

Wrapping up Speech of Dr. Ishrat Hussain for Session I

Dr. Ishrat Hussain: Distinguished ladies and gentlemen, first of all I am very grateful to SRB for inviting me this morning to listen to a very productive and useful discussion of taxes on services I would like to both summarize and at the same time articulate my own views. SRB has done a very good job in its first year and all of us should be extremely proud of their achievements. But going ahead like our history as then organizations do expand they get into a rut; they get into the routine which actually destroys the credibility of the institution.

So my advice to SRB is remain a lean organization whereby you use high level human resources of quality and integrity supported by technology platform, if you continue to that you will remain effective but if you burden yourself by incompetent political appointees, of dubious character, you will lose the confidence of the tax payers and your own performance will be jeopardized. So I think the challenge is how to maintain the kind of record that you have produced in first year over a long period of time, because you can see your own institutions which are entrusted with revenue collection in Sindh and what their condition is. So I want you to caution, that, you will be able to maintain this particular integrity, tax payer facilitation and service; and collection at the same time and this is my first advice to you.

If you look at the services sector ladies and gentlemen, it accounts for 55% of the national income. So according to the principle that every sector should pay proportionately to the taxes, the services sector is not doing that, the main burden is only the manufacturing sector and that's why our industrial growth has been not at the pace we would like to see, because it is heavily tax burdened sector. It accounts for 25 % of our national income but it pays 65 % of the taxes, so it's inequitable and creates wrong incentives for those who are planning to invest in manufacturing that is why we are a trading nation rather than a manufacturing nation.

The services sector accounts for 55% of but pays only 25% of the taxes and agriculture does not pay anything, so this kind of situation is not viable, we have to tax the services not at the rate of 16% or 19% which are quite damaging both for incentives but also for tax evasion. The higher the tax rate the more culpable people are to evade taxes, so we have to bring the tax rates lower but that has to be done by expanding the menu of services, you cannot do this only with 15 services. So I would request the Chairman and members of SRB that in the coming years they should try to expand the coverage of services.

There are new services which are coming in and I give you the situation as far as the fashion industry is concerned. The fashion industry today is booming which is good for the country because that is adding value but they should also pay the taxes, there are boutiques, there are hair cutting saloons, there are laboratories, there are tuition centers, there are clinics, there internet cafes, these are the new areas which are coming up as services and if want to tax the

courier services or the shipping services, it is incumbent upon us to also tax these new services which are coming in.

So you have to carry out surveys of new businesses and bring them under the tax-net and ask the Assembly to expand the coverage of your taxes. It will do two things, it will create an equitable distribution of burden of taxation, and everybody will feel that the other person is paying so I should also pay. Second, that it will lead you to reduce the rate of taxation from 16% to maybe a single digit and people don't mind if you ask them to pay 8% or 9%, people are willing to pay. If you are paying 16% or 19% then there is resistance. So that is my second point that I wanted to make.

My third point is that decentralization of tax collection is the most efficient way of doing business. Studies all over the world have shown that the more visible the effects of taxes are, the more willing are people to pay taxes. If your tax disappears somewhere in Islamabad and you cannot see what benefits you are getting for yourself or for your community you are more reluctant to pay. But if you are in your district and you see that the taxes are being paid for schools, for hospitals, for rural water supply, for roads the more willing you would be to pay because you have a visible, perceptible association with your taxes. But if they disappear in thin air somewhere in Islamabad and you do not know what the use of the taxes is, the more reluctant you are to pay your taxes.

So I have been arguing for devolution not only to the provincial level but also devolution to the district level, because we are 180 million people, at the time of the independence we were only 30 million people. It is administratively impossible to administer on the lives and provide the services to the lives of people in Jacobabad while sitting in Karachi. The people of Jacobabad should have the power, authority and responsibilities to carry out their own development and to carry out their own future services and benefit from that.

