

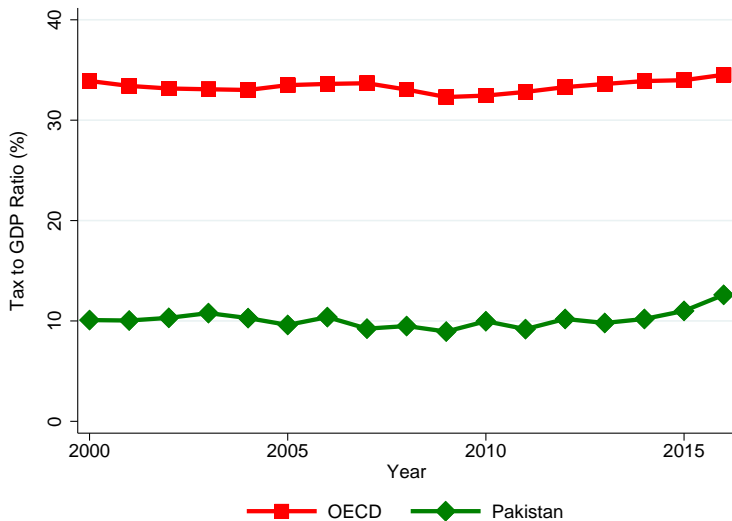
# Tax Policy in Emerging Economies: A Few Lessons

Mazhar Waseem

Second International Conference on Taxation, Lahore

March 2020

# The taxing problem!



Source: OECD, World Bank, Economic Survey of Pakistan

# The taxing problem!

- ▶ Tax revenue a country collects is given by

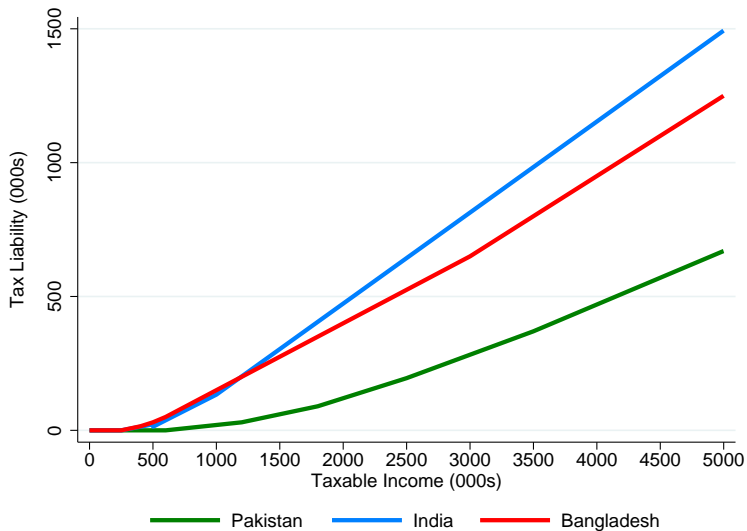
$$\text{Revenue} = \text{tax rate} \times \text{tax base} \times \text{compliance rate}$$

- ▶ In this talk we will look at all three factors
- ▶ The talk is organized around six statements one routinely hears in the public discourse on taxation in Pakistan

## Taxes tooooo high in Pakistan?

- ▶ Pakistani tax rates are one of the lowest in the world
- ▶ A person earning 1,200,000 annually would pay an income tax of
  - ▶ 30,000 in Pakistan
  - ▶ 201,500 in India, and
  - ▶ 200,000 in Bangladesh
- ▶ Our corporate income tax rate and consumption tax rate (sales tax + excise) are lower than India's and comparable to Bangladesh's

