues faced by Pakistan, instilling confidence and making them computer literate. An important area was to train them in modern participative management techniques. The course met its objectives in these areas. Participation in sports such as badminton, squash, table tennis were made compulsory..

The last day of the course was devoted to course evaluation by the participants ,where participants thanked the faculty for there hard work and devotion, praised the course contents as being highly useful but proposed to focus on departmental subjects rather than a generalist approach , choosing more than one district for Local Government studies and focusing on latest issues.



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PICTORIAL - "Train The Trainers" Module organized by the Audit Wing FBR













DOT Gazette

Conclusion of "Train The Trainers" Module organized by the Audit Wing FBR

By
Amna Faiz Bhatty
Deputy Director

The Audit Wing FBR has embarked upon a series of training sessions aimed at strengthening the skills of audit officers posted through out the country. These training programs commenced from April 2008 and shall run till February 2009 whereby a total of 27 training modules shall be delivered to audit officers through out Pakistan.

Out of these 27 modules, the first training module titled "Training the Trainers" was aimed at preparing in house FBR personnel as future trainers. The audit officers trained through this module shall assist in conducting the remaining 26 audit training sessions planned by the Audit Wing, FBR in collaboration with a professional accountancy training academy. These officers were trained not only in the field of audit, but they were also coached in training techniques including: preparation of Power Point Presentations, presentation skills, training models etc.

This first module comprising of three week long training commenced from 28th April at the Directorate General of Training & Research (Direct Taxes) Lahore. The course was conducted by Professionals' Academy of Commerce (PAC) and all the material and logistic support for this module was provided by DOT. DOT administration and faculty were also actively involved in planning and designing the course content.

The module comprised of case studies, presentation, discussions, field trips etc. The focus of this module was to enhance the audit skills of the field officers through interactive instructional techniques. Case studies focused on industries such as pharmaceuticals, paper and board, textiles, sugar, service sector etc. The participants were sensitized to the concepts of stages / processes and raw materials involved in the production of each industry. Industry averages, wastages, ratios and issues of management were posed in each case study requiring the participant's involvement through pertinent queries at the end of each case study. A group of two participants was required to give a presentation on a case study assigned randomly. The performance of each pair was evaluated objectively by the trainees along with the lead Trainers. The participants were trained in risk profiling of a given case through relevant case studies. Similarly internal controls for identification of risk areas were also discussed in detail followed by the audit techniques required to tackle risk areas identified.

Out of this three weeks training, two days were devoted to hands on training inside the computer lab. The participants were trained in data entry of returns of Income Tax and Sales Tax of various categories of taxpayers. Similarly the trainees were introduced to the concepts of computer softwares such as "Sage" for identification of sales, purchases, inventory etc. transactions involving over statements and fraud.

The participants also taken for field visit to industrial units such as textile, cements units etc. to gain first hand insight into production processes involved in each industry.

On the last days of the module the participants were required to give presentations on pre-assigned topics to polish their presentations/inter personal skills. The topics for presentations included: Anomalies in Income Tax Ordinance 2001, WTO , KSE 100 Index, ENRON ,Industrial Growth in Pakistan During Last Decade, Role of Information Technology in Tax Collection, Role of Pakistan's Judiciary in Tax Collection, Concept of Taxation in Islam etc.

The module in conclusion was a success in "integrated training" as officers of both Income Tax and Sales Tax Groups participated in the module. The course also trained the field audit officer in the necessary audit techniques required for conducting effective and meaningful audits.

DOT administration deserves to be complimented on its important role in making this module a success by providing maximum support and cooperation to the trainees as well as to the trainers.

