

Tackling Economic Inequality in Pakistan: A Fiscal Approach

Abdul Hadi

Lahore University of Management Sciences (LUMS), Pakistan

Keywords: Economic inequality, Welfare, Fiscal policy

Introduction

The subject of inequality, more specifically economic inequality has been on the forefronts of election speeches. However, what seems to be evidently missing from such public discourses is a comprehensive solution to it. Society is pillared upon decisions illustrated through policies, laws and economic choices, that either strengthen the welfare of the community or debilitate it. By allowing economic inequality to metastasize rampantly, Pakistan is embarking on a path of socio-economic destruction that may be irreparable if urgent policy measures aren't enacted immediately.

So why does economic inequality matter? Aren't inequalities inherited akin to genes and sometimes good for the functioning of the society? And what could the federal government possibly do in mitigating the inequality in Pakistan? First of all, we begin by defining the crux of our proposition – economic inequality. Economic inequality comprises of three parts - income inequality, wealth inequality and pay inequality, however, we would focus more on the former two in this paper. Income inequalities refer to the disparities in income not limited to the money received through pay, but all money received through employment whereas wealth inequality refers to the disparities in the amount of financial assets, stocks, bonds and property etc. Rampant income and wealth inequalities could very well transform into other inequalities such as education, health, gender, ethnicity in the long-run. This can be corroborated quite explicitly in Balochistan which has the lowest income/capita of the country and where in towns like Dera Bugti,

female literacy rates are hardly 0.06 %. The situation perjorates since future generations are simply unable to break free of this inequality trap. According to a recent report by Oxfam (Burki, Memon and Mir), children born in income-poor families in Pakistan in the year 2010-2011 are less likely than those born in the year 1994-1995 to break their poverty trap and move into the middle-class category. Dr. Hafiz Pasha, a former finance minister suggests that this has primarily been due to the underreporting of income for tax evasion. Gaping inequalities has corrupted politics, thwarted potential, fueled crime, stifled social mobility and hindered economic growth in Pakistan in the last few decades.

Objectives

Given the sheer increase in gaping economic inequalities and their diffused effects on other social indicators in Pakistan, it becomes imperative for the State to become a major player in the fight against inequality. This paper tries to establish this by advocating for a more robust, progressive and inclusive fiscal policy. In order to establish our case, we will first try and understand the reasons behind economic inequality in Pakistan. Then we will examine the current fiscal policy in practice in Pakistan and then suggest an alternative mechanism for achieving the goal of reducing economic inequality in a more efficient way.

Methodology

The methodology undertaken is purely secondary in nature. Papers and statistics taken from government statistics bureaus and research think tanks will form the main crux for our arguments. The Pakistan Economic Survey 2014-2015 was reviewed and thoroughly analyzed. News reports were also studied and analyzed to ensure the accuracy of the data.

Results and Discussion

According to the Pakistan Economic Survey and other reports, the reasons for Pakistan's hitherto situation can be traced back in history. The so-called establishment in Pakistan consisting of the coalition of military and democratic governments has ensured that since independence the country remains a 'security state' rather than a 'developmental state'. Albeit, military tenures were focused on paradigms of rapid growth and the reliance on the 'trickle-down'; nevertheless, they paradoxically remained the ones with the highest inequality. Estimates show that in Pakistan, Rs. 33 goes to the top 1 % for every Rs.100 worth of commodities generated and a mere Rs. 3 goes to the bottom 3%. Clearly the 'trickle down' theory is dubious and it's about time we start thinking about inverting the pyramid.

Examining the fiscal terrain of Pakistan with more scrutiny, we find that the allocation of assets is the most unequal when it comes to agricultural land. About two third of the Pakistani population resides in rural areas, it follows that the primary source of income for such people is through agriculture related activities. However, a recent study revealed that the top 1 % of farmers own as much as 22 % of farmland, 41 % of the tractors and 28 % of the tube wells. Despite agriculture dominating Pakistan's GDP, the sector has remained sufficiently under-taxed amounting up to just Rs. 1 billion for all four provinces combined. As a matter of fact, the maximum punishment for not filing agricultural tax returns is a hefty fine of just Rs. 1000 (Pasha, 2017).