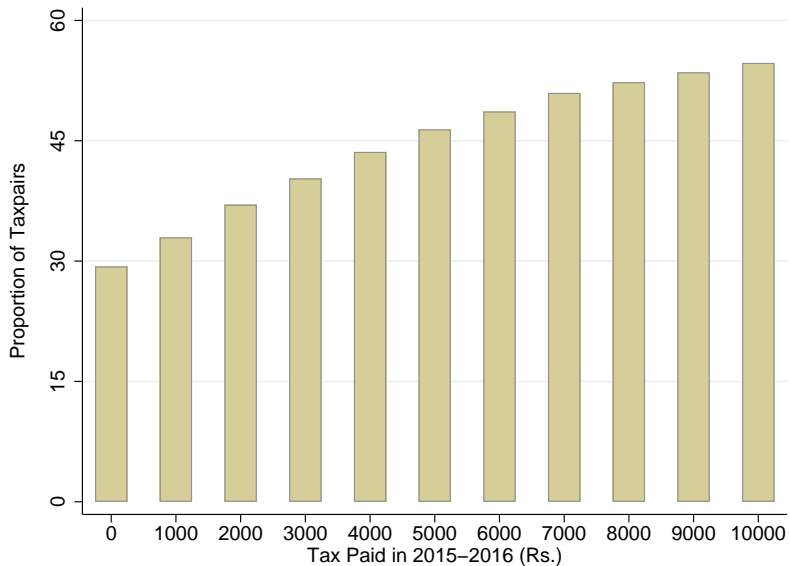
## Taxes toooooo high in Pakistan?



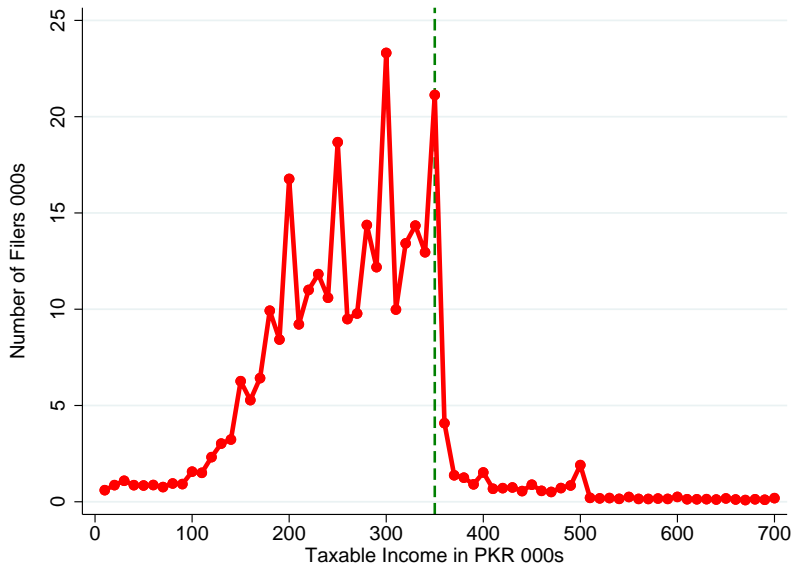
## Taxes tooooo high in Pakistan?

- ▶ For the year 2015-2016, of all individual tax filers
  - ▶ 30% paid zero tax
  - ▶ 46% paid less than Rs. 5,000
  - ▶ 56% paid less than Rs. 10,000