So this is a very good move that we have established the Sindh Revenue Board and I agree with Nazar, that, this is a lame excuse, which the Provinces are now using, that the local government do not have the capacity so we do not want to transfer any power to them , how do you develop a capacity, how do you create a capacity, once you give them the responsibilities you give them the resources both the human resources and the financial resources and keep away from meddling in their affairs they will develop the capacity, it will take time but it will develop the capacity. SRB has proved that the fears of FBR that they don't have the capacity are misplaced. In one year they have done that, I am glad that Punjab is now going to do that and hope that KPK and Baluchistan also follow this but don't level this at the Provincial level but also devolve this responsibility to the local level.

In India, 5-6 percent of the GDP is collected through the provincial or the state taxes. Here since the NFC award has given huge resources to the provinces, the contribution of the Provincial governments has come down to less than 1%, so we are becoming more dependent on the federal divisible pool, that's not how the country will progress. You have to have new sources of revenues which we can then utilize for the development of this country. You cannot have a zero sub-gain, that everybody is attacking on that divisible pool and everybody is fighting for that divisible pool, we need a positive sub-gain and one of the recommendations that I want to make and I am glad my friend Dr. Kaiser Bengali who is a member of the National Finance Commission is present here is that tax effort and revenue mobilization effort by the province should be given some weight age as far as the allocation formula is concerned. Otherwise you will be just fighting amongst yourself, of course KP and Baluchistan are not in that position but you can compensate them, otherwise Sindh and Punjab can do a great job. I mean I know for a fact that property tax in Karachi alone can generate 1-2% of the GDP without any difficulty but we are not doing it. That is why tax effort should be one of the weight-age in the NFC award and you will see how it changes the incentive.

The fourth point which I want to make to SRB is to minimize direct interaction between the tax payers and the tax collector. Use online technology based solutions in order to get the assessment. It should be self assessment but self assessment does not mean that you should abdicate your responsibility of verifying and validating the data that has been submitted to you. You must have other ancillary data bases which you use in order to verify the accuracy and veracity of those assessments.

You should have a risk based audit system whereby your risk parameters should allow you to pick up on a random basis some of the assessments and you do a thorough job. Unless there is a fear among the tax payers that they will be taken to task, they will be penalized if they understate their incomes, or if they conceal their incomes or if they do evasion of their incomes nothing will happen. It is not the action itself but it is the deterrent effect of audit which should keep them honest and that has not happened in the history of Pakistan. But I hope that SRB will be the pioneer in trying to have this capacity for both enforcement, as well as taking penal action against those who are proven wrong through due process. We do not want arbitrary nature of the process but the due process according to rule of law that should be followed. Once you have followed it whether that gentleman is Ishrat Hussain or that gentleman is some very lowly person you should be quite forceful in taking action against that person and that deterrent action will solve many of your problems and compliance rates will increase and I assure you that this is how other countries in world have been able to augment their revenue collection.

My fifth point is that you have a responsibility to just not concentrate on sales tax on services. I would very much like to recommend to the Chief Minister and to the Cabinet through this forum that the Sindh Revenue Board should be given the authority for other taxes also. Why? because you are starting with a clean slate. You have systems and procedures in place; you have men and women of integrity who are running this organization. It will be in the interest of Sindh Government to entrust you with other taxes collection also and you can see within one year those taxes will also record a substantial increase because organizational culture of SRB is very different as others, I d not want to name them but the beneficiaries will be the people of Sindh when they will see a large amount of taxes coming from the same sources.

I am not suggesting that you change the tax rate, maybe you will reduce the tax rate because the efficiency of your tax collection will be so high that at times you may say I don't want to have these tax rates, I want to decrease these tax rates. So I would very much like that you become Sindh Revenue Collection Authority for all taxes and the cesses which are being collected by the Sindh government, because in this way there will a perceptible shift, but you have to adhere to your organizational culture. If you also follow the organizational culture of the departments which we are asking to be divested than there is no gain, then we are standing on the same spot as we started.

With these few words I once again to thank the SRB, the panelists for extremely useful presentations to the audience for their patience and for asking very pertinent questions. I hope that next year SRB would be able to go from 0.5% of Sindh provincial product which is their performance this year to at least 1-2 % of Sindh provincial product as the revenue collection.

Thank you very much.