Possessing enormous political power and close ties with the government, the rich have successfully managed to evade taxes to ensure that the beneficiaries of growth hitherto were the ones with the most capital. These groups enjoy wide-ranging exemptions and concessions, low tax rates and can engage in tax evasion with a degree of impunity, frequently in connivance with a corrupt tax administration. This has engendered in a low tax-to-GDP ratio of around 8.5 % (2014) that is extremely low relative to other countries in the region.

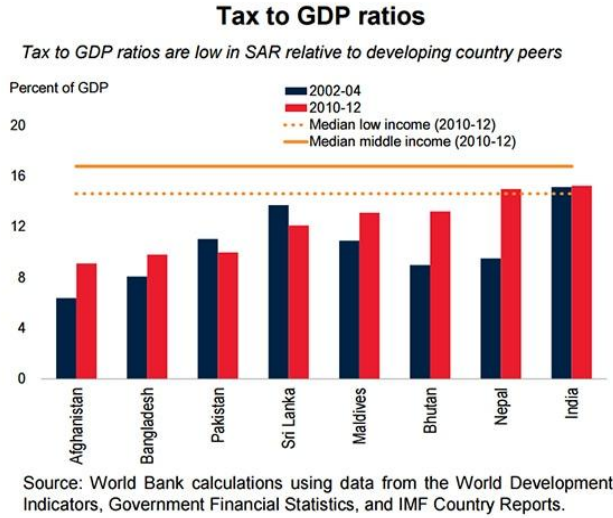


Figure 1 - Tax to GDP Ratios in South Asia

Let's now also understand the composition of tax revenues in the country. Instead of direct taxation, the government has persistently focused on indirect taxes to finance its expenditures. Not only has this failed to circumscribe the exorbitant income sources of the rich but has targeted the poor segments of society via an increase in the general prices of essential commodities, especially food.

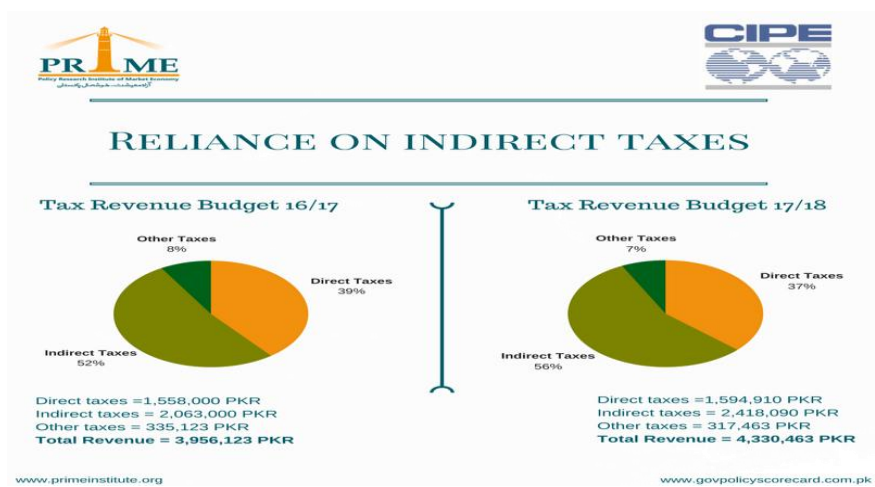


Figure 2 - Reliance on Indirect Taxation in Pakistan

Tax evasion has resulted in forgone revenue of approximately Rs. 500 billion for Pakistan which could otherwise have been utilized for the public good (Oxfam, 2017). When compared with its neighbor India where 1 in 40 people file tax returns, Pakistan's figures are estimated to be around 1 in 260. In fact, only 1/4th of the total population actually files returns and the total number of taxpayers has declined over the past 6 years, worsening the fiscal deficit. As Oliver Holmes acclaimed 'taxes are the price we pay for a civilized society', Pakistan's government needs to redesign its taxation policy to further the cause of inclusive growth and reducing the economic inequities in the population.