## Taxes tooooo high in Pakistan?



## Taxes toooooo high in Pakistan?

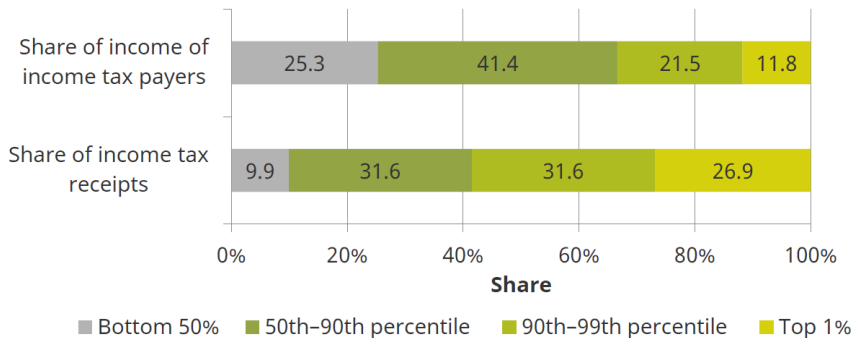




## Find new taxpayers, don't burden the current ones?

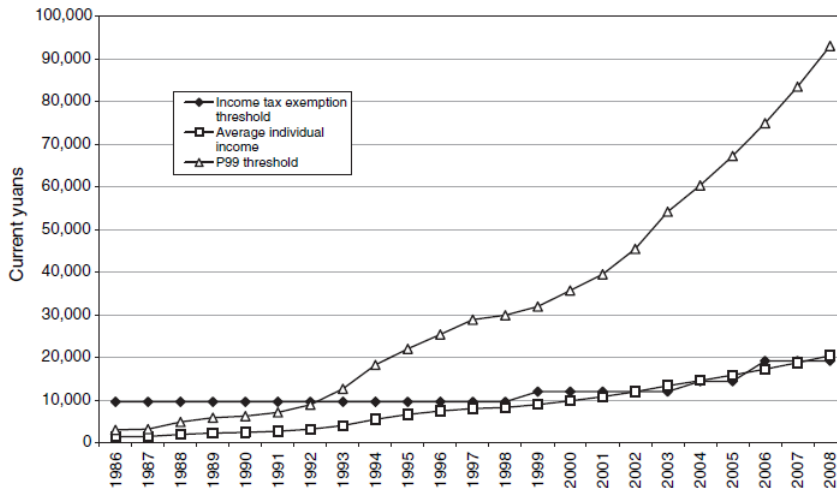
- ▶ Tax broadening is desirable
- ▶ But taxes are usually top-heavy → new taxpayers won't bring much revenue
- ▶ Tax deepening is perhaps equally pressing policy need

## Find new taxpayers, don't burden the current ones?



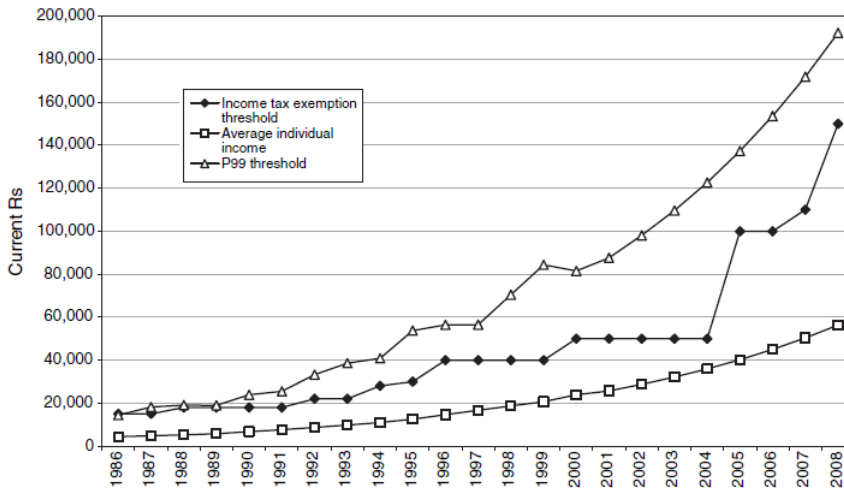
Source: IFS (2017)

# Find new taxpayers, don't burden the current ones?



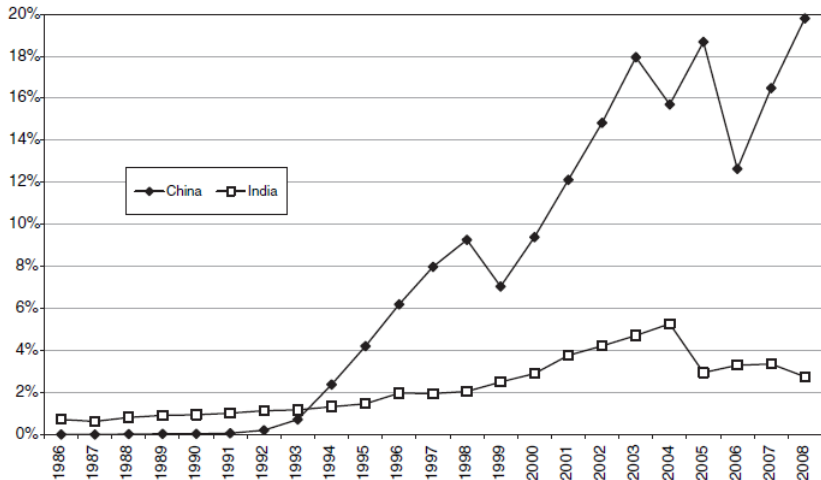
Source: Piketty & Qian (2009)

