

"Opposition to RGST is shortsighted and irresponsible"

RGST has turned out to be an explosive issue which is likely to alter the political landscape if not overturn it entirely. Meanwhile, the public as well as the stakeholders who are doing politics around it remain ignorant about the nature of the tax and how is it likely to impact Pakistan's economy. In an interview with The News on Sunday, economist Asad Sayeed clears certain misgivings about RGST even if he remains pessimistic about its political future

By Ather Naqvi

The News on Sunday: What is Reformed General Sales Tax (RGST) in layman's terms and do you think the government has been able to educate the public about what it actually is?

Asad Sayeed: In a nutshell, RGST will document the turnover at each stage of production for sectors where the tax is applicable. Ultimately, it is only the consumer who pays the tax at the retail stage.

Let us take the case of the textile sector. In principle, when the cotton grower sells cotton to the ginner, s/he will add x% to the price which will be the sales tax. The ginner in turn gets a refund of the sales tax s/he has paid once the cotton is ginned and sold to the yarn manufacturer. The ginner however, adds the x% sales tax to the price when selling it to the yarn manufacturer. And so on and so forth, until the domestic consumer of cloth or garments buys the product. It is only a tax on consumption of the consumer.



By documenting all input quantities and prices as well as the quantity sold to the next stage, the turnover at that particular stage of production is documented. This then becomes the basis on which the income (and thereby profit) earned by the business can be determined and direct tax imposed on them.

On government educating the public: No they have not. Let alone the general public, the FBR and finance ministry officials, it appears, have not been able to adequately educate parliamentarians and spokespersons of the government either. The finance minister, the deputy chairman Planning Commission and the FBR chairman should have done an extensive roadshow to explain the need for RGST and the implications for the economy if it is not imposed.

Having said that, one wonders how much difference it would have made given the contrarian mood of the media and the urban middle classes these days. The voice of reason and logic is being drowned in the shrill rhetoric of anger and

prejudice. So, if people have made up their mind already, there is no point in attempting to explain or 'educate'.

TNS: Some people have the impression that it would ultimately be the consumer who would have to pay more tax. How would you explain?

AS: Goods and services that have hitherto been exempt from GST and will now be included in the RGST will witness a new tax on the consumer. However, those goods on which GST in excess of 15% was imposed — which are more than 5000 commodities — the burden of taxation will reduce.



TNS: Is the RGST going to broaden the tax base? How is it going to affect the overall economy in the short and long term?

AS: The most important reason that Pakistan has one of the lowest tax-GDP ratios in the world is that the tax base is narrow. By increasing documentation in the economy, the tax base for direct taxation will naturally increase. In fact, to my mind this is the most salient reason for introducing the RGST.

In the short run, the new tax will yield only the indirect tax that will be levied by bringing exempted sectors in the net. This is expected to be in the range of Rs100 billion (based on which sectors finally make it in the bill). Now there is a lot of hue and cry that this will create inflationary pressures in the economy. As I mentioned earlier the impact of inflation has to be seen in net terms (reduction in rates of a range of items that are already paying sales tax will see a reduction in prices and removal of exemptions that will increase prices of those items).

However, if the government cannot reduce its expenditure and the money does not come from taxes, then it will most likely come from printing money. And printing money is way more inflationary — the affects of which resonate through the economy for years — than that coming through an increase in taxation.

Thus if inflation reduction is a goal, then it is better to tax than to print money.

TNS: Do you think the PML-N and other political parties' opposition to the bill is justified?

AS: Opposition is not only unjustified but also shortsighted and irresponsible. The two principal opponents to the RGST are PML-N and MQM. Both are urban parties and have businessmen and traders as their constituents. It is to appease these lobbies — whose financial power is perhaps important for the



parties — which forms the basis of this opposition. Contrary to their own rhetoric, their opposition to the bill will stoke more inflationary pressures in the economy than if the tax is imposed.

While the MQM will never come into power in the Centre, the PML-N clearly can (and perhaps will at some point). Will they not confront the issue of documentation of the economy then to improve the tax-GDP ratio? Is it not politically beneficial to let the present coalition do it and take the flak then to inherit a fiscal crisis when they come into power? Their political strategy defies logic — unless they will agree to the Bill at the last minute.

TNS: How far is it a true assumption that RGST is being imposed on the insistence of International Financial Institutions (IFIs) like the IMF and the World Bank?

AS: The issue of RGST is contentious and in all likelihood the government would not have picked it up if the floods had not created an extraordinary situation. The reconstruction phase will require a large outlay of resources. To get international donors to be interested, the government will have to demonstrate that it is making efforts to mobilize domestic taxes also. I think this is the central reason for the urgency of imposing the RGST.

So far as the IMF is concerned, the agreement signed with them was on the condition of reducing the budget deficit to manageable levels. The government could have perhaps made efforts to curb spending in a non-floods situation and postponed the inevitable further.

Moreover, to the extent it is true that the government had itself told the IMF in 2008 that it will improve its tax-GDP ratio through the RGST, the IMF is only asking them to fulfill their own pledge. Should they walk out of the IMF agreement? Well, Pakistan's external balances are in a comfortable situation right now — reserves are equal to more than 6 months of imports — and the current account deficit is also within manageable limits. As such there is no danger of a default on external commitments. However, renegeing on an agreement will hamper international credibility severely at a time when donor funding for reconstruction is an imperative.

TNS: How do you see the issue of tax evasion? Would the imposition of RGST have an in-built mechanism to deal with tax evasion?

AS: RGST, as I said earlier, increases documentation, which in turn will create a transparent and verifiable basis to assess incomes. But corruption in the tax machinery and the lack of capacity to manage such a complex system will be impediments in realising its full benefits in the short run.

It is thus critical that there is a time bound and coherent plan to reduce corruption in FBR and to improve its capacity. This is what the opposition should have demanded from government rather than throw the baby out with the bath water.

RGST is a necessary but not a sufficient condition to broaden the tax base and thereby improve the tax-GDP ratio.

TNS: As things stand, how do you see the future of legislation on the RGST? What if the bill is not passed by the parliament?

AS: Based on what is out in the press, it seems the government will not be able to get the bill through in December. Given this situation, in all likelihood it will delay it for a later date. Already half the fiscal year is gone and if the bill is again tabled in March, the deficit for the fiscal year would have increased commensurately and inflation also. I am sure though that sooner or later something like the RGST will be imposed. The world is no longer willing to bail out Pakistan without Pakistan making an effort to tax its own people. The sooner we smell the coffee the better.

The interview was conducted via email.