**What should the tax policy be in 2024?**

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There is an ongoing debate regarding the preferable size of government – big or small? ‘Big government’ is a political concept where the government plays a predominant role in social sector development, economic activities, market functioning, etc.

The idea gained traction during the New Deal post-World War II, with US president Roosevelt advocating for it to fund war expenses and support the US economy. However, in the 1980s, advanced economies like the US and the UK shifted away from this concept during the era of US president Reagan and British prime minister Thatcher, respectively. Thatcherism and Reaganomics promoted a concept of ‘little government’, characterized by minimal intervention and taxation (a government that does little and taxes little).

Meanwhile, in most developing countries, including Pakistan, the concept of an expansive and engaging government (big government) prevailed despite some successful examples of privatization of nationalized industries/organizations. The reasons are obvious: the governments want to increase their influence and footprint, whereas many citizens depend on government interventions.

Since 2020, amid the Triple C crisis – Covid-19, conflicts, and climate change – the notion of big government has resurfaced even in advanced economies. For developing countries, this translated into increased government responsibilities and delivering on many more fronts. However, doing more means higher public expenditures that are being met through debt, taxes, or both.

Additional borrowing is not a viable option for countries like Pakistan, necessitating a focus on mobilizing additional revenues and rationalizing expenditures. Yet, asking for increased taxes during times of low growth and a high cost of living poses political challenges. Innovative solutions leveraging new technologies and Big Data, such as data analytics and generative artificial intelligence (AI) guided systems, can identify potential new taxpayers, strengthen tax administration, and enhance compliance.

One can argue that all of the above is doable with the help of smart data gathered through systems like point-of-sale (POS), digital invoicing, digital payment platforms, and e-commerce. However, doing this requires a rethinking of the taxation system.

Furthermore, the government must consider that transitioning to green energy may not only imply additional spending but also potential reductions in levies, duties, and surcharges collected from conventional fossil fuels. Likewise, increased penetration of AI will cull jobs (it is one of the four priority topics at the World Economic Forum this year). The future of jobs will also affect the income tax collection across the world. These developments underscore the need for an innovative rethink of taxation policies and their implementation.

In this context, the proposal from the Ministry of Finance to pursue reforms in the Federal Board of Revenue (FBR) is a commendable step. While Pakistan has attempted revenue collection reforms in the past, the timing of the current proposal holds greater significance for the country’s fiscal and economic stability. The fiscal and economic stability of the country is linked with a transparent and accountable revenue collection system, which can finance public expenditures and at the same time have minimal impact on economic activity.

Assessing the proposed reforms (which have been approved by the apex committee of the Special Investment Facilitation Council or SIFC) involves questioning whether they can reduce anomalies in the taxation system, enhance transparency and accountability, curb smuggling (especially related to the misuse of the Afghan Transit Trade Agreement), improve tax collection efficiencies, and shift taxation into a data-led system minimizing rent-seeking opportunities.

While the current proposal seems to possess the necessary elements, its success depends on effective implementation in both letter and spirit. The hope is that the next government (which will follow the concept of ‘big government’ due to the electoral promises made by political parties aspiring to come into power) will have the appetite to increase revenue to finance its increased public spending. Additionally, the support of the SIFC for the current round of reforms and the likely inclusion of these reforms as a structural benchmark in the next IMF programme enhances the chances of its successful implementation.

Zooming in, the proposed creation of distinct inland revenue and customs (if implemented in a manner that does not create insecurities and turf-war within tax administration) will allow inland revenue to grow its own systems and focus on federal taxes, broadening the tax base and lowering tax rates. At the same time, customs will focus on anti-smuggling and trade facilitation, in line with international norms, working to help traders, importers, and exporters to fully interact with international markets.

Likewise, the proposed operational (budgetary and human resources) autonomy of tax administration and tenured positions of the senior officers (against medium-term objectives of collection and system development) of inland revenue services and customs will reduce the scope of political interference and politically negotiated postings and transfers. Removing fear of political pressures will allow them to lead their administrations professionally.

One can tweak the composition of the proposed independent oversight boards for both services. However, the mechanisms will potentially help protect tax administration autonomy from bureaucratic and political interference and buffer against interference in day-to-day tax collection and administration.

The boards are proposed to be responsible for effective policy and governance of the customs and inland revenue organizations. They are expected to set key performance indicators (KPI) and monitor the performance of the tax administration against them. This reform will improve organizational transparency and accountability. However, one needs to be mindful of the fact that such boards are as effective and independent as their members are. If the proposal is accepted, the government will have to use its best judgment while appointing its members.

There have been earlier attempts to separate tax policy from administration, and this is once again part of the current proposal. This initiative is necessary for transparency and minimizing SRO-based, at times ad hoc and variously inequitable, tax policy decisions affecting tax administration.

It can be argued that intertwined tax policy and tax administration opens the doors to political interference in tax administration, promotes rent-seeking, and favours short-term revenue measures over stable tax collection. Therefore, it has been globally abandoned, and countries have unburdened tax administrations from political decisions on tax levels, tax rates, and tax burdens. Hope this can happen in Pakistan as well.

Along with tax administration reforms, there is a proposal to restructure the Pakistan Revenue Automation Limited (PRAL, the public-sector company that provides IT services to the FBR), enhance collaboration with NADRA, digitize withholding tax collection, and introduce simple schemes for taxing traders, retailers, and specified persons. These allied reforms will help strengthen and modernize the tax administration, enabling it to face the challenges of revenue mobilization in rapidly changing economies.

As previously discussed, the upcoming government faces the imperative task of augmenting revenues to accommodate increased spending. It will also have to negotiate a new programme with the IMF to support Pakistan’s macroeconomic stability. The formulation of a viable plan to finance the expanding public expenditure will be a major agenda point during talks with the IMF. That is where the next government will find the current reform plan handy. It can always refine this plan and present it as a comprehensive homegrown reform agenda.

Crucially, all stakeholders, including the outgoing and incoming governments and the IMF, must be cognizant of the far-reaching impact of the tax policy. It not only influences the economy and markets but also impacts people and the environment. Striking a balance between the imperative of a big government and prudent fiscal policy responses is essential to ensure sustainable and inclusive development.

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