# Find new taxpayers, don't burden the current ones?



Source: Piketty & Qian (2009)

## Find new taxpayers, don't burden the current ones?



## People will pay more if rates are low?

- ▶ Only true if the tax rate is above the Laffer bound
- ▶ Formula for Laffer rate:

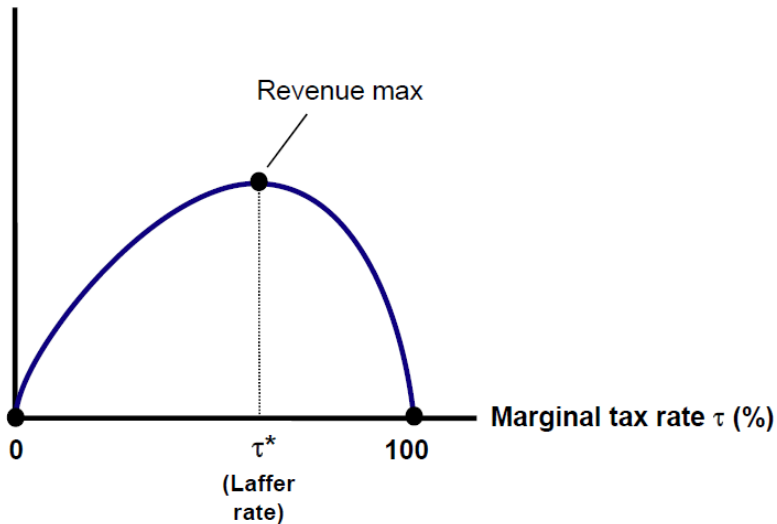
$$\tau^* = \frac{1}{1 + \varepsilon \cdot \alpha},$$

where  $\varepsilon$  is the elasticity of taxable income and  $\alpha$  is a parameter of the income distribution

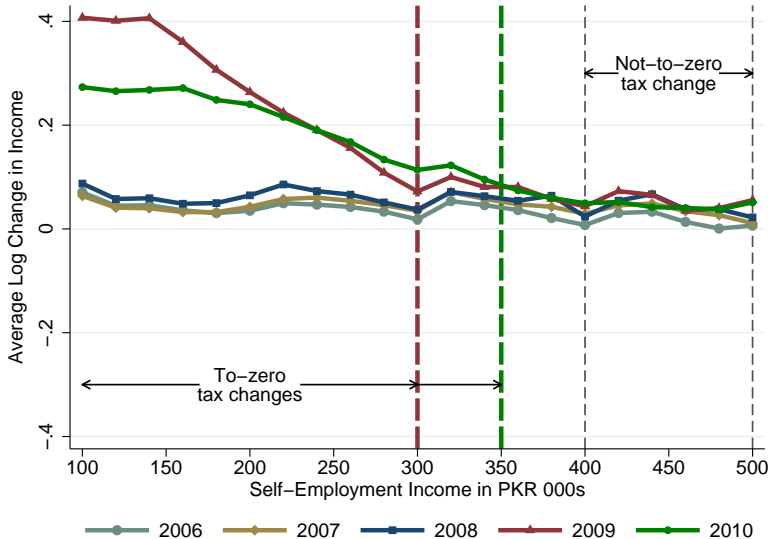
- ▶ In Pakistan, people underreport their income by 70% even when the tax rate is as low as 0.5% (Waseem, 2019)

People will pay more if rates are low?