Given the distorted tax system of Pakistan, a large fiscal deficit could be in theory be acceptable. Unfortunately, the statistics point towards the contrary. Due to inadequate receipts, not only is expenditure on public services abated, but the allocation of spending remains quite skewed. Spending on health and education, one of the cardinal tenets of social capital narrowly make 15 % of the total expenditure, and the expenditure on health is only one-third of the expenditure on education. Combined expenditure on social services approached 3 % of the GDP in 2012-2013. The realization that social expenditure on social services seems to be side lined by the federal government. Equally important is the establishment of a robust mechanism of social protection to safeguard the marginalized from their financial woes. Targeted programmes such as direct cash transfers or unemployment have received little attention in the past. The primary cash transfer programs include but are not limited to the Zakat, Bait-ul-Maal and the Benazir Income Support Programme (through which a monthly stipend of Rs. 1000 is transferred to the families of lower income classes). The system of Zakat transfers seems pretty obsolete given the current demands of this time. Similarly, the Bait-ul-Maal responsible for targeting the poor is constructed at the district level with no independently verifiable criteria for maintaining or updating the list of beneficiaries. Renewed interest in social protection in the form of the Benazir Income Support Programme, the Punjab Food Security Programme and the recently

developed Khushal Fund is also under scrutiny since only one fourth of the beneficiaries actually receive the funds (Gazdar).

Conclusion and Policy Implications

A fiscal policy should be designed in a way such that it is inclusive - that is, it benefits every Pakistani so that each party gets its deserved share of the economic pie and also sustainable so that future generations could benefit from its outcomes. On the taxation side, a number of steps can be possibly undertaken to increase tax revenue in a fair and equitable manner. Many advanced economies such as the Scandinavian countries have achieved their redistributive objectives more efficiently via the progressivity of their tax and transfer systems by augmenting marginal tax rates for higher income groups and exempting taxes for lower income groups.

In order to make the progressivity and inclusiveness of taxes yield results, the funds need to be spent in a way to target economic inequality both in the short and long run. Firstly, the government needs to do away with a myriad of price subsidies and supply it with direct cash transfers to poor households. Funding the development of better educational institutions from progressive taxation for low-income groups needs to be one of the top priorities of the expenditure side, particularly at the primary schooling level. Another proposition is the initiation of a comprehensive package of health insurance to provide adequate healthcare for every citizen of the country at subsidized prices, especially the poor. A recent report emphasizes the importance of a fiscally sustainable, publicly financed basic health package covering essential health care, which would disproportionately benefit the poor since they would do away with unproductive precautionary health saving (Jamison). Finally, analogous to a system of means-tested cash transfers, a system of non-contributory social pensions could be enacted with progressive tax receipts that provide a flat pension to the country's senior citizens.

All in all, despite some of the inherent limitations of fiscal policy in Pakistan, it is the most optimal tool at the government's disposal to achieve redistributive goals. Inequalities reflect the hierarchies of power, and both tend to produce and reproduce their privileged positions regardless of the force of intellectual and ethical arguments against its unacceptable manifestations. Indeed, inequality and economics are a complicated science, we never know whether fiscal policy would help achieve our objectives, however, the longer we wait, the more problems it will yield.

References

- Ahmed, S., Ahmed V. and C. O. Donoghue .2011. Reforming indirect taxation in Pakistan: A macro-micro analysis, *Journal of Tax Research* 9(2), pp. 153-74.
- Abid, B., Memon, R. and M. Khalid. 2015. Multiple inequalities and policies to mitigate inequality traps in Pakistan. *Oxfam*.
- Drèze, J. and A. Sen .2013. *An Uncertain Glory: India and its Contradictions*, London: Allen Lane.
- Government of Pakistan. 2014. *Economic Survey of Pakistan*, Ministry of Finance.
- .