DAWN

Editorial

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Tax exemptions

NOT all tax exemptions — the indirect, off-budget expenditures governments accrue by removing or reducing assigned tax liabilities that a person or a business is required to pay on income, property or transactions — are bad. Policymakers everywhere use them to attract new investments in one or more sectors of the economy, support struggling businesses, develop infrastructure, help people or boost growth. Sometimes such exemptions are necessary to make a country's tax regime simpler, more progressive and less opaque, and to reward compliance. But such concessions often become a drag on government budgets, undermine fair competition and discourage fresh investment, besides slowing down growth in underdeveloped countries like Pakistan. Why? Because the authorities don't have the capacity or will to design tax expenditure in a transparent manner to affect firms' investment decisions and fuel economic growth; instead, they cater to one power lobby or the other for various, including political, reasons.

Tax exemptions have always remained a popular tool for successive governments in Pakistan to shower favours on business lobbies for their support in spite of pressure from multilateral lenders to curtail these indirect expenditures in view of their impact on government budgets. A report by the FBR, Tax Expenditure 2020, estimates the total cost to the national exchequer of income tax, sales tax and customs duty exemptions allowed during the current financial year at Rs1.15tr. This is around 3pc of GDP and more than 29pc of the total projected tax collection of Rs3.9tr. However, the report doesn't go beyond cost estimations and fails to analyse the impact of this huge expenditure on new investments, industrial output and economic growth. Indeed, some of these exemptions — like customs duty concessions on industrial raw materials or machinery — might have had a salutary effect on domestic industrial production and companies' investment decisions. But without a cost-benefit analysis of each concession for the sector or firm for which it was meant, their continuation amounts to groping in the dark. For a developing country, it is never advisable to thoughtlessly allow generous tax exemptions; it is not easy to assess their economic impact or prevent their abuse by powerful vested interests. When and where it is necessary to allow a tax concession as an incentive for investment or for any other reason, it should be done in a transparent fashion — instead of shrouding it in secrecy like the Gwadar port deal — and after considering its potential effects on the economy and the business environment.