**Taxing the taxed**

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Every government comes up with a mantra of documenting the undocumented, and taxing the untaxed, but due to lack of imagination, inability to take decisions, and unavailability of political capital it taxes the taxed more.

As the economy transitions from one boom-bust cycle to another, the government in place continues to take the same decisions that it decried while in opposition. This is the Groundhog Day of budgets, where those who already pay taxes are taxed more, while those who do not pay any taxes, or minimal taxes, continue to have the last laugh.

Over the last two decades, if not more, to expand its revenue base each successive government has either increased corporate taxes, or imposed arbitrary one-off taxes which often become perpetual thereby distorting incentives in the economy discouraging investment. Due to such heavy taxes, capital continues to leave the formal economy, while the informal economy grows as can be evidenced by a substantial rise in cash in circulation over the last five years.

It makes more economic sense for capital to be parked in a non-productive segment as a store of value, rather than be reinvested in the economy to generate an economic multiplier and more jobs, given the distorted nature of incentives. Through its tax measures, the state is actively encouraging a move away from the formal economy to the informal economy – similar to what previous governments have done. The policy remains largely unchanged and regressive.

The size of the informal economy has increased substantially over the last one decade, as can be seen by an increase in cash in circulation, as well as the ratio between private-sector deposits and public-sector deposits, which has gradually been declining over the years. As the private sector avoids keeping capital in the formal economy, the taxation pie in real terms continues to shrink. Lack of policy continuity and consistency has pushed private capital to a point where there is little to no trust left in the government, which as a policy penalizes taxpayers, rather than tax evaders. As the taxation pie shrinks in real terms, if the existing policies continue and arbitrary taxes remain the order of the day, soon there will come a time when the government will only be taxing the public sector, and working in its own parallel economy, while the real economy will be largely informal in nature.

The highest brunt of bad policy actions is borne by the salaried taxpayers, who have not only seen real incomes eroded due to consistently higher inflation, but will now also pay higher taxes in an environment where inflation is expected to remain in double digits. This will significantly erode real disposable income, and purchasing power, inadvertently affecting overall aggregate demand. There is little incentive for any salaried taxpayer to pay taxes, and the only reason they even get collected is because they get deducted at source.

Given distorted incentives, and a broken service delivery model, it is no surprise that brain drain for the country has accelerated. The inability of successive governments to fix the fiscal side with a broad-based taxation regime has resulted in salaried taxpayers paying a significant chunk of their income relative to the non-salaried segment of the population which largely remains in the informal segment. The incentive structure is skewed such that it makes no economic sense to be involved in a capacity requiring a value-added skill, when you can simply become a trader in the informal economy, and minimize paying any income taxes.

The tax and service delivery structure has been broken for a few years now. If it is not resolved, it will be decimated. The inability of the government to tax the untaxed segments has already tainted the structure of the economy. If the same continues for a few more years, we would eventually be stuck in a low-growth and low-taxation loop because successive governments failed to take any corrective actions. The corrective actions which are also hailed are also various amnesties, which further sends a signal that there is no economic sense to pay taxes when an amnesty scheme will be available to make your capital squeaky clean at a much lower tax rate.

There is no denying that the country needs to increase its tax-to-GDP ratio which is much lower than its peers, but this cannot be done by taxing the manufacturing and salaried segment of the population, while pushing through an indirect tax regime. The tax-to-GDP ratio can only be increased if more segments are brought into the tax net.

The same approach has been repeated infinite times over the last few decades, but not much has been done. If history provides some guidance, not much can be expected to be done either and we will continue to relive this Groundhog Day for years to come till the time there is no one left to tax, and we are perpetually stuck in a low-growth loop solely due to a bloated and ineffective fiscal regime.

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