Tax revenue  $R$



## People will pay more if rates are low?



Source: Waseem (2019)

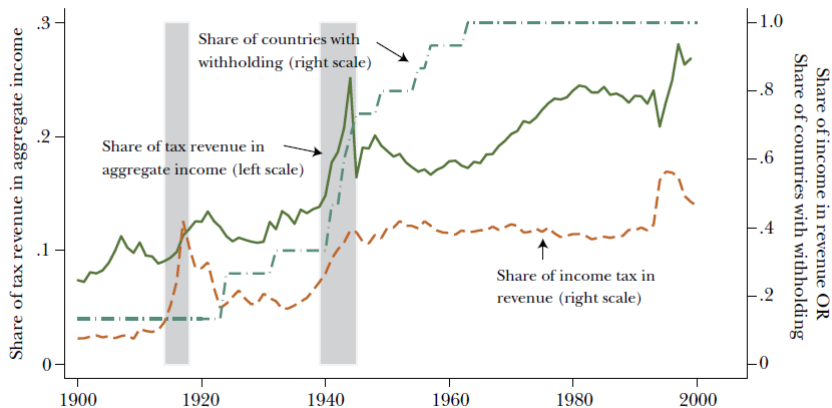


## It's all withholding!

- ▶ Withholding has been one of the most important technological innovations in taxation
- ▶ More than 90% of income tax in the rich world is collected through withholding
- ▶ Withholding is not distortive if:
  - ▶ the withheld tax is adjustable
  - ▶ refund of any excess amount is not costly

# It's all withholding!

## Evolution of Tax Revenue, Income Tax, and Tax Withholding in a Sample of 18 Countries

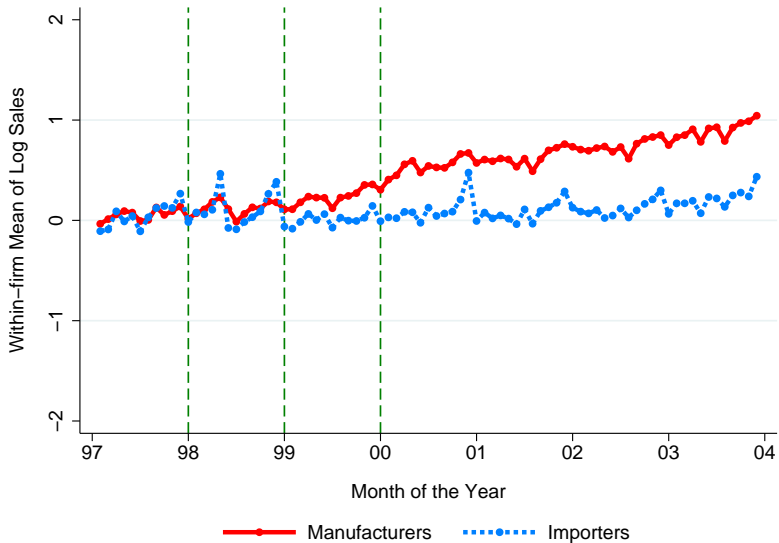


Source: Besley & Persson (2014)

## It's all withholding!

- ▶ Withholding is a built-in element of VAT
- ▶ For example, VAT paid at the time of imports acts as withholding if the firm is registered and as input tax if it is not
- ▶ It plays a major role in sales tax collection in Pakistan (see Waseem, 2020)

# It's all withholding!



Source: Waseem (2020)

## Direct taxes good, indirect bad?

- ▶ Distinction between direct and indirect taxes is quite superficial
- ▶ Over the lifetime of an individual

$$\sum_i q_i X_i = wL$$

- ▶ Taxing income at the rate of  $\tau$  is the same as taxing consumption at the rate of  $\frac{\tau}{1-\tau}$
- ▶ Are consumption taxes regressive? Not necessarily (Bachas, Gadenne & Jensen, 2019)
- ▶ In general, progressivity is a property of the overall tax system and all tax instruments need not be progressive

## Tax cheating is our culture?

- ▶ Evasion rate of sole proprietorship income in the US is 57%; of wage income 1% (Slemrod, 2007)
- ▶ Waseem (2019) finds similar evasion rates in Pakistan
- ▶ People in general evade if they can (Kleven et al, 2011)
- ▶ With third-party reporting evasion is generally not feasible. Our problem is that very little income is third-party reported

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