Subsidizing the Rich**[[1]](#footnote-2)**

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A progressive state caters to the needs of those, who are unable to generate adequate incomes and forced to live in subhuman conditions. Targeted subsidies to the poor are seen as an integral part of the state policy for promoting equity within a society. To finance these subsidies, the rich pay taxes. What is ironical in Pakistan is the role reversal — as those who should be financing subsidy to the needy, are its beneficiaries. First, they evade taxes on their income and then, they also receive bulk of subsidies and concessions to which they are least entitled. The only exceptions are the Benazir Income Support Programe, Baitul Mal and Zakat, which really targets the poor.

The most visible subsidy in the budgetary accounts is that on power. Each unit of electricity generated sells at 65 percent of the cost and the difference is paid by the government. Power sector losses in 2010-11 were a staggering Rs.350 billion. Domestic households have doubled their share of electricity consumption — from 23 percent in 1980-81 to 46 percent in 2007-08. One-third of the electricity is for air conditioning alone. Similarly, 70 percent of the CNG is consumed by motorists, who pay only 42 percent of the price of petroleum. Except those consuming less than 50 kwh, the 19 million consumers of the electricity and gas subsidies are those who can afford to pay full recovery cost.

The present tax rate structure also favors property owners. Tax rate on rental income is lower than the rate paid by a salary earner on the same income. If the two rates are made the same, the yields from rental income tax would double. The effective rate of property tax actually paid on rental incomes in the provinces is about 5 percent as opposed to the statutory rate of 20 percent. Tax concession to the property owners is in addition to the exemptions available on income tax to big agriculturists, professionals and other businesses engaged in services sector.
Under the export duty refund scheme, the Federal Board of Revenue pays more as refunds and rebates than it actually collects as duties. Fraudulent claims, fake and bogus supporting documents, over-invoicing in the value of exports, goods declared but not actually shipped deprived the State in billions of rupees in connivance with some unscrupulous FBR officials.
Protection in the form of higher tariffs on competing imports, non-tariff barriers, exemptions and freight subsidy is another subsidy given to businesses but borne by the ordinary consumers, who pay a higher price for domestic goods and services compared to the imported ones. The inefficiencies of domestic producers caused by protection make them uncompetitive in the global markets. The maximum tariff rate was brought down to 25 percent in 2002-03 but is now 35 percent, while edible oils and automobiles receive much higher rates of effective protection. Fertilizers and irrigation water have been subsidized for quite some time now. Large landowners and producers pay only a fraction of the actual cost leading to inefficient use of a scarce resource and leakage of revenues. Whether the output prices go up or not, subsidies continue. In the past, when the domestic prices were lower than the world prices of commodities, input subsidies would have made sense. But now that the domestic prices are equivalent or higher than the world prices and no income tax is paid by the producer there is hardly any justification for input subsidies.

State land is officially allotted or it acquires private land at less than market prices for Defense Societies, Development Authorities, Cooperative Housing Societies, private developers and government’s own housing schemes. The well-off buyers of these plots can afford to pay the full market price, but they get a huge windfall due to the difference in price at which they buy the plot and at which they sell. Civil and military bureaucrats, professionals and other private businessmen have become millionaires in this process. There is hardly any scheme of subsidized land for low-cost housing for the poor who have to fend themselves for shelter.
In the above calculations, the huge rents collected by politicians, bureaucrats, public corporation executives and others through massive corruption and leakages are not reflected.
Subsidies are also provided in the European Union but the average tax-GDP ratio in those countries varies between 30 to 40 percent. Even if subsidies are wrongly allocated, the resulting loss of one to two percent of GDP would not cause a big problem for the fiscal health. But if the total tax collection is 9 to 10 percent of GDP, as in Pakistan, a loss of one percent of GDP destabilizes fiscal situation.

What kind of economic logic makes us borrow from the central and commercial banks, the private savers (National Savings Scheme) or from the external creditors to finance subsidies for the rich? “Market-based economic system” has been grossly misused in this country. When the profit margins are exceptionally high, any government intervention to share part of those windfall gains causes a big hue and cry, i.e. the government is interfering in the operation of market forces. When the losses are made due to market forces, a storm is raised and the government is asked to come to their rescue and provide support. Threats are made that the country will lose market share and hard earned foreign exchange earnings, factories will be shutdown and workers will be laid off.

The two main pillars of the market economy are competition and price determination by the interaction of supply and demand. If efforts are made to stifle competition and indulge in collusive practices then the market is rigged and the resulting market price is not optimal. Resource allocation under those circumstances is inefficient and the economy gets hurts. Growth will be much lower as artificially higher prices reduce the aggregate demand.
The other tenet of the market economy - completely forgotten in Pakistan - is creative destruction. The firms quite efficient and profitable at a certain point of time may become totally redundant if the household preferences change, substitutes and alternatives become available or technology makes the industry or the firm uncompetitive. In Pakistan, this is hardly the case. The Karachi Stock Exchange listed companies reported to have been losing money and not paying dividends to minority shareholders for several years have never exited the scene. How owners of these loss making companies continue to maintain their ostentatious life style?
The above analysis shows a highly inequitable and inefficient use of scarce fiscal resources in Pakistan. Those who should be receiving subsidies in the form of education, health, drinking water are deprived of these basic public services. Those who should be paying taxes on their incomes to finance the subsidies for the poor are the ones who are appropriating government resources to enrich themselves and in turn destabilizing the public finances of the country.

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former governor of State Bank of Pakistan.

1. Published in The NEWS, Sep 19, 2011 (Business – Money Matters) [↑](#footnote-ref-2)